The question of arbitrability has puzzled courts across the world. Arbitrability of fraud in particular has generated a lot of discussion in India, because Courts never settled the matter conclusively. The absence of certainty in this regard enabled parties to delay arbitration proceedings by alleging fraud. The case of A. Ayyasamy v. A. Paramasivam has attempted to clarify the law in this regard.

In Ayyasamy, the Court settled the issue by holding that “mere allegations of fraud” are arbitrable, whereas “serious allegations of fraud” are not. The Court supported the well-recognized principles of arbitration embodied in the Arbitration and Conciliation Act, like minimum judicial intervention, kompetenz-kompetenz and party autonomy. However, the authors shall argue that the Court merely indulged in a pro-arbitration rhetoric and still seems to harbour apprehensions towards the arbitral process.

In this comment, the authors will argue that although Ayyasamy attempted to clarify the law with regards to arbitrability of fraud, it failed to do so. In the first part of this comment, we look at the Supreme Court cases dealing with the issue of arbitrability of fraud, and argue that the approach in the Swiss Timings case should be adopted in this regard. In the second part, we analyse the judgment in Ayyasamy, and argue that its dicta cannot be applied uniformly. Lastly, we conclude by arguing that the remedy to this problem is the principle of negative kompetenz-kompetenz which would entail that the jurisdiction of deciding matters of arbitrability will rest with the tribunal.
I. Introduction

On 4th October, 2016, a division bench of the Supreme Court consisting of A.K. Sikri and D.Y. Chandrachud, JJ. delivered the judgment in A. Ayyasamy v. A. Paramasivam. The Court sought to clarify the long-existing confusion with regards to the arbitrability of fraud claims in domestic arbitration cases. In Ayyasamy, the Court considered modern authorities and well-established principles of arbitration to rule that though “mere allegations of fraud” are arbitrable, “serious allegations of fraud” are not.

While a number of comments have praised this judgment for upholding recognized principles of arbitration, not everyone has welcomed this judgment. A close reading of the judgment would show that the distinction between “serious allegations of fraud” and “mere allegations of fraud” can never be made out uniformly, rendering the application of the dicta in the case impossible. In this comment, we will attempt to show that the Supreme Court has been following an erroneous reasoning in dealing with the issue of arbitrability of fraud, and that the solution lies in allowing the tribunal to decide upon the issue of arbitrability and making fraud arbitrable.

I. The Supreme Court's Struggle with Arbitrability of Fraud Claims

A. The Abdul Kadir Era

The issue of arbitrability of fraud claims was authoritatively dealt with by the Supreme Court for the first time in the landmark case of Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak. The court relied on the Chancery Division's judgment in Russell v. Russell and held that in a case where fraud has been alleged, if the party charged with fraud desires so, the matter shall not be referred to arbitration. According to the Court, the party charged with fraud must get an opportunity to prove himself innocent in an open court.

Abdul Kadir was decided under the Arbitration Act, 1940, which gave the courts a wide discretion with regard to referring a case to arbitration. The Madras High Court also opined on the issue of arbitrability of fraud claims prior to Abdul Kadir, wherein Schwabe, C.J. opined that if the court finds that an arbitral tribunal cannot mete out complete justice or that there are charges of fraud, reference to arbitration may be refused. Authors have noted that this approach was based purely on an apprehension towards arbitration and that by considering Russell, the Supreme Court adopted a more “tempered view”. The Court, in Abdul Kadir, was aware of the wide discretion conferred upon it, which was the “hallmark” of the 1940 Act.

On finding the facts, however, the Court found that the allegations of fraud, which related to statements of accounts and records of stock of goods, were not “serious allegations of fraud”. These allegations were not serious enough to warrant a trial in an open court over arbitration. The Court did not clarify what it meant by “serious allegations of fraud”, nor did it lay down any parameters for determining the same. It was left to the discretion of the Courts to determine such an issue, a discretion which the 1940 Act accorded to them.

B. Arbitrability of Fraud under the 1996 Act

While Abdul Kadir was good law for a very long time, it was...
necessary to reconsider it for two reasons. Firstly, because Russell, on which the Court in Abdul Kadir placed substantial reliance, had some glaring problems which were pointed out by the House of Lords as well as Indian Courts. Secondly, because the 1996 Act curtailed the discretion of the Courts with regard to reference to arbitration under Section 8.

