The Evolving Landscape of the Arbitrability of Fraud in India

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Introduction

In the complex realm of international dispute resolution, the convergence of fraud and arbitration creates a notably challenging and intricate issue. There is ongoing legislative debate regarding the arbitrability of fraud, with India's pro-dispute resolution environment suggesting a gradual shift towards a more lenient assessment. Both the judiciary and legislature have worked together to create a framework that balances rights *in rem* with rights *in personam* in fraud cases. However, India remains noticeably hesitant to fully endorse the arbitrability of fraud, as shown by the legislature's rejection of the Law Commission's proposal supporting it.[1] This article analyses the legal framework, judicial interpretations, and international perspectives shaping the arbitrability of fraud in India. In doing so, it outlines the challenges and opportunities associated with arbitrating fraud in the Indian context whilst drawing comparisons with international standards on the same.

Arbitrability of Fraud in India: Legislative Basis

The word ‘fraud’ has been defined under Section 17 of the Indian Contract Act 1872 as *“a misrepresentation of truth or an active concealment of fact in order to make the other party act to his disadvantage”*.[2] Where the contract is considered to be a product of fraud (such as in cases where consent is procured fraudulently), the contract is deemed voidable. Once voided, the general rule is that the arbitration clause in the contract would also be dissolved with the rest of the contract. Section 19 of the Arbitration and Conciliation Act 1996 (“the Act”) reiterates the general hesitance to impose an arbitration clause upon seemingly unwilling parties and provides ample discretion to the court to decline such arbitration requests.[3]

[1]Report 246, Law Commission Report.
[2] Indian Contract Act 1872, s.17.
[3] Arbitration and Conciliation Act 1996, s.19.

Indian legislation, however, has at no point excluded any category of cases as non-arbitrable. Section 8 of the Act permits the judiciary to refer cases to arbitration where a valid arbitration agreement exists between parties.[4] Arbitration is generally considered appropriate where rights *in personam* are affected and conversely, deemed unsuitable for cases involving rights *in rem*. Fraud, as an issue that involves both rights *in rem* as well as rights *in personam*, tends to be a grey area with regard to its arbitrability.

There is significant legislative hesitance to include a clause granting blanket arbitrability to fraud cases. The 246th Law Commission Report[5] suggested an addendum to Section 16 of the Act, allowing an arbitral tribunal to pass awards in cases of fraud.[6] The 2019 amendment of the Act overlooked this recommendation.[7] Thus, the current jurisprudence behind the arbitrability of fraud largely depends upon precedential developments, which set out tests to distinguish between arbitrable and non-arbitrable cases.

The Arbitration and Conciliation (Amendment) Act 2021 marked a shift towards a more pro-arbitration approach. This amendment introduced a significant change: it allowed for an automatic stay on awards if the court had *prima facie* evidence that the contract underlying the award was influenced by fraud or corruption. Previously, a party could file a Section 34 application to set aside an arbitral award[8]. The 2021 Amendment added a proviso to Section 36(3) of the Act[9], ensuring that if the court was *prima facie* satisfied with the case, an unconditional stay on the award would be granted pending the challenge's resolution. This applied to situations involving either the arbitration agreement or the contract forming the basis of the award, as well as cases where the award was influenced by fraud or corruption. This change was made effective retrospectively from October 23, 2015.

Several Indian Parliamentarians criticised the unconditional stay clause. Experts argued that such a stay impedes India’s pro-arbitration efforts. This is because it becomes easy for the losing party to allege corruption and automatically stay the enforcement of the arbitral award. This could undermine the alternative dispute resolution mechanism by diverting parties to courts and making the process prone to litigation. Another concern is the lack of a clear definition for fraud or corruption in legislation, creating ambiguity that may subject defendant

[4] Arbitration and Conciliation Act 1996, s.8.
[5] 246th Law Commission Report.
[6] Arbitration and Conciliation Act 1996, s.16.
[7] Arbitration and Conciliation (Amendment) Act, 2019.
[8] Arbitration and Conciliation Act 1996, s.34.
[9] Arbitration and Conciliation Act 1996, s.36(3).

parties to litigation even if they are correct. Thus, the retrospective effect of this amendment may lead to a surge in litigation cases, thereby overburdening the courts.

