THE ARBITRABILITY PROBLEM: THE ISSUE OF FRAUD

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Abstract

There has been no clear specific law in the field of arbitration on matters like fraud when alleged by one party on the other. In such cases, whether the arbitrator has the power to adjudicate the case or whether it is in the domain of the court is something which is not yet decided and has been the topic of research in this paper. There is no fixed answer to this question as per now but decisions have been made on the basis of doctrines like separability doctrine and doctrine of competency where the issue arises as to the validity of the entire agreement along with the arbitration clause. Moreover, many conflicting decisions by the court have been studied by the scholar on the issue of whether fraud is now a matter of private or a public forum. Many jurisdictions even decide this issue on the basis of preference of one party. The scholar in this paper has tried to decode the various considerations taken while deciding on such issues.

Introduction

The requirement that the parties to an arbitration agreement honour their undertaking to submit to arbitration any disputes covered by their agreement entails the consequence that the courts of the country has been prohibited from hearing such disputes. The purpose of this is to attain speedy justice with least hassle faced by the parties. If any such matter is brought before the court, it will be required, as according to the Section 8 of the Arbitration and Conciliation Act 1996, to refer the parties to arbitration.

The long debated question has been what would be the consequence of the situation where the fraud in the inducement of the agreement is being claimed by one of the parties. Will the arbitrator then have the authority to decide on the dispute? There have been many conflicting decisions and unclear legislation on this matter worldwide thus making the position very blurry.

The power of referral to arbitration by the court under Section 8 and 45 of Act

The Indian Arbitration law has been set on UNCITRAL model of arbitration and according to the Act[2] in the case of internationalagreements, the court has been provided the power to refer the parties to arbitration unless it finds that the said agreement is null and void, inoperative or

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[2]Section 45, Arbitration and Conciliation Act 1996.

incapable of being performed. The courts though are not required to inquire into the merits and validity of the arbitration agreement and they must restrict to only prima facie verification that the agreement exists and is valid[3].

But in case of domestic agreements, Section 8 does not provide the same. It uses the word "*shall*" hence making it peremptory and obligatory and nothing remains to be decided on the original action after such an application is made except to refer the dispute to an arbitrator[4].

Judicial intervention in matters governed by the part I of the act is permissible only to the extent as provided under it as provided by Section 5. This is in furtherance of the object to limit and define the scope of judicial intervention in the arbitral process. An arbitration agreement is a contract between the parties to settle their disputes through arbitration, rather than by litigation in court. Judicial intervention, therefore, should be in aid of arbitration.[5]

The objective of the act of 1996 was to limit the judicial interference in the arbitral proceedings to the minimum.[6]Pre-arbitral proceedings before the court seem to be in negation of it. *To shut out the arbitration at the initial stage would destroy the very purpose for which the parties had entered into arbitration.*

Holding a suit where the contract containing the arbitration clause is challenged on the ground of forgery as maintainable and which results is injunction of the arbitration proceeding is tantamount to negating the effect of the statute considering the Section 5,8 and 16 of 1996 Act[7].

Validity of the arbitration agreement itself in question

In cases where a party alleges fraud in the inducement of the contract, the problem arises in relation to the arbitration agreement when its validity itself is in question.

There have been many conflicting judgments in this regard worldwide. In the *Matter of Palmer & Pierce, Inc.*[8], one of the cases construing the New York arbitration statute, the appellant division established what has subsequently become the generally accepted rule

[3]Ibid.
[4]*P Anand Gajapathi Raju v PVG Raju* (2000) 4 SCC 539.
[5]OP Malhotra and Indu Malhotra, *The Law and Practice of Arbitratioon and Conciliation* (3rd edition, Thomson Reuters, 2006) 439.

[6]*Bharat Aluminium Co Ltd v Kaiser Aluminium Technical Services Ltd* (2012) (3) Arb LR 514(SC).
[7]*Shri Roshan Lal Gupta v Shri Parasram Holdings Pvt Ltd. And Anr*AIR 2009 Del 454.
[8]195 AppDiv523, 186 NY Supp 369 (1st Dept 1931).

where the existence or non-existence of the agreement to arbitrate is in issue. The court held that it could not compel performance of an arbitration agreement unless there was an agreement to arbitrate; therefore the question of whether the arbitration agreement was infact made had first to be determined by the court.

