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Takeaways from Ayyasamy: The Practical Impossibility of Determining "Serious Allegations of Fraud" and the Apprehension Towards Arbitration

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A few months back, the Supreme Court of India attempted to set the issue of arbitrability of fraud at rest in the case of *A. Ayyasamy v. A. Paramasivam* [(2016) 10 SCC 386]. The court, while deciding an application under Section 8 held that although "mere allegations of fraud simplicitor" are arbitrable, "serious allegations of fraud" are not. In a previous blog post, the authors have already expressed their reluctance in celebrating the judgment and pointed out the protectionist and interventionist attitude of the judgment. The authors commented that a positive aspect to this judgment is that "it will bring consistency in practice". I shall attempt to show that perhaps they are too optimistic by showing that a consistent application of the *Ayyasamy* dicta is perhaps impossible.

Problems with the Arbitrability Test in Ayyasamy

It is well settled in Indian law that the Court can examine the issue of arbitrability of a dispute under a Section 8 application. The Arbitration and Conciliation Act, 1996 [the Act] does not offer any guidance for determining arbitrability of a subject matter. Thus, in absence of any guidance, the Supreme Court devised a test for determining arbitrability (defined by the court as "capable of being adjudicated by a private forum") in *Booz-Allen & Hamilton Inc v. SBI Home Finance* [(2011) 5 SCC 532]. According to the Court disputes relating to a *right in personam* are arbitrable and disputes relating to *rights in rem* are not. The Court, however, added a caveat to this rule writing "this is not however a rigid or inflexible rule".

In *Ayyasamy*, the Court did not follow the *Booz-Allen* test for determining the arbitrability of fraud claims. It did not distinguish between "mere allegations of fraud simplicitor" and "serious allegations of fraud", while holding the latter non-arbitrable, on the basis of the type of right it affects. Instead, the Court held that "serious allegations of fraud" are not capable of being dealt by the arbitrator since it involves complicated issues of fact which require reviewing of voluminous evidence. The Court also opined that ordinary civil courts are better equipped to handle such cases as "[G]enerations of judges have dealt with such allegations in the context of civil and commercial disputes."

The Court, in *Ayyasami*, did not rely on the established precedent for determining arbitrability. While the *Booz-Allen* test has been criticized for being too generic and not practicable, it does find its basis in jurisprudence. The reasoning in *Ayyasamy*, however, is solely based on an apprehension

towards arbitration.

Interpreting "Serious Allegations of Fraud"

The phrase "serious allegations of fraud" can be traced back to one of the earliest cases on arbitrability of fraud claims in India, *Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak* [AIR 1962 SC 406]. In *Abdul Kadir*, the Court held that when there are "serious allegations of fraud" levelled at a party, if the party so desires, the Court shall refuse to refer the matter to arbitration. In *N. Radhakrishnan v. Maestro Engineers* [(2010) 1 SCC 72], the Court found that since there were "serious allegations of fraud" the matter could not be referred to an arbitrator. High Courts have also used this term while determining arbitrability of a dispute. But none of these cases have attempted to chalk out a uniform method of determining what makes an allegation a "serious" one. The *Ayyasamy* judgment has necessitated such a test.

At first one might interpret "serious allegations of fraud", as used in *Ayyasamy*, as allegations of fraud which involve copious amounts of sum or are serious enough to deserve a criminal trial. As a matter of policy, this could be a cogent interpretation since frauds of such magnitude affect a *right in rem* and should be tried in a public court for transparency and accountability. It could also be argued as being opposed to public policy, which is a ground for setting aside an award. However, a careful reading of the judgment would show that this interpretation is only partly correct.

The court found "serious allegations of fraud" non-arbitrable because it involves complicated issues of fact and requires adducing of elaborate evidence. Thus, when the court refers to "serious allegations of fraud" it is independent of the gravity of the alleged fraud but is dependent on the amount of evidence required to prove the allegation.

So if a case involves allegations of fraud consisting of a hefty sum of money, but does not require elaborate evidence to prove and does not involve complicated issues of fact; it can be referred to the arbitral tribunal. On the contrary an allegation of fraud with little money involved may be non-arbitrable due to complex issues of fact or elaborate evidence required to prove the allegations.

Problems with This Interpretation

The proposed interpretation of "serious allegations of fraud" gives rise to two problems. The first, and the graver one, being that the determination of the nature (whether "serious" or "mere") of the allegations shall depend on the nature of the judge. A pro-arbitration judge might refer a case to arbitration by finding a matter capable of being adjudicated by an arbitrator. A sceptic judge, however, might find the same matter non-arbitrable. This shall lead to judicial interference which the Act seeks to minimise.

The Court can come to a better conclusion by examining the qualifications of the appointed (or prospective) arbitrator. This shall help the Court determine whether the arbitrator will be capable of adjudicating upon a fraud claim or not. But there are problems with this approach as well. The Act does not contemplate a Court sitting in judgment over an arbitrator's qualification. This might not only be undesirable by the parties and the arbitrator but also practically impossible.

But if this approach is taken, it shall give rise to the second problem of further undesirable judicial intervention and delay. In *Ayyasamy*, the Court held that in order to determine whether an allegation is a "serious" one or not the Court shall conduct "a strict and meticulous inquiry into the allegations of fraud". This statement does not tell us about the standard of proof that the Court

requires, but one may assume that a *prima facie* case will not suffice. An examination of the qualifications of an arbitrator shall not add to this "strict and meticulous inquiry" requirement and lead to delays and increased judicial intervention which is contrary to the objectives of the Act.

Concluding Remarks

In *Ayyasamy*, the Court found that the allegations merely related to matters of accounts which could be looked into "even by the arbitrator." This statement clearly has the undertone of a lack of confidence in the process of arbitration. Even though, post the White Industries award, the Supreme Court has been forced to adopt the pro-arbitration rhetoric; *Ayyasamy* exhibits that subliminally the Court is still apprehensive of arbitration.

Ayyasamy, like most post-*BALCO* cases [see this post], indulges in pro-arbitration rhetoric while relying on international authorities and established principles of *Kompetenz-Kompetenz*, minimal interference, etc. But unfortunately it culled out the "serious allegations" and "mere allegations" dichotomy based on its apprehensions of fraud and not on precedents or policy. As I argued above, the interpretation of these terms which logically flow from the judgment are not practically possible without breaching the policies which are instrumental for fostering arbitration.

One may argue that legislative intervention is the only cure to this conundrum, but the fact is that the legislature already missed an opportunity by rejecting the Law Commission's recommendation in this regard. The Law Commission recommended, and rightly so, to amend Section 16 of the Act and make fraud expressly arbitrable. The legislature failed to do so for unexplained reasons. Thus, banking for a legislative intervention any time is perhaps not practicable.

But before we jump to criticize the Supreme Court's thinly veiled scepticism towards the capability of arbitration and arbitrators, we must introspect. The lack of confidence on arbitrators is not completely unfounded. India is still far behind in adopting the best practices in arbitration. Although arbitration is often resorted to, finding experienced arbitrators is often difficult. The lack of well-established institutional arbitration in India also adds to the problem. India still has a long way to go in developing confidence in arbitration as a reliable method of dispute resolution.

The issue of arbitrability of fraud claims might be resolved sooner or later by the judiciary or the legislature. But the problem of crisis of confidence can only be tackled by the community of lawyers and arbitrators by addressing the naysayer's concern in a legitimate manner. Recently the Government has constituted a High Level Committee to review the current arbitration regime in India and suggest measures for institutionalization [see this post] which definitely seems to be the best foot forward for bringing a change in the current domestic arbitration regime.

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