In cases where an application under Section 36(2) of the Act is pending before a court, applicants will now need to file renewed applications based on the grounds specified in the new amendment.[10] This is likely to cause delays and increase costs, thereby impacting the enforcement of awards and potentially damaging India's standing in 'Ease of Doing Business' reports. It is seen as a regressive step that goes against India's goal of bolstering arbitration within the country.

In response to this criticism, the Law Minister at the time argued that including the words "fraud" and "corruption" in Section 34 of the Act was necessary as the latter does not provide an "automatic stay" of the award.[11] He further asserted that the government aimed to prevent collusive attempts by parties to benefit from an award tainted by corruption. However, these arguments lack clarity and reasoning. Pro-amendment scholars contend that this change is essential to protect parties affected by fraudulent elements in arbitral awards, citing cases such as *Venture Global Engineering LLC v Tech Mahindra Ltd & Anr*[12], wherein fraud was alleged by the respondents three years after the award's enforcement, and yet it was set aside. Nonetheless, the broader impact of expanding the Act's scope in protecting innocent parties when challenges are made solely to delay award enforcement remains uncertain.

The authors understand the need to adopt a cautious approach in the matter as a blanket provision bestowing the power to pass awards in fraud cases may lead to all fraud cases being treated as civil cases, thereby fostering an environment where serious frauds are subject to arbitration via loopholes. However, the amendment largely proves inadequate as the ambiguity in the phrasing widens the ambit for judicial discretion, which may not be conducive for a dynamic nation like India. For example, although there is a necessity for *prima facie* evidence for fraud and corruption, no threshold for the same is defined. With such ambiguity in the Act, it becomes crucial to look at judicial trends to analyse India's stand regarding the arbitrability of fraud.

[10] Arbitration and Conciliation Act 1996, s.36(2).
[11] Report 246, Law Commission Report.
[12] [2017] SCC Online SC 1272.

Judicial Treatment of Arbitrability of Fraud

In *Abdul Kadir Shamsuddin Bubere v Madhav Prabhakar Oak*, the Indian Supreme Court established that disputes involving serious allegations of fraud were unsuitable for arbitration due to their complexity in factual inquiry.[13] Subsequently, the Court in *N. Radhakrishnan v Maestro Engineers*[14] reaffirmed the precedent set in *Abdul Kadir*. It emphasised that even with an existing arbitration agreement, the court could intervene if the dispute necessitated intricate investigation and extensive evidence presentation, deeming itself better equipped to handle such complex matters.[15]

In *Swiss Timing Ltd. v Commonwealth Games 2010 Organising Committee*[16], the Court rectified its error in its previous judgments by emphasising the obligation under Section 8 of the 1996 Act, which orders judicial authorities to refer disputes based on arbitration agreements to arbitration. The Court clarified that registering a criminal case related to fraud did not automatically bar arbitration referrals. Further, the distinction between fraud and 'serious fraud' was determined by the gravity and extent of the fraud; not every fraud bearing a criminal colour would be arbitrable.

The delineation between arbitrable and non-arbitrable fraud allegations was elucidated upon in the pivotal decision of *A. Ayyasamy v A. Paramasivam*.[17] This case highlighted that while mere allegations of fraud should not preclude arbitration, serious fraud allegations would render the contract (including the arbitration agreement) void, subject to the test considering whether the fraud allegation makes the contract void and also its impact on the public domain on account of its criminal nature. In *Avitel Post Studioz Ltd. v HSBC PI Holdings (Mauritius) Ltd*.,[18] the Supreme Court affirmed the twin test established in *Ayyasamy*. However, the determination of whether fraud allegations are simple or serious remains contingent on a case-by-case evaluation.

In 2020, the Supreme Court in *Vidya Drolia v Durga Trading Corporation* [19] for the first time clarified the position of law in this regard and overruled several earlier decisions. Further in

[13] AIR [1962] SC 406.
[14] [2010] 1 SCC 72.
[15] AIR [1962] SC 406.
[16] [2014] 6 SCC 677.
[17] [2016] 10 SCC 386.
[18] [2020] SCC OnLine SC 656.
[19] [2021] 2 SCC 1.

2021, in *N.N. Global Mercantile (P) Ltd. v Indo Unique Flame Ltd.*,[20] the Supreme Court took a similar stand as in *Vidya Drolia*.

In *Vidya Drolia*, the Supreme Court answered the question of whether fraud is arbitrable or not in the affirmative, but also laid down the two main exceptions wherein fraud would not be arbitrable (in furtherance of *Ayyasamy*):

(i) In case the nature of fraud is such that it impeaches the underlying contract, thus rendering the arbitration clause invalid and,
(ii) In case the dispute is criminal in nature.

