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DECIPHERING THE NOTION OF FRAUD AND ARBITRATION

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Abstract:

In the most recent times, the Indian Republic is witnessing some of the critical developments and evolutions in the legal concept as well as the terminology namely 'arbitrability of fraud' in both legislative as well as judicial perspective. The paper below analyses, explains as well as examines the above stated developments in the backdrop of earlier judicial pronouncements on this subject with concerned landmark case laws in addition and furthermore comment on whether they would reinforce a pro-arbitration approach and encourage arbitration in India as a mode of dispute resolution.

Nowadays an increase can be easily noticed in the number of disputes amongst the citizens. In view of the frequency of the Indian Judicial System where often a major backlog is witnessed with crores of pending cases before the various courts throughout the nation causing exorbitant delays in the trial and the passing of the judgments. Somehow, it is seen that the current judicial apparatus somehow lags behind in case of speedy disposal of cases, therefore, an increase in the Alternative Dispute Resolution cases can be noticed.

Not at all like court procedures, which can require a very long time to determine disputes between parties, arbitration in commercial issues has secured itself as a medium that gives a compelling and speedy debate goal structure. Parties resort to discretion since it considers a quicker resolution and disposal of issues between the courts and offers no place for extension. Arbitration has become the new litigation nowadays.

> "Early in the twentieth century, the dawn of the modern era of arbitration was heralded by the passage of a federal statute underpinning the enforcement of contractual agreements to arbitrate future disputes; advocates championed arbitration as a means of avoiding the "needless contention, i.e., incidental to the atmosphere of trials in court." Arbitration was popularly touted as a more efficient, less costly, and more final method for resolving disputes; there was little or no discovery, motion practice, judicial review,

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> or other trappings of litigation. By the beginning of the twenty-first century, however, it was common to speak of business arbitration in terms similar to civil litigation—"judicialized," formal, costly, time-consuming, and subject to hardball advocacy. Contractual provisions for the resolution of disputes by arbitrators are now featured in many kinds of commercial contracts. These practices, coupled with plenary judicial enforcement of broadly tailored arbitration provisions, have made arbitration a wide-ranging surrogate for trial in a public courtroom. As a consequence, the arbitration experience has become increasingly similar to civil litigation, and arbitration procedures have become increasingly like the civil procedures they were designed to supplant, including prehearing discovery and motion practice. Not surprisingly, clients and counsel often complain about the costliness and length of arbitration."[2]

Introduction to the concerned concepts:

What is ADR?

According to the Harvard Law School, "Alternative Dispute Resolution (ADR) refers to a variety of procedures and practices assigned to assist the parties for an agreement type of litigation. In other words, it can be said as a method of resolving disputes without the time taking process of litigation. The majorly enforced and practiced Alternative Dispute Resolution Processes include Arbitration, Mediation, Conciliation, Negotiation and LokAdalats. Practically, the appropriate appellate courts are often asked to review the validity and legality of decrees achieved through the ADR methods, but they rarely turn them down the decrees and awards if the concerned parties formed a valid arbitration agreement or an arbitration clause in their agreement.

Arbitration:

The said method of alternative dispute resolution is governed under the Arbitration and Conciliation Act, 1996 that was enforced from January 25th, 1996. This act consists of the provisions valid for domestic arbitration, international commercial arbitration and also enforcement of foreign arbitral rewards.

> "Background: the law on arbitration in India at the time of the adoption of the said act substantially contained in three enactments, namely, the Arbitration Act, 1940 the Arbitration (Protocol and Convention) Act, 1937, and the Foreign Awards (Recognition

[2] Thomas J. Stipanowich, Arbitration: The new litigation, *Available at:*http://www.illinoislawreview.org/wp-content/ilr-content/articles/2010/1/Stipanowich.pdf.

and Enforcement) Act, 1961. It was widely felt that the original act, which contained the general law of arbitration, had become outdated. The Law Commission of India, several representative bodies of trade and industry and experts in the field of arbitration had proposed amendments to this Act to make it more responsive to contemporary requirements. It was also recognized that the economic reforms might not become fully effective if the law dealing with settlement of both domestic and international commercial disputes remained out of time with such reforms."[3]

There are several concerned types of Arbitration:

- National arbitration: e.g., American arbitration, Indian arbitration, French arbitration or German arbitration which are all governed by different rules enacted by the institutions of each country.
- International commercial arbitration: used to settle disputes that arise from commercial contractual relations between buyers and sellers who are in two distinct countries.
- Investor-State arbitration: unilateral referral by private individual investors to an arbitral tribunal against a host State of their investment.

