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Harmonizing with Indian Arbitration Law: Supreme Court's Validation of the Group of Companies Doctrine

INTRODUCTION

In a group of matters reported as *Cox and Kings Ltd. v. SAP India Pvt. Ltd. & Anr.*, 2023 SCC OnLine SC 1634 (Cox and Kings II), a Constitution Bench comprising of five Supreme Court judges delivered a unanimous judgment supporting the inclusion of the *Group of Companies* doctrine (Doctrine) in the Indian arbitration framework. The Hon'ble Supreme Court (Court) has also established the guiding principles for of the Doctrine.

The application and defining parameters of the Doctrine have been embroiled in a protracted legal saga across multiple High Courts and even the Supreme Court. This article scrutinizes the extent of the judicial ruling in Cox and Kings, elucidating the principles set forth by the Court for the implementation of the Doctrine.

The questions of law referred to the Constitution Bench by the three-judge bench in the matter of *Cox and Kings Ltd. v. SAP India Pvt. Ltd. & Anr.*, (2022) 8 SCC 1 (Cox and Kings I) on 6 May 2022 were as follows:

- A. Whether phrase 'claiming through or under' in Sections 8 and 11 could be interpreted to include 'Group of Companies' doctrine?
- B. Whether the 'Group of Companies' doctrine as expounded by **Chloro Control Case** (supra) and subsequent judgments are valid in law?
- C. Whether the *Group of Companies* doctrine should be read into Section 8 of the Act or whether it can exist in Indian jurisprudence independent of any statutory provision?
- D. Whether the *Group of Companies* doctrine should continue to be invoked on the basis of the principle of 'single economic reality'?
- E. Whether the *Group of Companies* doctrine should be construed as a means of interpreting the implied consent or intent to arbitrate between the parties?
- F. Whether the principles of alter ego and/or piercing the corporate veil can alone justify pressing the *Group of Companies* doctrine into operation even in the absence of implied consent?

HISTORY

Hon'ble Chief Justice Dr. DY Chandrachud along with Hon'ble Mr. Justice Hrishikesh Roy, Hon'ble Mr. Justice J B Pardiwala and Hon'ble Mr. Justice Manoj Misra delivered a comprehensive verdict exploring the international and domestic origins of the Doctrine. The judgment delved into its applicability across various jurisdictions, ultimately establishing clear principles that define the parameters and application of this Doctrine under the Indian arbitration law. Hon'ble Mr. Justice Mr Pamidighantam Sri Narasimha provided additional insights and reasoning to complement the findings vide a separate judgment.

The judgment explored into the evolution of the Doctrine into two stages i.e. before the *Chloro Controls India (P) Ltd. v. Severn Trent Water Purification Inc.*, (2013) 1 SCC 641 (Chloro), and after Chloro. In the first stage, courts in India interpreted the term 'parties' by restricting it solely to those individuals who have signed the arbitration agreement. Before Chloro, three fundamental principles guided the way, namely: (i) arbitration could be initiated by a signatory to the arbitration agreement exclusively for disputes involving another signatory party; (ii) the court would adhere to a stringent interpretation of the provisions of the Arbitration and Conciliation Act, 1996 (A&C Act), especially the unamended Section 8, which permitted the reference of only the 'parties' to an arbitration agreement; and (iii) there was a focus on the formal consent of the parties, explicitly excluding any room for the implied consent of non-signatories to be obligated by an arbitration agreement.

The law underwent a sea change with the judgment pronounced in Chloro in 2012 by a three-judge bench when the Doctrine was accepted under the Indian arbitration jurisprudence and the Court determined that a non-signatory belonging to the same corporate group could be included as a party in the arbitration proceedings if it is evident from the circumstances surrounding the transaction that there was a 'mutually held intent' to bind both the signatory and the non-signatory to the arbitration agreement. This Doctrine could be employed to involve

non-signatories based on: (i) a direct relationship between the signatories and the non-signatories; (ii) a direct commonality of the subject matter; (iii) the composite nature of the transaction between the parties; and (iv) whether referring the disputes to arbitration would serve the interests of justice. The Apex Court established the principle that a person or entity not originally a signatory to an arbitration agreement could be brought into the proceedings by demonstrating a connection of 'claiming through or under' a signatory party (as was provided in Section 45 of the A&C Act). This allowance was made contingent on the circumstances as noted above.

