

# Dispute Resolution Hotline

June 26, 2020

## SIGNATORY OR NOT – A GROUP OF COMPANIES CAN BE REFERRED TO ARBITRATION, RULES DELHI HIGH COURT

### INTRODUCTION

In the recent case of *Magic Eye Developers Pvt. Ltd. ("Plaintiff") v. Green Edge Infra Pvt. Ltd. & Ors. ("Defendants")*<sup>1</sup>, the High Court of Delhi ("Court") considered whether non-signatories to an arbitration agreement are amenable to arbitration under Section 8 of the Arbitration & Conciliation Act, 1996 ("A&C Act"), by applying the *group of companies* doctrine.

### FACTS

The Plaintiff entered into a business relationship with the Defendant No. 1 through execution of several agreements namely a Shareholders Agreement dated 4th July 2012, ("SHA"), Share Purchase Agreement dated 24th July 2013 ("SPA") and Memorandum of Understanding ("MOU"). The Defendant No. 1 was required to render services to the Plaintiff, including but not limited to arrangement of necessary and applicable licenses for launching a real estate project in Gurgaon. As part of the composite transaction, the Plaintiff company advanced a sum of INR 8,00,00,000 to the Defendant No. 1. Of the said amount, an amount of INR 5,20,00,000 was advanced as a short term loan to Mr. S.K. Hooda (the erstwhile managing director of the Defendant No. 1 company).

Breach of contractual obligations by Defendant No.1 resulted in delays in launch of the project. The Plaintiff filed a commercial suit in the High Court of Delhi, claiming recovery of loan, along-with damages for breach of contract, loss of reputation and loss of business opportunity. Additionally, the Plaintiff alleged that Defendant No. 1 was a sham company used by Mr. S.K. Hooda's family, alongwith other front companies namely Defendants Nos. 2 and 3, to launder and siphon away money advanced by way of loan and other borrowings from companies such as that of the Plaintiff and members of the public. It was also alleged that there were several FIRs and criminal investigations filed against Mr. S.K. Hooda and that he had been arrested by the Economic Offences Wing.

The Defendant No. 1 filed an application under Section 8 of the A&C Act, and prayed for reference of disputes to arbitration under the SHA, SPA and MOU. It was averred that the said agreements are interconnected and cover the subject matter of the suit. Defendant Nos. 2 and 3 filed written statements and objected to being impleaded in the commercial suit.

### ISSUES

The High Court dealt with the following issues:

1. Whether or not the claim is capable of settlement by arbitration in light of the Plaintiff's twin-claim for recovery and damages?
2. Whether Defendant Nos. 2 & 3 can be made amenable to arbitration despite being non-signatories to the arbitration agreement(s)?

### JUDGMENT

#### Bifurcation of Reliefs

The Plaintiff contended that in addition to recovery of the loan, the Plaintiff had also claimed damages for which there was no arbitration agreement between the parties. The Plaintiff relied on the decision in *Sukanya Holdings Pvt. Ltd. vs. Jayesh H. Pandya*<sup>2</sup> and stated that since the reliefs claimed under the suit could not be bifurcated, the parties could not be referred to arbitration. The Court rejected the argument and held that the claim for damages was based on the failure of Defendant No.1 to perform its contractual obligations under the various agreements. This was an arbitrable dispute duly governed by arbitration clauses under the various agreements. As such, the two reliefs were not required to be bifurcated and could be decided by arbitration.

#### Group of Companies Doctrine

The Plaintiff claimed that since the disputes involved third parties such as Defendant Nos. 2 and 3 who were not signatory to the various agreements, the disputes could not be referred to arbitration.

The Court referred to the seminal decision of the Supreme Court of India ("Supreme Court") on the *group of companies* doctrine, in the case of *Chloro Controls India (P) Ltd. Vs. Severn Trent Water Purification Inc*<sup>3</sup>. It reiterated that a non-signatory or third party could be subjected to arbitration without their prior consent, but this would only be in exceptional cases. The court will examine these exceptions from the touchstone of direct relationship to the party signatory to the arbitration agreement, direct commonality of the subject matter and the agreement between the parties being a composite transaction.<sup>4</sup>

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The Court also relied upon the Supreme Court's decision in *Cheran Properties Limited vs Kasturi & Sons*

*Limited*<sup>6</sup> wherein the Supreme Court acknowledged that there may be transactions within a group of companies. The circumstances in which they have entered into them may reflect an intention to bind both signatory and non-signatory entities within the same group.<sup>6</sup>

The Court stated that the evolving body of academic literature as well as adjudicatory trends indicated that in certain situations, an arbitration agreement between two or more parties may operate to bind other parties as well. Relying on the requirement of an arbitration agreement to be in writing, the Court quoted from legal authorities such as Redfern and Hunter on International Arbitration, to state that the requirement of an agreement to arbitrate in writing *inter alia* does not exclude the possibility of an arbitration agreement concluded in proper form between two or more parties also binding other parties. This could be by operation of the *group of companies* doctrine, or by operation of law such as agency, assignment, agency or succession.<sup>7</sup>

