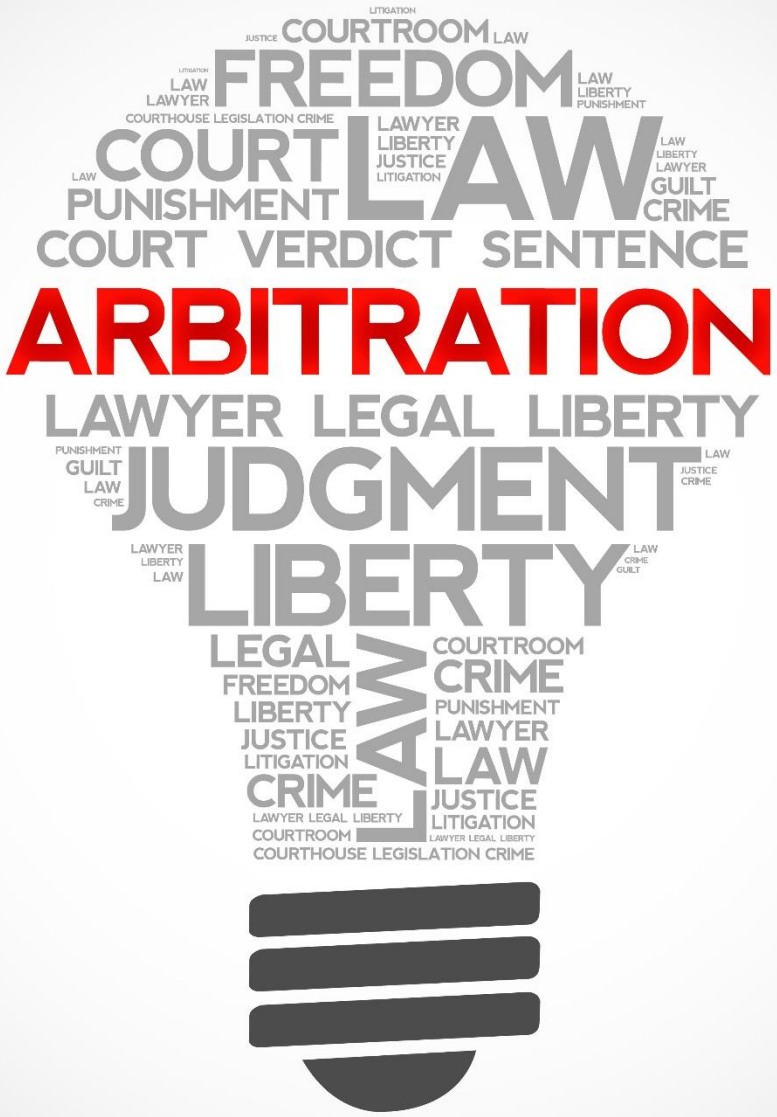

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SC INVOKES GROUP OF COMPANIES DOCTRINE AND IMPLEADS WHOLLY OWNED SUBSIDIARY OF RESPONDENT COMPANY TO THE ARBITRATION PROCEEDINGS

Mahanagar Telephone Nigam Ltd. v. Canara Bank & Ors.[1] *(August 8, 2019)*

Introduction

Parties to a writ petition before the Delhi High Court (**Court**) consented to refer their disputes to arbitration before a sole arbitrator. Accordingly, by way of an order, the Court recorded the reference of disputes to arbitration and appointed the sole arbitrator. However, on the date on which the reference was made, the proforma party to the writ petition was not present before the Court. In the circumstances, the issues which arose for consideration before the Supreme Court were (a) whether a valid arbitration agreement existed between the three parties; and (b) whether the proforma party to the writ petition was a party to the arbitration agreement and ought to be impleaded in the arbitration proceedings.

[1] Civil appeal Nos. 6202-6205 of 2019, Arising out of SLP (Civil) No. 13573-13576 of 2014

Facts

In 1992, Mahanagar Telephone Nigam Ltd. (**MTNL**) placed bonds with Can Bank Financial Services Ltd. (i.e. the wholly owned subsidiary of Canara Bank) **CANFINA**), under a Memorandum of Understanding Agreement (**Agreement**) in the form of fixed deposits. CANFINA paid back part of the fixed deposit and failed to pay back the remainder balance along with the interest accrued (**Balance**). With respect to the amount paid back by CANFINA, MTNL serviced the bonds only to partial extent to the public. In the circumstances, MTNL did not service the interest on the bonds and the transaction fell through.

Due to the circumstances of the secondary market, CANFINA was facing a liquidity crunch and therefore, Canara Bank purchased the bonds issued by MTNL from CANFINA. However, when Canara Bank requested for registration of these bonds in its name, MTNL refused to transfer the bonds and contended that the bond instruments were being retained on the ground that CANFINA failed to return the Balance.