The avenues of approach to the problem of who shall decide the issue of fraud are several and, to a certain extent, depend on the factual situation involved. If fraud is alleged as to the arbitration agreement itself the courts must determine the question.It is well settled that an allegation that the contract is void, the arbitration clause or both, must be decided by the courts. To have the arbitratorsdecided issues under a void contract would be to give validity to the contract[9].

At common law the defrauded party to the contract had an election of remedies. In the *Matter of Wrap-Vertiser Corp*.[10] the defrauded party sought to have arbitrated his demand for damages based on fraud and breach of contract. The Court of Appeals though held that the arbitration clause was not broad enough to encompass the issue of fraud, clearly recognized the innocent party's right to arbitrate in view of his affirmance of the contract including the arbitration agreement by his suit for damages. Therefore, it may be postulated that the New York Courts are willing to permit arbitration of fraud provided the innocent party affirms the contract and the agreement is broad to include the question of fraud. The innocent party thus if affirms the fraudulently induced arbitration agreement and compels arbitration, the court has not much say in this.

The Indian courts seem to follow a different approach. The reasoning provided while solving such disputes has been that *party which is alleged to have committed the fraud should be given the opportunity to decide to which forum it would like to be subjected* and if the party desires that the matter be tried in open court or private forum the court must do so. Where it held that in a case where fraud is charged, the court will in general refuse to send the dispute to arbitration if the party charged with the fraud desires a public inquiry.[11]

Thus whatever may the approach be, though well established that the court should decide the issue of fraud, the decisions of the court do not fully uphold this principle.

[9]*Metro Plan Inc v Miscione*257 AppDiv652, 15 NYS 2d 35.
[10]163 NY S 2d 639 (1957).
[11]*Abdul Kadir Shamsuddin Bubere v Madhav Prabhakar* Oak AIR 1962 SC 406; *Radhakrishnan v Maestro Engineers Ltd* (2010) 1 SCC 72.

But such an approach would be only valid if the arbitration agreement is considered as separable from the main contract. The parties at the time of dispute indulge in the dilatory tactics of negating the underlying contract on grounds of it being voidable, and hence non-arbitrable. It is in this context that the *doctrine of separability* has importance where the arbitration clause is considered separate and independent and does not invalidate it.

The test of separability is the content of the contract and the intention of the parties. The parties do not think in terms of a severable contract when they add an arbitration clause to a substantive contract. Lacking a clear intention to the contrary, separability should not be presumed. They can obviously provide that the agreement of arbitration is severable.

This doctrine of separability is not an absolute rule of law and many times it too would have to face the repercussions of the invalidity of the underlying contract.

The doctrine has been interpreted variedly in various arbitration jurisdictions. Switzerland was the first major arbitration country which had a acquired the separability doctrine. The Federal Supreme Court declared that the invalidity of the main contract could not affect the arbitration clause. But Swiss Federal Tribunal held that this doctrine would not be applicable when the grounds of invalidity of the underlying contract affect the arbitration clause. It is true in cases of deficiency of assent or lack of authority[12]. The same was held by the House of Lords in England in the decision of *Premium Nafta Products Ltd. Fili Shipping Co. Ltd.*[13], that the validity of the arbitration agreement would be in question in cases where the ground of attack is not the invalidity of the main contract but where the party had no authority to sign the contract.

US courts too recognised the doctrine on the principle that the purpose of the arbitration agreement added in the contract by consent of both the parties is that the arbitration procedure should be speedy and not subject to delay and construction in the courts and so does not permit the court to consider the claims of fraud in the inducement of the contract too[14]. Though in a later decision in David L. Threlkeld & Co. Inc. v Metallgesellschaft Ltd[15], the court observed that any doubts concerning the scope of arbitral issues should be resolved in favour of arbitration and that the clause should be construed as broadly as possible.

[12]National Power Corpn v Westinghouse DFT 119 II 380 (Swiss Federal Tribunal).
[13][2007] UKHL 40.
[14]*Prima Paint Corpn v Flood &Conklin Mfg Co*[1967] 388 US 395.
[15]923 F 2d 245 (2nd Cir 1991).

The Indian Arbitration and Conciliation Act 1996, recognises the principle of *Competenz-Competenz* principle which provides that the Arbitral Tribunal may rule on its own jurisdiction, including ruling on any objections with respect to the existence and validity of the arbitration agreement, and for that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract and a decision by the Arbitral Tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause[16]. The arbitration clause is valid, even if the contract becomes null and void.

