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CASE BRIEF

Avitel Post Studioz Limited & Ors. v. HSBC PI Holdings (Mauritius) Limited

Case No.	**Civil Appeal Nos. 5145 and 5158 of 2016**
Citation	**2020 SCC OnLine SC 656**
Date	**19 August 2020**
Court	**Supreme Court of India**
Coram	**R. F. Nariman J., Navin Sinha J.**

1. Facts

2011 HSBC entered into a Share Subscription Agreement ('**SSA**') and Shareholder's Agreement ('**SHA**') with Avitel, both of which contained identical SIAC arbitration clauses, to acquire Avitel's 7.8% shares for an amount of USD 60 million.
This investment was based upon Avitel's warranty and representation that it was at an advanced stage of finalising a contract with the British Broadcasting Corporation ('**BBC**') which had the potential to generate revenue upto USD 1 Billion in future.

2012 HSBC grew suspicious of the Avitel's business and plans, and hence, appointed Ernst & Young and KPMG Dubai ('**Investigating Agencies**') to inquire into its business activities.
The discoveries by the Investigating Agencies indicated the purported BBC contract, was non-existent and only a ploy to induce HSBC to make the investment. Further, it was also learnt that a huge portion of the investment money had been siphoned off to companies connected with the promoter group of Avitel.

2012 HSBC sent notices of arbitration to the Singapore International Arbitration Centre ('**SIAC**') and sought urgent relief in the emergency arbitration proceedings.
An Emergency Arbitrator was appointed, who passed two interim awards ('**Interim Awards**') in favour of HSBC, directing Avitel to refrain from disposing and diminishing its assets less than USD 50 million.

2012 HSBC filed a Petition under section 9 of the Arbitration Act 1996 ('**1996 Act**') before the Single Judge bench of Bombay High Court, seeking interim relief for directions to call upon Avitel to deposit a security amount of USD 60 million to secure the dispute amount in arbitration.
As such, the court passed an interim order ('**Order 1**') in favor of HSBC, directing to freeze Avitel's bank accounts.

2012 At the same time, Avitel challenged the jurisdiction of SIAC's 3-member Arbitral Tribunal and the Arbitral Tribunal was pleased to pass a unanimous final partial award on jurisdiction, dismissing Avitel's jurisdictional challenge.

2013 Meanwhile, HSBC filled a criminal complaint against Avitel with the Economic Offences Wing ('**EOW**'), Mumbai. A closure report in this respect was filled before the Magistrate in Mumbai.

Dissatisfied, HSBC filled a protest petition against the closure report, which was dismissed by the Magistrate. HSBC's challenge against the said dismissal is still pending before the Bombay High Court.

2014 The Single Judge bench of Bombay High Court, with the observations, that HSBC has a good chance of success in the final arbitral proceedings, passed an order ('**Order 2**'), in furtherance of the Order 1, and directed Avitel to deposit any shortfall amount from the USD 60 Million.

2014 Aggrieved, Avitel preferred an appeal an under section 37 of the 1996 Act against the Order 2, before the Division Bench of Bombay High Court. The Division Bench passed an order ('**Order 3**') holding that since Singapore law governs the arbitration agreement, the question of arbitrability should be decided with reference to Singapore law. And refused to interfere with the findings of the Single Judge. However, the court reconsidered the actual damages to which HSBC may be entitled and eased the deposit to be made by Avitel i.e. USD 60 Million to USD 30 million.

2014 Finally, the SIAC Arbitral Tribunal rendered the final award ('**Final Award**') in favor of HSBC and held that Avitel is guilty of fraudulent misrepresentation and legally responsible to indemnify HSBC on account of fraud played, to amount of USD 60 million along with interest.

2015 Aggrieved by the Final Award, Avitel challenged the same before Bombay High Court under section 34 of the 1996 Act. However, the court dismissed the petition as not maintainable. Avitel's appeal under section 37 of the 1996 Act against this order was also rejected.

2015 To enforce the Final Award, HSBC moved the Bombay High Court in accordance with section 48 of the 1996 Act, and such enforcement proceedings are pending.

2017 The Hon'ble Supreme Court finally heard the appeals and cross appeals filed by the parties against Order 3 passed by the Division bench of the Bombay High Court.

