

IN THE HIGH COURT OF DELHI AT NEW DELHI

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Judgment delivered on: 06.12.2021

+ **ARB.P. 361/2020 & IA No. 12093/2020 (modification)**

AVANTHA HOLDINGS LTD

..... Petitioner

versus

CG POWER AND INDUSTRIAL
SOLUTIONS LTD

..... Respondent

Advocates who appeared in this case:

For the Petitioner	: Mr Sandeep Sethi, Senior Advocate with : Mr Jayant Mehta, Mr Marezbán P. : Bharucha, Ms Sneha Jais Singh, : Mr Aniruddha Banerji, Ms Jaidhara Shah, : Mr Shafiq Ahmed, Mr Akshit Mago, : Mr Pranay Chitale, Advocates.
For the Respondent	: Mr Amit Sibal Senior Advocate with : Mr Nitin Mishra, Mr Mitali Gupta, Mr : Firoz Bharucha, Mr Narendra Dingankar, : Mr Sohíl Shah and Ms Vedika Shah, : Advocates.

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HON'BLE MR JUSTICE VIBHU BAKHRU

Introduction

1. The petitioner has filed the present petition under Section 11 of the Arbitration and Conciliation Act, 1996 (hereafter the '**A&C Act**'), *inter alia*, praying that an arbitrator be appointed to adjudicate the disputes that have arisen between the parties in terms of Clause 18.6 of

the Brand Usage Agreement dated 13.02.2019 (hereafter referred to as the '**Agreement**').

2. The petitioner claims that the brand name, 'Avantha', was created by the petitioner as a common brand to cater to diverse businesses under the Avantha Group. It claims that it is an exclusive licensee of the 'Avantha Brand' and has the right to sub-license the same to other entities for its use and promotion.

3. The petitioner claims that the respondent had entered into an Avantha Brand License and Brand Support Agreement dated 25.01.2010 (hereafter the '**2010 Royalty Agreement**'), in terms of which the respondent has been using the 'Avantha Brand' since 01.10.2009.

4. The petitioner claims that in terms of the Agreement, the respondent had agreed to pay the petitioner Brand Royalty computed at the rate of 1% of its Annual Consolidated Net Operating Revenue. The Agreement provides that 50% of the said royalty would be paid in lumpsum computed at the Net Present Value (NPV) of the Royalty in perpetuity, quantified at ₹411,20,00,000/- (Rupees Four Hundred and Eleven Crores and Twenty Lakhs only). The remaining 50% of the Brand Royalty would be paid on a quarterly basis commencing from 01.10.2018.

5. The petitioner claims that at the request of the respondent, it had raised an invoice for the aforesaid amount of ₹411,20,00,000/- and ₹74,01,60,000/- being the GST payable on the said Royalty. However,

the petitioner was compelled to withdraw the said invoice as the respondent had failed to make the payment under the invoice raised. This was because if the petitioner did not withdraw the invoices, it would be liable to pay the GST without recovering any amount from the respondent.

6. The petitioner claims that since the Brand Royalty was not paid, it addressed a letter dated 06.05.2019 proposing to settle the entire liability of the respondent to pay Brand Royalty liability against a one-time lumpsum payment, which would be adjusted against the advances payable by the petitioner to the respondent and its subsidiary, CG Power Solutions Ltd. The respondent declined to pay the same and, by a letter dated 26.11.2019, rescinded the Agreement leveling certain allegations. The petitioner claims that in view of the aforesaid dispute, it had issued a notice dated 23.07.2020 invoking the arbitration under Clause 18.6 of the Agreement, however, the respondent has declined to concur on appointment of an arbitrator. The petitioner claims that this has led it to file the present petition.

7. The respondent has contested and opposed the present petition on the ground that the subject disputes are not arbitrable. According to the respondent, the Agreement as setup by the petitioner, is a product of a serious fraud; the disputes under the subject agreement are inextricably intertwined with fraud concerning third parties, who are not parties to the Agreement; and, the fraud concerns wider public interest including public shareholders of the respondent. It was also contended that the dispute regarding the fraud perpetuated in respect of the affairs of the

petitioner company is the subject-matter of investigation by the Securities and Exchange Board of India (SEBI) and Serious Fraud Investigation Office (SFIO). The respondent further contends that the Civil Courts are also seized of the issues regarding the fraud, which is pending investigation; therefore, the said disputes are not arbitrable.

8. Concededly, in terms of Section 11 (6A) of the A&C Act, the scope of examination under the A&C Act is limited to the existence of the arbitration agreement. However, the question whether an arbitration agreement exists cannot be considered in the context of and in reference of the disputes between the parties. (See: *Vidya Drolia v. Durga Trading Corporation: (2021) 2 SCC 1*) [hereafter '*Vidya Drolia*'].

9. It is thus, essential to briefly examine the disputes between the parties.

The Disputes

10. The respondent is a public limited company incorporated under the Companies Act, 1913 and the shares of the respondent company are listed on the National Stock Exchange of India Limited (hereafter '**NSEL**') and Bombay Stock Exchange Limited (hereafter '**BSEL**').

11. On 25.01.2010, the petitioner and respondent entered into the 2010 Royalty Agreement, pursuant to which the respondent was entitled to use the petitioner's brand name 'Avantha'. In terms of the 2010 Royalty Agreement, the respondent was liable to pay a royalty fee of 0.25% of its Annual Consolidated Net Operating Revenue to the

petitioner. The 2010 Royalty Agreement was amended from time to time in terms of Amendment Agreements dated 17.12.2012, 15.10.2013, 30.09.2015 and 30.01.2017.

12. At the meeting of the Risk and Audit Committee (RAC) of the respondent held on 30.08.2016, it was noted that the respondent had granted a loan amounting to ₹530,00,00,000/- (Rupees Five Hundred and Thirty Crores only) (hereafter the '**loan amount**') to the petitioner. The RAC gave its post-facto approval to the loan at the said meeting and it was thereby resolved that (i) the loan amount advanced to the petitioner shall not exceed ₹1000,00,00,000/- (Rupees One Thousand Crore only) and the loan granted to the petitioner shall carry interest at the bank rate plus 2%; (ii) the loan advanced to the petitioner shall be repaid in full by 31.03.2017; and (iii) any further money advanced to the petitioner shall be informed to the RAC prior to making any such payment.

13. The respondent states that the petitioner failed to pay the loan amount advanced to it. The same was recorded at the meeting of the Board of Directors of the respondent held on 13.11.2018. At the said meeting, the petitioner advanced its proposal to repay the loan amount. The petitioner proposed that it would pay the loan amount through (i) cash amounting to ₹225 crores (₹80 crores from the petitioner company and ₹145 crores from the proceeds of sale of Solaris Chemtech Industries Limited); (ii) waiver of 50% of the Brand Royalty fees, which was payable by the respondent to the petitioner at the rate of 1% of the Annual Consolidated Revenue of the respondent under the amended

2010 Royalty Agreement; and (iii) pledge of 62,51,05,150 equity shares of Avantha Power and Infrastructure Limited and 10,85,47,731 equity shares of Jhabua Power Limited. The proposal of the petitioner was approved at the meeting of the Board of Directors of the respondent held on 13.11.2018.

14. Even though 50% of the Brand Royalty payable by the respondent to the petitioner under the amended 2010 Royalty Agreement was waived, the respondent was, nevertheless, liable to pay to the petitioner the balance 50% of the Brand Royalty computed at the rate of 1% of its Annual Consolidated Net Operating Revenue. In this regard, the petitioner and the respondent entered into the Agreement on 13.02.2019.

15. The Agreement was effective from 01.10.2018 and it superseded all existing agreements *qua* the usage of the brand name 'Avantha' including the 2010 Royalty Agreement as amended by the Amendment Agreements. In terms of the Agreement, the payment of royalty was divided into two parts – (i) 50% royalty would be paid in quarterly instalments, which would be calculated on the quarterly consolidated Net Operating Revenue of the respondent; and, (ii) the remaining 50% of the said royalty would be a one-time discounted lump sum payment at the Net Present Value of the Brand Royalty in perpetuity agreed at ₹411,20,00,000/-.