This authority of the tribunal under Section 16 is not confined to the width of its jurisdiction but goes to the very root of the jurisdiction.[17] The scope of intervention is envisaged under Section 34 of the Arbitration and Conciliation Act, 1996 meaning thereby that at the initial stage if any person or a party has raised an objection with regard to the validity of the arbitration clause or the competence of the arbitral tribunal to adjudicate the dispute then under Section 16 of the Arbitration and Conciliation Act, 1996, the Tribunal itself has the jurisdiction to decide the said issue and it is not open to such a party to rush to the court for adjudication. Section 5 of the act reinforces this principle by non-obstante clause that there cannot be any judicial intervention.

In a landmark decision of *India Household and Healthcare Ltd. v L.G. Household and Healthcare Ltd*.[18], the Supreme Court observed that the separability doctrine reflect the principle of competence-competence and this is used to decide on the jurisdictional dispute. But the question would be different in case where the entire agreement is stands vitiated by fraud of such nature. If the agreement is not validly entered into, then prima facie, it is invalid as a whole including the arbitration clause.

[16]Section 16, Arbitration and Conciliation Act 1996.
[17]*Konkan Railway v Rani Constructions Ltd* 2002 (1) CTC 679[21].
[18](2007) 5 SCC 510.

Competency of the arbitrator to decide on such issues

The issue of competency of the arbitrator to hear cases of serious allegations of fraud has been the core issue in various judgments of the courts in this country.

The Court in the case of *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd.*[19] held that where the issue of arbitrability arises in the context of an application under Section 8 of the Act, all aspects of arbitrability will have to be decided by the court, and cannot be left to the decision of the arbitrator. Even if there is an arbitration agreement between the parties, and even if the dispute is covered by the arbitration agreement, the court will refuse an application under Section 8 of the act, if the subject matter of the suit is capable of adjudication only by a public forum or by a special court or tribunal.

In a deciding case of Abdul Kadir[20] where the case related to allegations of fraud and serious malpractices on the part of respondents, the court held that such a situation can only be settled in court through furtherance of detailed evidence by either parties and such a situation cannot be properly gone into by the arbitrator[21].

Reference can be made to the decision given on this issue by the Supreme Court in the case of *Radhakrishnan v Maestro Engineers Ltd*[22] where the court held that for the furtherance of justice, such cases should be tried in a court of law, which would be more competent and have the means to decide such a complicated matter involving various questions and issues raised in the present dispute.

In the case of *Haryana Telecom Ltd v Sterlite Industries (India) Ltd*.[23], the court affirmed the decision in Abdul Kadir[24] case and held that:

"*Under Section 8, though the judicial authority before which the action is brought in a matter will refer the parties to arbitration, what can be referred to the arbitrator is only that matter or dispute which he is competent or empowered to decide*."

The jurisdiction of the court is barred at a pre objection stage except where there are serious allegationsof fraud involved which are prima facie supported by the documentary evidence so

[19](2011) 5 SCC 532.
[20]*Abdul Kadir Shamsuddin Bubere v Madhav PrabhakarOak* AIR 1962 SC 406.
[21]Ibid.
[22](2010) 1 SCC 72.
[23](1999) 5 SCC 688.
[24]*Abdul Kadir Shamsuddin Bubere v Madhav Prabhakar Oak* AIR 1962 SC 406.

as to prima facie convince the court that there are real allegations of fraud which need to be investigated by the court.[25]

In the case of *Russel v Russel*[26], the court observed that it is only the cases of allegations of fraud of serious nature in which the court can refuse to order an arbitration agreement to be filed and reference to be made.

The same has been elaborated in *HG Oomor Sait v O Aslam Sait*[27], wherein it was held that:

"*Power of civil court to refuse to refer to stay of suit in view of arbitration clause on existence of certain grounds available under the 1940 Act continues to be available under the 1996 Act as well and the civil court is not prevented from proceeding with the suit despite an arbitration clause if dispute involves serious question of law or complicated questions of fact adjudication of which would depend upon detailed oral and documentary evidence*."

In an arbitration appeal in *Goldstar Metal Solutions v Dattarao Gajanan*[28], the tribunal took the view that when serious allegations of fraud are demonstrable, such an issue could not be left open to be decided by the arbitral tribunal.