The Apex Court considered the issue again in N. Radhakrishnan v. Maestro Engineers. Maestro was decided by a Division Bench under Section 8. In Maestro, the Court found at the outset that the arbitration clause in the case covered the dispute in question. However, it proceeded to rule that the case can only be settled in court as it involved serious allegations of fraud. The court reasoned that such allegations require adducing of detailed evidence, which cannot be dealt with properly by an arbitrator.

The Apex Court relied upon a number of cases, including Abdul Kadir, to arrive at its conclusion. However, it failed to distinguish Abdul Kadir as an authority under the old Act, perhaps because there was no need to do so. Maestro was interpreted as a blanket ban on referring parties to arbitration when fraud has been alleged, whereas the Law Commission Report recognized Abdul Kadir as an “authority for the proposition that a party against whom an allegation of fraud is made in a public forum, has a right to defend himself in that public forum.”

The most problematic aspect of Maestro is its use of the term “serious allegations of fraud”. The Court, in Maestro, uses this term to distinguish non-arbitrable subject matters. However, it fails to define any set parameters to assess the “seriousness” of an allegation of fraud. The judgment in Ayyasamy also attempted to distinguish between a mere allegation of fraud and a serious allegation of fraud; however, we shall argue in the next section that the Court failed in that regard.

C. The Year of Change: MSM Satellite and Swiss Timings

Academic works and even Courts often read the cases of World Sport Group (Mauritus) Ltd. v. MSM Satellite (Singapore) and Swiss Timing Ltd. v. Organising Committee, Commonwealth Games 2010 as rulings on arbitrability of fraud. But neither of these cases dealt with the issue of arbitrability of fraud claims. Rather, the Apex Court in both instances dealt with the principles of kompetenz-kompetenz and autonomy (separability) of the arbitration agreement.

In MSM, the Apex Court was seized upon to determine whether the Facilitation Deed between the appellant and the respondent was void due to allegations of fraud. The issue framed in the case was not one of arbitrability but rather of jurisdiction, i.e., who will decide the question of whether the Facilitation Deed was void? The Court relied on the House of Lords judgment in Nafta Products Ltd. v. Fili Shipping Company to decide the case on the basis of principle of separability (or autonomy of the arbitration agreement). The Court distinguished Maestro as a case under Section 8 and foreclosed its applicability on International Commercial Arbitration. According to the Court, “[W]here fraud in the procurement or performance of a contract is alleged, there appears to be no reason for the arbitral tribunal to decline jurisdiction.” Thus, the Court relied on the principle of separability and kompetenz-kompetenz.
inherent in the Act, to hold that the tribunal shall have the jurisdiction to determine questions relating to fraud in International Commercial Arbitration.

Similarly, in Swiss Timing, the issue framed was not of arbitrability but again that of jurisdiction. The Court had to decide whether the contract between the parties was void on the ground of there being fraud. The Court refused to apply Maestro and held it to be per incuriam for not relying on the cases of Hindustan Petroleum Corp. Ltd. v. Pinkcity Midway Petroleums and P. Anand Gajapathi Raju & Ors. v. P.V.G. Raju (Dead) & Ors., where the Apex Court held that Section 8 mandates a reference to arbitration according to the terms of the agreement. The Court, in Swiss Timings, also noted that the judgment in Maestro did not rely on Section 16 of the Act and thus ignored the cardinal principles of arbitration, i.e., autonomy of the arbitration agreement and kompetenz-kompetenz. The Court adopted the policy of least interference embodied in Section 5 and Section 16 to arrive at its conclusion that the Court should decline reference to arbitration only when it finds that the contract is void on a reading of the contract itself (without requiring any external evidence).

Even though none of the cases dealt with the issue of arbitrability, they are often discussed in the context of arbitrability of fraud claims. Both these cases did not consider a fraud claim as something which is not capable of settlement by arbitration. Instead, they relied on well-established principles and policies of arbitration and deferred to the statutory provisions to arrive at their conclusions. In our opinion, the approach of the Courts in this regard is the correct one. We will, however, take a different stance with regard to the extent of kompetenz-kompetenz endorsed by Swiss Timings later in our comment.