16. The respondent alleges that in the month of April 2019, certain unauthorised transactions were brought to the notice of the Operations

Committee of the respondent company as the same were not recorded within the financial statements. Accordingly, on 24.04.2019, an independent law firm was appointed to investigate into the purported transactions. The law firm submitted its Phase-I report dated 05.08.2019 to the RAC of the respondent company. According to the said report, the transactions referred were improper and unauthorised. The report also indicated that the unauthorised transactions involved the petitioner and its group entities, which were under the control of one Mr Gautam Thapar, who at the material time was the Chairman of the Board of Directors and a majority shareholder of the petitioner, holding 86.15% of its total paid up shares. He was also the Chairman of the Board of the respondent from 22.07.2004 till 29.08.2019. The Phase-I report also implicated one Mr V.R. Venkatesh (Director and Chief Financial Officer of the respondent at the material time), one Mr Madhav Acharya (Director and Chief Financial Officer of the respondent at the material time) and one Mr B Hariharan (Director of the respondent at the material time). The aforesaid report further indicated that the assets of the respondent were provided as securities against loans without due approval of the Board of Directors of the respondent and, the funds so obtained were siphoned off, for the benefit of the petitioner and other group entities controlled by Mr Gautam Thapar.

17. The respondent, by its letter dated 19.08.2019, made a disclosure under Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to the two Stock Exchanges, NSEL and BSEL. In its disclosure, the respondent stated that the liabilities of

the respondent and its group companies, as on 31.03.2018, were grossly understated by ₹1053,54,00,000/- and ₹1608,17,00,000/-, respectively.

18. On 20.08.2019, SEBI took *suo-moto* cognizance of the matter in respect of the suspected fraud. Thereafter, the respondent submitted a copy of the Phase-I report prepared by the independent law firm to SEBI on 26.08.2019. SEBI further sought responses from the involved individuals on matters mentioned in the report. On 29.08.2019, the respondent issued a circular resolution for removal of Mr Gautam Thapar as its Chairman of the Board of Directors. The circular resolution was passed by majority. At the Board Meeting of the respondent company held on 30.08.2019, the employment of Mr VR Venkatesh, Chief Financial Officer (CFO) of the respondent company was also terminated with immediate effect. The same was disclosed to SEBI on 29.08.2019 and 30.08.2019.

19. On 17.09.2019, SEBI passed an order, *inter-alia*, restraining Mr Gautam Thapar and other employees/directors of the respondent and its related entities from accessing the securities market or from buying, selling or dealing in securities, either directly or indirectly. SEBI further restrained the petitioner, Solaris Industrial Chemicals Limited, and Acton Global Private Limited, from disposing, selling or alienating its assets or funds until further orders and, also directed BSEL to appoint an independent auditor to conduct a forensic audit into the books of accounts of the respondent from the financial year 2015-2016 till date.

20. The respondent was also directed to take all necessary steps to recover the amounts due to it. The respondent claims that it has instituted suits to recover the amounts due to it.

21. The aforesaid order was challenged by the individuals. However, the appeal was dismissed by the Securities Appellate Tribunal, by its order dated 01.10.2019

22. On 25.09.2019, the respondent issued a demand notice to the petitioner for a sum of ₹685,30,79,271.35/- in respect of the outstanding amount due and payable by the petitioner. However, on 09.10.2019, the petitioner denied any sum due to the respondent and further made a demand request of ₹411,20,00,000/- and ₹39,98,98,500/- under the Agreement. The respondent, by its letter dated 26.11.2019, stated that no payment was due to the petitioner and also conveyed its intention to rescind the Agreement. The respondent further stated that the amount owed by the petitioner to the respondent is significantly higher than the amount indicated by the petitioner before the Board in its earlier meeting. The respondent alleged that the petitioner had misrepresented before the Board of the respondent and withheld material facts with the intent of perpetuating fraud on the respondent. The allegations of the respondent were denied by the petitioner in its letter dated 02.12.2019, however, the petitioner accepted the rescission of the Agreement as a repudiatory breach and called upon the respondent to stop using the brand name – ‘Avantha’.

23. In the meanwhile, by its order dated 11.11.2019, the office of the Director General, Ministry of Corporate Affairs directed the Serious Fraud Investigation Office (SFIO) under Section 212 of the Companies Act, 2013 to conduct an investigation into the affairs of the respondent company. On 09.12.2019, the SFIO sought information and documents from the respondent to conduct the investigation. In furtherance to the submissions made by the Ministry of Corporate Affairs, the National Company Law Tribunal, Mumbai (hereafter the '**NCLT, Mumbai**') passed an order dated 05.03.2020 directing re-opening of the books of accounts and, recasting of the financial statements of the respondent and its group companies, for the previous five years ending on 31.03.2019. The NCLT, Mumbai also directed the SFIO to conduct an investigation into the affairs of the petitioner and its group companies. The SFIO commenced its investigation on 11.11.2020.

24. SEBI also conducted its independent investigation and issued a reasoned order dated 11.03.2020, whereby it confirmed its earlier order dated 17.09.2019. SEBI expressed a *prima-facie* view that Mr Gautam Thapar and other former employees of the respondent (that is, Mr V.R. Venkatesh, Mr Madhav Acharya and Mr B Hariharan) had misused the powers granted to them by the Board of the respondent and entered into fraudulent transactions for the benefit of the petitioner and its group companies.

25. On 23.07.2020, the petitioner issued a notice and invoked the Arbitration Clause: Clause 18.6 of the Agreement. The respondent in its reply dated 21.08.2020 refused to provide its consent for the

appointment of an arbitrator. The respondent stated that the Agreement was vitiated by fraud and misrepresentation and, said disputes cannot be adjudicated by an arbitral tribunal.

Submissions of Counsel

26. Mr. Amit Sibal, learned senior counsel appearing for the respondent has opposed the present petition on, essentially, two fronts. First, he submitted that Clause 18.6 of the Agreement does not contemplate reference of the subject disputes to arbitration. He submitted that the scope of the Arbitration Clause was restricted to refer disputes in respect of interpretation of the content of the Agreement to arbitration. He stated that in the present case, there was no dispute as to the interpretation of the terms of the Agreement or its content. The dispute, essentially, is whether the Agreement is a part of large-scale fraud perpetrated by the Promoters of the respondent company to siphon off funds from the said company and, the present Agreement is one of the devices to do so. The respondent had by a letter dated 25.09.2019 demanded a sum of ₹685,30,79,271.35 (Rupees Six Hundred Eighty-Five Crores Thirty Lakhs Seventy-Nine Thousand Two Hundred and Seventy-One and Paisas Thirty-Five only) and the petitioner had resisted the said demand by raising a counter demand for a sum of ₹411,00,00,000/- (Rupees Four Hundred Eleven Crores only) under the Agreement. The respondent had rescinded the Agreement. He submitted that according to the respondent, the Agreement was void and was used as a device by the Promoters of respondent to siphon off funds

from the said company, which is also a public company. And, this dispute was outside the scope of the Arbitration Clause.

27. Next Mr Sibal submitted that, the disputes involve allegations of serious fraud that vitiate the Agreement as well as the agreement to refer the disputes to arbitration included therein. He submitted that one of the devices to siphon funds from the respondent company was by creating a sham transaction for licensing the Avantha Brand which is of little value and there existed no advantage to the respondent. Further, the royalty payments payable in perpetuity were accelerated to provide an upfront payment.

28. He submitted that the promoters of the respondent company had also siphoned funds through unlisted subsidiaries and had understated the liability. It is stated that these were part of an integrated scheme to defraud the respondent, its lenders and its public shareholders. He submitted that such disputes were not arbitrable. He relied upon the decisions of the Supreme Court in *A. Ayyasamy v. A. Paramasivam: (2016) 10 SCC 386* [hereafter '*A. Ayyasamy*']; *Rashid Raza v. Sadaf Akhtar: (2019) 8 SCC 710* [hereafter '*Rashid Raza*']; *Vidya Drolia (supra)*; and *N. N. Global Mercantile Private Limited v. Indo Unique Flame Limited & Ors.: 2021 SCC OnLine SC 13* [hereafter '*N. N. Global Mercantile Private Limited*'] in support of his contention.

29. He submitted that the fraud committed in this case is that of a public nature and is a subject matter of orders passed by SEBI as well as investigations being conducted by the SFIO.

30. He submitted that the Agreement, including the arbitration agreement, was void as a product of fraud. He submitted that at the material time Mr Gautam Thapar was in control of both the parties – the petitioner as well as the respondent. He further submitted that Mr Gautam Thapar had committed fraud in collusion with two other senior employees of the respondent company, who were appointed as Chief Financial Officers and were also closely associated with him. They had acted under his direct influence and also misrepresented the facts to the Board of Directors of the respondent company. The independent directors were unaware of the fraudulent transactions.

31. Mr Sethi, learned senior counsel appearing for the petitioner countered the aforesaid contentions. He submitted that the disputes were arising out of a contractual relationship and therefore, the disputes were arbitrable. He submitted that the respondent had used the Avantha Brand and its Logo till 04.11.2020 and could not avoid the royalty payments due under the Agreement after taking advantage of the same. He submitted that the allegations of fraud arise from a misleading disclosure made by the respondent after its management was taken over.

