Fraud now in the ambit of Arbitration: Supreme Court

The Arbitration and Conciliation Act, 1996 as amended in 2015 does not, in specific terms exclude any category of disputes. Section 8 contains a mandate that where an action is brought before a judicial authority in a matter which is the subject of an arbitration agreement, parties shall be referred by it to arbitration, if a party so claiming through a party to the arbitration agreements applies not later than the date of submitting the first statement on the dispute.

Supreme Court, while dealing with an application In ***P. Anand Gajapathi Raju v. P.V.G. Raju,***[1] set out condition which are required to be satisfied under sub- section (1) and (2) of Section 8 before the court can exercise its power are:-

1. There is an arbitration agreement;
2. A party to the agreement brings a action in the court against the other party;
3. Subject matter of the action is the same, as the subject matter of the arbitration agreement.
4. The other party moves the court for referring the parties the parties to the arbitration before it submits his first statement on the Substance of the disputes.

The supreme court, to assist the different High Court, of India for correct interpretation of section 8 of the Arbitration and Conciliation Act, 1996 and to have flexibility of arbitration law in India, set out the above condition.

Supreme Court held that the language of section 8 is peremptory in nature. Hence, where there is an arbitration agreement, it is obligatory for the court to refer parties to arbitration and nothing remains to be deiced in the original action after such an application is made, except to refer the dispute to an arbitrator.

The Division Bench of the Supreme Court In ***N. Radhakrishnan v. Maestro Engineers***, [2] held that the issues of fraud and malpractices committed are alleged warrant investigation and production of elaborate evidence. The Division Bench made reliance upon the judgment in ***Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak*****,** [3] held that in the interest of Justice, it should be tried in a court of law which would be more competent and have the means to decide such a complicated issue of facts.

In ***Booz- Allen and Hamilton Inc. v. SBI Home Finance Ltd***,[4] the Supreme Court set down certain non arbitrable disputes being:-

1. Disputes relating to rights and liabilities which give rise to or arise out of criminal offences;
2. Matrimonial disputes relating to divorce, judicial separation, restitution of conjugal rights and child custody;
3. Matters of guardianship;
4. Insolvency and winding up;
5. Testamentary matters, such as the grant of probate, letters of administration and succession certificate; and

6. Eviction or tenancy matters governed by special statutes where a tenant enjoys special protection against eviction and specific courts are conferred with the exclusive jurisdiction to deal with the dispute.

The Supreme Court in ***Vimal Kishore Shah v. Jayesh Dinesh Shah***,[5] in furtherance to the above six non arbitrable categories, added a seventh category of case:-

7. Disputes relating to trusts, trustees and beneficiaries arising out of a trust deed and the Trust Act.

In, ***Swiss Timing Limited v. Common Wealth Games 2010 Organising Committee***,[6] The single judge of the Supreme court held that ***N. Radhakrishnan v. Maestro Engineers*** per incuraim on two grounds;

1. The judgment in ***Hindustan Petroleum Corp. Ltd. v. Pinkcity Midway Petroleums***,[7] though referred to has not been distinguished but at the same time is not followed also, The judgment in *P. Anad Gajapathi Raju v. P.V.G. Raju,* was not even brought to the notice of to the Court.

2. The provisions contained in section 16 of the Arbitration Act, 1996 were also not brought to the notice by the Court.

Therefore the Single Judge of the Supreme Court observes that the judgment in *N. Radhakrishnan* does not lay down the correct law and cannot be relied upon. The Single Judge held that it is mandatory for Court to refer disputes to arbitration. Thus, registering of criminal case in relation to agreement concerned on grounds of fraud, corruption and collusion is not an absolute bar to refer disputes to arbitration. Further stalling of arbitration proceedings till disposal of criminal proceedings, not warranted holding the arbitrator can decide allegation of fraud in obtaining of the contract.

The issue of fraud in the arbitration proceedings has generated a considerable degree of uncertainty in the law of arbitration in India. The division bench of the Supreme Court of India in the recent judgment passed in Appeal between ***A. Ayyasamy v. A. Paramsivam & Ors.***[8] intervened to ensure that a cloud on the efficacy of arbitral proceedings to resolve issues of fraud conclusively- held the allegation of frauds are arbitral.

