

RASHID RAZA V. SADAF AKHTAR 2019 SCC ONLINE SC 1170

Supreme Court of India, **R. F. Nariman**, R. Subhash Reddy and Surya Kant JJ, decided on- 04 September 2019

Arbitrability of fraud; working test contained in Ayyasamy's case

(A) CRIMINAL ACTION (FIR) BY ONE PARTY AND APPLICATION TO APPOINT AN ARBITRATOR BY ANOTHER

Rashid Raza was a partner in a partnership firm by the name of S.R. Coating. Another Partner, Sadaf Raza initiated criminal action against Rashid by filing a first information report (in November 2017) under Section 406, 467, 468, 471, 472, and 420 of the Indian Penal Code. The allegations revolved around siphoning funds, cheating, creating fake agreements.

Rashid invoked the arbitration clause of the partnership deed and applied to the High Court of Jharkhand for appointment of an arbitrator under Section 11 ACA.

(B) THE HIGH COURT—PRINCIPLES LAID IN AYYASAMY DISCUSSED (INCLUDING PARAGRAPH 25), BUT FACTS OF AYYASAMY (APPLIED HERE AT PARAGRAPH 26) DISTINGUISHED AND APPLICATION TO APPOINT ARBITRATOR DISMISSED

The High Court considered the principles set out in *Swiss Timing v. Commonwealth Games*, (2014) 6 SCC 677 and *A. Ayyasamy v. A. Paramasivam*, (2016) 10 SCC 386. It set out paragraphs 14, 15, 18, 23 and 25 of the *Ayyasamy* case. Then it observed referring to paragraph 26 of *Ayyasamy* that according to its ratio, mere allegation of fraud is not a ground to nullify the effect of arbitration agreement between the parties. The court then reproduced the circumstances set in *Ayyasamy's* case when the arbitration clause "can be ignored by the Court."

The High Court then concluded that the allegations of fraud are complicated and can be decided only by a civil court on appreciation of voluminous evidence. Also, it was not a case of mere allegation of fraud simpliciter which could not be a ground to nullify the effect of arbitration agreement between the parties.

The High Court then said: "In ... *Ayyasamy*, the Apex Court has after laying down the principles of law, at para 25 applied these principles to the fact of

the case and concluded⁸ that it did not involve any complex issues which could nullify the arbitration agreement". The High Court then distinguished the facts from Ayyasamy's case and held that the present facts "are much more complex" and "may require voluminous evidence ... which can be only properly undertaken by a civil court of competent jurisdiction".

Rashid now approached the Supreme Court.

(C) THE SUPREME COURT: DISPUTE WAS ARBITRABLE (CONFUSION ABOUT AYYASAMY'S REFERENCE)

The Supreme Court:

- (i) Noted firstly that the High Court cited *Ayyasamy* and in its holding extracted para 26 of *Ayyasamy*.
- (ii) Then secondly said the law laid down in *Ayyasamy* is in para 25 and not in para 26.
- (iii) Thirdly, explained *Ayyasamy* and held that "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.
- (iv) Fourthly, concluded that judging by these two tests, the case fell on the side of "simple allegations" as there is no allegation of fraud, which would vitiate the partnership deed or the arbitration clause. Also, all the allegations pertain to the affairs of the partnership and siphoning off funds and not to any matter in the public domain.

⁸ In *Ayyasamy*, the court's conclusion, after applying the principles laid down at paragraph 25 to the facts of the case, was set out at paragraph 26 as follows: "26. When we apply the aforesaid principles to the facts of this case, we find that the only allegation of fraud that is levelled is that the appellant had signed and issued a cheque of Rs 10,00,050 dated 17-6-2010 of "Hotel Arunagiri" in favour of his son without the knowledge and consent of the other partners i.e. the respondents. It is a mere matter of accounts which can be looked into and found out even by the arbitrator. It does not involve any complex issue. If such a cheque is issued from the hotel account by the appellant in favour of his son, it is easy to prove the same and then the onus is upon the appellant to show as to what was the reason for giving that amount from the partnership firm to his son and he will have to account for the same. Likewise, the allegation of the respondents that daily collections are not deposited in the bank accounts is to be proved by the respondents which is again a matter of accounts."