



Supreme Court settles law on arbitrability of fraud and holds institution of criminal proceedings on same subject matter to be insufficient to render dispute non-arbitrable¹

Brief Facts

Avitel Post Studioz Ltd. (“**Appellant**”) and HSBC PI Holdings (Mauritius) Limited (“**Respondent**”) entered into a Share Subscription Agreement (“**SSA**”), pursuant to which the Respondent undertook an investment of USD 60 million to acquire 7.8% of the Appellant’s paid-up equity capital. The arbitration clause of the SSA stipulated resolution of disputes by arbitration at the Singapore International Arbitration Centre, with Singapore as the seat of the arbitration.

The Respondent invoked arbitration, along with filing a criminal complaint, after discovering that the Appellant’s representation regarding negotiating and executing a contract with the British Broadcasting Corporation was fraudulent and a set up to induce the Respondent into executing the SSA. Interim awards were passed by emergency arbitrators, *inter alia*, permitting the Respondent to approach financial institutions to freeze the Appellant’s accounts.

The Respondent filed a petition under Section 9 of the Arbitration & Conciliation Act, 1996 (“**Act**”) before the

Bombay High Court seeking deposit of USD 60 million as the security amount to the extent of the Respondent’s claim against the Appellant, which was allowed. The learned Division Bench partly allowed the appeal and held, *inter alia*, that (i) the allegations of fraud were primarily in the context of Sections 17 and 18 of the Indian Contract Act, 1872 (“**Contract Act**”), thus establishing a civil profile of the disputes and rendering it arbitrable despite allegations of fraud; and (ii) a security deposit of USD 30 million was to be maintained in the Appellant’s account, which was the difference between the price paid by the Respondent in acquiring the shares and the price the Respondent would have received upon reselling the said shares in the market. The decision was appealed before the Supreme Court of India (“**Court**”).

Issue

Whether the Respondent’s application under Section 9 of the Act seeking deposit of USD 60 million should be allowed considering allegations of fraud were raised by one of the parties to the arbitration agreement?

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Judgment

The Court referred to the substantive law in India qua arbitrability and stated that serious allegations of fraud arose only if either of the two tests of arbitrability of fraud, as set out in **Rashid Raza v. Sadaf Akhtar**,² were satisfied. While holding the dispute to be arbitrable despite allegations of fraud, the Court stated that the arbitration clause was not vitiated by allegations of fraud, and the fraudulent actions were only related to internal affairs of the parties and had no implications in the public domain. The Court clarified that a civil dispute involving questions of fraud and misrepresentation under the Contract Act, which is arbitrable, will not become non-arbitrable on account of institution of criminal proceedings on the same subject matter.

The Court held that the measure of damages for such fraudulent misrepresentation was not the difference between the price paid by the Respondent in acquiring the shares and the price the Respondent would have received upon reselling the said shares in the market, as erroneously held by the learned Division Bench of the Bombay High Court. The correct measure of such damages was putting the Respondent in the same position as if the contract had never been entered into. Consequently, the Court held that the Respondent had made out a strong *prima facie* case necessitating the deposit of USD 60 million as the security deposit, which was also the principal amount awarded to them in the final award rendered by the arbitral tribunal.

Analysis

While arguing upon the question of arbitrability of fraud, the Appellant cited

N. Radhakrishnan v. Maestro Engineers,³ which had held that wherever serious allegations of fraud were raised in a case in which there was an arbitration agreement, it should be tried in a court of law. However, **N. Radhakrishnan (supra)** relied heavily on **Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak**,⁴ decided under the Arbitration Act, 1940, under which the court had wider discretion in referring matters to arbitration. In contrast, Sections 5, 8 and 16 of the Act are indicative of a narrower approach and impose a positive obligation on courts to make a reference to arbitration, which clearly indicates the unsuitability of placing reliance on **N. Radhakrishnan (supra)** and **Abdul Kadir (supra)**. This was also the reasoning adopted in **Swiss Timing Ltd. v. Commonwealth Games 2010 Organising Committee**.⁵ Although this judgment does not have precedential value on account of being a judgment under Section 11 of the Act, the Court held the said reasoning, that has been adopted in the present decision, to have strong persuasive value.

The Court then proceeded to examine the decisions in **A. Ayyasamy v. A. Paramasivam**⁶ and **Rashid Raza (supra)** against the broader list of non-arbitrable matters set out in **Afcons Infrastructure Ltd. v. Cherian Varkey Construction Co. (P) Ltd.**⁷ and **Booz Allen and Hamilton Inc. v. SBI Home Finance Limited**.⁸ While the list of non-arbitrable matters does include criminal proceedings, it is now subject to the qualification that the same set of facts may lead to civil and criminal proceedings. The Court has rightly held that if a civil dispute involves questions of fraud, misrepresentation, etc. which can be the subject matter of section 17 of the Contract Act and/

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or the tort of deceit, the mere fact that criminal proceedings can or have been instituted in respect of the same subject matter would not render an arbitrable dispute non-arbitrable.

Pertinently, this decision has elaborately clarified that merely raising allegations of fraud, often as a tactic to evade the arbitration clause

and delay proceedings, is insufficient to hold a subject matter as non-arbitrable. The reasoning in this judgment has already been adopted and followed in **Deccan Paper Mills Co. Ltd. v. Regency Mahavir Properties and Others**,⁹ and the judgment joins a series of precedents intended to strengthen the efficacy of arbitration in India.

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1 Authored by Nitesh Jain, Partner and Shambhavi Pandey, Associate; *Avitel Post Studios Limited & Ors. v. HSBC PI Holdings (Mauritius) Limited*, Civil Appeal No.5145 of 2016 with Civil Appeal No. 5158 of 2016, Supreme Court of India, 2020 SCC OnLine SC 656, judgment dated 19 August 2020.

Coram: Rohinton F. Nariman and Navin Sinha, JJ.

2 (2019) 8 SCC 710: "4. *The principles of law laid down in this appeal make a distinction between serious allegations of forgery/fabrication in support of the plea of fraud as opposed to "simple allegations". Two working tests laid down in para 25 are: (1) does this plea permeate the entire contract and above all, the agreement of 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*".

3 (2010) 1 SCC 72.

4 (1962) 3 SCR 702.

5 (2014) 6 SCC 677.

6 (2016) 10 SCC 386.

7 (2010) 8 SCC 24.

8 (2011) 5 SCC 532.

9 2020 SCC OnLine SC 655.

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