



NON-SIGNATORIES BOUND BY AN ARBITRATION AGREEMENT*

Abstract

It is a recognised principle of contract law that an agreement binds only the parties to it, termed as the “rule of privity of contract”. Outsiders or the third parties to an agreement are not to fulfill any obligations and neither can they be sued by the parties to an agreement. This general rule has its exceptions which are well defined under the common law. However, nowhere does this rule lay that a third party is bound by the agreement merely because he is being referred to in the contract. The High Court of Bombay in the case of *Rakesh S. Kathotia & Anr. v. Milton Global Ltd. & Ors* has, however, held that non-signatories to an arbitration agreement are bound by the terms of it, if they are referred in the agreement.

The paper makes a comment on this decision and the consequences or the impact of such a ruling.

Keywords

Arbitration and Conciliation Act, 1996; parties to an agreement; non-signatories; arbitration agreement

Introduction

The consequence of any commercial agreement is that it binds the parties to it, i.e., bounds them to the obligations flowing under the agreement. It is well recognised that parties privy to the contract are the ones who can sue and be sued by each other. A third party or a stranger to the contract cannot sue the parties to it. Moreover, the parties to an agreement cannot impose any liability on a third party. This is what is known as ‘privity of contract’¹. The rule has its recognised exceptions² wherein the third party can also sue the parties to the contract and make them liable under the contract. However, what is to be noted is that the agreement is for the benefit of the third party or some advantage accrues to the stranger under the contract.

The Division Bench of a Bombay High Court (hereinafter referred to as “the Court”) has, however, in the case of *Rakesh S. Kathotia & Anr. v. Milton Global Ltd. & Ors*³, makes the third parties liable and imposes obligations on them under the agreement. The Court held that

* Ms. Kavita Chawla, Research Scholar, Faculty of Law, Jamia Millia Islamia, New Delhi.

¹ *M.C. Chacko v. State of Travancore*, AIR 1970 SC 500.

² The exceptions to the rule of privity between the parties to an agreement are the following: (a) Beneficiaries under a trust or a charge; (b) covenants running with the land; (c) Family arrangements, marriage settlements; (d) Estoppel; (e) Assignment; (f) Statutory exceptions.

³ 2014 SCC Online Bom 1119.

group entities which are non-signatories to an arbitration agreement will be bound by it, if they are referred to in the agreement.

Now, this is a significant departure from the traditional understanding of the contract and arbitration law. This is because, the whole purpose of signing a contract is to demonstrate intention to be bound by its terms and undertake to fulfill all the obligations flowing from it. If individuals/entities could become bound merely on the ground that a contract between some third parties makes a reference to them, the purpose of having a contract becomes defeated. This in turn, would mean that, consent is not required for becoming a part of an agreement. Neither is intention a significant essential for having a valid contract.

This paper addresses the issue raised by the judgment of the Bombay High Court.

Facts

A joint venture agreement was entered into by the 'Subhkam Group' and the 'Vaghani Group' constituting 'Milton Global Limited', a Joint Venture Company ("JVC"). The management of JVC was appointed by the 'Subhkam Group' – holding 49.99% of shares and 'Vaghani Group' – holding 50.01% of the shares. The JVC was to undertake distribution and marketing of 'Milton Plastic Limited', which was owned by the 'Vaghani Group'. However, the 'Vaghani Group' set up a competitive business through 'Hamilton Housewares Private Limited'. This was evident, as the authorised representative of the 'Vaghani Group' was also the managing director of Hamilton Housewares, to whom the business was being diverted to. Thus, the 'Subhkam Group' filed a petition seeking an injunction and other appropriate remedies under Section 9 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as "the Act").

The Single bench dismissed the petition on the ground that there was 'no identity' of the parties to the arbitration agreement. In particular, the Judge held that parties to the suit were not parties to the arbitration agreement and hence no remedy was available under the Act. The 'Subhkam Group' consequently filed an appeal challenging the decision.

The Division Bench reversed the decision on maintainability issue (holding the non-signatories are bound) but dismissed the appeal on merits. It is this reasoning that is the basis of controversy.

Legal Background

The case deals with the premise that even the non-signatories, i.e., entities who have not signed the agreement or who are not 'party' to it, can be bound by it and hence will be within the ambit of the court to conform to the necessary strictures. *Prima facie*, this goes against the principle of 'privity of contract'. The principle recognises that an agreement cannot confer any right or obligation on any person except the parties to it. However, this is exactly the moot point here. Entities who have not given their consent to the agreement will be burdened with liabilities.

Moreover, in the landmark decision of *Sukanya Holdings (P) Ltd. v. Jayesh H. Pandya*⁴ in which the Supreme Court had held, *inter alia*, that if the suit is between parties to the agreement and strangers to it, the court would not refer the parties to arbitration as the Act does not allow for dual actions of arbitration and suit to proceed simultaneously. In addition, such bifurcation of the case would mean inordinate delay which goes against the very notion of the Act.

