

# Dispute Resolution Hotline

November 23, 2012

## NON-SIGNATORIES TO ARBITRATION AGREEMENT REFERRED TO ARBITRATION

After BALCO v. Kaiser which has completely changed the landscape of arbitration law in India, the Supreme Court of India, on September 28, 2012 in yet another landmark ruling has completely renewed the way in which international commercial arbitrations would now function. In the case of *Chloro Controls (I) P. Ltd. (Appellant) v. Severn Trent Water Purification Inc. & Ors. (Respondent)*, the Hon'ble Supreme Court has held that 'the expression 'person claiming through or under' as provided under section 45<sup>1</sup> of the Arbitration and Conciliation Act, 1996 ("**Act**") would mean and take within its ambit multiple and multi-party agreements and hence even non-signatory parties to some of the agreements can pray and be referred to arbitration.

This ruling has widespread implications for foreign investors and parties as now in certain exceptional cases involving composite transactions and interlinked agreements, even non-parties such as the parent company, subsidiary, group companies or directors can be referred to and made parties to an international commercial arbitration.

## DISPUTE AND JUDGMENT

The case involved a highly convoluted set of facts where the parties had entered into multiple agreements and disputes had arisen between the Indian promoter and the foreign collaborator in relation to a joint venture which had been undertaken by the two.

The below table provides the agreements (Transaction Documents) which were entered into between the parties and around which the dispute primarily revolved.

Agreement	Parties	Particulars	Governing Law	Arbitration Clause
Shareholders Agreement executed on November 16, 1995 (" <b>SHA</b> ")	1. Capital Controls (Delaware) Company Inc. (" <b>Respondent No. 2</b> ") 2. Chloro Controls India Private Limited (" <b>Respondent No. 5</b> ") 3. Mr. M.B. Kocha (" <b>Respondent No. 9</b> ")	Principal Agreement, pursuant to which the JV Company i.e. Respondent No. 5 was established. All other agreements signed pursuant to the SHA and drafts of the agreement had been annexed to the SHA.	Laws of India	In accordance with rules of International Chamber of Commerce (" <b>ICC</b> "), held at London and governed by English laws.
International Distributor Agreement executed on November 16, 1995 (" <b>IDA</b> ")	1. Capital Controls Company Inc./ Severn Trent Water Purification Inc. (" <b>Respondent No. 1</b> ") 2. Capital Controls (India) Pvt. Ltd.	Respondent No. 5 was appointed as the exclusive distributor of the products for India, Afghanistan, Nepal and Bhutan. IDA provided that the Respondent No. 5 was an independent contractor and not a joint venture partner or employee of the seller.	Laws of Pennsylvania, U.S.A. and courts located in Eastern District of Commonwealth of Pennsylvania	No arbitration clause
Managing Directors Agreement executed on November 16, 1995 (" <b>MDA</b> ")	1. Capital Controls (India) Private Ltd. 2. Mr. M.B. Kocha	Mr. M.B. Kocha i.e. Respondent No. 9 to be the M.D. of Respondent No. 5 for initial 3 years. Powers of M.D. spelt out.	Laws of India	No arbitration clause
Financial & Technical Know-how License Agreement executed on November 16, 1995 (" <b>License Agreement</b> ")	1. Capital Controls Company Inc./Severn Trent Water Purification Inc.2. Capital Controls (India) Private Ltd.	Terms of the SHA to be implemented through this agreement. License provided to Respondent No. 5 to manufacture the products. Rights under the agreement were non-transferable and restricted to selling products exclusively in India and only through Respondent No. 5.		In accordance with the rules of ICC, to be held in London and shall be governed by English law.
Export Sales Agreement executed on November 16, 1995 (" <b>ESA</b> ")	1. Capital Controls Company Inc./Severn Trent Water Purification Inc.2. Capital	Respondent No. 5 was required to manufacture products as provided under ESA and the SHA and were required to export the same as per the terms of the ESA. Further Respondent No. 1 was to act as the sole and exclusive agent for sale of the products.	Laws of State of Pennsylvania, U.S.A	In accordance with rules of American Arbitration Association to be held in Pennsylvania, U.S.A.

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Trademark Registered User License Agreement executed on November 16, 1995 ("TMA")	Controls (India) Private Ltd. 1. Capital Controls Company Inc./Severn Trent Water Purification Inc. 2. Capital Controls (India) Private Ltd.	Provided a non-exclusive right to use the trademark. Agreement's duration was co-terminus with the License Agreement.	No arbitration clause
Supplementary Collaboration Agreement executed on August 1997 ("Collaboration Agreement")	1. Capital Controls Company Inc./Severn Trent Water Purification Inc. 2. Capital Controls (India) Private Ltd.	Executed to commence operations after the government approval was obtained and was for confirmation of the SHA.	

The allegations inter alia were that Respondent No. 1 and 2 were to undertake distribution activities in India solely through Respondent No. 5 i.e. the entity formed due to the joint venture between the Appellant and the Respondent No.1 and 2 and not through any of their group entities. However, Severn Trent (Delaware) Inc. i.e. the ultimate parent company of Respondent No. 1 and 2 was distributing the products in India also through Respondent No. 4 which through a set of subsidiaries and joint ventures was also alleged to be a group entity of Respondent No. 1 and 2. Thus, the Appellant filed a suit before the Bombay High Court inter alia praying for declaration that the Transaction Documents entered into are valid, subsisting and binding and sought injunction against the Respondents from committing breach of contract by directly or indirectly dealing with any person other than the Respondent No.5 in relation to the products. An application under section 45 of the Act was filed by certain Respondents requesting for the matter to be referred to arbitration in light of the arbitration clause under the SHA. The application was firstly dismissed by the Single Judge and thereafter on appeal, the Division Bench of the High Court allowed the application ("**Impugned Order**"). Thus, the Appellant filled an appeal challenging the impugned order.