The Court examined Section 34(2)(b)(i) and (ii) of the Act.[21] These clauses provide that a court may set aside an arbitral award if the subject matter of the dispute cannot be resolved by arbitration under the current law, or if the award passed by the arbitrator goes against the public policy of India. As explained by the statute, only that award which is affected by fraud or corruption would be deemed to be in conflict with the public policy of India. The Court clarified that conflict with public policy and arbitrability of the subject matter of a dispute are two separate grounds on which the Court can set aside an award.

Further, the Supreme Court set aside a decision of the Delhi High Court in *HDFC Bank Ltd. v Satpal Singh Bakshi,* [22] which affirmed the arbitrability of matters which are dealt with by the Debt Recovery Tribunal. The Apex Court thereafter explicitly overruled *N. Radhakrishnan v Maestro Engineers*[23] as it was noted that the complexity of a dispute cannot be a factor to render it non-arbitrable. In fact, arbitrators too are equally bound to resolve disputes following the public policy of the law, just like the Courts, failing which would defeat the objective of the legislature behind the enactment of the Act.

In *NN Global*, the Supreme Court took a similar view as in the *Vidya Drolia* judgment. The Court acknowledged that civil fraud is typically considered arbitrable under current arbitration law, except when the arbitration agreement is compromised by fraud. This scenario challenges the validity of the underlying contract and, consequently, the arbitration clause. A further exception is where the substantive contract itself is "expressly declared to be void" under Section 10 of the Indian Contract Act 1872.[24] In *NN Global,* the Court held that the civil aspect

[20] [2021] 4 SCC 379.
[21] Arbitration and Conciliation Act 1996, s.34.
[22] [2012] SCC OnLine Del 4815.
[23] [2010] 1 SCC 72.
[24] Indian Contract Act 1872, s.10.

of fraud is arbitrable and looked to Section 17 of the Indian Contract Act 1872 wherein fraud has been defined.

The competency of the Arbitral Tribunal was also scrutinised by the Court in *NN Global*. It was noted that earlier when fraud was held as non-arbitrable, it was on the ground that it would require the examination of voluminous evidence, which would be complicated to decide in arbitration. However, this view is archaic and needs to be reconsidered as appointed arbitrators are mainly retired judges who possess the capability to examine complex evidence due to their professional experience. Numerous jurisdictions across the world (such as the United Kingdom and the United States) have codified the arbitrability of fraud. Moreover, arbitration and criminal proceedings can also co-exist since most arbitrators are retired judges and have ample experience in resolving disputes involving criminal allegations of fraud. This would also minimise the intervention of courts, thus promoting arbitration. Such legislative intervention would result in a comprehensive solution, settling the matter conclusively.

International Perspectives

The international stand on the arbitrability of fraud involves complex considerations, drawing on various legal frameworks and national jurisdictions. The United Nations Commission on International Trade Law ("UNCITRAL") Guide on Recognising and Preventing Commercial Fraud, 2013, defines commercial fraud as involving deceit with a serious economic dimension, often intertwined with corruption and bribery.[25] Historically, states were hesitant to allow arbitrators to decide matters involving these criminal actions, as they were perceived to be against public peace and state interests.

Examining key instruments such as the New York Convention 1958[26] and the UNCITRAL Model Law on International Commercial Arbitration 1985[27] ("Model Law") reveals that the issue of arbitrability depends on the subject matter and its capacity to be settled through arbitration. The Model Law, lacking a specific provision on arbitrability, implies that all disputes are arbitrable subject to domestic laws.

[25] UNCITRAL Guide on Recognizing and Preventing Commercial Fraud 2013.
[26] New York Convention 1958.
[27] UNCITRAL Model Law on International Commercial Arbitration 1985.

National jurisdictions exhibit varying attitudes towards the arbitrability of fraud. In jurisdictions such as the United Kingdom and Singapore, disputes tainted with corruption and bribery are typically considered arbitrable with determinations made on a case-by-case basis. In the UK, the *Fiona Trust & Holding Corporation v Privalov* case[28] underscored that even fraud-tainted disputes are arbitrable, emphasising the principle of separability. This principle provides for the separation of the arbitration agreement from the main agreement, which implies that the arbitration agreement cannot be deemed void merely on the grounds of the main agreement being deemed invalid. Rather, only when the arbitration agreement has been directly impacted can it be voided.