2. Avitel's Contentions

2.1 Avitel's submitted that under Indian law, if a transaction between the parties involves a serious criminal offence, such as forgery and impersonation, then such dispute would not be arbitrable. It was also submitted that arbitrability of fraud needs to be determined under Indian law and not the Singapore law in section 9 proceedings. It was further argued that the Division Bench of the Bombay High Court had relied upon a Single Judge judgment of the Supreme Court reported as *Swiss Timing Ltd. v.*

Commonwealth Games 2010 Organising Committee, (2014) 6 SCC 677 (‘**Swiss Timing’**) which had erroneously held the two judges bench judgment in *N. Radhakrishnan v. Maestro Engineers, (2010) 1 SCC 72* (‘**N. Radhakrishnan’**) as *per incuriam.*

2.2 It was also contended that in enforcement proceedings in India, the gateways of section 48 of the 1996 Act have to be met. “The public policy of India” is contained in the judgments of this Court regarding serious allegations of fraud made in arbitral proceedings, and if HSBC cannot pass this gateway, then enforcing a foreign award in India would not be possible. It was from this prism that a prima facie case had to be made out under section 9 of the 1996 Act.

2.3 Avitel also sought to raise an issue of bias of the Chairman of the SIAC Tribunal alleging that HSBC was a client of the firm to which Chairman of the Arbitral Tribunal belongs. Further, it also claimed that the award was insufficiently stamped.

2.4 Lastly, Avitel argued, that despite the recommendations of the 246th Law Commission Report that a section 16(7) needs to be incorporated in the 1996 Act so as to do away with the ratio of N. Radhakrishnan judgement, the Parliament thought fit to not include such a section, thereby implying that even today the N. Radhakrishnan judgement holds water.

3. HSBC’s Contentions

3.1 HSBC countered the arguments relying upon various judgements on the issue of fraud and arbitrability, starting with three judge bench decision in *Rashid Raza v. Sadaf Akhtar, (2019) 8 SCC 710* (‘**Rashid Raza**’), which explained the judgement in *A. Ayyasamy v. A. Paramasivam, (2016) 10 SCC 386* (‘**Ayyasamy**’), which elucidates two situations when serious allegations of fraud are non-arbitrable in nature.

3.2 HSBC then referred to the Final Award, which records that Avitel not only impersonated and fraudulently misrepresented but also siphoned off the investment amount. Hence, these issues are predominantly to be decided inter-parties and the fraud alleged does not have any public flavour.

3.3 Regarding the issue of bias, HSBC contended that this is not the appropriate stage and forum to deal with this issue and the same shall be addressed in the enforcement proceedings pending under section 48 before the Bombay High Court. Furthermore, the Final Award was a unanimous award by the 3-member Arbitral Tribunal, hence the Chairman could not be understood as biased.

3.4 Regarding the issue of award being insufficiently stamped, HSBC submitted that issue was being raised for the first time, that too without any pleading by Avitel. Thus, in the interest of justice and in absence of any opportunity being provided to HSBC to rebut the claim, the same ought to be disregarded.

3.5 Lastly, HSBC supported the Order 1 in toto, and argued that the Division Bench ought not to have reduced the security deposit from USD 60 million to USD 30 million, without any cogent reasoning.

4. Issues Involved

4.1 The Hon'ble Supreme Court observed that only real question that needs to be addressed in the section 9 proceedings is the extent to which HSBC could be said to have a strong *prima facie* case in the enforcement proceedings under section 48 which are pending before the Bombay High Court.

4.2 If so, whether irreparable prejudice would be caused to HSBC if protective orders were not issued in its favour, and generally, whether the balance of convenience tilts in its favour and to what extent.

5. Judgement by the Supreme Court

5.1 The Hon'ble Supreme Court accepting the contention of Avitel held that the prima facie case in the present matter would necessarily depend upon what is the substantive law in India qua arbitrability when allegations of fraud are raised by one of the parties to the arbitration agreement. The Court then proceeded to analyse all the relevant judicial precedents on the issue of arbitrability of fraud.

5.2 In *Abdul Kadir Shamsuddin Bubere v. Madhav Prabhakar Oak, [1962] 3 SCR 702* ('**Abdul Kadir**'), a matter under the Arbitration Act 1940 ('**1940 Act**') which was repealed by the 1996 Act, the Supreme Court held -

> *"the Court will, in general, refuse to send a dispute to arbitration if the party charged with fraud desires a public inquiry, but where the objection to arbitration is by the party charging the fraud, the Court will not necessarily accede to it, and will never do so unless a prima facie case of fraud is proved."*
>
> *"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. But it is not every allegation imputing some kind of dishonesty, particularly in matters of accounts, which would be enough to dispose a court to take the matter out of the forum which the parties themselves have chosen"*.