32. Next, he referred to the decision of the Supreme Court in ***Avitel Post Studioz Limited & Ors. v. HSBC PI Holdings (Mauritius) Ltd.***: **2020 SCC OnLine SC 656** [hereafter '*Avitel*'] and contended that only the allegations that are made against the State and/or arise in a public law domain can be excluded from arbitration. He also submitted that the arbitrability of the disputes is required to be addressed in reference

to the claims made by the claimant (petitioner in this case) and not on the basis of a possible defence to such claims.

33. In addition, he submitted that the question whether a dispute is arbitrable is also required to be addressed by the Arbitral Tribunal. Applying the doctrine of *kompetenz-kompetenz* and the principle of severability, the Arbitral Tribunal had the jurisdiction to decide all questions regarding the validity of the Agreement. He referred to ***Vidya Drolia*** (*supra*) in support of his contention.

34. Next, he referred to the decision of the Supreme Court in ***Mayavati Trading Pvt. Ltd. v. Pradyut Deb Burman: (2019) 8 SCC 714*** [hereafter '***Mayavati Trading***'] in support of his contention that the scope of examination at the present stage is limited to examining the existence of an arbitration agreement.

35. In so far as the Arbitration Clause is concerned, Mr Sethi submitted that the same was required to be read in an expansive manner. He relied upon the decisions in ***Ranjit Kaur v Union of India & Ors.: ILR (1996) 1 Delhi 568*** [hereafter '***Ranjit Kaur***']; ***Printers (Mysore) Private Limited v. Pothan Joesph: AIR 1960 SC 1156*** [hereafter '***Printers (Mysore) Private Limited***']; ***Mohammed Imaduddin Farooqui v. Karkhana Zinda Tilismath: 2017 SCC OnLine Hyd 242*** [hereafter '***Mohammed Imaduddin Farooqui***']; and ***Union of India v. Salween Timber and Construction Co.: (1969) 2 SCR 224*** [hereafter '***Salween Timber and Construction Co.***'] in support of his contention.

Questions to be addressed

36. There are three principal questions that fall for consideration before this Court in these proceedings. First, whether the subject disputes fall within the scope of the arbitration clause. Second, whether the disputes between the parties are not arbitrable as they involve allegations of fraud. And third, whether this Court is required to address the question whether the disputes are arbitrable or not. The second and third questions are inter-connected.

Scope of the Arbitration Clause

37. At the outset, it is necessary to bear in mind that by virtue of Section 11(6A) of the A&C Act, the examination in these proceedings is limited to the existence of the arbitration agreement. In ***M/s. Duro Felguera, S.A. v. M/s. Gangavaram Port Limited: (2017) 9 SCC 729*** [hereafter '***Duro Felguera***'], the Supreme Court had observed as under:

“48. ... From a reading of Section 11(6-A), the intention of the legislature is crystal clear i.e. the court should and need only look into one aspect—the existence of an arbitration agreement. What are the factors for deciding as to whether there is an arbitration agreement is the next question. The resolution to that is simple—it needs to be seen if the agreement contains a clause which provides for arbitration pertaining to the disputes which have arisen between the parties to the agreement.

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59. The scope of the power under Section 11(6) of the 1996 Act was considerably wide in view of the decisions in *SBP & Co.* [*SBP & Co. v. Patel Engg. Ltd.*, (2005) 8 SCC 618] and *Boghara Polyfab* [*National Insurance Co. Ltd. v. Boghara Polyfab (P) Ltd.*, (2009) 1 SCC 267 :

(2009) 1 SCC (Civ) 117] . This position continued till the amendment brought about in 2015. After the amendment, all that the courts need to see is whether an arbitration agreement exists—nothing more, nothing less. The legislative policy and purpose is essentially to minimise the Court's intervention at the stage of appointing the arbitrator and this intention as incorporated in Section 11(6-A) ought to be respected.”

38. In ***Mayavati Trading*** (*supra*), the Supreme Court had referred to the aforesaid decision and concluded as under:

“10. This being the position, it is clear that the law prior to the 2015 Amendment that has been laid down by this Court, which would have included going into whether accord and satisfaction has taken place, has now been legislatively overruled. This being the position, it is difficult to agree with the reasoning contained in the aforesaid judgment [*United India Insurance Co. Ltd. v. Antique Art Exports (P) Ltd.*, (2019) 5 SCC 362 : (2019) 2 SCC (Civ) 785] , as Section 11(6-A) is confined to the examination of the *existence* of an arbitration agreement and is to be understood in the narrow sense as has been laid down in the judgment in *Duro Felguera, S.A.* [*Duro Felguera, S.A. v. Gangavaram Port Ltd.*, (2017) 9 SCC 729 : (2017) 4 SCC (Civ) 764] ”

39. However, in ***Vidya Drolia*** (*supra*), the Court had observed that examination under Section 8 of the A&C Act is not mechanical and the Court may, to prevent wastage of public and private resources exercise judicial discretion to conduct a summary yet intense, *prima facie*, review to determine whether the disputes are arbitrable. The Court also noted that in its earlier decisions in ***Oriental Insurance Company Limited v. M/s Narbheram Power and Steel Pvt. Ltd.***: (2018) 6 SCC 534, [hereafter '*Narbheram Power and Steel Pvt. Ltd.*'] the Court had

declined to refer the parties to arbitration as it found that the disputes were not arbitrable. The said decision was also followed by the Supreme Court in its later decision in ***United India Insurance Co. Ltd. and Anr. v. Hyundai Engineering and Construction Co. Ltd. and Ors.: (2018) 17 SCC 607*** [hereafter '***United India Insurance Co. Ltd.***']. The Court had held that at the referral stage the “*court is required to take a limited view*”.

40. Indisputably, the question whether there exists an arbitration agreement cannot be decided in a vacuum and without reference to the subject disputes. In one sense, if it is found that the disputes are outside the scope of the arbitration clause; an arbitration agreement for adjudicating the said disputes cannot be stated to be in existence. Having stated the above, it is also now well settled that the standards of examination under Section 11 of the A&C Act are limited. In ***NCC Limited v. Indian Oil Corporation Limited: (2019) SCC OnLine Del 6964***, a Coordinate bench of this Court had observed as under:

“107. In my view, the scope of examination as to whether or not the claims lodged are Notified Claims has narrowed down considerably in view of the language of Section 11(6-A) of the 1996 Act. To my mind, once the Court is persuaded that it has jurisdiction to entertain a Section 11 petition all that is required to examine is as to whether or not an arbitration agreement exists between the parties which is relatable to the dispute at hand. The latter part of the exercise adverted to above, which involves correlating the dispute with the arbitration agreement obtaining between the parties, is an aspect which is implicitly embedded in sub-section (6-A) of Section 11 of the 1996 Act, which, otherwise, requires the

Court to confine its examination only to the existence of the arbitration agreement. Therefore, if on a bare perusal of the agreement it is found that a particular dispute is not relatable to the arbitration agreement, then, perhaps, the Court may decline the relief sought for by a party in a Section 11 petition. However, if there is a contestation with regard to the issue as to whether the dispute falls within the realm of the arbitration agreement, then, the best course would be to allow the arbitrator to form a view in the matter.

108. Thus, unless it is in a manner of speech, a chalk and cheese situation or a black and white situation without shades of grey, the court concerned hearing Section 11 petition should follow the more conservative course of allowing parties to have their say before the Arbitral Tribunal.”

41. The aforesaid passage was also referred to by the Supreme Court in *Vidya Drolia* (*supra*).

42. Thus, the limited scope of examination under Section 11 of the A&C Act would also include an *ex facie* view on the question whether the disputes are arbitrable and whether the parties are required to be relegated to arbitration.

43. In *Bharat Sanchar Nigam Limited and Anr. v. Nortel Networks India Pvt. Ltd.*: 2021 5 SCC 738, the Supreme Court had held that in cases where the claims are *ex facie* barred by limitation, the parties would not be referred to arbitration. Similarly, in cases where the disputes are *ex facie* beyond the scope of the arbitration agreement, the Courts have declined to refer the parties to arbitration. [See:

Narbheram Power and Steel Pvt. Ltd. (supra) and *United India Insurance Co. Ltd. (supra)*].