Thereafter, in the matter of *Cheran Properties Ltd. v. Kasturi & Sons Ltd.*, (2018) 16 SCC 413 (Cheran), a three-judge bench of the Apex Court noted that the essence of the Doctrine lies in aiding the realization of a shared intention between parties, evident in circumstances suggesting a commitment to bind both signatories and non-signatories. The aim is to uncover the genuine nature of the business arrangement, navigating through complex layers of commercial agreements to identify an intent to bind an individual who may not be a formal signatory but has willingly undertaken the obligation to be bound by the actions of a signatory.

Thereafter, the Supreme Court in the case of *Ameet Lalchand Shah and Ors. v. Rishabh Enterprises and Anr.*, (2018) 15 SCC 678 applied the Doctrine, allowing the inclusion of non-signatories as parties in a combined transaction, even though the involved parties were not part of the same corporate group. The focus was on interconnected agreements relating to a singular commercial project. In the case of *MTNL v. Canara Bank and Others*, (2010) 12 SCC 767, the Apex Court reaffirmed that the Doctrine can be invoked when the conduct of parties demonstrates a clear intention to bind both signatories and non-signatories, or when a tight group structure with substantial organizational and financial ties constitutes a single economic unit or reality. Similarly, in the case of *Reckitt Benckiser (India) Private Limited v. Reynders Label Printing India Private Limited and Another*, (2019) 7 SCC 62, the Supreme Court emphasized that the mutual intention to bind parties through their conduct is crucial for invoking the Doctrine.

A three-judge Bench of the Supreme Court in *ONGC Ltd. v. Discovery Enterprises (P) Ltd. & Anr.*, (2022) 8 SCC 42 (Discovery) revisited the nuances of the Doctrine and noted that in deciding whether a non-signatory company within a group of companies would be bound by the arbitration agreement, consideration should be given to the following factors:

- a. The mutual intent of the parties;
- b. The relationship of a non-signatory to a party which is a signatory to the agreement;
- c. The commonality of the subject matter;
- d. The composite nature of the transaction; and
- e. The performance of the contract."

PRINCIPLES LAID DOWN

At the outset, it is imperative to note that the Supreme Court specifically noted that the factors as noted in the Discovery (supra) must be applied cumulatively and holistically to identify the intention of the parties to bind the non-signatory party to the arbitration agreement. The party seeking joinder of a non-signatory bears the burden of proof of satisfying the above factors to the satisfaction of the court or tribunal, as the case may be. The balance between the consensual nature of arbitration and the modern commercial reality where a non-signatory becomes implicated in a commercial transaction in a number of different ways can be achieved if the factors laid in Discovery (supra) are applied holistically. Though, the Apex Court has also noted that the application of the factors as laid out in Discovery (supra) must be fact-specific, and the adjudicating body has to decide on how much weightage they ought to give to the above factors.

The Apex Court noted that in case of an implied contract, the consent of the parties to be bound by such contract is determined through the acts and conduct of the parties. It was further noted that the legislative purpose behind Section 7 of the A&C Act suggests that a legal relationship may arise from a party's actions or conduct, even if no contract exists between the individuals or entities involved and can be considered as a valid subject for an arbitration agreement under Section 7 of A&C Act. Specifically, Section 7 (4) (b) of the A&C Act diverges

from the customary notion of an agreement as a document bearing signatures. Instead, it highlights the indication of consent by individuals or entities through the exchange of documents. The only aspect to be determined is whether the non-signatory intended or consented to enter the legal relationship by the *dint* of their action or conduct.

It was further specifically noted by the Apex Court that the existence of shared or common shareholders or directors does not automatically imply that a subsidiary company will be obligated by the actions of the parent company. Statements or assertions made by a promoter or director in individual capacity do not legally obligate a company. Likewise, the mere presence of common shareholders or a shared Board of Directors between two companies is not enough to establish that they form a unified economic entity. The Court has specifically held that holding a non-signatory company accountable for the actions of other group members solely because they are considered a "single economic unit" would disregard the principle of maintaining distinct corporate identities and therefore, the principle of "single economic entity" cannot be used as a sole basis to invoke the Doctrine.

The Court further relying on the ruling in *Bank of India vs K. Mohandas*, (2009) 5 SCC 313, observed that the intention of parties must be ascertained from the words used in the contract, considered in light of the surrounding circumstances and the object of such contract. The Doctrine hinges on two key elements: the presence of a corporate group and the actions of both signatory and non-signatory parties, reflecting their shared intention to involve the non-signatory in the arbitration agreement. In this way, the Doctrine is akin to other consent-based principles like agency, assignment, assumption, and guarantee.

