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Does the Assignment of a Contract Assign the Arbitration Agreement: The Indian Perspective

Ajar Rab (ANR LAW LLP) · Tuesday, March 19th, 2024

Under the Indian Contract Act 1872 (“ICA”), an arbitration agreement is a distinct and separate contract. Like all other contracts, it can be transferred by way of assignment to third parties under Section 37 of the ICA. The Supreme Court of India in *Khardah Company Ltd vs Raymon & Co. (India) Private Ltd* has held that there is a distinction between the assignment of “rights” and “liabilities.” A contract stands novated when assigning rights and liabilities to a third party. This raises a fundamental question – does the arbitration agreement also stand novated when the principal contract is assigned to a third party? If it does, then as held by the Supreme Court in *Kapilaben v. Ashok Kumar Jayantilal Sheth* the assignment of every obligation, such as the obligation to refer the dispute to arbitration, requires the parties’ fresh consent.

If, on the other hand, the arbitration agreement does not stand novated on assignment of the principal contract, does it mean that the arbitration agreement is automatically transferred along with the principal contract to the third party without the need for fresh consent (“**Automatic Transfer Approach**”)?

Many jurisdictions like Switzerland¹⁾, France²⁾, the United Kingdom³⁾, and Singapore⁴⁾ follow the Automatic Transfer Approach. Other jurisdictions, such as Sweden, require specific notice of assignment before binding the assignee by the arbitration agreement⁵⁾.

The United States courts have always been divided in their approach. Some earlier decisions, such as *Hosiery Mfrs’ Corp. v. Goldston* and *Nissan Motor Acceptance Corp v. Ross*, support the Automatic Transfer Approach. On the contrary, decisions like *Lachmar v. Trunkline LNG Co.* require express consent of the assignee (third party). However, in recent years courts have critically analysed the principal contract than merely choosing sides to ascertain assignment of the arbitration agreement, adopting an approach similar to the highest court of Bulgaria.

In similar vein, the Indian courts have been inconsistent in their decisions on whether the assignment of a contract also amounts to the assignment of the arbitration agreement to a third party.

Requirement of Specific Consent

In *Delhi Iron and Steel Co. Ltd. v. U.P. Electricity Board*, the Delhi High Court took the view that the assignment of the principal contract does not *ipso facto* result in the assignment of the arbitration agreement. The principal contract is assignable, but the arbitration agreement is not. Since an arbitration agreement is a distinct and separate agreement, the arbitral intent between the original party and the assignee of the other party must be made manifest. A similar view was adopted in *Vishranti CHSL v. Tattva Mittal Corpn. (P) Ltd.* holding that in the absence of specific consent to the assignment of the arbitration agreement, the arbitration agreement would not be assigned to the third party, even if the principal contract has been assigned.

The basis for this view can be found in the judgement of the Indian Supreme Court in *M.C. Chacko v. State of Travancore* which held that a person who is not a party to the contract cannot enforce the terms of the contract. However, it is pertinent to note that even in this judgement, the Supreme Court had recognised the assignment exception. Thus, the requirement of specific consent by the assignee to transfer the arbitration agreement is an approach adopted by Indian courts only in a handful cases.

No Separate Consent Required

The predominant view by Indian courts has been that the doctrine of separability enshrined under Section 16 of the Arbitration and Conciliation Act 1996 (“Act”) relates to the right of the arbitral tribunal to rule on its own jurisdiction. The doctrine of separability and its jurisprudence cannot be extended to mean that a separate arbitration agreement is to be executed between the parties at the time of assignment of a contract. Therefore, as held by the Bombay High Court in *DLF Power Ltd. v. Mangalore Refinery & Petrochemicals Ltd.* (“DLF”), a third party, to whom the principal contract is assigned, can enforce the arbitration agreement.

Specifically, if the rights and obligations under the principal contract are assigned to a third party and this third party also performs obligations under the contract, such as making payments, seeking extension of time or approval, joint survey, etc., this third party is entitled to invoke arbitration.

Consensual Theory of Arbitration

Taking a similar approach, the Delhi High Court in *Rajesh Gupta v. Mohit Lata Sunda* held that if the parties to the principal contract knew of the assignment and were fully aware that a third party ‘had stepped into the shoes’ of another party, the arbitration agreement stood assigned. These views are essentially based on the consensual theory in arbitration stated in *Aerens Goldsouk International Co. Ltd. v. Samit Kavdia*, which recognises that non-signatories to the arbitration agreement can invoke the arbitration clause and are thus ‘parties’ to the arbitration agreement under Section 2(1)(h) of the Act.

Consequently, the consensual theory aims to infer consent from the parties’ behaviour if an agreement is not self-evident. Agency, assignment, and group of companies doctrine are among such theories. Recently, the Delhi High Court in *Tomorrow Sales Agency (P) Ltd. v. SBS Holdings Inc.*, held that the non-signatories may either invoke the arbitration agreement, being the beneficiaries of the contract, or otherwise be bound by the same. The Court noted, “30. Gary B. Born, has explained that the legal basis for holding that a non-signatory is bound by an arbitration

agreement includes “both purely consensual theories (e.g., agency, assumption, assignment) and non-consensual theories (e.g., estoppels, alter ego).” However, this decision has been challenged in an appeal which is currently pending. It would be interesting to see how the court deals with the question of third parties invoking arbitration, especially in cases of assignment of the principal contract.

Nonetheless, the Bombay High Court in *DLF* echoed a similar view and held that the arbitration clause does not take away the right of assignment of a party to a contract if it is otherwise assignable. The High Court noted that there is a clear distinction between the assignment of rights under a contract by a party who has performed its obligations under the contract and the assignment of a claim. The latter is a mere claim which cannot be assigned in law. It further observed that once the other party has accepted the assignment and insisted on compliance with rights, duties and obligations, the assignee steps into the shoes of the assignor and will be entitled to all rights, obligations and benefits, including the arbitration agreement forming part of the said agreement.

Similarly, in *Bestech India (P) Ltd. v. MGF Developments Ltd.*, the Delhi High Court considered the parties’ conduct post-assignment of the contract and rejected the submissions of the original party that the assignee had no *locus standi* to file an application for appointment of an arbitrator or that the assignee had no privity of the contract with the original party.

Conclusion

While Indian courts have been inconsistent in following the Automatic Transfer Approach when the principal contract is assigned, the predominant view aligns with international practices. Though the minority view requiring specific consent for assignment of the arbitration agreement may be correct on a strict reading of the requirement of express consent to refer the dispute to arbitration, a more practical and pragmatic approach requires inferring such consent by the assignment.

As explained by the Singapore Court of Appeal in the case of *BXH v. BXI*, “an arbitration agreement does not have a purpose or life independent of the substantive obligations that it attaches to.” Thus, the requirement of express consent, though sound, defies a more holistic understanding of the purpose of the arbitration agreement, *i.e.*, to refer disputes arising out of the obligations under the principal contract to arbitration.

While the views discussed above were from different Indian High Courts, the applicability and binding nature of the arbitration agreement to non-signatories through assignment has now been recognised in the recent landmark judgment by the Indian Supreme Court in *Cox and Kings Ltd. v. SAP India Pvt. Ltd. and Another* which has been discussed on the Blog [here](#). Though the Supreme Court has not explicitly addressed the issue of the requirement of express consent for assignment of the arbitration agreement, the extension of the arbitration agreement to non-signatories implies that specific consent may not be required for assignment of the arbitration agreement when the principal contract is assigned.

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