**Contentions of the Appellant :** The Appellant inter alia contended that Respondent No. 3 and 4 were necessary and proper parties as substantive reliefs had been claimed against them and as they were not a party to any of the agreements, the dispute is not covered by the arbitration clause. Further, it was stated the expression 'parties' as used under Section 45 of the Act means all the parties and not some or any of them and refers to the parties to the agreement. In furtherance to this, it was argued that under the Act, it was not possible to refer some parties/or some matters to arbitration while leaving the balance to be decided by another forum and that bifurcation of cause of action is not permissible. Lastly, it was contended that the IDA, MDA, TMA and Collaboration Agreement did not contain any arbitration clause and further IDA provided for courts at Pennsylvania to have exclusive jurisdiction and thus due to the uncertainty and indefiniteness the arbitration clause is not enforceable.

**Contentions of Respondent :** The Respondents primarily contended that the entire dispute revolved around the SHA and that Respondent No. 3 and 4 had been added merely to defeat the arbitration clause. The Transaction Documents executed were in furtherance to the SHA and together formed a composite transaction and that their performance was dependent on the performance of the SHA. Further, it was argued that the Act did not provide for any limitation on reference to arbitration and thus the court, in light of the facts of the case, has the power to refer parties to the arbitration with the aid of the inherent powers of the court as provided under Section 151 of the Code of Civil Procedure, 1908. Lastly, equating between section 3 of the Foreign Awards (Recognition and enforcement) Act, 1961 (now repealed) and section 45 of the Act, it was contended that under section 45, the applicant seeking reference can either be a party to the arbitration agreement or a person claiming through or under such party.

**Judgment and Reasoning :** The court extensively relying on jurisprudence internationally available, established that there were two distinct schools of thought existing. One adopting a pro arbitration approach, which allowed for even non-signatories to be subject to arbitration, if the facts in the case justified the referral to arbitration, while the other adopts a very strict approach providing that only if the subject matter of the dispute was covered by the arbitration clause and that the parties to the dispute were parties to the arbitration agreement could a matter be referred to arbitration.

The court observed that language of section 45 is worded in favour of making a reference to arbitration provided the court is satisfied that a valid, enforceable and operative arbitration agreement exists. It was held that the expression '*person claiming through or under*' provided under Section 45 of the Act indicates that the section does not refer to parties to the agreement but persons in general and if it is established that a person is claiming through or under the signatory to the arbitration agreement then the matter could be referred to arbitration. The court however made a cautionary remark that such reference could be done though only in exceptional cases where the facts principally justify a reference.

Following were certain important factors which the court provided would have to be considered while dealing with such an issue:

1. Direct relationship to the party signatory to the arbitration agreement;
2. Direct commonality of the subject matter;
3. Agreement between parties being a composite transaction;
4. Transaction should be of composite nature where performance of principal agreement may not be feasible without the aid, execution and performance of the supplementary or ancillary agreements, for achieving the common object and collectively having bearing on the dispute; and
5. Whether a composite reference of such parties would serve the ends of justice.

The court thereafter deliberating upon the various agreements executed by the parties pointed out that they all formed part of a composite transaction where the SHA was akin to a mother agreement and the other agreements were executed were ancillary and for effective implementation of the SHA. Thus, the court held in favour of making a reference to arbitration even though certain parties were not signatories to the SHA.

ANALYSIS

The judgment is a clear indication of the robust pro-arbitration jurisprudence which has developed in India. This judgment further demonstrates the shift in the intent and mindset of the judiciary, towards a more pro-arbitration stance. An onerous, expensive and the dawdling dispute resolution mechanism was one of the major apprehensions of foreign investors and arbitration was adopted as an answer to the problem. The judgment now makes it clear that in situations of composite transactions, transactions involving group companies, arbitration clauses in the principal agreements would be acted upon in an international commercial arbitration.

Previously, the law as laid down in the case of *Sukanya Holdings Pvt. Ltd. v. Jayesh H. Pandya*<sup>2</sup>, was said to hold the field, whereby if a dispute involved non-signatories or included subject matter which was not strictly within the arbitration agreement, the matter could not be referred to arbitration. However, the present judgment has clearly distinguished between the Sukanya case, which now applies only to domestic arbitrations and where an application under section 8 of the Act is made. Thus, in international commercial arbitrations, parties claiming through or under a signatory to an arbitration agreement can also be referred or apply for the dispute to be referred to arbitration, whereas in a purely domestic scenario that may not be the case.

Further, in relation to composite transactions, the dispute resolution clauses would now have to be looked at more holistically. In a number of transactions such as in case of joint ventures, lending agreements involving security creation, acquisitions where a number of agreements are executed, particular care needs to be taken while incorporating the dispute resolution clauses. In an attempt to broaden the scope of the dispute resolution clause by use of terms such as 'disputes arising out of or in connection with', care would have to be taken that in such scenarios disputes, which do not solely relate to the said agreement may also be covered leading to non-parties being subject to arbitration which may include group entities and directors.

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You can direct your queries or comments to the authors

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<sup>1</sup> Section 45. Power of judicial authority to refer parties to arbitration.- Notwithstanding anything contained in Part I or in the Code of Civil Procedure, 1908 (5 of 1908), a judicial authority, when seized of an action in a matter in respect of which the parties have made an agreement referred to in section 44, shall, at the request of one of the parties or any person claiming through or under him, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.

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

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