5.3 In an English judgment, *Charles Osenton & Co. v. Johnston, 1942 A.C. 130* ('**Charles**') where assertion of fraud against a party in respect of entries in accounts were made, the Court held –

> *"It seems to us that every allegation tending to suggest or imply moral dishonesty or moral misconduct in the matter of keeping accounts would not amount to such serious allegation of fraud as would impel a court to refuse to order the arbitration agreement to be filed and refuse to make a reference."*

5.4 In N. Radhakrishnan judgement, allegations were made against the respondents pertaining to certain malpractices in the books of account of the company. The Supreme Court ostensibly relying on the jurisprudence laid down in Abdul Kadir judgement, dismissed the application under section 8 of the 1996 Act to refer the parties to arbitration holding that the matter was not capable of settlement by arbitration due to allegations of fraud. However, the judgment in N. Radhakrishnan failed to consider the earlier relevant judgment in *Hindustan Petroleum Corporation Ltd. Pinkcity Midway Petroleums, (2003) 6 SCC 503* ('**Hindustan**') relating to section 8 of the 1996 Act and principles under section 5 and 16 of the 1996 Act.

5.5 In *Afcons Infrastructure Ltd. Cherian Varkey Construction Co. (P) Ltd., (2010) 8 SCC 24* ('**Afcons**'), the Supreme Court had an occasion to discuss categories of cases that are normally considered to be not suitable for ADR process having regard to their nature. It was thus observed that such cases include "*cases involving serious and specific allegations of fraud, fabrication of documents, forgery, impersonation, coercion, etc*.", and "*cases involving prosecution for criminal offences.*"

5.6 In *Booz Allen & Hamilton Inc. v. SBI Home Finance Ltd., (2011) 5 SCC 532* ('**Booz Allen**'), the Supreme Court held, the proceedings *in rem*, such as in a mortgage suit, would not be arbitrable and only such proceedings which entailed rights *in personem* may be settled through arbitration. The court set forth six kinds of disputes, which are non-arbitrable in nature, including *disputes relating to rights and liabilities which arise out of criminal offences*. The Hon'ble Supreme Court observed at paragraph 15 of the judgment that the judgments in Afcons and Booz Allen made broad statement of the law and required to be explained in light of subsequent decisions on the subject.

5.7 A new seventh kind, was added by the *Vimal Kishor Shah v. Jayesh Dinesh Shah, (2016) 8 SCC 788* ('**Vimal Kishor Shah**'), for disputes arising in respect of trust deeds governed by the Trusts Act, 1882 ('**1882 Act**').

5.8 The Supreme Court carefully analysed the Swiss Timing judgement and observed that though Swiss Timing was not a binding precedent, its reasoning has "*strong persuasive value which the court is inclined to adopt*". After analysing sections 5, 8 and 16 of the 1996 Act, as well as section 20, 35 of the 1940 Act, it was held –

> "*As against this, sections 5, 8 and 16 of the 1996 Act reflect a completely new approach to arbitration, which is that when a judicial authority is shown an arbitration clause in an agreement, it is mandatory for the authority to refer parties to arbitration bearing in mind the fact that the arbitration clause is an agreement independent of the other terms of the contract and that, therefore, a*

decision by the arbitral tribunal that the contract is null and void does not entail ipso jure the invalidity of the arbitration clause."

5.9 The Court then proceeded to discuss the leading Ayyasamy judgement and referred to the opinion of Sikri J. in detail and where court discussed the need for a meticulous inquiry when allegations of fraud are raised –

> *"those cases where there are serious allegations of fraud, they are to be treated as non-arbitrable and it is only the civil court which should decide such matters. However, where there are allegations of fraud simpliciter and such allegations are merely alleged, we are of the opinion that it may not be necessary to nullify the effect of the arbitration agreement between the parties as such issues can be determined by the Arbitral Tribunal.*
> ...
> *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."*

The Court also referred to Chandrachud J's separate concurring opinion and observed that Chandrachud J. had "*cautioned against the use of N. Radhakrishnan as a precedent and distinguished it*"

5.10 The Court also referred to the judgment in *Ameet Lalchand Shah v. Rishabh Enterprises,* (2018) 15 SCC 678 where relying on Ayyasamy judgment, the court rejected the argument that allegations of misrepresentation and inducement to pay higher price could not be arbitrated.