Most importantly, the Apex Court has also clarified that the principle of alter ego or piercing the corporate veil cannot be the basis for the application of the Doctrine. While the alter ego principle overlooks corporate separateness and party intentions in favour of equity and good faith, the Doctrine aids in identifying the parties' intentions to ascertain the true participants in the arbitration agreement without

undermining the legal identity of the involved entity. The primary test for the application of Doctrine is to determine the intention of the parties on the basis of underlying *factual* circumstances.

The Apex Court also noted that the criterion is whether the non-signatory possesses a tangible, direct, and significant role in the negotiation, execution, or termination of the contract. Merely having an incidental role in the negotiation or performance of the contract is insufficient to infer the non-signatory's consent to be bound by the underlying contract or its arbitration agreement. The responsibility lies with the party advocating the inclusion of the non-signatory in the arbitration agreement to demonstrate a purposeful and conscious engagement of the non-signatory supported by objective evidence. For instance, a non-signatory may merely participate in the performance of a contract to carry out a specific task or assist the parent company. Such incidental involvement in the contractual performance is insufficient to constitute consent to the underlying contract, let alone the arbitration agreement.

The Apex Court over-ruled the judgment in *Chloro* on one aspect wherein it was held that non-signatory entities, being part of the same corporate group as the signatory parties, were subsidiaries in interest or subsidiary companies, and therefore were "claiming through or under" the signatory parties. The Court noted that the phrase "claiming through or under" only applies to entities acting in a derivative capacity and not with respect to joinder of parties in their own right as it is used in the context of successors in interest that act in a derivative capacity and substitute the signatory party to the arbitration agreement.

Finally, the Apex Court has clarified that the scope of reference under both Sections 8 and 11 of A&C Act is limited. Where Section 8 of the A&C Act requires the referral court to investigate the *prima facie* existence of a valid arbitration agreement, Section 11 of the A&C Act confines the court's jurisdiction to the existence of the examination of an arbitration agreement. Therefore, the Apex Court has held that the referral court should leave it for the arbitral tribunal to decide whether the non-signatory party is indeed a party to the arbitration agreement based on

the factual evidence and application of legal doctrine.

CONCLUSION

The Apex Court vide this judgment clarified the scope of *Group of Companies* doctrine and delineated the principles applicable to invoke the Doctrine. Most importantly, it has been clarified that the factors as were laid down in *Discovery* (supra) must be applied holistically. The court/ tribunal may decide upon the weightage to be given to each factor but all of them must be satisfied in one manner or another. Further, the Apex Court also clarified that the intention and consent of both the non-signatory and signatory must be looked into for making the non-signatory a party to the arbitration proceedings.

In addition, the Apex Court has also specifically made it clear that the test is to determine whether the non-signatory has a positive, direct, and substantial involvement in the negotiation, performance, or termination of the contract. Mere incidental involvement in the negotiation or performance of the contract is not sufficient to infer the consent of the non-signatory to be bound by the underlying contract or its arbitration agreement. The burden is on the party seeking joinder of the non-signatory to the arbitration agreement to prove a conscious and deliberate conduct of involvement of the non-signatory based on objective evidence.

Moreover, by clarifying that a court operating under Section 8 or Section 11 of the A&C Act possesses restricted authority, and the determination of invoking the *Group of Companies* doctrine rests with the arbitral tribunal, the Supreme Court has streamlined the process and procedure for joinder of non-signatory parties to an arbitration. This procedural streamlining will be beneficial for an arbitral tribunal to decide the appropriate course of action in an arbitration.

This judgment resolves the inconsistency regarding the application of the *Group of Companies* doctrine in the realm of arbitration jurisprudence in India, where companies maintain separate legal entity status. The judgment achieves this by establishing tests and factors for invoking the Doctrine. It also signals the consequences that may arise if a non-signatory participates in the negotiation, performance, and termination of a contract for a company. Ultimately, the *Group of Companies* doctrine hinges on the consent and intention of the parties, making it an evidence-based principle.

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Khaitan and Co Team Ajay Bhargava, Vanita Bhargava, Aseem Chaturvedi, Trishala Trivedi, and Milind Sharma appeared on behalf of M/s Jindal Drilling & Industries Limited in the proceedings before the Supreme Court.

Khaitan and Co Team Padam Khaitan, Jeevan Ballav Panda, Shalini Sati Prasad, Satish Padhi, Srinjoy Bhattacharya, Meher Tandon, Gaurav Sharma and Dhriti Mehta, appeared on behalf of McLeod Russel India Ltd in the proceedings before the High Court of Delhi and the Supreme Court.

KCO has exercised due caution in the preparation and publication of this Ergo so as not to compromise sensitive details in the interest of confidentiality.

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