The Supreme Court observed that while dispensing with the element of judicial discretion, the statute imposes an affirmative obligation on every judicial authority to hold down parties to the terms of the agreement entered into between the parties and refer the parties/ disputes to arbitration.

The fraud is a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his detriment. The Black law Dictionary defines “fraud” as a concealment or false representation through a statement or conduct that injures another who relies on it.

However dealing with application in *A. Ayyasamy v. A. Paramsivam & Ors.* question which has to be addressed would be as to *“whether mere allegation of fraud by one party against the other would be sufficient to exclude the subject matter of dispute from arbitration and decision thereof necessary by the civil court?”*

The Division Bench held that mere allegation 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 the court, while dealing with section 8 of the Act, finds that there are very serious allegation of fraud which make a virtual case of criminal offence or where allegations of fraud are so complicated that it becomes absolutely essential that such complex issues can be decided only by civil court on the appreciation of the voluminous evidence that needs to be considered.

The Supreme Court, placing reliance on the Judgment by the House of Lords in ***Permium Nafta Products Ltd. v. Fily Shipping Co. Ltd.***[9] observed that the basic principle which must guide judicial decision making is that arbitration is essentially a voluntary assumption of an obligation by contracting parties to resolve their disputes through a private tribunal. The intent of the parties is expressed in the terms of their agreement. Where commercial entities and person of business enter into such dealings, they do so with knowledge of the efficacy of the arbitral process. The commercial undertaking is reflected in the terms of the agreement between the parties. The duty of the court is to impart to that commercial understanding a sense of business efficacy.

Even the invalidity of the main agreement does not ipso jure result in the invalidity of the arbitration agreement. Parties having agreed to refer disputes to arbitration, the plain meaning and effect of Section 8 must ensue.

Supreme Court observed that the Arbitration and Conciliation Act, 1996 be interpreted to bring in line the principles underlying the interpretation of the act in a manner that is consistent with prevailing approaches in the common law world. Jurisprudence in India must evolve towards strengthening the institutional efficacy of arbitration.

CONCLUSION:-

Insofar as the Arbitration and Conciliation Act, 1996 is concerned; it does not make any specific provision excluding any category of disputes terming them to be non- arbitral. Numbers of pronouncements have been rendered laying down the scope of judicial intervention, in cases where there is an arbitration clause, with clear and unambiguous message that in such an event judicial intervention would be very limited and minimal. The position is law is culled out from reading of Section 5 of the Arbitration and Conciliation Act, 1996, when arbitration proceedings are triggered by one of the parties because of the existence of an arbitration agreement between them, section 5 of the Act, by a non- obstante clause, provides a clear message that there should not be any judicial intervention at that stage scuttling the arbitration proceedings.

In view of the divergence of views between the different high Courts where two views have been expressed, one is in favor of the civil court having jurisdiction in cases of serious fraud and the other view encompasses that even in cases of serious fraud, the Arbitral Tribunal will rule on its own jurisdiction.

The Division Bench in interpretation of Section 8 of the Act, hold that once an application in due compliance of section 8 of the act, the approach of the civil court should be not to see whether the

court has jurisdiction. It should be to see whether its jurisdiction has been ousted. The general law should yield to the special law- "*GENERALIA SPECIALIBUS NON DEROGANT"*.

The Supreme Court, in *A. Ayyasamy v. A. Paramsivam & Ors.* Highlighted the issue of fraud, holding in cases where there are allegation of fraud simplicitor and such allegation are merely alleged, the same can be appropriately adjudicated by the Arbitration Tribunal. However in cases of serious fraud courts have entertained civil suits.

The Division Bench by the judgment successfully has drawn a line to ensure that the fulfillment of the intent of Parliament in enacting at Act of 1996 and towards supporting commercial understandings grounded in the faith in arbitration. Promoting the international arbitration the Supreme Court held that fraud can be arbitral, by the arbitration tribunal, and parties should not be promoted to avoid the arbitration unless there are prima facie appear serious fraud.