5.11 Pertinently, referring to the Rashid Raza judgement, the Supreme Court observed that two working tests were laid down in paragraph 25 of the Ayyasamy judgement to check the arbitrability of a dispute where serious allegations of fraud are made by a party, that whether –

i. the plea permeates the entire contract and above all, the agreement of arbitration, rendering it void; or
ii. the allegations of fraud touch upon the internal affairs of the parties, inter se, having no implication in the public domain.

The Supreme Court emphatically noted that "*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*"

5.12 As such, R.F. Nariman J. speaking for the bench observed that:

- 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 malafide 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.

5.13 It was expressly clarified that paragraph 27(vi) of Afcons judgment and paragraph 36(i) of Booz Allen judgment must now be read subject to the rider that the same set of facts may lead to civil and criminal proceedings. Furthermore, 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.

5.14 Referring to *Fazal D. Allana v. Mangaldas M. Pakvasa, AIR 1922 Bom 303* ('**Fazal**'), the Court explained that fraud can be of two types, those where the –

i. contract is obtained by fraud (formation issue); and
ii. performance of a contract (which is perfectly valid) being vitiated by fraud or cheating.

The latter, it was observed, would fall outside the scope of the Contract Act and the remedy for damages would be available under the law of tort or deceit, but not the remedy to treat the contract itself as being void. However, both the situations would be arbitrable and jurisdiction of arbitral tribunal is not ousted.

5.15 The Court then discussed the precedents pertaining to measure of damages for fraudulent misrepresentation when a party to the contract is induced to enter the contract. Referring to the House of Lords judgement *in Doyle v. Olby (Ironmongers) Ltd., [1969] 2 All ER 119 (Queen's Bench)* ('**Doyle**'), the facts of which were similar to the dispute between Avitel and HSBC, the Court summarised the 'date of transaction rule', which explains –

> *"in cases of fraudulent misrepresentation, there is only one and not two alternative measures of damages, namely, the loss truly suffered by the party affected who must be put back in the same place as if he had never entered into the transaction."*

5.16 After this detailed analysis, the Court proceeded to evaluate the Final Award, which found that most of the representations made by the Avitel were with a deliberate and dishonest intention to induce HSBC for an investment, and not only that, Avitel thereafter siphoned off the large amount of this investment into their personal bank accounts. Thus, as a result thereof, HSBC in respect of its claim for fraudulent misrepresentation was awarded damages to the total amount of USD 60 million along with interest.

5.17 Finally, the Court opined that the issues raised have a civil profile inter se the parties and criminal proceedings have no bearing and held –

- *First,* the fraud in the present case, is not of such nature, as would vitiate the arbitration agreement entered between the parties, as it must be read as an independent clause. Further, any finding that the contract itself is either null and void or voidable because of fraud or misrepresentation does not entail the invalidity of the arbitration clause, which is extremely wide.
- *Second,* the impersonation, false representations made, and diversion of funds done by the Avitel, have no "public flavour", hence the dispute is arbitrable.

5.18 Further, the Court held that HSBC is entitled to recover the price paid for the shares and all other consequential losses. Hence, the Order 3 by the Division Bench of the Bombay High Court to reduce the deposit from USD 60 million to USD 30 million, was not acceptable as it was based on an erroneous assessment of damages. Ultimately, the Court also held that the balance of convenience lies in favour of HSBC, and it was successful in building a prima facie case against Avitel.

6. PSL Opinion

This judgment has deftly plugged the interpretational lacunae that surrounded the issue at hand and provides much needed clarity with respect to arbitrability of disputes involving serious allegations of fraud in domestic arbitrations as well as India seated international arbitrations. Pertinently, such disputes are arbitrable in foreign seated arbitrations as held by the Supreme Court in *World Sport Group (Mauritius) Ltd v MSM Satellite (Singapore) Pte Ltd,* AIR 2014 SC 968 ('**World Sport**').

The Supreme Court's endeavour to iron out the creases that remained after the Rashid Raza judgment and lucidly expound objective tests to determine arbitrability of serious/complex fraud is commendable. This judgment goes a long way in augmenting India's pro arbitration regime and bring it in consonance with international best practices by giving due deference to the cardinal principles of competence-competence and separability. From a practical perspective, this judgment will ensure that frivolous and vexatious pleas of fraud by a party with an intent to wriggle out of the arbitration agreement are rejected. It will also obviate and eliminate moonshine pleas of serious fraud made with an oblique motive to scuttle or derail arbitration proceedings as an afterthought.