

Dispute Resolution Hotline

May 09, 2011

NOT A PARTY TO THE AGREEMENT: CANNOT BE PARTY TO ARBITRATION

INTRODUCTION:

The Supreme Court of India in the case of *Deutsche Post Bank Home Finance Ltd. ("Appellant") -Vs- Taduri Sridhar ("Respondent No.1") & Anr. ("Respondent no.2")*¹ held that the Appellant not being a party to the arbitration agreement cannot be impleaded as a party to arbitration.

FACTS OF THE CASE:

The Respondent no.2 (a real estate developer) entered into a development agreement with the owners of certain lands in Ranga Reddy District, Andhra Pradesh for constructing independent houses and multistoried apartment buildings with common facilities in township format to be named "Hill Country Township". Respondent No 1 wanted to acquire an apartment in Hill Country Township and towards this an agreement for sale ("Agreement for sale") was entered into with the landowners as the first party, the Respondent no.2 as the second party and the Respondent no.1 as the third party. The total consideration agreed to be paid for acquiring the said apartment was Rs. 55, 89, 368.

The Appellant at the request of Respondent no.1 sanctioned a housing loan of Rs. 52 lakhs in terms of a loan agreement ("Loan Agreement") entered by and between the Respondent no.1 as the borrower and the Appellant as the lender for purchase of the said apartment. The Loan Agreement contained an arbitration clause and any dispute and/or differences arising out of the Loan Agreement were to be resolved through arbitration by the Managing Director of the Appellant or its nominee as the sole arbitrator.

Separately, a tripartite agreement ("Tripartite Agreement") was executed among Respondent no.1 as borrower, the Respondent no.2 as guarantor and the Appellant as the lender under which it was agreed that the loan amount shall be disbursed directly to the Respondent no.2 Pursuant to Agreement for Sale, the Respondent no.1 paid the entire sale price to the Respondent no.2. Subsequently, the Respondent no.2 executed a registered sale deed ("Sale Deed") whereby a land measuring 87 square yards with semi finished apartment was conveyed to the Respondent no.1.

On the same day a separate construction agreement ("Construction Agreement") was executed between Respondent no.2 and Respondent no.1. Under the Construction Agreement, the Respondent no.2 acknowledged receipt of total cost of construction and it was agreed that the completely constructed flat shall be delivered to the Respondent no.1 by October 16, 2008 with a grace period of three months. Clause 7 of the Construction Agreement provided for arbitration.

The apartment was not ready within the agreed time and a notice was issued by the Respondent no.1 to the Respondent no.2 to pay Rs. 54, 778 per month as compensation for the period of delay being the period from due date of completion till date of actual completion.

Subsequently, by way of another letter the Respondent no.1 invoked the arbitration clause contained in the Construction Agreement. However, there was no response to this by the Respondent no.2. Therefore, the Respondent no.1 filed a petition under Section 11 of the Arbitration and Conciliation Act, 1996 ("1996 Act") before the Andhra Pradesh High Court for appointment of an arbitrator. In the said petition, the Appellant was impleaded as a respondent along with the Respondent no.2 and therefore brought into the dispute for the first time.

ARGUMENTS BEFORE THE ANDHRA PRADESH HIGH COURT:

In the petition under Sec.11 of 1996 Act before the Andhra Pradesh High Court, the Respondent no.1 alleged that the Respondent no.2 committed breach of contract as he had not fulfilled part of his contractual obligations and that the Appellant has committed breach of trust as it clandestinely and deliberately released the payment without checking the ground realities and without due intimation to the Respondent no.1.

Thus, the Respondent no.2 raised these disputes and asserted that they have to be decided by arbitration as per clause 7 of the Construction Agreement.

The Appellant challenged the Sec. 11 Petition on the ground that the Respondent no.1 and the Respondent no.2 were the only parties to the Construction Agreement containing the arbitration agreement and therefore the Appellant could not be made a party to the Sec.11 Petition.

After hearing the parties, the Andhra Pradesh High Court appointed a retired judge as the sole arbitrator. Pursuant to the said order, the Appellant though was not concerned with the disputes nor was it a party to the Construction Agreement was made a party to the arbitration proceedings.

This order of Andhra Pradesh High Court appointing sole arbitrator was challenged before the Supreme Court.

DECISION AND RATIONALE OF THE SUPREME COURT:

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The question before the Supreme Court in the appeal was whether a non party to the arbitration agreement could be made a party to the arbitration proceedings. In this case the Supreme Court held that only the appointment of the arbitrator in relation to the disputes between the Respondent no.1 and Respondent no.2 was justified.

Therefore, the Supreme Court allowed the Appeal and set aside the order of the Andhra Pradesh High Court only in relation to the Appellant. The appointment of the sole arbitrator for the disputes between Respondent 1 and the Respondent no.2 was upheld.

The Supreme Court held that the existence of an arbitration agreement between the parties to the petition and existence of dispute(s) are conditions precedent for appointment of an Arbitrator under Section 11 of 1996 Act. The Supreme Court went ahead to hold that it is only after a party to such an agreement makes a claim or demand against the other party to the arbitration agreement which is refused or denied will a dispute arise.

The Supreme Court also discussed Section 7 of the 1996 Act which deals with arbitration agreements and held that Sec.7 of 1996 Act mandates that the arbitration proceedings should be between the parties to the Arbitration Agreement.

Supreme Court discussed its decision in *Jagdish Chander vs Ramesh Chander*² and held that the existence of an arbitration agreement was a condition precedent for the exercise of power to appoint an arbitrator/Arbitral tribunal under Section 11 of the 1996 Act and it was not permissible to appoint an arbitrator in the absence of an arbitration agreement or by mutual consent.

It also referred to the Supreme Court case of *Yogi Agarwal vs Inspiration Clothes & U*³ where two conditions were laid down for an arbitration agreement to be valid- first that it should be between the parties to the disputes and secondly, it should relate to or be applicable to the disputes.

The Supreme Court gave the following illustration. It stated that if for example 'X' enters into two contracts, one with 'M' and another with 'D', each containing an arbitration clause providing for the settlement of disputes arising under the respective contracts, in a claim for arbitration by 'X' against 'M' in regard to contract with 'M', 'X' cannot implead 'D' as a party on the ground that there is an arbitration clause in the agreement between 'X' and 'D'.⁴

The Supreme Court held that in the present case, the Respondent no.1 made a claim for damages under the Construction Agreement where the only parties were the Respondent no.2 and him. Therefore, the Supreme Court held that Chief Justice of Andhra Pradesh High Court was justified in appointing an Arbitrator for the dispute concerning them. However, the Supreme Court held that to make the Appellant a party to the proceedings the Respondent no.1 ought to have invoked the Arbitration clause contained in the Loan Agreement which had the Appellant as the Creditor.

Therefore, the Supreme Court allowed the appeal and set aside the order of the Andhra Pradesh High Court appointing sole arbitrator with regard to the Appellant only.

ANALYSIS:

With regard to arbitration agreement, the Supreme Court upheld the position of law that the Agreement between the parties is to be given primary importance⁵. Even though there are serious points of conflict which have to be addressed by means of arbitration, the Supreme Court reiterated that the precondition for the arbitration proceeding is the arbitration agreement and the parties to it.

- **Debargha Basu & Vyapak Desai**

¹ Civil Appeal No.2691 of 2011 arising out of SLO [C] No. 34139/2010

² [2007] (5) SCC 719]

³ [2009] (1) SCC 372]

⁴ See, paragraph 12

⁵ *The Iron and Steel Company Limited v Tiwari Road Lines* AIR2007SC2064, (2007)5SCC703, [2007]6SCR156

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