Fraud:

Fraud in law means deliberate misrepresentation of fact for the purpose of depriving someone of a valuable possession. In spite of the fact that fraud is sometimes a crime in itself, more often it is an element of crimes such as obtaining money by false pretense or by impersonation.

In the Indian Contract Act, 1872 'Fraud' is defined under section 17 as follows:

"Fraud means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:

1. The suggestion, as a fact, of that which is not true, by one which does not believe it to be true;
2. the active concealment of a fact by one having knowledge or belief of the fact;
3. a promise made without any intention of performing it;
4. any other act fitted to deceive;
5. any such act or omission as the law specially declares to be fraudulent."[4]

Fraud is covered by both criminal and civil laws. In criminal context, fraud must be proved

[3]Avtar Singh, Law of Arbitration & Conciliation, *EBC Publications.*
[4] The Indian Contract Act, 1872.

'beyond any reasonable doubt'. If convicted of a crime, a defendant may be sentenced to jail or probation or monetary punishment. In private civil lawsuits, the standard of proof is lower, and punishment is often restitution and monetary damages.

Arbitrability of fraud:

This concept refers to whether a specific type of issue may be resolved by arbitration. Arbitrability is the rule in India's existing legal structure, while non-arbitrability is the exception. The Arbitration and Conciliation Act, 1996.

> "The arbitrability of fraud has been a matter of long discussion in the field of arbitration law with various courts in the country holding differing views on the subject matter."[5]

Section 2(3) of the Arbitration and Conciliation Act specifically states that Part 1 of the act shall not override any other law whereby certain issues be submitted to arbitration. This furthermore permits the concerned Courts[6] to overturn an arbitral award if the subject matter of the subject mater is not arbitrable according to the aforementioned[7] act and the decree of courts from different countries can also be set aside through the same aforesaid[8] act.

> "The impossibility of enforcing a foreign award due to non-arbitrability is not limited to India. In fact, the rules of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 (the New York Convention) and the Convention on the Execution of Foreign Arbitral Awards, 1927 form the basis of Indian law on this topic (the Geneva Convention)."[9]

Therefore, it makes an implied reference to non-arbitrability, it neither classifies arbitrability nor specifies any group of disputes as non-arbitrable. The legal setup in this sector basically has evolved as an outcome of the judicial decrees in the recent times. The analysis of arbitrability in India would be incomplete without mentioning the outcome of conflicts involving allegations of fraud.

Some of the landmark judgments in the field of Arbitration Law are mentioned below:

1. Booz Allen & Hamilton Inc. vs. SBI Home Finance Ltd. (Booz Allen case)[10]: the apex court held that a range of disputes to be non-arbitrable One such classification of

[5]Chirag M. Bhatia, *Arbitrability of* fraud, CBM LEGAL, *Available at*:https://www.hg.org/legal-articles/arbitrability-of-fraud-what-does-the-supreme-court-of-india-say-57857.
[6] Section 2(e) of The Arbitration and Conciliation Act, 1996.
[7] Ibid.
[8] Ibid.
[9]MatishaBansal, 6 January 2022, *Available at: https://blog.ipleaders.in/demystifying-the-notion-of-fraud-and-arbitration-special-reference-to-the-case-of-rashid-raza-v-sadaf-akhtar/*.
[10] (2011) 5 SCC 532.

disputes was "eviction or tenancy matters governed by special statutes where the tenant enjoys statutory protection against eviction"[11].

