Kluwer Arbitration Blog

Two's Company, Three's A Crowd: Revisiting the Group of Companies Doctrine

Anjali Anchayil, Tamoghna Goswami (J. Sagar Associates) · Thursday, June 24th, 2021

The use of the group of companies doctrine in India to join non-signatories to an arbitration is an interesting but underexplored topic. *First*, since its adoption in 2012, Indian courts have either: (i) applied the doctrine in conjunction with other doctrines including alter ego and piercing of the corporate veil, or (ii) focussed on specific elements of the doctrine, ignoring others. *Second*, the factual assessment done by Indian courts to apply the doctrine presents another set of problems on account of the tenuous connections often used to determine mutual intent. Thus, the application of the doctrine has resulted in a muddled jurisprudence.

A. The Necessity for Group of Companies Doctrine?

As previously discussed on the Blog, the Indian Supreme Court first adopted the group of companies doctrine in *Chloro Controls (I) P. Ltd. v. Severn Trent Water Purification Inc. & Ors.* in the context of a reference to arbitration under Section 45 of the (Indian) Arbitration and Conciliation Act, 1996 ("**Act**"). ***Chloro Controls*** came in the background of an earlier Supreme Court decision, *Sukanya Holdings Pvt. Ltd v. Jayesh H. Pandya & Anr.* which was in the context of Section 8 of the Act. ***Sukanya Holdings*** held that: (i) a composite reference to arbitration would not be permissible where some parties were not bound by the arbitration agreement; and (ii) since the bifurcation of causes of action or parties was not permissible, this necessarily meant that the arbitration agreement could not be enforced even between signatories. The adoption of the group of companies doctrine in ***Chloro Controls*** solved this problem by permitting arbitration of disputes involving multiple interrelated agreements, some of which contained arbitration agreements while others did not. This was not only pro-arbitration but also served as an efficiency rationale as parties would avoid multiplicity of proceedings and conflicting findings.

Chloro Controls held that a non-signatory forming part of the same corporate group as a signatory could be made a party to the arbitration where it is clear from circumstances surrounding the transaction that the "mutually held intent" was to bind the signatory as well as the non-signatory to the arbitration agreement. The doctrine could be applied to join non-signatories based on: (i) direct relationship between the signatories and the non-signatories; (ii) direct commonality of the subject matter; (iii) the composite nature of the transaction between the parties; and (iv) whether the ends of justice would be served by referring the disputes to arbitration.

The doctrine laid down in ***Chloro Controls*** was borrowed from certain international arbitration precedents, although even today the doctrine's applicability is not universally accepted (see here and here). In adopting the doctrine, the Supreme Court diverged from the position taken by most common law countries (including England, which does not recognise the group of companies doctrine) and civil law countries. The reluctance to adopt the doctrine by other jurisdictions had to do with the fact that fundamentally it is at odds with ideas of separate legal personality, privity of contract, and party consent to arbitrate (for example, see here). Subsequent expositions of the doctrine by the Supreme Court have only added to the fundamental challenge of applying this doctrine as part of Indian law.

For instance, in *Cheran Properties Ltd. v. Kasturi and Sons Ltd. and Ors.*, the Supreme Court applied the doctrine to enforce an award against a non-signatory even though there was no composite transaction, and the non-signatory was never sought to be joined as a party to the arbitration. Then, in *Ameet Lalchand Shah and Ors. v. Rishabh Enterprises and Anr.*, the Supreme Court applied the doctrine to join non-signatories as parties in a composite transaction even though the participants in the transaction were not part of the same corporate group. The emphasis was on the interlinked agreements for a single commercial project. Finally, in *Mahanagar Telephone Nigam Limited v. Canara Bank*, the Supreme Court extended the application of the doctrine in cases of a tight group structure with strong organizational and financial links, so as to constitute a single economic unit or a single economic reality. The Supreme Court has gone a step ahead and adverted to fund flow between group companies as an adequate circumstance for applying the doctrine. Thus, piercing of the corporate veil, which could only be done in extremely limited circumstances, could be circumvented through the group of companies doctrine.