44. In *Narbheram Power and Steel Pvt. Ltd. (supra)*, the Supreme Court also observed that the arbitration clause is required to be strictly construed. The relevant extract of the said decision is set out below:

“23. It does not need special emphasis that an arbitration clause is required to be strictly construed. Any expression in the clause must unequivocally express the intent of arbitration. It can also lay the postulate in which situations the arbitration clause cannot be given effect to. If a clause stipulates that under certain circumstances there can be no arbitration, and they are demonstrably clear then the controversy pertaining to the appointment of arbitrator has to be put to rest.”

45. In the present case, the Arbitration Clause (clause 18.6 of the Agreement) reads as under:

“18.6 Differences between the Parties:

In case of any dispute between the Parties, with respect to the interpretation of the contents of this Agreement, all Parties shall, in the first instance, endeavour to settle the same through mutual dialogue. If however, the said dispute remains unresolved for a period of 60 days, then the same shall be referred to arbitration of a sole arbitrator and, the said arbitration shall be carried out at New Delhi, under the provisions of the Arbitration and Conciliation Act, 1996 and any modifications or amendment thereto from time to time. The award of the said arbitrator shall be final and binding on the Parties. The parties agree that during the aforesaid period of 60 days and/or during the period that the arbitration is in progress, the status quo

with respect to the subject matter of any dispute will be maintained.”

46. It is clear from the plain language of the Arbitration Agreement that its scope is restricted to disputes “*with respect to the interpretation of the contents of this agreement*”.

47. As noted above, the disputes between the parties are essentially whether the Agreement is part of the fraudulent scheme to siphon funds from the respondent company. There is no dispute as to the interpretation of its contents. The respondent does not dispute the meaning of any clause and has not set up a case that any of the clauses of the Agreement must be interpreted in any different manner.

48. In view of the above, it is clear that adjudication of the disputes in the present case do not fall within the scope of the arbitration clause.

49. Mr Sethi, relied upon the decision of this Court in ***Ranjit Kaur*** (*supra*) in support of his contention that the words “interpretation of” as used in the Arbitration Clause should be read in an expansive manner. In that case the disputes between the parties arose in the context of an agreement of sale dated 07.07.1987. Clause 25 of the said agreement recorded that “*in case any dispute or difference arises between the parties hereto concerning the meaning, interpretation or effect of any of the provisions of this agreement, the same shall be referred to arbitration.*” In the said case, the appellant (Ranjit Kaur) had appealed against the decision of the learned Single Judge of the High Court to stay the civil proceedings under Section 34 of the Arbitration Act, 1940.

The appellant had claimed that respondent no. 2, M/s Delhi Polymer & Chemicals Private Limited, had failed to provide possession of the premises to the buyers within the stipulated time period. Consequently, the agreement stood frustrated as time was the essence of the contract. The appellant contended that only disputes relating to the *meaning, interpretation or effect of any of the provisions of this agreement*, could be referred to arbitration. Therefore, the issues relating to frustration of the agreement to sale or whether time was of the essence of the contract were outside the scope of arbitration. This contention was rejected. The decision turned on interpretation of the words '*effect of any provisions of this agreement*'. The court held that the said phrase means the same as 'application of the contract' and relates to disputes arising during the 'working out' of the contract. Accordingly, the Court dismissed the appeal and referred the parties to arbitration.

50. The decision of the Supreme Court in ***Printers (Mysore) Private Limited*** (*supra*) referred to by Mr Sethi, does not take the petitioner's case any further. In that case, the Court interpreted the words 'application of the contract' in the context of 'interpretation of the contract'. The Supreme Court accordingly held that the dispute between the parties concerning the respondent's entitlement to one-tenth share in the profits of the Deccan Herald Newspaper from 1948 till the date of termination of his service, was a question involving *the application of the contract* and thus, fell within the four corners of the arbitration agreement.

51. In the case of **Mohammed Imaduddin Farooqui** (*supra*) the partners of a firm had entered into a deed of partnership dated 30.03.2013 which included an arbitration clause. The relevant extract of the said clause read as: “*any dispute or difference of opinion arising among the partners in any manner connected with the partners in connection with interpretation of any of the clauses herein, such disputes or differences shall be referred to an Arbitrator..*” The dispute arose between the parties in relation to admission of an heir of a deceased partner, as a partner to the partnership firm and the respondent contended that the procedure provided under the deed of partnership dated 30.03.2013 for induction of the partner to the firm had not been complied with. The decision of the aforesaid case is of little assistance to the petitioner as the Court held that the question whether the petitioner is already a partner or had just acquired a mere right to be admitted to the partnership, involves interpretation of Clause 10(b) of the partnership deed. Accordingly, the parties were referred to arbitration in terms of the arbitration clause.

52. Mr Sethi had also referred to the decision of the Supreme Court in **Salween Timber and Construction Co.** (*supra*). The Supreme Court dealt with the interpretation of an arbitration agreement, the relevant extract of which reads as: “*in the event of any question or dispute arising under these conditions or any special conditions of contract or in connection with this contract (except as to any matters the decision of which is specially provided for by these conditions) the same shall be referred to the award of an arbitrator to be nominated by the*

Purchaser...”. The question before the Supreme Court was whether claims relating to a transaction of involuntary bailment, return of the good, and damages for deterioration are disputes fell within the scope of the arbitration clause. There is no cavil that the words ‘arising out of the contract’ or ‘in connection with the contract’ are of wide import. In the case of ***Renusagar Power Co. Ltd. v. General Electric Company & Anr.: (1984) 4 SCC 679***, the Supreme Court had held that phrases “with respect to”, “in respect of” and “in connection with” widen the scope of an arbitration agreement.

53. As stated above, the arbitration agreement as contained in Clause 18.6 of the agreement has a limited scope to include only those disputes involving ‘*interpretation of contents of this agreement*’, and the decisions relied upon by Mr Sethi do not further the petitioner’s case.

54. In view of the above, the present petition for appointment of an arbitrator is required to be rejected.

55. In the aforesaid view, it is not necessary to address the other questions; however, for the sake of completeness, this court considers it apposite to do so.

Fraud, whether an exception to arbitration

56. The question whether disputes involving an allegation of fraud can be referred to arbitration has been a matter of much debate.

57. In ***Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak: AIR 1962 SC 406*** [hereafter ‘*Abdul Kadir Shamsuddin Bubere*’],

rendered in the context of the Arbitration Act, 1940, the Supreme Court had observed as under: -

“17. There is no doubt that where serious allegations of fraud are made against a party and the party who is charged with fraud desires that the matter should be tried in open court, that would be a sufficient cause for the court not to order an arbitration agreement to be filed and not to make the reference.”

58. In *N. Radhakrishnan v. M/s Mastero Engineers & Ors.: (2010) 1 SCC 72* [hereafter ‘*N. Radhakrishnan*’], the Supreme Court followed the decision in *Abdul Kadir Shamsuddin Bubere (supra)* and upheld the decision of the High Court rejecting the revision against an order passed by the Trial Court rejecting the appellant’s application under Section 8 of the A&C Act. The Trial Court had rejected the said application to refer the parties to arbitration as it found that the appellant had raised issues relating to misappropriation of funds and malpractices, which ought to be resolved by a Civil Court.

59. The correctness of the decision in *N Radhakrishnan (supra)* was doubted by a Single Bench of the Supreme Court in *Swiss Timing Ltd. v. Commonwealth Games 2010 Organizing Committee: 2014 6 SCC 677* [hereafter ‘*Swiss Timing Ltd.*’]. In that case the court held that the said decision was *per incuriam* as the Supreme had not referred to its earlier judgments in the case of *P. Anand Gajapathi Raju v. P.V.G. Raju: 2000 4 SCC 539* [hereafter ‘*P. Anand Gajapathi Raju*’] and *Hindustan Petroleum Corporation Ltd. v. Pinkcity Midway Petroleums: 2003 6 SCC 503* [hereafter ‘*Hindustan Petroleum*’]

Corporation Ltd.’]. However, as noted by the Supreme Court in *A. Ayyasamy (supra)*, the decision in *Swiss Timing Ltd. (supra)* has no precedent value as it was a judgment delivered in exercise of powers under Section 11(6) of the A&C Act.

60. In *Afcons Infrastructure Ltd v. Cherian Varkey Construction (P) Ltd.: 2010 8 SCC 24* [hereafter ‘*Afcons Infrastructure Ltd.*’], the Supreme Court had listed out a category of cases which were not normally considered to be suitable for reference to arbitration having regard to their nature. Paragraph 27 of the said decision reads as under:-

“27. The following categories of cases are normally considered to be not suitable for ADR process having regard to their nature:

- (i) Representative suits under Order 1 Rule 8 CPC which involve public interest or interest of numerous persons who are not parties before the court. (In fact, even a compromise in such a suit is a difficult process requiring notice to the persons interested in the suit, before its acceptance).
- (ii) Disputes relating to election to public offices (as contrasted from disputes between two groups trying to get control over the management of societies, clubs, association, etc.).
- (iii) Cases involving grant of authority by the court after enquiry, as for example, suits for grant of probate or letters of administration.
- (iv) Cases involving serious and specific allegations of fraud, fabrication of documents, forgery, impersonation, coercion, etc.