2. Abdul KadirShamsuddinBubere vs. MadhavPrabhakar Oak[12]: "The landmark judgment of the said case was the first ever judgment by the Hon'ble Supreme Court of India on the issue of arbitrability of fraud. It was held that a dispute containing fraud of any nature cannot be decided upon by an arbitral tribunal (even where the party accused of committing a fraud does not wish to pursue the case in an open court), since questions of fraud involve complicated factual questions that should be decided in an open court. In such a situation, the jurisdiction of an arbitrator would have to be presumed to be ousted. This decision having been rendered under the 1940's Arbitration Act, it was subsequently followed by the legislature by incorporating the principle in the 1996 act."[13]
3. A. Ayyasamy vs. A. Paramasivam[14]: "The case of A. Ayyasamy v. A. Paramasivam can be said to be one of the most important cases wherein the Supreme Court tried to set this issue of arbitrability of fraud to rest by holding that the mere allegations of fraud simplicitor are arbitrable whereas serious allegations of fraud are not."[15]
4. Rashid Raza vs. SadafAkhtar[16]: "The Hon'ble Apex Court in the said case clarified the scope of arbitrability of disputes involving allegations of fraud. Justice R. F. Nariman relying upon the landmark judgment of Supreme Court in A. Ayyasamy vs. A. Paramasivam[17] set out the tests to determine whether or not an allegation of fraud is arbitrable. The fraud in the present case was in a partnership firm wherein one party had utilized the assets of the partnership firm in another firm run by his father; created proprietorship firm with a same name, S. R. Coating, and introduced it to one of the firm's existing business partners, Reliance Industries Ltd.; opened a new bank account on the basis of a fake agreement; and transferred money into the Petitioner's personal bank account and his father's bank account.

In the aforementioned case, the Apex Court held that the series allegations of fraud would also involve:

- Allegations which constitute a clear-cut case of a criminal offence

[11] *Supra* note 4 at 4.
[12] 1962 AIR 406.
[13] *Supra* note 10 at 5.
[14] (2016) 10 SCC 386.
[15] *Supra* note 12 at 5.
[16] (2019) 8 SCC 710.
[17] *Supra* note 13 at 5.

- Complex allegations of fraud to the extent that it becomes necessary for the fraud to be tried by a Civil Court on account of voluminous evidence to be adduced
- Serious allegations of forgery/fabrication of documents being the way of committing fraud
- Case where the fraud goes to the validity of the contract thereby alleging fraud against the arbitration clause itself. "[18]

5. AmbujaNeotia Holdings Pvt. Ltd. vs. M/s Planet M Retail Ltd.[19]: "The Hon'ble Calcutta High Court in the aforementioned case held that the lease deed disputes, governed by the TP Act are arbitrable, as the TP Act codifies the general law of transfer of property and is not a special statute. The Court was of the view that Booz Allen[20] Case does not render all eviction or tenancy matters non-arbitrable but covers only such disputes which are governed by a special statute"[21].
6. Deccan Paper Mills Co. Ltd. vs. Regency Mahavir Properties[22]: Popularly known as The Deccan Paper Mills Case, "the first respondent had filed an application under Section 8 of the Arbitration and Conciliation Act, 1996. The appellant challenged the enforceability of the arbitration agreement on the ground that the same was null and void. The appellant argued that the disputes in the instant matter arose out of contracts that were fraudulently executed. The matter reached the Hon'ble Supreme Court after the district court at Pune and thereafter the Bombay High Court referred the parties to arbitration. The Hon'ble Supreme Court relied upon its judgment in Avitel Post Studioz wherein it was held that when the alleged fraud lies within the scope of performance of the contract or under Section 17 of the Indian Contract Act, 1872 – the dispute would be arbitrable. The Apex Court further clarified that the decision in N. Radhakrishnan was bad in law and had no legs to stand on. It was reiterated that merely because a particular transaction may have criminal overtones, it does not mean that its subject matter becomes non-arbitrable. In view of recent judgments, it observed that there has been a sea of change in Section 8 of the said Act as we see in the Arbitration Act today, vis-à-

[18] *Supra* note 14 at 5.
[19] (2016) 1 Cal LJ 147.
[20] *Supra* note 9 at 5.
[21] Binsy Susan and HimanshuMalhotra, 19 February 2018, *Wolters Kluwer*, *Available at*: http://arbitrationblog.kluwerarbitration.com/2018/02/19/arbitrability-lease-deed-disputes-india-apex-court-answers/.
[22] (2021) 4 SCC 786.

vis Section 20 of the Arbitration Act of 1940. It was held that if an action was brought before a judicial authority and all conditions of Section 8 were met, then such judicial body shall refer the parties to arbitration unless it finds that prima facie, no valid arbitration agreement exists. Therefore, the Hon'ble Supreme Court concluded that the judgment of the Bombay High Court needed no interference."[23]

