

(2016) 11 DEL CK 0058

In the Delhi High Court

Case No : Arb. A. (Comm.) 25 of 2016 & IA No. 9919 of 2016

M/s STCI Finance Limited

APPELLANT

Vs

M/s Sukhmani Technologies Pvt. Ltd.

RESPONDENT

Date of Decision : 15-11-2016

Acts Referred:

Arbitration and Conciliation Act, 1996 — Section 16, Section 37, Section 7

Citation : (2017) 2 ADDelhi 132 : (2016) 235 DLT 150 : (2016) 160 DRJ 332

Hon'ble Judges : Mr. Vibhu Bakhru, J.

Bench : Single Bench

Advocate : Mr. Achal Gupta and Ms. Annie Rais, Advocates, for the Respondent No. 5; Mr. Ashim Vachher, Mr. P. Piyush and Mr. Vaibhav Dabas, Advocates, for the Respondent Nos. 1 to 4; Mr. B.B. Gupta, Senior Advocate with Ms. Vinita Sasidhar, Advocate, for the Appella

Final Decision : Dismissed

Judgement

Mr. Vibhu Bakhru, J. - STCI Finance Limited (hereafter "STCI") has filed the present appeal under Section 37 of the Arbitration and Conciliation Act, 1996 (hereafter "the Act") for setting aside the order dated 27.04.2016 (hereafter "the impugned order") passed by the Sole Arbitrator, Justice R. C. Chopra (Retd.) under Section 16 of the Act. By the impugned order, the Arbitrator disposed of five applications filed by the respondents under Section 16 of the Act; he allowed the applications filed by respondent Nos. 2 to 5 but rejected the one filed by respondent no.1, Sukhmani Technologies Private Limited (hereafter "STPL")

2. The principal controversy involved in this petition is whether respondent nos 2 to 5 are bound by the arbitration clause in the "Facility Agreement" executed between STPL (through respondent no. 2) and STCI.

3. Before addressing the controversy, it is relevant to briefly narrate the background in which the applications filed by respondent nos. 2 to 5 under Section 16 of the Act came to be considered by the Arbitrator.

4. STCI (formerly known as Securities Trading Corporation of India Limited) is a Non-Banking Finance Company registered with the Reserve Bank of India. STPL is a private limited company, registered under the Companies Act, 1956, and engaged in trading of computers hardware and networking equipment. Respondent Nos. 2 and 3 are the Directors of STPL and respondent No. 4 is a sister concern of STPL. Respondent no. 5 is a Director of respondent no. 4. In the present appeal, no relief is being sought against respondent no. 5 and he has been arrayed only as a proforma respondent.

5. It is stated that in the month of January 2012, STPL approached STCI for granting a loan of Rs.50 crores. STCI vide Letter of Intent dated 08.02.2012 (hereafter "LOA") agreed to sanction loan amount to the extent of Rs.50 crores against pledge of equity shares of Tulip Telecom Ltd. (hereafter "Tulip"). An agreement captioned "Facility Agreement" was executed between STCI and STPL on 10.02.2012 setting out the terms for the grant of loan.

6. In order to secure the loan facility granted by STCI, STPL along with respondent nos. 2 and 4 executed a Share-Pledge Agreement dated 10.02.2012, pledging shares of Tulip held by them with STCI. In addition to the Share-Pledge Agreement, respondents also executed various other documents like irrevocable Demand Promissory Note, continuing Security Letter, Irrevocable Power of Attorney, Undertaking-cum-Indemnity, Declaration, etc. Respondent nos. 2 and 3 also executed the Deeds of Guarantee dated 10.02.2012 and 19.10.2012 guaranteeing the repayment of loan disbursed in favour of STPL.

7. Respondent Nos. 2 and 3 are the owners of Property bearing No. 5, Paschimi Marg, Vasant Vihar, New Delhi- 110057 (hereafter "the Vasant Vihar property"). They offered the said property to STCI as collateral security and created a second mortgage on the said property, as the first charge was in favour of HDFC Ltd.

8. In view of certain defaults in the repayment of loan, STCI by a letter dated 19.05.2014 called upon STPL to clear its outstanding dues. Thereafter, on 01.08.2014, STCI declared the account of STPL as "Non-Performing Asset" (NPA) and issued a legal notice dated 02.09.2014, stating that an amount of Rs.55,21,68,064/- was outstanding as on 01.09.2014. On 15.09.2014, STCI sent another legal notice invoking the guarantees. Vide the said legal notice, STCI once again called upon the respondents to clear the outstanding amount of Rs.55,21,68,064/-. It is claimed that despite the above notices, the respondents have failed to clear the outstanding dues. In view of the default in payments, STCI during the period of August 2012 to October 2012 invoked pledge of 1,01,50,000 shares, out of the 1,37,13,000 unencumbered equity shares pledged by respondent nos. 2 and 5.