In 1993, by way of a letter, MTNL cancelled all the bonds *inter alia* on the ground that the letters of consideration were with CANFINA. Consequently, Canara Bank stated that being the holder in due course, it is entitled to have the shares registered in its name and to receive interest as and when it accrued.

Thereafter, MTNL circulated a statement of accounts whereunder it adjusted the proceeds of cancellation of bonds towards the dues of CANFINA. Under a letter dated 13 January 1994, MTNL enclosed a cheque in the amount of INR 5 crores approx. for payment towards Canara Bank. In response, under a letter dated 10 February 1994, Canara Bank returned the cheque and demanded restoration and registration of the bonds.

Canara Bank filed a Writ Petition (**Writ Petition**) before the Court to challenge the cancellation of the bonds and sought a direction for MTNL to pay the interest accrued on the bonds. Pertinently, CANFINA was joined as a proforma party in the Writ Petition.

MTNL and Canara Bank agreed to refer disputes to arbitration

On 16 September 2011, during the proceedings before the Court, MTNL and Canara Bank agreed that the disputes may be referred to arbitration under the Arbitration and Conciliation Act, 1996 (**the Act**) and the Court passed an Order in terms thereof (**Order I**). On 21 October 2011, Canara Bank proposed the name of a sole arbitrator and MTNL accepted the nomination (**Order II**). Accordingly, the tribunal was constituted.

Impleadment of CANFINA to the arbitration proceedings

While the tribunal issued notice to all three parties i.e. MTNL, Canara Bank, and CANFINA, Canara Bank submitted before the tribunal that CANFINA ought not to be joined as a party to the arbitration. By way of an interim award, the tribunal held that since CANFINA did not appear before the Court when the disputes were referred to arbitration, CANFINA was not a party to the arbitration agreement and cannot be impleaded as a party to the arbitration proceedings.

MTNL filed an application before the Court (**Application for Clarification**) seeking clarification of the Order, i.e. whether CANFINA ought to be impleaded as a necessary party to the arbitration agreement. By an Order dated 5 July 2013 (**Order III**), the Court dismissed the application as "*not pressed".*

Thereafter, MTNL filed an application for recall of the Order I, Order II, and Order III passed in the Writ Petition (**Application for Recall**). By an Order dated 10 January 2014 (**Order IV**), the Court dismissed the Application for Recall as it was identical to Application for Clarification which had not been pressed at the time by MTNL.

In the meanwhile, Canara Bank filed its statement of claim in the arbitration and MTNL filed its statement of defence and its counter claim in the arbitration.

Aggrieved by Order I, Order II, Order III, Order IV (collectively referred to as **Subject Orders**), MTNL filed a special leave petition before the Supreme Court. The Supreme Court issued notice to MTNL, Canara Bank, and CANFINA.

Findings of the Court

In the proceedings before the Supreme Court, MTNL submitted that (a) there was no written arbitration agreement between the parties and therefore there was no valid arbitration agreement in terms of section 7 (3) and section 7 (4) (c) of the Act; and (b) since the bonds were purchased from MTNL by CANFINA, there was no privity of contract or legal relationship between MTNL and Canara Bank. On the other hand, Canara Bank objected to the joinder of CANFINA as a party to the arbitration proceedings.

Existence of a valid arbitration agreement

The Supreme Court perused the definition of 'arbitration agreement' under section 7 of the Act, the amendments introduced to section 7 by the Arbitration and Conciliation (Amendment) Act, 2015, and the decision of the apex court in *Khardah Company Ltd.*[2] Relying upon *Enercon*[3], the Supreme Court held that a common-sense approach has to be adopted to give effect to the intention of the parties to arbitrate the disputes, and being a commercial contract, the arbitration clause cannot be construed with a purely legal mindset.

The Supreme Court noted that Order I *inter alia* stated that "*the parties themselves have agreed to go in for arbitration as a mode for resolving their disputes*". Referring to *State of Maharashtra*[4] and *Chitra Kumari*[5], the Supreme Court concluded that the agreement between the parties is recorded in the judicial Order I and is final and conclusive. The Supreme Court held that having consented to refer the disputes to arbitration before the Court, MTNL is estopped from resisting arbitration on the basis that there is no written agreement.

Further, the Supreme Court observed that MTNL participated in the proceedings before the tribunal and filed its pleadings without raising any objection to the effect that there was no arbitration agreement in writing between the parties.

Since MTNL and Canara Bank had filed their pleadings before the tribunal, the Supreme Court held that the pleadings were evidence of the existence of an arbitration agreement which had not been denied by the other party under section 7(4) (c) of the Act.