(v) Cases requiring protection of courts, as for example, claims against minors, deities and mentally challenged and suits for declaration of title against the Government.

(vi) Cases involving prosecution for criminal offences.”

61. In a subsequent decision in the case of **Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd: (2011) 5 SCC 532** [hereafter ‘**Booz Allen & Hamilton Inc.**’], the Supreme Court again referred to certain categories of arbitrable disputes and observed as under:-

“36. The well-recognised examples of non-arbitrable disputes are: (i) disputes relating to rights and liabilities which give rise to or arise out of criminal offences; (ii) matrimonial disputes relating to divorce, judicial separation, restitution of conjugal rights, child custody; (iii) guardianship matters; (iv) insolvency and winding-up matters; (v) testamentary matters (grant of probate, letters of administration and succession certificate); and (vi) eviction or tenancy matters governed by special statutes where the tenant enjoys statutory protection against eviction and only the specified courts are conferred jurisdiction to grant eviction or decide the disputes.”

62. In **A. Ayyasamy (supra)**, the Supreme Court examined various earlier decisions including the decision in **N. Radhakrishnan (supra)** and held as under:-

“25 In view of our aforesaid discussions, we are of the opinion that mere allegation of fraud simpliciter 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 allegations 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 the civil court on the appreciation of the voluminous evidence that needs to be produced, the court can sidetrack the agreement by dismissing the application under Section 8 and proceed with the suit on merits. It can be so done also in those cases where there are serious allegations of forgery/fabrication of documents in support of the plea of fraud or where fraud is alleged against the arbitration provision itself or is of such a nature that permeates the entire contract, including the agreement to arbitrate, meaning thereby in those cases where fraud goes to the validity of the contract itself 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. While dealing with such an issue in an 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 as to whether the court has jurisdiction 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 aforesaid aspect viz. whether the nature of 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 of 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.”

63. Dr C.Y. Chandrachud, J., penned a supplementary and concurring opinion. He referred to the earlier decisions of the Court in ***P. Anand Gajapathi Raju*** (*supra*) and ***Hindustan Petroleum Corporation Ltd.*** (*supra*) and observed as under:-

“43. Hence, the allegations of criminal wrongdoing or of statutory violation would not detract from the jurisdiction of the Arbitral Tribunal to resolve a dispute arising out of a civil or contractual relationship on the basis of the jurisdiction conferred by the arbitration agreement.

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45. The position that emerges both before and after the decision in *N. Radhakrishnan* [*N. Radhakrishnan v. Maestro Engineers*, (2010) 1 SCC 72 : (2010) 1 SCC (Civ) 12] is that successive decisions of this Court have given effect to the binding precept incorporated in Section 8. Once there is an arbitration agreement between the parties, a judicial authority before whom an action is brought covering the subject-matter of the arbitration agreement is under a positive obligation to refer parties to arbitration by enforcing the terms of the contract. There is no element of discretion left in the court or judicial authority to obviate the legislative mandate of compelling parties to seek recourse to arbitration. The judgment in *N. Radhakrishnan* [*N. Radhakrishnan v. Maestro Engineers*, (2010) 1 SCC 72 : (2010) 1 SCC (Civ) 12] has, however,

been utilised by parties seeking a convenient ruse to avoid arbitration to raise a defence of fraud:

45.1. First and foremost, it is necessary to emphasise that the judgment in *N. Radhakrishnan v. Maestro Engineers*, (2010) 1 SCC 72 : (2010) 1 SCC (Civ) 12] does not subscribe to the broad proposition that a mere allegation of fraud is ground enough not to compel parties to abide by their agreement to refer disputes to arbitration. More often than not, a bogey of fraud is set forth if only to plead that the dispute cannot be arbitrated upon. To allow such a plea would be a plain misreading of the judgment in *N. Radhakrishnan v. Maestro Engineers*, (2010) 1 SCC 72 : (2010) 1 SCC (Civ) 12]. As I have noted earlier, that was a case where the appellant who had filed an application under Section 8 faced with a suit on a dispute in partnership had raised serious issues of criminal wrongdoing, misappropriation of funds and malpractice on the part of the respondent. It was in this background that this Court accepted the submission of the respondent that the arbitrator would not be competent to deal with matters “which involved an elaborate production of evidence to establish the claims relating to fraud and criminal misappropriation”. Hence, it is necessary to emphasise that as a matter of first principle, this Court has not held that a mere allegation of fraud will exclude arbitrability. The burden must lie heavily on a party which avoids compliance with the obligation assumed by it to submit disputes to arbitration to establish the dispute is not arbitrable under the law for the time being in force. In each such case where an objection on the ground of fraud and criminal wrongdoing is raised, it is for the judicial authority to carefully sift through the

materials for the purpose of determining whether the defence is merely a pretext to avoid arbitration. It is only where there is a serious issue of fraud involving criminal wrongdoing that the exception to arbitrability carved out in *N. Radhakrishnan* [*N. Radhakrishnan v. Maestro Engineers*, (2010) 1 SCC 72 : (2010) 1 SCC (Civ) 12] may come into existence.

45.2. Allegations of fraud are not alien to ordinary civil courts. Generations of judges have dealt with such allegations in the context of civil and commercial disputes. If an allegation of fraud can be adjudicated upon in the course of a trial before an ordinary civil court, there is no reason or justification to exclude such disputes from the ambit and purview of a claim in arbitration. The parties who enter into commercial dealings and agree to a resolution of disputes by an arbitral forum exercise an option and express a choice of a preferred mode for the resolution of their disputes. The parties in choosing arbitration place priority upon the speed, flexibility and expertise inherent in arbitral adjudication. Once parties have agreed to refer disputes to arbitration, the court must plainly discourage and discountenance litigative strategies designed to avoid recourse to arbitration. Any other approach would seriously place in uncertainty the institutional efficacy of arbitration. Such a consequence must be eschewed.”

64. It is clear from the above that the Supreme Court has in unambiguous terms held that allegations of fraud can be adjudicated in arbitration. If a trial court can adjudicate such disputes, there is no ground to hold that an Arbitral Tribunal cannot. However, the Supreme Court did not completely discard the exception of fraud; it held that a

serious issue of fraud involving criminal wrongdoing could be an exception as carved out in *N. Radhakrishnan* (*supra*).

65. In *Ameet Lalchand Shah v. Rishabh Enterprises: 2018 15 SCC 678* [hereafter '*Ameet Lalchand Shah*'], the Supreme Court once again observed that only in cases where serious questions of fraud are involved, referral of such disputes to arbitration can be refused. However, in that case the court found that there were no such serious questions of fraud. Although, the Supreme Court noted that there was a criminal case registered against the appellant before the Economic Offences Wing, Delhi, nonetheless the Supreme Court held it was not necessary to express any views on the same and in any event, the arbitrator appointed could examine the allegations regarding fraud. The relevant extract of the said decision is set out below:-

“37. It is only where serious questions of fraud are involved, the arbitration can be refused. In this case, as contended by the appellants there were no serious allegations of fraud; the allegations levelled against Astonfield is that Appellant 1 Ameet Lalchand Shah misrepresented by inducing the respondents to pay higher price for the purchase of the equipments. There is, of course, a criminal case registered against the appellants in FIR No. 30 of 2015 dated 5-3-2015 before the Economic Offences Wing, Delhi. Appellant 1 Ameet Lalchand Shah has filed Criminal Writ Petition No. 619 of 2016 before the High Court of Delhi for quashing the said FIR. The said writ petition is stated to be pending and therefore, we do not propose to express any views in this regard, lest, it would prejudice the parties. Suffice to say that the allegations cannot be said to be so serious to refuse to refer the parties to arbitration. In any event, the

arbitrator appointed can very well examine the allegations regarding fraud.”

66. In **Rashid Raza** (*supra*), which was rendered after the decision in the case of **Ameet Lalchand Shah** (*supra*), the Supreme Court further restricted the exception of fraud. It articulated two tests which were required to be met for a dispute involving allegations of fraud to be non-arbitrable. The court referred to the decision in **A. Ayyasamy** (*supra*) and observed as under:-

“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.”