After expounding on the above principles, the Court considered the Plaintiff's averments to the effect that Defendant Nos. 1, 2 and 3 belonged to the Hooda family. As such, the Plaintiff had itself averred that the Defendants formed a group of companies. Additionally, the Court noted the pleadings of Defendant Nos. 2 and 3. In response to the cause of action in the Plaintiff (whereby the Plaintiff stated that the subject matter of the suit cannot be referred to arbitration as there is no provision for splitting the cause or the parties), the Defendant Nos. 2 and 3 had simply rebutted the said paragraph as 'denied for want of knowledge and that it did not pertain to defendant Nos.2 and 3'. Further, during the course of arguments, the Defendant Nos.2 and 3 did not oppose the plea of Defendant No.1 to the effect that disputes should be referred to arbitration.

The Court held that from the intent of the parties as noticed from the various agreements, as also the averments in the plaint and the arguments, it was evident that not only would Defendant No.1 but also the Defendant Nos. 2 and 3 were amenable to arbitration. The Court accordingly referred all parties to arbitration.

## ANALYSIS

Indian courts have been called upon several times to consider amenability of non-signatory parties to arbitration. An oft-faced question by courts as well as arbitrators is - whether an arbitration agreement signed by an entity belonging to a group of companies can be extended to include other entities in the group. Since companies have separate legal entities, it could be difficult to argue that one or more separate legal entities be treated as a single entity under a group of companies, for the purposes of jurisdiction. However, this may not be strictly impossible.

Several factors need to be considered by court and arbitrators when a claim relates to entities in a group of companies. For instance, a party attempting to claim against non-signatories in an arbitration could demonstrate that the relevant group of companies can be considered to be 'one and the same economic reality'. This can be done in various ways such as by establishing that a parent company owns all the shares of the subsidiaries, such that it can control every movement of the subsidiaries. Parties can demonstrate that performance under an agreement with a group entity is intrinsically linked with performance by another non-signatory group entity. In some circumstances, involvement of an entity in negotiation of the agreement could also be considered as a tacit agreement by the non-signatory party to be bound by the agreement. Several factors need to be demonstrated before a party can pierce the corporate veil to locate the "true" party in interest and to target the creditworthy member of a group of companies.

In contradistinction, a party resisting a claim to involve its sister entities could demonstrate under some circumstances that the involvement of the sister entity had no bearing on performance under the agreement, and its involvement was merely ancillary to the main agreement. One could plead that there are not enough circumstances to look at the economic entity of the whole group and ignore the separate legal entities of various companies within a group. Through all factors and circumstances, a party needs to either prove (or disprove) a common thread of intention that runs between the signatories and the non-signatories to be bound by the agreement. Consent of parties, express or implied, therefore plays a pivotal role in either fortifying or dismantling a claim under the *group of companies* doctrine.

The present judgment expounds on the principles underlying application of *group of companies* doctrine. However, it throws sparse light on the circumstances that led the Court to refer the non-signatories to arbitration in the case at hand. The Plaintiff's averred that Defendant Nos. 2 and 3 siphoned off loan advanced by Plaintiff to Defendant No. 1, and that they belonged to a group of companies operated by the Hooda family. However, the judgment does not cull out circumstances to connect the Defendant Nos. 2 and 3, or demonstrate their involvement or intention to be bound, by the various agreements (although the Court merely stated that intent of the parties could be noticed from the agreements).

Additionally, the Court relied on inadequacies in the pleadings and arguments of Defendant Nos. 2 and 3 in response to reference of disputes to arbitration. While this may be considered as a win on technicality, in substance, this may not be adequate to apply the group of companies doctrine. Circumstances must be spelt out clearly to connect the non-signatory entities in the group with the subject transaction, as also to demonstrate an objective intention of non-signatory parties to be bound by the subject agreement.

The group of companies doctrine is an exception to the rule of privity of contract i.e. the arbitration agreement between parties. It is also an exception to Section 7 of the A&C Act that an arbitration agreement must be in writing, thereby being enforceable only against parties who are signatories to the agreement. Therefore, application of the group of companies doctrine to non-signatories must be made only when certain circumstances (some referred above) are demonstrated that can pull the separate signatory and non-signatory entities into a 'single economic reality'. It may also help to be cautious of contradictory pleadings and arguments. After all, adversarial dispute resolution is not a matter of mere substance, but also of constructive pleading and court craft.

– Kshama Loya Modani & Moazzam Khan

You can direct your queries or comments to the authors

<sup>1</sup> CS(COMM) 1290/2018

<sup>2</sup> 2003 (5) SCC 531

<sup>3</sup> (2013) 1 SCC 641

<sup>4</sup> Ibid. para 73

<sup>5</sup> 2018 (16) SCC 413

<sup>6</sup> Ibid. para 23

<sup>7</sup> Redfern and Hunter on International Arbitration, 5th Edn., 2.13, pages 89-90

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