Kluwer Arbitration Blog

You, Me and Dupree: Indian Supreme Court Rethinks the Tenability of Using the Group of Companies Doctrine to Bind Non-Signatories to an Arbitration Agreement

Shruti Sabharwal, Ujval Mohan (Shardul Amarchand Mangaldas & Co.) · Wednesday, July 13th, 2022

The group of companies doctrine in arbitration has always been contentious in India. The doctrine was first recognised by the Indian Supreme Court in *Chloro Controls India Private Limited v. Severn Trent Water Purification Inc.* (2013) 1 SCC 641 (hereinafter *Chloro Controls*). Since then, Indian courts have applied the doctrine to bind group companies of signatories to arbitration agreements, forcing them to participate in arbitrations without their consent. Consequently, such group companies, particularly parent companies, are left to satisfy arbitral awards, in a manner contrary to the commercial understanding at the time of entering into the underlying agreements.

Separate and distinct corporate personality lies at the foundation of company law. It enables the modern corporate structuring practice of housing specific businesses or projects in separate purpose-specific entities, each bearing a distinct legal identity. The group of companies doctrine has its origin in the "single economic reality" view of corporate conglomerates, which ignores the legal identities of constituent companies, and views the entire undertaking as one (*See, Dow Chemical France, the Dow Chemical Company v. Isover Saint Gobain*, (ICC Case No. 4131); *Mahanagar Telephone Nigam Ltd. v. Canara Bank*, (2020) 12 SCC 767 (hereinafter *MTNL*); *See also*, observations in *Cox & Kings Limited v. SAP India Private Limited & Anr. (Arbitration Petition (Civil) 38 of 2020*, SC, Judgment dated May 6, 2022 (hereinafter *Cox & Kings*), para. 37 (Majority Opinion), para. 29 (Separate Opinion)). While the doctrine has certainly evolved away from this primitive premise it continues to implicate group companies to arbitration based on the tests of common control or transaction and the intention of the parties.

Recently, the Supreme Court rendered two judgments taking differing stands in relation to the doctrine. First, in *ONGC v. Discovery Enterprises Pvt Ltd*., Civil Appeal 2042 of 2022, SC (hereinafter *ONGC*), a full bench of the Court affirmed the application of the group of companies doctrine in Indian law and set aside an arbitral award that failed to consider the applicability of the doctrine. Close on its heels, in *Cox & Kings*, another full bench of the Supreme Court seemingly hit the brakes on the growing use of the doctrine. The Court questioned the doctrine's consistency with foundational principles like party autonomy and distinct corporate personality. Ultimately, these issues of clarifying the basis, scope, and applicability of the doctrine have now been referred to a larger bench of the Supreme Court.

From *Chloro Controls* to *Cheran Properties Ltd. v. Kasturi & Sons Ltd., (2018) 16 SCC 413* to *MTNL*, jurisprudence anchors the application of the doctrine to a mutual intention amongst all the

parties to bind the non-signatory to the arbitration agreement. However, different courts have used varying standards to gauge such mutual intention, and some proceeded to propound additional considerations to apply the doctrine. *ONGC* summarises these developments, and draws the following five considerations that apply justifying the invocation of the doctrine:

1. *"The mutual intent of the parties;*
2. *The relationship of a non-signatory to a party which is a signatory to the agreement;*
3. *The commonality of the subject matter;*
4. *The composite nature of the transaction; and*
5. *[The party that has actually performed the contract]." (See, ONGC, para. 26.]*

Not only is there no authoritative guidance as to the meaning of these "considerations", there are also no clear demarcations as to the scope and the preconditions for the application of the doctrine. As a result, the outcomes of cases involving the group of companies doctrine have become wildly unpredictable. As discussed on the Blog previously, previously, High Courts have relied on the nebulous discussion from the Supreme Court to "order" into existence arbitration agreements binding a diverse set of non-signatories.

Tensions with arbitration law

The doctrine turns on the crucial test of the mutual intention of parties to bind all (including non-signatories) to an arbitration. Ironically, courts are forced to look for such an intention in the face of an agreement which specifically identifies the parties to the arbitration. Often these parties are consciously chosen (or even incorporated) to enter into commercial and arbitration agreements, keeping out other group entities. Looking for such a mutual intention is in effect a search for an unwritten arbitration agreement that also includes the non-signatory.

Making matters more precarious, such an exercise ignores that Indian arbitration law that requires arbitration agreements to necessarily be reduced to writing under Section 7(3) of the Arbitration and Conciliation Act, 1996. In all, the doctrine undermines the principles of consent and party autonomy which is central to arbitration as an avenue of dispute resolution.

Statutory basis for derivative standing

Many of the questions referred to the large bench by way of the *Cox & Kings* decision involve interpretation of Section 8 of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**"), and whether the group of companies doctrine can be read into it. Section 8 provides that "*a party to the arbitration agreement or any person claiming through or under him*" can compel a court seized of a dispute subject to an arbitration agreement to refer the parties to arbitration instead of itself deciding the matter.