7. VidyaDrolia vs. Durga Trading Corporation[24]: "In this case, a three-Judge bench of the Hon'ble Supreme Court undertook a thorough assessment of the law on arbitrability in contemporary jurisprudence. While the larger moot point related to the law on the arbitrability of landlord and tenant disputes, the Hon'ble Supreme Court also looked into the arbitrability of fraud. The decree in the aforementioned case noted that it would be entirely wrong to mistrust and treat arbitration as a flawed or inferior adjudication process unfit to deal with public policy aspects of a legislations. The Hon'ble Supreme Court drew a parallel between arbitral tribunals and courts. It was held that arbitrators, like courts, are bound to be impartial and independent, adhere to natural justice and follow a fair and just procedure. In conclusion, the N. Radhakrishnanjudgement was overruled while the bench in VidyaDrolia observed that allegations of fraud could be made the subject matter of arbitration when they related to a civil dispute. The exception to this rule is a dispute arising out of fraud which would vitiate and invalidate the arbitration clause itself."[25]

Nonetheless, keeping in view the most recent pro-arbitration developments in India, the Hon'ble Supreme Court of India has somewhat made it clear and optimistically, settled, the position on arbitrability of disputes involving allegations of fraud in the past times including some of the above-mentioned landmark case laws.

Interpretation of 'serious allegations of fraud':

A mere go through (minimal reading) of the aforementioned terminology would surely propose to a reasonable layman with adequate mental capabilities that the court in discussing "serious allegations of fraud" is likely alluding to frauds wherein colossal measures of money is involved or such claims which are of such a nature in order to deserve a full-fledged criminal

[23]VasanthRajasekaran& others, *The Evolving Jurisprudence of 'arbitrability of fraud' in India*, Phoenix Legal, *Available at:*https://www.mondaq.com/india/arbitration-dispute-resolution/1039916/the-evolving-jurisprudence-of-39arbitrability-of-fraud39-in-india-where-do-we-stand.

[24] AIR 2019 SC 3498.

[25]*Supra* note 22 at 7.

trial. As an issue of strategy, this could be a cogent interpretation since such allegations having criminal nature and most likely including public money are the most appropriate for arbitration by a public institution, in other words, specifically the Hon'ble Courts in the country. Notwithstanding, when one goes through a critical analysis of the judgment, one would come to know that this interpretation is more-what accurate. The Hon'ble Courts in the above-mentioned landmark cases found that the serious allegations of fraud are non-arbitrable in the light of the fact that they include confounded issues of fact and require illustrating of elaborated evidence also. As a consequence, 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. The issue with this understanding is that charge of fraud including gigantic totals on money might be referred to arbitration since they may not require immense measures of proof or claims of misrepresentation, depending upon the nature of fraud varying from case to case.

Analysis:

Simple Allegations of fraud which do not go to the base of the question and vitiate the basic agreement as well as the arbitration clause will not draw the fraud exception. For a fraud to be non-arbitrable, it is important that it vitiates the underlying contract delivering the arbitration clause itself as void by claiming the fraud against the intervention proviso itself.

Allegations of fraud which make little difference to the rights in rem will be held as arbitrable. Henceforth it is vital for the charges of fraud to have difficulties in the public space in order to draw in the fraud against the arbitration clause itself. Allegations of fraud which affect the rights in rem are inter-se parties and touches upon their internal affairs in their private domain alone, will be arbitrable how may ever be serious in nature they may seem. Through a less theoretical standpoint, the previously mentioned decrees additionally restrict the extent to which an award can be challenged on the basis of arbitrability.

Conclusion:

The judicial decrees or in other words the aforesaid judgments in the paper above are indeed a welcomed development. These judgments would empower the Indian arbitral system to draw imminent to the objective of turning into a mature jurisdiction. The said judgments not just meet the object of lessening obstruction of the courts in the arbitral interaction yet in addition are an obvious sign of the trust.

At present, the settled legal position concerning the arbitrability of fraud in India is that the allegations of fraud that permeate the entire contract and do not simply affect the internal affairs of the parties but instead affect the rights in rem are non-arbitrable. The principles of arbitrability of frauds developed by the courts are conducive. However, as we move forward their effectiveness remains to be seen in the cases where the parties may raise the allegations of fraud to willfully avoid the arbitral process.

However, if the Constitution of India is amended to provide for settlement by arbitration under 'procedure established by law' and sufficient legislative safeguards (including appeal mechanisms) are enacted for an arbitral tribunal to follow, India could become a jurisdiction that permits arbitral tribunals to adjudicate on fraud in the same manner that of a court of law.