

Impact of Allegations of Fraud on an Arbitration Clause in Commercial Contracts

written by Abhishek Bagga | October 10, 2019

The Bench comprising of Justice Rohinton

Fali Nariman, Justice R. Subhash Reddy and Justice Surya Kant of Hon'ble Supreme Court of India in judgement dated September 4, 2019 in the case of *Rashid Raza Vs. Sadaf Akhtar*^[1],

set aside the judgment under the appeal by stating that the dispute between the

parties are arbitrable and hence, application of Section 11 under Arbitration and Conciliation Act, 1996 (hereinafter referred to as the "Act") would be maintainable.

Facts:

The present case arises out of a

partnership dispute between the partners of a company. A FIR was lodged by one of

the partners alleging the siphoning of funds and various other business improprieties that were committed. An arbitration petition was filed by Sadaf Akhtar (hereinafter "Appellant") before the Ld. High Court under Section 11 of the Act seeking appointment of an Arbitrator under the Arbitration Clause

forming part of the partnership deed between the partners. The Ld. High Court,

by the impugned order dated December 6, 2018, cited the judgement of *A. Ayyasamy vs. A. Paramasivan and others*^[2],

wherein, the distinction between serious allegations of forgery/fabrication and

simple allegations was laid down.

Procedural History:

The High Court, by the impugned order

dated 06.12.2018, cited the judgement of *A.*

Ayyasamy, wherein, the distinction between serious allegations of forgery/fabrication and simple allegations were laid down. The parties to the dispute relied on para 26 of the supra order passed by the Ld. High Court.

Para 26 of the order states that "the nature

of the dispute involving serious allegations of fraud of complicated nature are

not fit to be decided in an arbitration proceeding. The dispute may require voluminous evidence on part of both the parties to come to a finding which can

be only properly undertaken by a Civil Court of competent jurisdiction".

Ruling By The High Court:

The High Court while dismissing the

application under Section 11 of the Act gave the verdict that "the facts of the

instant case are much more complex as per the material on records disclosed.

The Court, however, did not intend to make any comments on merits of the

allegations lest it may prejudice the case of parties in an appropriate

proceeding before the competent Court". However, considered in totality, the Court

was of the firm opinion that the nature of the dispute involves serious

allegations of fraud which are of complicated nature which cannot be decided in an arbitration proceeding "as it may require voluminous evidence on part of both the parties to come to a finding which can be only properly undertaken by a Civil Court of competent jurisdiction".

Submission Before The Hon'ble Supreme Court:

Counsel for both the parties made their submissions before the Hon'ble Supreme Court, stating that the law laid down in

A. Ayyasamy's case is in para 25 and

not in para 26 of the judgement and while dealing with an issue for application

under Section 8 of the Act, the focus of the Court has to be on the question as

to "whether jurisdiction of the Court has been ousted instead of focusing on the issue or not. It has to be kept in mind that insofar as the statutory scheme of the Act is concerned, it does not specifically exclude any category of cases as non-arbitrable. Such categories of non-arbitrable subjects are carved out by the Courts, keeping in mind the principle of common law that certain disputes which are of public nature, etc. are not capable of adjudication and settlement by arbitration and for resolution of such disputes,

Courts, i.e. public fora, are better suited than a private forum of arbitration".

Therefore, the inquiry of the Court,

while dealing with an application under Section 8 of the Act, should be on the

aforsaid aspect, viz. "whether the nature of the dispute is such that it cannot be referred to arbitration, even if there is an arbitration agreement between the parties. When the case of fraud is set up by one of the parties and

on that basis that party wants to wriggle out that arbitration agreement, a strict and meticulous inquiry into the allegations of fraud is needed and only

when the Court is satisfied that the allegations are of serious and complicated

nature that it would be more appropriate for the Court to deal with the subject

matter rather than relegating the parties to arbitration, then alone such an application under Section 8 should be rejected".

The Court relied on the two tests laid

down in para 25 of the judgement in order to differentiate between "serious allegations" of forgery/fabrication in support of the plea of fraud as opposed

to "simple allegation"

1. Does this plea permeate the entire contract and above all, the agreement on arbitration, rendering it void, or;
2. Whether the allegations of fraud touch upon the internal affairs of the parties inter se having no implication in the

public domain.

Upon implementing the above tests, it

is clear that this is a case that falls on the side of "simple allegation" as there is no allegation of fraud which would vitiate the partnership deed as a whole or, in particular, the arbitration clause concerned in the said deed.

Secondly, all the allegations made which have been relied upon by the learned counsel appearing on behalf of the respondent, pertain to the affairs of the partnership and siphoning of funds therefrom and not to any matter in the public domain.

This being the case, the judges were of

the view that the disputes raised between the parties are arbitral and hence, Section

11 application under the Act would be maintainable.

Ruling By The Supreme Court:

The Hon'ble Court was of the opinion

that mere allegations of fraud simplicitor may not be a ground to nullify the effect of arbitration agreement between the parties, it is only in those cases

where fraud goes to the validity of the contract itself, or of the entire contract which contains the arbitration clause or the validity of the arbitration clause itself. "Reverse position thereof would be that where there

are simple allegations of fraud touching upon the internal affairs of the party

inter se and it has no implication in

the public domain, the arbitration clause need not be avoided and the parties can be relegated to arbitration".

Conclusion:

The Supreme Court adopted an efficient

and pragmatic view in the present case in order to ensure that the very purpose

and objective of the Act should not get defeated. The tests as laid down under

para 25 of the A. Ayyasamy's case were upheld which also clarifies the law on the subject that Court should over look arbitration agreement only if:

1. There are very serious allegations of fraud;
2. Such complex allegations can only be adjudicated by Civil Court;
3. The allegation is of such nature that it covers the entire contract including the provisions of the arbitration clause as well.

• [1] Civil Appeal No. 7005 of 2019

• [2] Civil Appeal No. 8245-8246 of 2016

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