⁴ (2003) 5 SCC 531.

Thus, faced with such unambiguous position of law and a clear precedent of the Supreme Court, it seemed that the Court will out rightly reject the idea of binding the non-signatories to the agreement. However, the Court gave an entirely different outcome.

The Judgment

To make the non-signatory affiliates bound, the Court had to first determine as to who are the parties to the agreement. The primary issue therefore was, whether the agreement was between ‘Subhkam Group’ and ‘Vaghani Group’ or between the named individuals.

For this it is pertinent to note the following definitions in the agreement:

“The Vaghani Group shall mean Milton Plastics Limited Mr Dineshkumar Ishwarlal Vaghani, Mr Kanaiyalal Ishwarlal Vaghani, Mr Chirnajiv Ishwarlal Vaghani, Mr Nilesh Ishwarlal Vaghani and Mr Madhup Bansilal Vaghani and their immediate relatives taken together and such other entities controlled by them or their immediate relatives directly or indirectly.”

“The Subhkam Group shall mean Mr Rakesh S Kathotia and such other entities controlled by him or his immediate relatives or his group companies directly or indirectly.”

The Court observed that on a bare perusal of the definition it is clear that the agreement was between the groups and not just the named individuals and thus would include their immediate relatives and other entities controlled by them. However, as these groups did not sign the agreement and thus had not given their consent, can they be made liable under it?

For this, the Court turned to the rules of interpretation. It noted that the on first principle the whole agreement must be given effect to and no part of it must be treated as inadequate or meaningless. If there is any ambiguity in its interpretation the intention of the parties must be looked at, which can be ascertained by the language used in the agreement. The Court reasoned that as the terms ‘Subhkam Group’ and ‘Vaghani Group’ have been used extensively in the agreement and more importantly these terms have been defined in the recitals of the agreement, it means that the parties intended to make the groups bound by the agreement and hence it cannot be said that there is no identity between the parties to the arbitration agreement.

Next, the Division Bench discussed as to how the principle of *Sukanya Holdings (P) Ltd. v. Jayesh H. Pandya*⁵ would not apply to the present case as here the suit is not against strangers but against groups which though are non-signatories to the agreement are referred extensively to in the arbitration agreement. This observation by the Court lay the foundation of what was to come next as it was clear that Court was differentiating between the two judgments based on the relation of the third parties with the parties of the agreement.

Further, the next issue was whether the Court could apply the principle of ‘group of companies principle’ approved by the Apex Court in *Cholro Controls India Private Limited v. Severn Trent Water Purification Inc. & Ors*⁶ for furthering its logic. The principle as developed by the Apex Court in that case is that a company, being one within a group of companies, can bind

⁵ *Ibid.*

⁶ (2013) 1 SCC 641.

its non-signatory sister or parent concerns, if the facts exhibit that the parties intended to bind the affiliates of the company. The Courts would look at the intention of the parties. This principle has been evolved in international context so as to help tribunals take jurisdiction over a non-signatory affiliate.

The Bombay High Court, however, clearly separated the two cases and held that the principle is not applicable to the current case as according to the Court the agreement in the instant case was between two 'groups' and not just the named individuals, who only acted as representatives of the groups.

The Court, thus, based on the above discussion held that the Single Judge was wrong in holding that there is no identity between the parties and thus held the non-signatories to be bound by the agreement. It is to be noted however that the Court on merits of the case dismissed the appeal.

Analysis

The impact of the judgment is powerful as it binds the non-signatories of an arbitration agreement to the terms and obligations set in it. At the first instance, the decision seems to be sound in law as the Court referred to the precedents and then step by step gave reasons as to why it does not agree with their application to the case at hand. However, the consequences of this decision are far reaching.

Firstly, it negates the settled principle of privity of contract – how can a third party be imposed with obligations under an agreement it neither sign and nor gave consent to? The whole concept of consent is changed by this judgment. The act of signing the agreement is rendered redundant as even the parties who did not sign it have become a part of it. In turn, it means that parties to an agreement can bind others to the contract simply by making references to them in the contract. This negates the significance of the concept of consent, which is an essential characteristic of a valid agreement. Moreover, the case does not seem to fit in any of the exceptions of the rule of "privity of contract".

Secondly, due to bad drafting on behalf of the lawyers, non-signatories can now be bound by the obligations of the contract. The draftsmen will have to be very careful and cautious of the language they use as now the agreements are open to be manipulated by the parties, who may take help of the judgment to shift the burden of obligations on the innocent 'non-party' to the agreement.

Lastly, even though the Court did not expressly apply 'group of companies' doctrine; the result was similar to it, as the Court considered intention of the parties as the dominant criteria for interpreting the agreement.

On a final note, the decision given by the Bombay High Court has placed the non-signatories in a very precarious position. The fact that third parties, by mere reference in the agreement can become bound to it is an end which even the parties to the agreement could not have anticipated when making such mentions in the arbitration agreement.