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A Ghost Laid to Rest?

Kate Davies (Allen & Overy LLP) · Thursday, March 12th, 2009 · YIAG

In November 2008 in the *City of London v. Sancheti*, the English Court of Appeal overturned the decision in *Roussel-Uclaf v. G.D. Searle*, where the English High Court had held that a subsidiary claiming the benefit of an arbitration agreement to which it was not a party was entitled to a stay of court proceedings in favour of arbitration. The *Sancheti* decision affirms the restrictive approach of the English courts to determination of the parties to international arbitration agreements and confirms the divide between English and a number of other jurisdictions on the topic.

Roussel-Uclaf was decided under the former English Arbitration Act 1975. In *Roussel-Uclaf*, the claimants held a licensing agreement with Searle (US), the second defendant, granting the claimants an exclusive licence for the whole of the world, except the U.S., for the manufacture and use of a life-saving compound. All disputes under the licensing agreement were to be settled by arbitration.

Searle (US) also used its wholly owned subsidiary, Searle (UK) – the first defendant in the action but not a party to the licensing agreement – for the sale and distribution of its products in the U.K., including the phosphate element of the life-saving compound. A dispute arose as to the scope of the licensing agreement and which products it covered (whether it covered the base of the compound, or the phosphate as well), in relation to which the claimant initiated proceedings against Searle (UK) and Searle (US) in the English court.

Both defendants applied for a stay of the action under section 1 of the Arbitration Act 1975 (section 9 of the Arbitration Act 1996) – Searle (UK) claiming not as a party to the arbitration agreement, but as a party claiming "through or under" Searle (US) (what is now section 82(2) of the Arbitration Act 1996). The stay was granted on the basis that the two defendants and their actions were "so closely related on the facts in this case that it would be right to hold that the subsidiary can establish that it is within the purview of the arbitration clause." (The English court would also have granted the stay on the basis of its inherent jurisdiction, on the basis that the proceedings were "frivolous and vexatious.")

Some authorities have questioned the specific finding in *Roussel-Uclaf v. G.D. Searle* as improperly importing the so-called "group of companies doctrine" into English law, particularly following decisions such as *Peterson Farms v. C & M Farming* and *Caparo v. Fagor* which had rejected that doctrine for England. The so-called "group of companies doctrine" – broadly accepted in other jurisdictions, most notably France following the decision in an ICC arbitration in *Dow Chemical v. Isover-Saint Gobain* (confirmed by the Paris Court of Appeals) – provides that two separate legal entities in the same group may be regarded as "one and the same economic reality (*une réalité économique unique*)." This doctrine has found expression in various forms in a substantial body of arbitral awards and decisions of national courts.

English courts have taken a different approach. There can be little doubt, following *Peterson Farms* and *Caparo v. Fagor*, that the group of companies doctrine "forms no part of English law." Nonetheless, at least until *Sancheti*, *Roussel-Uclaf* left open the possibility under English law of reaching results not dissimilar from the group of companies

doctrine by concluding that the non-signatory to an arbitration agreement was claiming "through or under" that agreement.

Until now, that is: the English Court of Appeal has ruled in *City of London v. Sancheti* that *Roussel-Uclaf* was "***wrongly decided on this point and should not be followed***." Specifically, the English Court of Appeal determined that Sancheti – who brought various claims arising in relation to a lease agreement against the City of London under the arbitration agreement in the India/United Kingdom BIT – was not entitled to a stay of English court proceedings initiated by the City of London for rent arrears because the City of London was not a party to the arbitration agreement contained in the BIT.

Relying on *Roussel-Uclaf*, Sancheti argued that the City of London was a person claiming "through or under" the United Kingdom (section 82(2) Arbitration Act 1996). The Court of Appeal disagreed and, overturning *Roussel-Uclaf* on this point, has now held that "a mere legal or commercial connection" to the relevant agreements "is not sufficient" to bind a non-party, claiming "through or under" a party to an arbitration agreement.

The Court of Appeal left unclear what, beyond "a mere legal or commercial connection," might qualify as claiming "through or under" a party. Thus, in circumstances where a parent company abuses its control over the subsidiary for illegitimate purposes or otherwise uses the corporate structure to conceal a legal impropriety (*Adams v. Cape Industries Inc.*) or where there is evidence of fraud (*Jones v. Lipman; BCCI v. Adham; Glencore v. Dalby*), a non-signatory to the arbitration agreement may nonetheless be able to invoke (or may be bound by) that agreement. Recognizing that "the application involved a point of some general importance, namely whether [*Roussel-Uclaf*] was correctly decided," the Court of Appeal gave leave to appeal the decision.

In many jurisdictions, the effects of an arbitration agreement are extended to non-signatories through a variety of means, all motivated by the basic objective of ensuring that the parties' agreement to arbitrate is given a sensible, commercial effect, not obstructed by jurisdictional disputes and parallel litigation. In some jurisdictions, this is accomplished through the *group of companies* doctrine; in others, through more traditional principles, such as veil piercing, *alter ego*, agency, estoppel, ratification or third party beneficiary arguments. While the application of some of these principles has been rejected under English law, others remain at least potentially available (for example, English principles of agency and estoppel). It may also be possible for a non-signatory party to be bound by an arbitration agreement where the contract in which the arbitration agreement appears confers on that party a substantive right (by virtue of the Contracts (Rights of Third Parties) Act 1999, §8, relied on successfully in *Nisshin Shipping v. Cleaves*). More generally, one must wonder whether the narrow approach of English courts – assessed by international standards – conforms either to the expectations of commercial parties in agreeing to arbitrate or to the 1996 Act's aspirations to ensure England's attractiveness as a seat for international arbitration.

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