67. In **Avitel** (*supra*) the Supreme Court examined its earlier decision, *inter alia*, regarding arbitrability of disputes involving allegations of fraud. The court further explained the two tests as culled out in **Rashid Raza** (*supra*) as stated above. The relevant extract of the said decision is set out below:-

“ 35. After these judgments, it is clear that “serious allegations of fraud” arise only if either of the two tests laid down are satisfied, and not otherwise. The first test is satisfied only when it can be said that the arbitration clause or agreement itself cannot be said to exist in a clear case in which the court finds that the party against whom

breach is alleged cannot be said to have entered into the agreement relating to arbitration at all. The second test can be said to have been met in cases in which allegations are made against the State or its instrumentalities of arbitrary, fraudulent, or mala fide conduct, thus necessitating the hearing of the case by a writ court in which questions are raised which are not predominantly questions arising from the contract itself or breach thereof, but questions arising in the public law domain.”

68. In *Avitel (supra)* the Supreme Court also referred to the decisions of the Supreme Court in *Afcons Infrastructure Ltd. (supra)* and *Booz Allen & Hamilton Inc. (supra)* and clarified that merely because some facts involve civil and criminal proceedings, it would not necessarily lead to the conclusion that the disputes cease to be arbitrable on that count. The relevant observations of the Court are as under:

“43. In the light of the aforesaid judgments, para 27(vi) of *Afcons [Afcons Infrastructure Ltd. v. Cherian Varkey Construction Co. (P) Ltd., (2010) 8 SCC 24 : (2010) 3 SCC (Civ) 235]* and para 36(i) of *Booz Allen [Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd., (2011) 5 SCC 532 : (2011) 2 SCC (Civ) 781]*, must now be read subject to the rider that the same set of facts may lead to civil and criminal proceedings and if it is clear that a civil dispute involves questions of fraud, misrepresentation, etc. which can be the subject-matter of such proceeding under Section 17 of the Contract Act, and/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 lead to the conclusion that a dispute which is otherwise arbitrable, ceases to be so.”

69. The Supreme Court observed that the decision in *N. Radhakrishnan (supra)* was no longer a good precedent. Subsequently,

in *Vidya Drolia* (*supra*), the Supreme Court expressly overruled the decision in *N. Radhakrishnan* (*supra*) while observing that “*allegations of fraud can be made a subject matter of arbitration when they relate to a civil dispute*”. However, the Court also observed that fraud, which would vitiate or invalidate an arbitration clause, would be an aspect relating to non-arbitrability.

70. In *Vidya Drolia* (*supra*), the Supreme Court referred to its earlier decisions in *Avitel* (*supra*) and *Rashid Raza* (*supra*) and set down a four-fold test for determining whether a dispute in an arbitration agreement is arbitrable. The relevant extract setting out the four tests are reproduced below:

“76. In view of the above discussion, we would like to propound a fourfold test for determining when the subject-matter of a dispute in an arbitration agreement is not arbitrable:

76.1. (1) When cause of action and subject-matter of the dispute relates to actions in rem, that do not pertain to subordinate rights in personam that arise from rights in rem.

76.2. (2) When cause of action and subject-matter of the dispute affects third-party rights; have *erga omnes* effect; require centralised adjudication, and mutual adjudication would not be appropriate and enforceable.

76.3. (3) When cause of action and subject-matter of the dispute relates to inalienable sovereign and public interest functions of the State and hence mutual adjudication would be unenforceable.

76.4. (4) When the subject-matter of the dispute is expressly or by necessary implication non-arbitrable as per mandatory statute(s).”

71. The Court further explained as under:

“77. Applying the above principles to determine non-arbitrability, it is apparent that insolvency or intracompany disputes have to be addressed by a centralised forum, be the court or a special forum, which would be more efficient and has complete jurisdiction to efficaciously and fully dispose of the entire matter. They are also actions in rem. Similarly, grant and issue of patents and registration of trade marks are exclusive matters falling within the sovereign or government functions and have *erga omnes* effect. Such grants confer monopoly rights. They are non-arbitrable. Criminal cases again are not arbitrable as they relate to sovereign functions of the State. Further, violations of criminal law are offences against the State and not just against the victim. Matrimonial disputes relating to the dissolution of marriage, restitution of conjugal rights, etc. are not arbitrable as they fall within the ambit of sovereign functions and do not have any commercial and economic value. The decisions have *erga omnes* effect. Matters relating to probate, testamentary matter, etc. are actions in rem and are a declaration to the world at large and hence are non-arbitrable.

72. In *N. N. Global Mercantile Pvt. Ltd.* (*supra*), the Supreme Court once again referred to the illustrations of non-arbitrable disputes as referred to in the case of *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd.* (*supra*) and observed as under:-

“45. The civil aspect of fraud is considered to be arbitrable in contemporary arbitration jurisprudence, with the only exception being where the allegation is

that the arbitration agreement itself is vitiated by fraud or fraudulent inducement, or the fraud goes to the validity of the underlying contract, and impeaches the arbitration clause itself. Another category of cases is where the substantive contract is “*expressly declared to be void*” under Section 10 [“**10. What agreements are contracts.**—All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void. Nothing herein contained shall affect any law in force in India and not hereby expressly repealed, by which any contract is required to be made in writing or in the presence of witnesses, or any law relating to the registration of documents. **11. Who are competent to contract.**—Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind and is not disqualified from contracting by any law to which he is subject.”] of the Contract Act, 1872 where the agreement is entered into by a minor (without following the procedure prescribed under the Guardians and Wards Act, 1890) or a lunatic, which would be with a party incompetent to enter into a contract.

46. The civil aspect of fraud can be adjudicated by an Arbitral Tribunal.”

73. The Court thereafter proceeded to consider whether voidable agreements are arbitrable. The observations are set out below:-

“47. We will now consider whether voidable agreements are arbitrable. Voidable agreements are defined by Section 19 of the Contract Act as:

“**19. Voidability of agreements without free consent.**—When consent to an agreement is caused by coercion, fraud or misrepresentation, the agreement is a contract voidable at the

option of the party whose consent was so caused.

A party to a contract, whose consent was caused by fraud or misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been if the representation made had been true.

Exception.—If such consent was caused by misrepresentation or by silence, fraudulent within the meaning of Section 17, the contract, nevertheless, is not voidable, if the party whose consent was so caused had the means of discovering the truth with ordinary diligence.

Explanation.—A fraud or misrepresentation which did not cause the consent to a contract of the party of whom such fraud was practised, or to whom such misrepresentation was made, does not render a contract voidable.”

In the case of voidable agreements, such disputes would be arbitrable, since the issue whether the consent was procured by coercion, fraud, or misrepresentation requires to be adjudicated upon by leading cogent evidence, which can very well be decided through arbitration. Until it is so proved and upheld as per Sections 2(i) and (j) of the Contract Act, 1872 such an agreement would remain enforceable, and is not void.

48. In *Swiss Timing Ltd. v. Commonwealth Games 2010 Organising Committee* [Swiss Timing Ltd. v. Commonwealth Games 2010 Organising Committee, (2014) 6 SCC 677 : (2014) 3 SCC (Civ) 642] , a Single Judge (exercising powers under Section 11) opined that when a plea is taken to avoid arbitration on the ground of the underlying contract being void, the court is required to ascertain the true nature of the defence. Often,

the terms “void” and “voidable” are used loosely and interchangeably. The court ought to examine the plea by keeping in mind the provisions of the Contract Act, 1872. In cases where the court comes to a conclusion that the contract is void without receiving any evidence, it may be justified in declining the reference to arbitration in a few isolated cases. These would be cases where the court can readily conclude that the contract is void upon a meaningful reading of the contract document itself. However, it would not be permissible to circumvent arbitration where the defence taken is that the contract is voidable, which are cases covered under circumstances mentioned inter alia in Sections 12, 14, 15, 16, 17, 18 of the Contract Act, 1872.

