

Dispute Resolution Hotline

May 12, 2010

SC SAYS UNINCORPORATED COMPANY CAN'T ARBITRATE

The Supreme Court of India ("Court") has, in the case of *Andhra Pradesh Tourism Development Corporation & Anr. ("Appellant") Vs. Ms. Pampa Hotels Ltd. ("Respondent")*, by its order dated April 20, 2010, held that where an unincorporated company enters into a contract containing an arbitration clause, such contract and the arbitration agreement therein is non-existent and not binding upon the parties.

Brief facts:

The Appellant and the Respondent had entered into two agreements (both dated March 30, 2002) with regard to a property known as Hill View Guest House situated at *Tirupati ("Property")*, one being a lease agreement and the other being a development and management agreement ("**Agreements**"). Both Agreements contained an arbitration clause. The Appellant claimed that they terminated the Agreements and took possession of the Property.

The Respondent filed an application under Section 11 (for appointment of an arbitrator) of the Arbitration & Conciliation Act, 1996 ("**the Act**"), before the Andhra Pradesh High Court ("**Andhra Pradesh High Court**") seeking appointment of a sole arbitrator. The Appellant resisted the said application, *inter alia*, on the ground that there was no arbitration agreement between the parties.

Relying upon the judgment of the Court in *Konkan Railway Corporation Vs. Mehul Construction Co. and Konkan Railway Corporation Vs. Rani Construction Pvt. Ltd.*¹ ("**Decisions**"), the Andhra Pradesh High Court appointed an arbitrator by its order dated August 16, 2005, leaving all contentious issues open for the arbitrator to decide.

The Appellant filed an appeal against the said order.

Judgment:

¶ The Court noted that the Decisions were overruled by a seven-Judge bench of the Court² a few weeks after the order of the Andhra Pradesh High Court. Subsequently, *inter alia*, it was held that the Chief Justice or his designate exercises a judicial power under Section 11 of the Act and therefore, would need to establish the existence of an arbitration agreement before appointment of the arbitral tribunal.

¶ Further, a perusal of the Agreements described the Respondent as under:

"Ms. Pampa Hotels Limited, a company incorporated under the provisions of the Companies Act, 1956, and having its registered office at through its Managing Director Sri. S. Jayarama Chowdary....."

Noting that the Respondent had been incorporated only on April 09, 2003, the Court held that the Respondent was non-existent on the date of execution of the Agreements (being March 30, 2002).

Relying on the requirements of Section 7 (arbitration agreement) of the Act, the Court held in a situation where one of the parties to an arbitration agreement was not in existence when the contract was made, the entire contract not in existence and consequently, any arbitration agreement therein would also be non-existent.

¶ The Court noted that the position would have been different had the Agreements been entered into by the promoters of the Respondent prior to its incorporation and such Agreements were duly warranted by the terms of incorporation.

¶ Interestingly, a peculiarity came about on account of the prospective overruling direction passed by the Court in *SBP & Co. Vs. Patel Engineering Ltd.* and its subsequent decision in *Maharishi Dayanand University Vs. Anand Co-op Society Ltd.*³ As the arbitral tribunal had already been appointed, by virtue of the said prospective overruling direction, the Court did not interfere with the appointment of the arbitral tribunal and held that it was not in a position to accept the contention of the Appellant. Thus, the arbitral tribunal would have to decide on the issue of whether there was an arbitration agreement between the parties, with reference to the legal position explained by the Court in its order even though such exercise would merely be academic in light of this judgment.

Analysis:

In recent judgments, we have seen courts give the widest possible amplitude and interpretation and upon the whiff of an arbitration agreement between the parties, courts have referred the matter to arbitration. However, the facts in this case prove to be slightly different and even though a signed contract does exist, parties appear to have overlooked the basic principles of a valid contract and therefore, such signed arbitration agreement is considered as non-existent in the eyes of the court.

In today's world, Special Purpose Vehicles ("**SPV**") are set up for each individual project which a company wishes to enter into with a view to ring fence the assets and liabilities. By this judgment, it is evident that care must be taken to ensure that even if an arbitration agreement is provided for, such arbitration agreement is valid and binding upon the parties.

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Where promoters of a company are entering into an agreement containing an arbitration clause for a SPV which is due to be set up, care must be taken to ensure that the procedure set forth is followed and such contracts are duly warranted/ratified by the company upon its incorporation. Failing this, such contract may even be considered non-existent in the eyes of the law.

- Sahil Kanuga & Vyapak Desai

1 2000 (7) SCC 201 and 2002 (2) SCC 388;

2 SBP & Co. Vs. Patel Engineering Ltd. 2005 (8) SCC 618; Judgment dated October 26, 2005;

3 2007 (5) SCC 295.

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