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Binding Non-Signatories to Arbitration Agreement

December 15, 2018

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GOVERNING LAW

SECTION 7

Arbitration agreement.—(1) In this Part, “arbitration agreement” means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

(2) An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

(3) An arbitration agreement shall be in writing.

(4) An arbitration agreement is in writing if it is contained in—

(a) a document signed by the parties;

(b) an exchange of letters, telex, telegrams or other means of telecommunication ¹ [including communication through electronic means] which provide a record of the agreement; or

(c) an exchange of statements of claim and defence in which the existence of the agreement is alleged by one party and not denied by the other.

(5) The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract

**Cheran Properties Limited v.
Kasturi & Sons Limited & Ors.
(2018) 16 SCC 413**

BRIEF FACTS

- Sporting Pastime India Limited (Respondent No 2. “**SPIL**”), a wholly owned subsidiary of Kasturi & Sons Limited & Ors (Respondent No. 1, “**KSL**”) entered into an agreement with KC Palaniswamy (“**KCP**”) and Hindcorp Resorts Pvt. Ltd. (**Hindcorp**) for transfer of shares to KCP or his nominees. Cheran Properties Limited (“**Cheran**”), a nominee of KCP received 95% of the shares pursuant to said agreement.
- A dispute arose between the parties and arbitration was invoked. Cheran, which was recipient of 95 % of shares, however was neither a party to the main agreement containing Arbitration Clause or nor made a party in the arbitration proceedings. The arbitral award directed KCP and SPIL to return the documents of title and share certificates to KSL and KSL would have to simultaneously return to KCP an amount of Rs. 3,58,11,000/-.
- Further KSL also initiated proceedings under Section 111 of the Companies Act, 1956 for rectification of register of SPIL before National Company Law Tribunal (“**NCLT**”) to give effect to the arbitral award which was opposed by Cheran. The petition was allowed by NCLT and appeal was filed by Cheran before the National Company Law Appellate Tribunal, (“**NCLAT**”). The Appeal was dismissed by the NCLAT following which the proceedings moved to the Supreme Court by way of Civil Appeal.

ISSUES

1. Whether the Arbitration Award is applicable to the Appellant who was neither a party to the Agreement containing Arbitration Clause nor a party to the Arbitral Proceedings?
2. Whether the proceedings for enforcement of the Arbitral Award *vide* a petition before the Hon'ble National Company Law Tribunal (NCLT) were maintainable?

JUDGMENT OF THE COURT

- With regards to the first issue the Apex court relied on the case of Chloro Controls Pvt Ltd v. Severn Trent Water Purification Inc. [(2013) 1 SCC 641] which applied the English doctrine of ‘Group of Companies’. According to this doctrine an arbitration agreement entered into by a company which is a part of a group of companies would become binding on the non-signatory companies as well, if the mutual intention of the parties to bind both the signatory and non-signatory companies is established. In holding a non-signatory party bound by arbitration agreement factors such as relationship of a third party to the signatory party, commonality of subject matter and composite nature of transaction are to be taken into account.
- The court further observed that Section 35 of the Arbitration and Conciliation Act, 1996 made an arbitral award binding on parties as well as persons claiming under such parties.
- Since KCP transferred its shares to its nominees on the express condition that they would abide by the terms of the shares transfer agreement and Cheran being a nominee of KCP and KCP being bound by the share transfer agreement – Cheran would be given the same position as that of KCP and hence Cheran as a party claiming under KCP would be bound by the Arbitration Agreement and Section 35.
- With regards to the second issue the Court opined that the enforcement of the award required transmission of shares back to KSL which could only be done by the rectification of the register of SPIL. The Court referred to the case of Sundaram Finance Limited v. Abdul Samnad [(2018) 2 SCALE 467], whereby it was held that the proceeding for enforcement of arbitral award could be initiated anywhere in the country where the assets of the judgment debtor was located. In order to actually give effect to the arbitral award by rectifying the register of SPIL under section 111 of the Companies Act, 1956 KSL had to approach NCLT. Therefore the proceedings before NCLT were maintainable.

ANALYSIS

The analysis of the judgment can be essentially done in two parts:

- Firstly, the use of the English Doctrine of ‘Group of Companies’ in the given case has been used to pierce the corporate veil in order to ascertain the actual intention of the parties. It is important to determine as whether the actual intention of the parties was to bind someone who is not formally a signatory and whether such non-signatory parties gave implied consent to be bound by such arbitration agreement irrespective of their formal status as non-signatories.
- In the present context it is pertinent to note that while a non-signatory party may become bound by the arbitration agreement, in actuality there exists no arbitration agreement between such parties as mandated by Section 7 of the Arbitration and Conciliation Act, 1996.
- The dispensation of a separate arbitration agreement or arbitration clause binding such non-signatory parties implies the over riding effect of the a judicial decision over an essential statutory requirement. Moreover, no relevant criteria for determination of the circumstances which would make an arbitration agreement applicable on third party has been laid down in the above case.
- Secondly, on question of maintainability of the proceedings before the NCLT the Supreme Court of India answered in the affirmative. The Court in giving substantive powers to the NCLT has established its pro arbitration attitude. Widening the scope of the Sundaram Finance Case [(2018) 2 SCALE 467] the court has further conferred tribunals (in this case the NCLT) with the power to enforce the arbitral award. Therefore the parties can initiate proceedings not only before any of the courts of the country but before NCLT as well.
- However this decision has only dealt with the aspect of share transfer and the decision is silent about any other aspect. Thus the question remains to be answered as to whether the proceedings for enforcement of arbitral award can only be filed before NCLT or it can be filed before any other relevant tribunal(s) as per the facts and circumstances of the case.

CONCLUSION

The present case has opened doors to a new domain for facilitating arbitration. Setting forth precedent, an arbitration agreement can be made binding on a non-signatory, if the intention to bind both signatory and non-signatory parties can be established. However, the burden of proving the intention to consent is on the applicant. Establishment of Intention plays a very important role in such cases. Further in the present case the Court while expanding the scope of Sundaram Finance case upheld the proceedings for enforcement of arbitral award before NCLT. Perhaps the most important outcome of this case was the use of the 'Group of Companies' doctrine to understand the actual intention of the parties to bind the signatories and non-signatories to the arbitration agreement and the conferring NCLT with substantive powers to enforce an arbitral award. However this judgment is not bereft of certain lacunas like absence of an arbitration agreement as mandated by section 7 of the Arbitration and Conciliation Act, 1996 or the powers of other tribunals apart from NCLT to enforce arbitral award. However the futurity of the judgment remains to be seen.

THANK YOU