49. Even though *Swiss Timing Ltd.* [*Swiss Timing Ltd. v. Commonwealth Games 2010 Organising Committee*, (2014) 6 SCC 677 : (2014) 3 SCC (Civ) 642] was a decision of a designate of the Chief Justice under Section 11 of the 1996 Act (prior to the Amendment), and would have no precedential value in view of the judgment of this Court in *State of W.B. v. Associated Contractors* [*State of W.B. v. Associated Contractors*, (2015) 1 SCC 32 : (2015) 1 SCC (Civ) 1], the reasoning in *Swiss Timing Ltd.* [*Swiss Timing Ltd. v. Commonwealth Games 2010 Organising Committee*, (2014) 6 SCC 677 : (2014) 3 SCC (Civ) 642] has been cited with approval by this Court in *Avitel Post Studioz Ltd. v. HSBC PI Holdings (Mauritius) Ltd.* [*Avitel Post Studioz Ltd. v. HSBC PI Holdings (Mauritius) Ltd.*, (2021) 4 SCC 713]

50. The ground on which fraud was held to be non-arbitrable earlier was that it would entail voluminous and extensive evidence, and would be too complicated to be decided in arbitration. In contemporary arbitration practice, Arbitral Tribunals are required to traverse through volumes of material in various kinds of disputes such as oil, natural gas, construction industry, etc. The ground that allegations of fraud are not arbitrable is a

wholly archaic view, which has become obsolete, and deserves to be discarded. However, the criminal aspect of fraud, forgery, or fabrication, which would be visited with penal consequences and criminal sanctions can be adjudicated only by a court of law, since it may result in a conviction, which is in the realm of public law.”

[underlined for emphasis]

74. It is clear that fraud as an exception to arbitrability of disputes, which was highlighted in *N. Radhakrishnan* (*supra*) has been diluted by successive judgements rendered subsequently. The said decision has been expressly overruled in *Vidya Drolia* (*supra*). The fraud exception remains but a ghost of what it was considered earlier. It is now settled that the disputes involving allegations of fraud are not *per se* non-arbitrable. It is only the allegations of fraud that fall within the realm of public law (and public law remedies) that cannot be made a subject matter of arbitration. Private disputes, inter se parties are arbitrable. However, fraud that vitiates the arbitration agreement would have a bearing on arbitrability.

75. Having stated the above, there is yet another aspect that is required to be considered and that is, the question as to whether the Court is required to examine the issue of the Agreement being invalid on account of fraud.

76. Undisputedly, if the arbitration agreement is invalid, the Arbitral Tribunal would have no jurisdiction to decide the disputes between the parties. However, the vexed question is whether the Court is, at the referral stage, required to finally determine the same. The said question

can be answered by referring to the opinion of B.N. Srikrishna, J. in ***Shin-Etsu Chemical Co. Ltd. v. Aksh Optifibre Ltd.***: (2005) 7 SCC 234 [hereafter '*Shin-Etsu Chemical Co. Ltd.*'] and the decision of the Supreme Court in ***Vidya Drolia*** (*supra*).

77. The question as to the standards of examination at the stage of referring the parties to arbitration was considered by the Supreme Court in ***Shin-Etsu Chemical Co. Ltd.*** (*supra*) *albeit*, in the context of Section 45 of the A&C Act. In view of the opinion of B.N. Srikrishna, J., the Court was merely required to take a *prima facie* view at the stage of referring the parties to arbitration. The said view would not prevent an arbitrator from trying the issue fully and rendering a final decision. The relevant extract from the opinion of B.N. Srikrishna, J. is set out below:

“74. There are distinct advantages in veering to the view that Section 45 does not require a final determinative finding by the court. First, under the Rules of Arbitration of the International Chamber of Commerce (as in force with effect from 1-1-1998), as in the present case, invariably the Arbitral Tribunal is vested with the power to rule upon its own jurisdiction. Even if the court takes the view that the arbitral agreement is not vitiated or that it is not invalid, inoperative or unenforceable, based upon purely a *prima facie* view, nothing prevents the arbitrator from trying the issue fully and rendering a final decision thereupon. If the arbitrator finds the agreement valid, there is no problem as the arbitration will proceed and the award will be made. However, if the arbitrator finds the agreement invalid, inoperative or void, this means that the party who wanted to proceed for arbitration was given an opportunity of proceeding to arbitration, and the arbitrator after fully trying the issue has found that there is no scope for arbitration. Since the arbitrator's finding would not be

an enforceable award, there is no need to take recourse to the judicial intercession available under Section 48(1)(a) of the Act.

75. The finding of the court that the arbitration agreement is valid, operative and enforceable, if in favour of the party setting up the arbitration agreement, is not appealable under Section 50 as a matter of legislative policy. Refusing to refer parties to arbitration under Section 45, is however, made appealable under Section 50(1)(a) of the Act. Even after the court takes a *prima facie* view that the arbitration agreement is not vitiated on account of factors enumerated in Section 45, and the arbitrator upon a full trial holds that there is no vitiating factor in the arbitration agreement and makes an award, such an award can be challenged under Section 48(1)(a). The award will be set aside if the party against whom it is invoked satisfies the court *inter alia* that the agreement was not valid under the law to which the parties had subjected it or under the law of the country where the award was made. The two basic requirements, namely, expedition at the pre-reference stage, and a fair opportunity to contest the award after full trial, would be fully satisfied by interpreting Section 45 as enabling the court to act on a *prima facie* view.”

78. In ***Vidya Drolia*** (*supra*), the Court held that the courts at a referral stage do not perform a ministerial function. In terms of Section 8 of the A&C Act, the Court is required to refer the parties to arbitration “*unless it finds that prima facie no valid arbitration agreement exists*”. The Court had further explained as under:

“133. Prima facie case in the context of Section 8 is not to be confused with the merits of the case put up by the parties which has to be established before the Arbitral Tribunal. It is restricted to the subject-matter of the suit being prima facie arbitrable under a valid arbitration agreement. Prima facie case means that the assertions on these aspects are

bona fide. When read with the principles of separation and competence-competence and Section 34 of the Arbitration Act, the referral court without getting bogged down would compel the parties to abide unless there are good and substantial reasons to the contrary. [The European Convention on International Commercial Arbitration appears to recognise the prima facie test in Article VI(3): “**VI. (3)** Where either party to an arbitration agreement has initiated arbitration proceedings before any resort is had to a court, courts of contracting States subsequently asked to deal with the same subject-matter between the same parties or with the question whether the arbitration agreement was non-existent or null and void or had lapsed, shall stay their ruling on the arbitrator's jurisdiction until the arbitral award is made, unless they have good and substantial reasons to the contrary.”]

134. Prima facie examination is not full review but a primary first review to weed out manifestly and ex facie non-existent and invalid arbitration agreements and non-arbitrable disputes. The prima facie review at the reference stage is to cut the deadwood and trim off the side branches in straightforward cases where dismissal is barefaced and pellucid and when on the facts and law the litigation must stop at the first stage. Only when the court is certain that no valid arbitration agreement exists or the disputes/subject-matter are not arbitrable, the application under Section 8 would be rejected. At this stage, the court should not get lost in thickets and decide debatable questions of facts. Referral proceedings are preliminary and summary and not a mini trial. This necessarily reflects on the nature of the jurisdiction exercised by the court and in this context, the observations of B.N. Srikrishna, J. of “plainly arguable” case in *Shin-Etsu Chemical Co. Ltd.* [*Shin-Etsu Chemical Co. Ltd. v. Aksh Optifibre Ltd.*, (2005) 7 SCC 234] are of importance and relevance. Similar views are expressed by this Court in *Vimal Kishor Shah* [*Vimal Kishor Shah v. Jayesh Dinesh Shah*, (2016) 8

SCC 788 : (2016) 4 SCC (Civ) 303] wherein the test applied at the pre-arbitration stage was whether there is a “good arguable case” for the existence of an arbitration agreement.”

79. The Supreme Court also approved the principle that the question of non-arbitrability of dispute could be examined finally at a later stage after the arbitral award was rendered.

80. It is relevant to refer to the following extract from the said decision, which sets out the standard of examination at the referral stage:

“154.2. Scope of judicial review and jurisdiction of the court under Sections 8 and 11 of the Arbitration Act is identical but extremely limited and restricted.

154.3. The general rule and principle, in view of the legislative mandate clear from Act 3 of 2016 and Act 33 of 2019, and the principle of severability and competence-competence, is that the Arbitral Tribunal is the preferred first authority to determine and decide all questions of non-arbitrability. The court has been conferred power of “second look” on aspects of non-arbitrability post the award in terms of sub-clauses (i), (ii) or (iv) of Section 34(2)(a) or sub-clause (i) of Section 34(2)(b) of the Arbitration Act.

154.4. Rarely as a demurrer the court may interfere at Section 8 or 11 stage when it is manifestly and ex facie certain that the arbitration agreement is non-existent, invalid or the disputes are non-arbitrable, though the nature and facet of non-arbitrability would, to some extent, determine the level and nature of judicial scrutiny. The restricted and limited review is to check and protect parties from being forced to arbitrate when the matter is

demonstrably “non-arbitrable” and to cut off the deadwood. The court by default would refer the matter when contentions relating to non-arbitrability are plainly arguable; when consideration in summary proceedings would be insufficient and inconclusive; when facts are contested; when the party opposing arbitration adopts delaying tactics or impairs conduct of arbitration proceedings. This is not the stage for the court to enter into a mini trial or elaborate review so as to usurp the jurisdiction of the Arbitral Tribunal but to affirm and uphold integrity and efficacy of arbitration as an alternative dispute resolution mechanism.”