1. (2000) 4 SCC 539
2. (2010) 1 SCC 72
3. AIR 1962 SC 406
4. (2011) 5 SCC 532
5. Civil Appeal No. 8164 of 2016
6. (2014) 6 SCC 677
7. (2003) 6 SCC 503
8. Civil APPEAL Nos. 8245- 8246 of 2016.
9. (2007) UKHL 40

Sale of Stressed Assets by Banks

With an increase in the Non-Performing Assets ("**NPAs**") and restructured accounts, the Reserve Bank of India ("**RBI**") had released a framework on Revitalising Distressed Assets in the Economy on 30th January 2014 with a purpose for developing corrective action plan for early detection of problem accounts and restructuring the accounts which can be considered as viable and sale or recovery of assets by lenders of the accounts which can be considered unviable.

RBI had issued a notification on 'Framework for Revitalising Distressed Assets in the Economy - Refinancing of Project Loans, Sale of Assets and other Regulatory Measures' dated 26th February 2014, forming a detailed guideline for Refinancing of Project Loans, Sale of Assets and other Regulatory Measures.

With a view to further resolve the issue of stressed assets, RBI decided to improve the framework and strengthen the guidelines to be followed for sale of stressed assets by the banks to Securitisation Companies ("**SCs**")/Reconstruction Companies ("**RCs**")/other banks/Non-Banking

Financial Institutes (NBFCs)/Financial Institutes (FIs) etc. and issued a Notification bearing No. DBR.No.BP.BC.9/21.04.048/2016-17 dated 1st September 2016 on "**Guidelines on Sale of Stressed Assets by Banks**".

Policy on Sale of Stressed Assets:

Board of the bank have been empowered to lay the guidelines and policies for sale of such stressed assets to SCs/RCs keeping in view the following aspects:

i) Financial assets to be sold;

ii) Norms and Procedure for sale of such financial assets;

iii) Valuation procedure to be followed to ensure that the realisable value of financial assets is reasonably estimated;

iv) Delegation of powers of various functionaries for taking decision on the sale of the financial assets.

Enhancement of Transparency

One of the important requirements of the guideline is to enhance the transparency in the sale of stressed assets by active involvement of the head office/corporate office of the banks in the identification of stressed assets including early identification to help in low vintage and better price realisation for banks.

The bank shall at beginning of every year identify and list the assets for sale to other institutions including SCs/RCs. Further a periodic review of the 'doubtful assets' shall be done by the board/ board committee and those identified for exit shall be listed for the purpose of sale to prospective buyers which shall not be restricted to SCs/RCs.

The sale of the stressed assets should involve an open auction process for which bank should lay down a board approved policy. The policy should involve adequate time frame for due diligence by prospective buyers and also valuation of assets clearly mentioning requirement of internal and external valuation. The policy should clearly state that any exposure beyond Rs.50 Crore requires two external valuation reports. The policy should also clearly mention other factors in relation to the cost involved for conducting valuation, discount rate etc.

Swiss Challenge Method

For the purpose of lowering the vintage of NPAs, the banks to put up a board approved policy on adoption of Swiss Challenge Method for sale of stressed assets to SCs/RCs/other banks/NBFCs/FIs. As mentioned above, the bank shall carry out a periodic review of their accounts and identify stressed assets, accordingly prepare a list of the assets which can be offered for sale to the prospective buyers. The authenticated list will be shared with the prospective buyers upon entering a confidentiality agreement.

Outline of the Swiss Challenge Method:

The bank enables the prospective buyer to offer a bid. The banks shall call for counter bids if the prospective buyers offer in cash more the minimum percentage set for the stressed asset. Bank can

sell the asset either to the winning bidder or else will be required to make immediate provision in the account.

Takeover of Standard Accounts

The banks can takeover the standard accounts from SCs/RCs where SCs/RCs are successful to restructure the stressed assets on completion of a specified period. Whereas, the assets which are sold to SCs/Rcs cannot be taken back by the banks.

Conclusion

Amended framework enabled the banks to frame their own guideline and policy based on the guidelines issued by RBI so that the 'doubtful assets' can be easily identified and an in time action can be taken to sale such assets.