In the case of *Bharat Rasiklal v Gautam Rasiklal*[29], distinction has been made by the Courts between serious issue of fraud and mere allegation of fraud and the former has been held to be non-arbitrable. There may be cases where fraud is prima facie supported by way of evidence and where fraud is merely alleged. In the former case, the arbitral tribunal may be conceive to have no jurisdiction.

In the very recent case of *Abubackkar Siddiq v Ganesan*[30], the Madras High Court referred to the decision laid down in the case of Radhakrishnan and Oomor Sait case and dismissed the petition of the appellant pleading the case related to serious allegation of fraud to be referred to arbitration.

Where all these judgments point to the fact that the arbitrator does not have the authority to arbitrate on serious matters like fraud, there are various other judgments which interpreted the act in favour of arbitration on grounds of section 8 being peremptory in nature, objective of the act and interpretation of section 8 and section 16 of the act.

[25] *RRB Energy Ltd v Vestas Wind Systems* 2015 SCCOnline Del 8734.
[26] (1880) LR 14 Ch D 471.
[27] (2001) 2 MLJ 672.
[28] Arb. Appeal No. 12 of 2013 dt 13/03/2013.
[29] (2012) 2 SCC 144.
[30] CRP (PD) (MD) Nos 1242 of 2010 and 1243 of 2010 and MP (MD) No 1 of 2010 (2 June 2015)

Supreme Court in the recent case of *Swiss Timing Ltd v Commonwealth Games 2010 Organising Committee*[31] has settled the discussion on this issue by referring to the case of the same court *Hindustan Petroleum Corpn Ltd v Pinkcity Midway Petroleums*[32], wherein this court has observed that

"*If an agreement between the parties before the civil court, there is a clause for arbitration, it is mandatory for the civil court to refer the dispute to an arbitrator. In view of the mandatory language of Section 8 of the Act, the courts ought to have referred the dispute to arbitration."*

The court in Swiss timing Case considered the contradictory judgments given by the Supreme Court and high courts and held that the observations in Hindustan Petroleum laid down the correct law and considered the Radhakrishnan judgment as per incuriam as Section 16 of the Act and various other judgments were not even noticed or referred by the court.

Merely because there is requirement of oral and documentary evidence in such cases is noground for refusal to refer to arbitration. Owing to section 34 of the Act, the court can take into consideration the validity of the award but stay on the arbitral proceeding would go beyond the scope of judicial authority.[33]

The Supreme court gave a generic test on the question of arbitrability of dispute-

"*Generally and traditionallyall disputes relating to rights in personam are considered to be amenable to arbitration; and all disputes relating to rights in rem are required to be adjudicated by courts and public tribunals, being unsuited for private arbitration.*"[34]

The *246th Law Commission Report* brought full closure to the entire controversy by legislatively providing that allegations of fraud, complicated questions of fact or serious questions of law are expressly arbitrable and proposed an amendment for the same in Section 16.

Even after amendment act 2015 which though has not dealt with the issue expressly, there have been courts like Bombay high court in the case of *Capri Global Capital Ltd v Lavasa Corpn Ltd*[35] which followed the Swiss Timing Judgment of the Supreme Court and held the

[31]*Swiss Timing Ltd v Commonwealth Games 2010 Organising Committee* (2014) 6 SCC 677.
[32]*Hindustan Petroleum Corpn Ltd v Pinkcity Midway Petroleums* (2003) 6 SCC 503.
[33]*Radhakrishnan v Maestro Engineers Ltd* (2010) 1 SCC 72.
[34]*Booz Allen & Hamilton Inc v SBI Home Finance Ltd* (2011) 5 SCC 532.
[35]*Capri Global Capital Ltd v Lavasa Corpn Ltd* 2016 SCC Online Bom 4328.

view that even cases where fraud was alleged the disputes could be referred to arbitration thus rejecting the decision in Radhakrishnan.

There is still no certain answer to the dispute of arbitrability. All is left on the case to case basis and the court's approach towards the issue though the recent trend bends the scale more towards in the favour of arbitration considering the already present load of pending cases on the judiciary.There are arguments both in the favour of adjudication by the court as well as the arbitrator but the total analysis after the research, the scholar finds that the arbitration would be a better avenue in such cases and the court then has the power to review the award. This would reduce the court's burden as well as further the purpose ofarbitration otherwise it would be rendered useless by the parties who later just by raising a question on the validity of the arbitration clause escape from its duties under the agreement signed by him.