81. In order for the Court to decline the request to refer the parties to arbitration, it would be necessary for the Court to finally conclude that the disputes are not arbitrable. In case of an allegation of fraud, the said decision would necessarily entail the conclusion that the arbitration agreement is invalid or vitiated on that ground. In this context, it is also relevant to refer to the Law Commission’s 246th Report which is substantially the basis for enactment of the Arbitration and Conciliation (Amendment) Act, 2015. Paragraph 32 and 33 of the said Report is set out below:

“32. In relation to the nature of intervention, the exposition of the law is to be found in the decision of the Supreme Court in *Shin-Etsu Chemical Co. Ltd. v. Aksh Optifibre Ltd.* [*Shin-Etsu Chemical Co. Ltd. v. Aksh Optifibre Ltd.*, (2005) 7 SCC 234], (in the context of Section 45 of the Act), where the Supreme Court has ruled in favour of looking at the issues/controversy only prima facie.

33. It is in this context, the Commission has recommended amendments to sections 8 and 11 of the Arbitration and Conciliation Act, 1996. The scope of the judicial intervention is only restricted to situations where the

Court/Judicial Authority finds that the arbitration agreement does not exist or is null and void. In so far as the nature of intervention is concerned, it is recommended that in the event the Court/Judicial Authority is prima facie satisfied against the argument challenging the arbitration agreement, it shall appoint the arbitrator and/or refer the parties to arbitration, as the case may be. The amendment envisages that the judicial authority shall not refer the parties to arbitration only if it finds that there does not exist an arbitration agreement or that it is null and void. If the judicial authority is of the opinion that prima facie the arbitration agreement exists, then it shall refer the dispute to arbitration, and leave the existence of the arbitration agreement to be finally determined by the arbitral tribunal. However, if the judicial authority concludes that the agreement does not exist, then the conclusion will be final and not prima facie. The amendment also envisages that there shall be a conclusive determination as to whether the arbitration agreement is null and void. In the event that the judicial authority refers the dispute to arbitration and/or appoints an arbitrator, under sections 8 and 11 respectively, such a decision will be final and non-appealable. An appeal can be maintained under section 37 only in the event of refusal to refer parties to arbitration, or refusal to appoint an arbitrator.”

82. The decision of the Supreme Court in *N. N. Global Mercantile Private Limited (supra)* has put the aforesaid issue to rest. The court has clearly held that it is only in such cases “*where the court comes to a conclusion that the contract is void without receiving any evidence, it may be justified in declining the reference to arbitration in a few isolated cases*”.

83. In the facts of the present case, there is no dispute that the respondent had entered into the agreement that includes the arbitration

clause. The dispute, essentially, is whether the said agreement is invalid as being part of the fraudulent exercise by the promoters of the respondent to siphon funds from the respondent company. The dispute whether the consent is vitiated on account of fraud, as defined under Section 17 of the Indian Contract Act 1872, and the agreement is voidable under Section 19 of the said Act, is clearly a matter that can be referred to arbitration. The said issue is no longer *res integra* in view of the decision of the Supreme Court in *N.N. Global Mercantile Private Limited* (*supra*).

84. As noted above, an agreement, which is invalid on account of fraud, would undoubtedly have a bearing on the question of arbitrability of the disputes. If the arbitration agreement is invalid, it is obvious that recourse to arbitration would not be available for deciding any dispute. However, unless the Court finally concludes that the arbitration agreement is invalid, it would not be apposite to deny the request to arbitration. As highlighted in the Law Commission's 246th Report, a reference by any judicial authority is required to be made to arbitration if *prima facie* an arbitration agreement exists. However, the conclusion that an arbitration agreement does not exist would be conclusive and not *prima facie*. The Supreme Court also clearly held that where the summary consideration in a summary proceeding would be insufficient and inconclusive, the parties are required to be referred to arbitration. Unless the Court gives a conclusion that *ex facie* the arbitration agreement is non-existent, invalid or the disputes are not arbitrable, the

parties would be referred to arbitration [See: paragraph 154.4 of the decision in *Vidya Drolia (supra)*].

85. It is well settled that an Arbitral Tribunal is also competent to decide the question regarding arbitrability of disputes [See: *Zostel Hospitality Private Limited v. Oravel Stays Private Limited: 2018 SCC OnLine SC 3675* and *Arasmeta Captive Power Company Private Limited and Anr. v. Lafarge India Private Limited: (2013) 15 SCC 414*]

86. As noticed above, in *Vidya Drolia (supra)*, the Court had expressly indicated that at this stage, the Court would be guided in their review to check and protect the parties from being forced to arbitrate when the matter is demonstrably non-arbitrable. The disputes in the present case are required to be examined on the anvil of the aforesaid principles.

87. The allegations of fraud made against the promoters and certain erstwhile officials of the respondent company are serious. The respondent had heavily relied on the order dated 05.03.2020 passed by the NCLT, Mumbai in the petition filed by Union of India, Ministry of Corporate Affairs against the respondent and other individuals, under Section 130 of the Companies Act, 2013 (*C.P. No. 4127 of 2019* captioned *Union of India, Ministry of Corporate Affairs v. C.G. Power and Industrial Solution Ltd. and Anr.*). The petitioner had also relied upon the order dated 11.03.2020 passed by SEBI under Section 19 read with Section 11(1), 11(4) and 11(B) of the Securities Exchange Board

of India Act, 1992. A bare reading of the order dated 05.03.2020 passed by the NCLT, Mumbai indicates that there were nine related party transactions, which were found to be questionable by the Regional Director, Ministry of Corporate Affairs. It is alleged that the amounts receivable by the respondent from various promoters, affiliated company and connected parties was understated and allegedly a sum of ₹2,935.84 crores is receivable. It is alleged that several related party transactions were undisclosed.

88. The NCLT, Mumbai after hearing the parties had observed that there is an internal fight between Mr Gautam Thapar and the present management of the respondent. It also noted that a complaint had been made by the existing management and it had declared the alleged irregularities to various stock exchanges. The NCLT, Mumbai observed that the Government machinery could not be used by either of the disputing parties to settle their scores and a fair and impartial inquiry was required to be conducted. The NCLT, Mumbai also noted that the report submitted by the professional firm engaged by the existing management of the respondent was the sole basis for the Regional Director, Ministry of Corporate Affairs to conclude that there was fraud and irregularities and, the same was required to be corroborated by inspection and investigation by an independent government agency. The NCLT, Mumbai noted that the investigation by SFIO had already been ordered. NCLT, Mumbai further granted the permission to re-open the accounts, with the aforesaid observations and with further direction

that the report of the investigating agency (SFIO) would also be considered while submitting the recast accounts.

89. The thrust of the allegations against the promoters of the respondent company are that they have through various related party transactions siphoned funds, *inter alia*, from the respondent company. SEBI had also issued a confirmatory order dated 11.03.2020, *inter alia*, restraining Mr Gautam Thapar and certain other ex-employees of the respondent from accessing the securities market. The petitioner and other companies have been directed to retain funds to the extent of receivables shown as outstanding to the respondent company. The respondent had been directed to take all necessary steps to recover the amounts due to the respondent company. The said order also notes that notices have been issued by the respondent to the petitioner for recovering an amount of ₹685.31 crores and the petitioner had responded by, *inter alia*, claiming a sum of ₹411.20 crores plus GST of ₹74.01 crores.

90. The petitioner claims the amount, which was agreed to be paid by the respondent as the net present value of the future royalty. The respondent has disputed the claim by contending that the entire transaction is fraudulent and a device to siphon off funds from the respondent company. It is, *inter alia*, claimed that that the agreement is void on account of fraud.

91. *Prima facie*, this Court finds no reason why an Arbitral Tribunal cannot decide the said disputes. It has been held by the Supreme Court

in a number of occasions that an Arbitral Tribunal can decide, what the trial court can adjudicate. In this view, this Court is unable to accept that the present petition is liable to be rejected only on the ground that it involves allegations of fraud.

92. In view of the above, the petition is dismissed. This is not on the ground that the disputes are *per se* not arbitrable but because this court finds that *ex facie*, the disputes fall outside the scope of the Arbitration Clause.

93. The pending application is also disposed of.

DECEMBER 06, 2021
pkv/RK

VIBHU BAKHRU, J



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