MSM was delivered in the context of International Arbitrations under Part II of the Act, whereas Swiss Timings was delivered under Part I. However, Courts were reluctant in considering Swiss Timings as an authority overruling Maestro. The judgment in Swiss Timings was delivered under a Section 11 petition by Nijjar J., sitting as a designate of the Chief Justice. The judgment came into question because a bench of lower strength cannot overrule a decision by a bench of higher strength. Secondly, the Supreme Court later ruled that the decision of the Chief Justice or his designate under Section 11 does not have any precedential value. Thus, even though Swiss Timings took a progressive view it did not lay down any precedent and the issue of arbitrability of fraud was governed by the Maestro dicta until Ayyasamy.

II. Analysis of the Judgment in Ayyasamy

The case arose out of a dispute between brothers who entered into a partnership deed for running a hotel. The respondents filed a suit against the appellants seeking a declaration of their entitlement to participate in the administration of the hotel. The appellants filed an application under Section 8 in order to give effect to the arbitration clause in the partnership deed. The respondents resisted the application by claiming that since there were serious allegations of fraud, the case could not be referred to the arbitrator. The respondents relied on Maestro, whereas the appellants relied on Swiss Timings to oppose it.

The Trial Court as well as the High Court applied the Maestro dicta and refused to refer the dispute to an arbitrator. The appellants preferred an appeal to the High Court order. The issue was whether Maestro was applicable in the present case or not.

The Court at the very outset established that the issue was that of “arbitrability”, by noting that the Act “does not make any specific provision excluding any category of disputes terming them to be non-arbitrable”. Arbitrability in its accepted usage means that the subject-matter of a dispute is “capable of being resolved by arbitration”. It may sometimes be used in a broader meaning, covering even the existence and validity of the arbitration agreement. However, such usage is often

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20 Arbitration And Conciliation Act, 1996, §16.
criticized for creating confusion. 26

Certain disputes are exclusively reserved for national courts due to their very nature as adjudication of such disputes may have public consequences. 27 This is termed as objective arbitrability. 28 Arbitrability has been defined as “one of the issues where the contractual and jurisdictional natures of international commercial arbitration collide head on.” 29 In determining arbitrability, a court should assume that the process of arbitration is effective and efficient and the consent of the parties is implied. 30 In our opinion, the Court’s consideration of the issue of arbitrability was bereft of any such assumption and its conclusion is a result of its apprehensions towards the process of arbitration.

In Ayyasamy, the Court held that in a Section 8 application, the Court must decide the arbitrability of the dispute. It went on to consider the existing authorities of Abdul Kadir and Maestro. The Court distinguished the dicta in both cases by holding that they are applicable when there are “serious allegations of fraud” and not when there are mere allegations of fraud. So, the Court found that “serious allegations of fraud” are not arbitrable whereas “mere allegations of fraud” are.

The authors find the distinction between a “serious allegation” and a “mere allegation” a very vague one. 31 If serious allegations of fraud would have meant allegations of fraud deserving a criminal trial (which the judgment contemplates to an extent), it would have been in line with the Booz Allen test as such fraud would affect rights in rem. But this understanding is partly correct. Whether the allegations are “serious” or not must be determined by looking at the amount and nature of the evidence which would be adduced before the tribunal to establish it. 32

This interpretation gives the court a wide amount of discretion in deciding what amounts to a serious allegation of fraud. 33 The use of vague phrases like “serious allegations” allows the Courts to find discretion when there should be none. No uniformity can be achieved through the distinction between “serious” and “mere allegations”, since it will depend upon the attitude of the Court towards arbitration. A court which is pro-arbitration might find that the arbitral tribunal is capable of dealing with a certain amount and nature of evidence, as well as civil courts can. However, a court which, is apprehensive about arbitration may decide otherwise.

The judgment in Ayyasamy is clearly a result of the Court’s apprehensions towards arbitration. In this regard the Law Commission suggested amendments to Section 16 which would affirm the tribunal’s power to rule on “serious questions of law, complicated questions of fact or allegations of fraud, corruption etc.” 34 This suggestion not only implies that fraud should be arbitrable, but also contemplates negative kompetenz-kompetenz, wherein the tribunal shall rule on issues of fraud. The legislature did not incorporate the suggestions in the 2015 amendment Act. In the next section, we shall suggest that the appropriate way to solve this problem will be by adopting the Law Commission’s suggestions and giving due deference to the principle of kompetenz-kompetenz.