Joinder of CANFINA

Reiterating the settled principles of law, the Supreme Court observed as follows:

- that an agreement entered into by one of the companies in a group, cannot be binding on the other members of the same group, as each company is a separate legal entity which has separate legal rights and liabilities;
- the parent, or the subsidiary company, entering into an agreement, unless acting in accord with the principles of agency or representation, will be the only entity in a group to be bound by that agreement. Applying the foregoing principle to an arbitration agreement, it emerges that only the company entering into the arbitration agreement shall be bound by it;
- a non-signatory can be bound by an arbitration agreement pursuant to the "Group of Companies" doctrine, where the conduct of the parties evidences the intent of the parties to bind the signatory and the non-signatory parties;
- relying upon Dow Chemicals6 and ICC Case No. 41317, the Supreme Court held that when the facts and circumstances of the case demonstrate that it was the mutual intention of all parties to bind both the signatories and the non-signatory affiliates in the group, the courts and arbitral tribunals have invoked the 'Group of Companies' doctrine;
- the Supreme Court held that the circumstances in which the 'Group of Companies' doctrine could be invoked are- if there is a direct relationship between the party which is signatory to the arbitration agreement; direct commonality of the subject matter; the composite nature of the transaction between the parties; and where there is a tight group structure with strong organizational and financial links, so as to constitute a single economic unit or a single economic reality.
- relying upon Chloro Controls8, and Ameet Lal Chand9, the Supreme Court noted that the 'Group of Companies' doctrine has been invoked in context of an international commercial agreement and a domestic arbitration respectively.

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[2] *Khardah Company Ltd.* v. *Raymon and Co. (India) Pvt. Ltd.,* [1963] 3 SCR 183.

[3] *Enercon (India) Ltd. and Ors.* v. *Enercon GMBH,* (2014) 5 SCC 1.

[4] *State of Maharashtra* v. *Ramdas Shrinivas Nayak,* (1982) 2 SCC 463.

[5] *Chitra Kumari* v. *Union of India* (2001) 3 SCC 208.

[6] *Dow Chemical v. Isover Saint Gobain,* 1984 Rev Arb 137; 110 JDI 899 (1983).

[7] Interim Award in ICC Case No. 4131, IX YB Comm Arb 131 (1984); Award in ICC Case No. 5103, 115 JDI (Clunet) 1206 (1988).

[8] *Chloro Controls India (P) Ltd. v. Severn Trent Water Purification Inc.,* (2013) 1 SCC 641.

[9] *Ameet Lal Chand Shah* v. *Rishabh Enterprises,* (2018) 15 SCC 678.

Applying the judicial precedents to the present facts, the Supreme Court observed that:

- CANFINA was a wholly owned subsidiary of Canara Bank;
- direct nexus between the issuance of the bonds, its subsequent transfer by CANFINA to Canara Bank, and the cancellation by MTNL, which has led to disputes between the three parties;
- determining the disputes only between MTNL and Canara Bank would be futile since admittedly, the original transaction emanated from a transaction between MTNL and CANFINA;
- CANFINA is a necessary and proper party to the arbitration proceedings;
- CANFINA participated in the proceedings inter alia before the Court in the Writ Petition (albeit as a proforma party) and before the tribunal. Hence, as evident from the conduct of the parties, there is implied or tacit consent by CANFINA to being impleaded in the arbitral proceedings.
- while CANFINA's counsel was not present when the matter was referred to arbitration, the same was not sufficient to disallow CANFINA from being impleaded in the arbitration because the order of the Court recorded that there was no necessity for requiring Canara Bank to take over the liabilities of CANFINA prior to the arbitration proceedings;
- The objection to CANFINA being impleaded in the arbitration was raised by Canara Bank and not CANFINA.
- upon examining the facts, it is noted that in the years 2009-2010, Canara Bank had circulated a draft arbitration agreement wherein it had stated the arbitration would be between Canara Bank and CANFINA as the first part and MTNL as the second part.

Conclusion

Based on the above findings, the Supreme Court invoked the 'Group of Companies' doctrine and joined CANFINA in the arbitration proceedings pending before the tribunal. The Supreme Court remitted the matter to the tribunal and clarified that it has not expressed any opinion on the merits of the dispute.

In Indian jurisprudence, arbitration agreements have been extended to non-signatories and on certain occasions such impleadment has also been refused, owing, *inter alia*, to party autonomy. Reflecting upon the recent position of the courts in India, it appears that the courts are recognizing and applying the rules of business efficacy to arbitration agreements. It is relevant to note that corporate ties within a group is not sufficient ground to implead a non-signatory, and mutuality of intention, the manner of performance of the contract in question, tacit conduct of the parties, and the role of the non-signatory in such performance of contract is likely to weigh in on the court before it orders impleadment of a non-signatory to arbitration proceedings.