In fact, the expression "*any person claiming through or under him*" was amended into the provision in the wake of *Chloro Controls*. The amendment allowed a non-signatory to derive its standing before the arbitral tribunal from the signatory, as a successor in interest.

Importantly, the Law Commission of India recommended a similar amendment to Section 2(1)(h)

(which defines a “party”), thereby allowing successors in interest to exercise all rights that a signatory of an arbitration agreement was entitled to, since they effectively stepped into the shoes of the signatory. Had this proposal been enacted, successors in interest, regardless of their membership to the same corporate group, would find themselves bound by arbitration agreements that their predecessors had opted into.

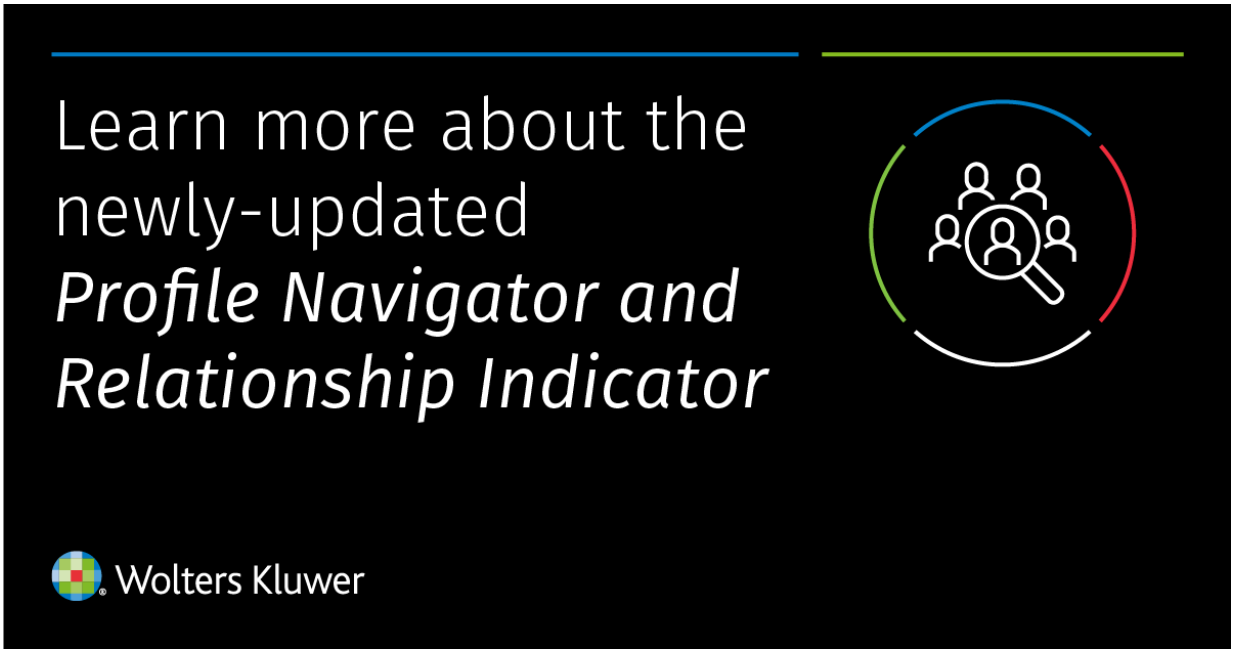
As noted in *Cox & Kings*, Parliament chose not to amend the definition of “party”. The effect of this omission to amend Section 2(1)(h) will likely be significant in assessing the validity of the group of companies doctrine.

Crucially, the language of the amended Section 8 tests a non-signatory’s standing against the interest they derive form a signatory, and *not* by their membership to the signatory’s group of companies. If the focus before the larger bench shifts to this language in Section 8 and the, it is likely that the Court may embrace the doctrine only in light of group companies that are in fact successor in interest to the signatories. With that outcome, the “group of companies” could be rendered a misnomer, given that its application is predicated on derivative interest, and not on membership to a group.

Practical implications

The doctrine comes to the aid of hopeful claimants who fear that the signatory to the arbitration agreement may not satisfy an award, and therefore seek to implicate financially healthier group companies to the proceedings. For the same reason, the doctrine is a thorn in the flesh for larger conglomerates whose parent companies might end up having to provision for costly arbitrations in their books, despite (intentionally) not being a party to the underlying arbitration agreement. Accordingly, this litigation strategy might not be very fruitful, since counter-parties might rely on the doubts now cast in *Cox & Kings*.

That said, ending up with an award but no way to enforce it meaningfully is a legitimate concern that parties will have. Parties may be better protected against such situations by obtaining indemnities, guarantees, or other contractual comfort from promoters or parent companies to cover such potential losses. Where agreements have already been entered into, it would be worthwhile to look out for and bring actions against contractual counterparties that are dissipating their assets in apprehension of an adverse award. In any case, relying on the group of companies doctrine to hedge against this risk may not prove successful for long.



This entry was posted on Wednesday, July 13th, 2022 at 8:53 am and is filed under Group of Companies Doctrine, India
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.