These expansions by the Supreme Court have left the High Courts in India with a difficult task when applying this doctrine. High Courts have often applied the doctrine, with very little focus on determining the mutual intent, provided other elements such as composite interlinked transaction or tight group structure are satisfied. One example is the Madras High Court's judgment in *SEI Adhavan Power Private Limited & Ors. v. Jinneng Clean Energy Technology Limited*, where non-signatories to an undertaking were made parties to an arbitration pertaining to breach of the undertaking. This was done on the basis that they were part of the same economic group as the signatory to the undertaking, having common central control, common email ids, and common premises, and the transactions were undertaken in relation to a common project. Similarly, the Delhi High Court in *Magic Eye Developers Pvt. Ltd. v. Green Edge Infra Private Limited*, only cursorily referred to intent while joining two non-signatories on the basis of them being group companies of the signatory. Another example is *RV Solutions Pvt. Ltd. v. Ajay Kumar Dixit & Ors.* where the Delhi High Court referred non-signatories to arbitration simply on the basis of commonality of subject matter, interests, and parties although none of the other requirements for application of the doctrine were met. Notably, the respondents were ex-employees of the plaintiff company and their new employer (the non-signatory) who were alleged to have conspired together to solicit the plaintiff's clients and employees.

There have also been instances where High Courts have applied the doctrine with a mix of other principles to join non-signatories to arbitration. Recently, the Delhi High Court in *Shapoorji Pallonji and Co. Pvt. Ltd. v. Rattan India Power Ltd.* has applied group of companies doctrine along with principles of alter ego and lifting of the corporate veil.

The above discussion makes clear that while it promotes efficiency in arbitration proceedings, the doctrine and its application have certain pitfalls.

First, the application of the doctrine carries a high risk of undermining party consent (which is a fundamental principle of arbitration) as non-signatories may be compelled to join an arbitration proceeding that they did not intend to join. The determination of mutual intent entails extensive factual assessment in judicial proceedings under Sections 8, 9, 11, or 45 of the Act which contemplate only prima facie scrutiny.

Second, it is seen that the doctrine is poorly understood and/or applied. Along with the doctrine, the courts resort to multiple corporate law principles, such as alter ego and lifting of corporate veil, since these are additional justifications in support of the result indicated by the doctrine. As a result, in some cases, substantive liability under the contracts could arise rather than just a joinder of non-signatories, even if it is a prima facie assessment.

The reality is that transactions are often structured to take advantage of separate legal personalities by limiting risk and liabilities. The same is fairly common, legally well recognised, and in certain cases even statutorily approved. While several agreements put together may form a single composite transaction, very often the idea is to limit parts of the transaction to specific entities. By collapsing them, non-signatories may be compelled to assume risks that they might not have envisaged at the time of contracting. For example, for a project, a special purpose vehicle may be set up to execute and perform the agreement, so as to insulate other companies in the group from the risks of that particular project.

Third, courts have often determined parties' mutual intent based on tenuous connections such as the use of a common letterhead, addresses or email id, negotiations by representatives having authority in multiple capacities, or financial support given by entities in the same corporate group to one another. The use of such tenuous connections often undermines the commercial realities of business transactions and complex corporate structures used to implement them.

B. An Alternate Approach

It is evident from the above discussion that the application of the group of companies doctrine has ventured into diverse directions, even moving away from the initial principles laid down in ***Chloro Controls***. Therefore, there is certainly a need to reconsider the use of the group of companies doctrine, or at the very least clarify its contours.

One way of doing this is by amending the definition of "party" under Section 2(1)(h) of the Act.

The 246th Law Commission Report had initially suggested amending Sections 2(1)(h) and Section 8 of the Act to include persons claiming through or under a party to an arbitration agreement within their fold. However, such an amendment was only brought about to Section 8 of the Act. The Law Commission's suggestion was given with the intent of making the definition of party wider to include non-signatories so as to be consistent with ***Chloro Controls***. But given the manner in which the doctrine is being applied, this amendment may not be appropriate. Instead, the definition of a party under Section 2(1)(h) of the Act should be amended to include third parties/non-signatories subject to a definite rule that the contract confers a direct benefit on the third party rather than an incidental benefit on the performance of the contract. This would ensure that third parties who are only involved in a limited or ancillary manner in the transaction are not

dragged into arbitrations without their consent. It would also avoid situations like ***Ameet Lalchand Shah*** or ***RV Solutions*** where third parties who were not even members of the same corporate group were compelled to arbitrate on the basis that they were participants in a composite interlinked transaction. Where members of corporate groups are involved in composite interconnected transactions, the tests of alter ego, agency, piercing the corporate veil and acquiescence continue to be available to join them as parties.

In the meanwhile, the parties to contracts governed by Indian law can exclude the application of the doctrine by specifically providing in their contracts (including arbitration agreements) that (i) the benefits derived from the contract will be limited to only the parties to the contract; and (ii) only the signatories and defined individuals/entities will be treated as parties.

Anjali Anchayil and Tamoghna Goswami are Senior Associates at J. Sagar Associates.

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