### III. Suggestions & Concluding Remarks

The principle of kompetenz-kompetenz and autonomy of the arbitration agreement are statutorily recognized in Section 16 of the
Kompetenz-kompetenz has two effects—a positive one (positive kompetenz-kompetenz), which obliges the parties to refer their dispute to the tribunal in accordance with their agreement and a negative one (negative kompetenz-kompetenz), which bars them from approaching national courts with regards to disputes covered by the agreement.\(^{36}\)

Negative kompetenz-kompetenz allows the arbitrators to be first judges of their jurisdiction and limit the role of the courts to review the award.\(^{37}\) Negative kompetenz-kompetenz is beneficial, since it entails that jurisdictional questions shall be decided by the arbitral tribunal itself, which would in turn save time.\(^{38}\) It is a concept which is embodied in Section 16, but in effect it is denuded. According to the Apex Court's judgment in SBP v. Patel Engineering Ltd.,\(^{39}\) any ruling on jurisdiction by a Court under Section 8 or Section 11 would be binding on the arbitral tribunal.\(^{40}\) In effect, if the Court decides that the issues of fraud are capable of settlement by the tribunal, the tribunal has to accept the decision and cannot arrive at a contrary conclusion.

The Act also allows vacating an arbitral award on the ground of the subject-matter not being arbitrable.\(^{41}\) If issues of arbitrability are decided by the Courts in the referral stage, it would only add to the opportunities that a conniving party will have to delay the process of arbitration as the party will have the opportunity to raise issues of arbitrability at the referral stage as well as the post-award stage. Thus, clearly, negative kompetenz-kompetenz is required in such a situation wherein issues of arbitrability will not be decided in the referral stage but only after the award has been passed.

The authors do not recommend that negative kompetenz-kompetenz be adopted in its complete form which would allow the tribunal to look into questions of “formal validity”\(^{42}\) of the arbitration agreement. The Swiss Timing case contemplated negative kompetenz-kompetenz by holding that the Court can only look at the contract prima facie to satisfy itself of its validity. Brekoulakis opposes complete negative kompetenz-kompetenz on theoretical, practical and policy grounds.\(^{43}\) He believes that a concurrent jurisdiction of the courts and tribunals with regards to validity of the arbitration agreement strikes the right balance. In our opinion that will only be possible if SBP is overruled, since a concurrent jurisdiction will not be possible if the Court finds no valid agreement and thus no jurisdictional effect.

Although arguments favouring kompetenz-kompetenz have been made by academics\(^{44}\) as well as the Law Commission, the legislature did not adopt it expressly, and the judiciary seems indifferent and confused. Allegations of fraud are common in commercial disputes, and to hold such allegations non-arbitrable would foreclose a very effective and desirable mode of dispute resolution for the parties. It is a sad state of affairs that the question of arbitrability of fraud claims is still alive and is being decided by archaic notions of arbitrability. In our opinion, adopting negative kompetenz-kompetenz is the way out of this quagmire.

\(^{35}\) Indu Malhotra, Supra Note 9 At 763.

\(^{36}\) See Gaillard, Supra Note 24 At ¶624.

\(^{37}\) Id At ¶660.


\(^{39}\) Air 2006 Sc 450. [hereinafter Sbp]

\(^{40}\) Sbp Was Severely Criticized For Creating An “absurdity In The Law” And For Exercising Judicial Legislation. See O.p. Malhotra, Opening The Pandora’s Box: An Analysis Of The Supreme Court’s Decision In S.b.p. V. Patel Engineering, ( 2 0 0 7 ) , At Http://www.manupatra.co.in/newsline/articles/upload/30693c83-676b-4cd5-9d46-73c1810e46bc.pdf.

\(^{41}\) Arbitration And Conciliation Act, 1996 §§34(2)(b) & 48(2).

\(^{42}\) Questions Regarding Formation And Conclusion Of The Arbitration Agreement. See Gary Born, International Commercial Arbitration 581 (2nd Ed. 2014).