Nigeria allows for the arbitrability of fraud unless it affects the validity of the arbitration agreement as held by the Court of Appeal in *Dr. Charles D. Mekwunye v Lotus Capital Limited & Ors*, [29] while England deems fraud arbitrable as long as it pertains to the main agreement rather than the arbitration agreement[30].

Suggestions and Recommendations

As we navigate the intricate landscape of fraud and arbitration within the international dispute resolution arena, the need for strategic interventions becomes apparent. The following recommendations are crafted with the aim of fortifying India's arbitration landscape, mitigating challenges, and harnessing opportunities regarding the arbitrability of fraud.

Alignment with International Standards and Harmonisation:

India should align its laws with international standards such as the New York Convention and the UNCITRAL Model Law, while harmonising regional practices to ensure consistency and facilitate cross-border cooperation. This alignment enhances the enforceability of arbitral awards related to fraud internationally, providing parties with confidence in choosing arbitration as a dispute resolution mechanism. Moreover, harmonisation fosters predictability and reduces the risk of conflicting legal interpretations, thus promoting a more efficient and effective resolution of fraud-related disputes.

[28] [2007] UKHL 40.
[29] (2018) LPELR-45546 (CA).
[30] English Arbitration Act 1996, s.7(2).

Clarity and Certainty in Legislative Framework:

Advocating for clear legislative provisions and judicial guidance regarding the arbitrability of fraud is essential to promote confidence and minimise ambiguity in India's arbitration regime. Clarity in the legal framework enables parties to understand the scope of arbitrable fraud matters, leading to faster and more cost-effective resolutions. Certainty in the legislative framework also encourages parties to opt for arbitration, knowing that their fraud-related disputes will be handled consistently and impartially.

Engagement with International Experts and Stakeholders:

Collaborating with international experts, organisations, and stakeholders can provide valuable insight and promote knowledge exchange to inform the development of India's arbitration laws and practices. Engaging with global expertise can enhance India's understanding of best practices in fraud arbitration, encouraging the adoption of innovative approaches, and building trust among international parties in India's arbitration system.

Continuous Review, Judicial Reform, and Promotion of ADR:

Regular review of arbitration laws, judicial education on fraud-related arbitrations, and promotion of alternative dispute resolution mechanisms are vital for maintaining competitiveness, consistency, and efficiency in India's arbitration landscape. Continuous review ensures that the legal framework remains responsive to evolving fraud-related challenges, while judicial education enhances the competence of arbitrators and judges in handling complex fraud disputes. Additionally, promoting ADR mechanisms encourages parties to explore amicable resolutions, reducing the burden on courts and fostering a culture of dispute resolution through arbitration.

There is a compelling argument to be made for the arbitrability of criminal cases of fraud, especially in the context of commercial disputes. Arbitration offers several advantages over traditional criminal proceedings, including confidentiality, flexibility, expertise of arbitrators, and faster resolution. Allowing criminal cases of fraud to be arbitrable can expedite the resolution of complex disputes, reduce strain on overloaded criminal justice systems, and provide parties with a more tailored and efficient mechanism for addressing fraud-related issues. Moreover, with proper safeguards and oversight, arbitrations can uphold due process rights and ensure fair and just outcomes.

By addressing these recommendations and considering the arguments for the arbitrability of criminal cases of fraud, India can potentially enhance its legal framework, promote transparency, and create a more conducive environment for resolving fraud-related disputes through arbitration. The goal is to strike a balance that safeguards the interests of the parties involved, maintains judicial integrity, and supports the overarching objective of fostering a pro-arbitration regime in the country.

Conclusion

The intricate interplay between fraud and arbitration in India's legal landscape demands strategic interventions to fortify its arbitral framework while navigating complexities. Despite recent legislative amendments and judicial clarifications, ambiguity persists, highlighting the need for further alignment with international standards and clarity within the legislative framework. Engagement with international experts and stakeholders, coupled with the promotion of alternative dispute resolution mechanisms, will enhance transparency and efficiency. Continuous review, judicial education, and harmonisation with global best practices are vital for maintaining India's competitiveness as an arbitration destination while upholding judicial integrity. By implementing these recommendations, India can strike a balance that safeguards the interests of all parties involved and fosters a robust pro-arbitration regime conducive to efficient dispute resolution.

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