

Dispute Resolution Hotline

May 11, 2010

ENTITY NOT A PARTY TO AN ARBITRATION AGREEMENT NOT BOUND BY ARBITRATION CLAUSE

Supreme Court of India decides that an entity not a party to arbitration agreement is not bound by arbitration clause in the agreement

INTRODUCTION:

The Hon'ble Supreme Court of India in the case of *Indowind Energy Ltd. ("Appellant") vs. Wescare (I) Ltd. ("Respondent no.1") & Subuthi Finance Ltd. ("Respondent no.2")*¹ held that the third party to the arbitration agreement is not bound by arbitration clause in the agreement and also made an important observation that in a proceeding under Sec. 11 of the Arbitration & Conciliation Act, 1996 (hereinafter "**the Act**"), the High Court is not permitted to hold that a party is a *prima facie* party to an arbitration agreement but has to pass a final decision as to who are the parties to arbitration agreement. The Hon'ble Supreme Court categorically stated that once the High Court renders a decision under Sec. 11 of the Act holding that there is an arbitration agreement between the parties, it will not be permissible for the arbitrator to consider or examine the same issue and record a finding contrary to the finding recorded by the High Court.

FACTS OF THE CASE:

The Respondent no. 2 was the promoter of Appellant. Respondent no.2 entered into an Agreement with Respondent no.1 for sale of certain business assets belonging to Respondent no.1 for consideration partly in cash and partly in shares. Though Appellant was not a party to the Agreement. Respondent No.2 was described as "promoters of Indowind Energy Ltd." in the Agreement."

This Agreement consisted of an arbitration clause in reference to disputes arising between the parties under the Agreement. Certain dispute arose between Appellant and Respondent no.1 under the Agreement. Respondent no.1 proceeded to file an application for the appointment of an Arbitrator under Section. 11 of the Act before the Hon'ble Madras High Court making Appellant a party. Appellant challenged the said application claiming that since it was not a party to the Agreement therefore it was not bound by any arbitration clause.

The Hon'ble Madras High Court rejected the contention of the Appellant *inter alia* for the following reasons:-

- (i) Existence of the Agreement was not in dispute
- (ii) Respondent no.2 is one of the promoters of Appellant and both of them had a common registered office and common Directors including the same Director who executed the Agreement on behalf Respondent no.2
- (iii) Appellant contemplated purchasing the assets of Respondent no.1 under the Agreement

This Judgment of Madras High Court was challenged before the Hon'ble Supreme Court of India .

DECISION:

The main issue before the Supreme Court was whether arbitration clause contained in an arbitration agreement is binding on a 'third party' which has not signed the agreement in question.

The Supreme Court, by interpreting the definition of "party" contained in Sec. 2 (h) of the Act read with Section 7 of the Act and also considering the fact that there was no acknowledgement or statement that the Agreement was authorized to be entered by Appellant on its behalf nor did the Board of the Appellant ratify or approve the said Agreement, held that Appellant is not bound by the arbitration Clause contained in the said Agreement.

The Hon'ble Madras High Court while allowing the application of Respondent no.1 under Section. 11 of the Act for the appointment of an Arbitrator, held that even though the Appellant was not a signatory to the Agreement, it was *prima facie* a party to the arbitration agreement.

The Hon'ble Supreme Court disagreed with the observation made by the Madras High Court by categorically stating that :

"...the learned Chief Justice or his designate is required to decide the issue finally and it is not permissible in a proceeding under section 11 to merely hold that a party is prima facie a party to the arbitration agreement and that a party is prima facie bound by it. It is not as if the Chief Justice or his Designate will subsequently be passing any other final decision as to who are the parties to the arbitration agreement. Once a decision is rendered by the Chief Justice or his Designate under section 11 of the Act, holding that there is an arbitration agreement between the parties, it will not be permissible for the arbitrator to consider or examine the same issues and record a finding contrary to the finding recorded by the Court."

Therefore, the Madras High Court order was set aside.

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The Hon'ble Supreme Court has passed an order in line with the precedents set by it of strictly interpreting who could be 'parties' to arbitration. It has made clear that only the parties who have signed or accepted the agreement can be considered as the parties to the arbitration agreement. In this context, it may be quite relevant to state that the Arbitration Act, 1996 of U.K has a wider scope by expanding the definition of 'parties' to include *any person* claiming under or through a party to the agreement.²

- Debargha Basu & Vyapak Desai

¹ Civil Appeal No. 3874 of 2010

² Sec. 82 (2) of the U.K Arbitration Act, 1996.

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