9. STCI invoked the arbitration clause on 12.02.2016 and called upon the respondents to pay a sum of Rs.70,36,97,219.5/-. The Arbitrator vide order dated 02.04.2016, directed respondent nos. 2 and 3 to not to dispose of the

Vasant Vihar property without the permission of the Arbitrator. Thereafter, the each respondent filed a separate application under Section 16 of the Act, praying for termination of the proceedings against them.

10. Vide order dated 27.04.2016, the Arbitrator dismissed the application filed by STPL as the Arbitrator held that the pleas raised by STPL in regard to the existence of the Facility Agreement containing Arbitration Clause and the termination thereof, cannot be adjudicated upon without allowing the parties to adduce evidence which according to the Arbitrator, was not possible at that stage.

11. With regard to the applications filed by respondent nos. 2 and 3, the Arbitrator observed that respondent No. 2 and 3 were not parties to the Facility Agreement. He held that respondent no 2 had signed the same as an Authorised Signatory on behalf of STPL and was not the borrower. The Deeds of Guarantee dated 10.02.2012 and 19.10.2012 executed by respondent Nos. 2 and 3, by which they had guaranteed re-payment of the loan, did not contain any arbitration clause. Consequently, the Arbitrator held that in the absence of any Arbitration Agreement between STCI and respondent nos. 2 and 3, invocation of arbitration against them was without any basis and bad in law.

12. Insofar as respondent no. 5 was concerned, the Arbitrator held that respondent no. 5, being a director of STPL, cannot be held personally liable for the amounts payable by the company unless they have undertaken some liability in their personal capacity; that is, independent of the liability of the Company. Thus, the application of respondent no. 5 was also allowed.

13. Similarly, the application filed by respondent no. 4 was also allowed as the Arbitrator held that mere reference of the Share-Pledge Agreement in the Facility Agreement and vice-versa, did not establish that the Arbitration Clause in the Facility Agreement also applied to respondent nos. 2 and 4 being the signatories to the Share Pledge Agreement. The Arbitrator further noticed that Article 1 of the Facility Agreement was incorporated into the Share Pledge Agreement vide Clause 1.24 of the Share Pledge Agreement but no similar stipulation was made in the Share Pledge Agreement in regard to the Arbitration Clause contained in the Clause 21.12 of the Facility Agreement.

14. STCI has challenged the impugned order mainly on the grounds that:

(i) the Guarantee Deeds and the Share Pledge Agreement are not distinct and separate from the Facility Agreement and have to be read in consonance with each other; (ii) the Guarantee Deeds stipulate that respondent nos. 2 and 3 shall be deemed to be principal debtors for the loan and payment thereof, thus, making them jointly and severally liable for the same and (iii) Respondent No.4 being a sister company of STPL would also be liable as it was a party to the Share Pledge Agreement which forms part of the same commercial transaction .

Submissions

15. Mr. B.B. Gupta, learned Senior Advocate appearing for STCI earnestly

contended that the Facility Agreement was in the nature of a framework contract and other agreements such as guarantee deeds and Share Pledge Agreement were subsumed as a part of the contract which was recorded in the Facility Agreement. He strongly relied upon clause 1.15 of the Facility Agreement which specifically included the LOA, the Facility Agreement, share pledge agreement, power of attorney, demand promissory notes, continuing security letter, deed of guarantee, board resolution and other documents within the definition of "Facility Documents". He also relied on the decisions of this Court in *Canbank Financial Services Ltd. v. SFL Industries Ltd.*: (2004) ILR 1 Delhi 430; the decision of the Bombay High Court in *M/s Sahyadri Earthmovers & Ors. v. L& T Finance Ltd. & Ors.*: 2013 (3) ABR 602; and the decision of the Supreme Court in *Chloro Controls (I) P. Ltd. v. Severn Trent Water Purification Inc. and Ors.*: (2013) 1 SCC 641 in support of his contention that even non-signatories could be made parties to arbitration proceedings if the agreements executed by them were interrelated and formed a part of a composite transaction.

16. Mr. Ashim Vachher, learned counsel appearing for the respondents countered the contentions advanced on behalf of STCI. He submitted that the arbitration agreement was an independent agreement and even though parties had signed several documents, which may be related to the main facility agreement, the same did not imply that the parties had agreed to the arbitration clause. He contended that the parties would be bound only by the covenants of their respective agreements and not by terms of an agreement not executed by them.

17. He relied on the decision of the Supreme Court in *M.R. Engineers and Contractors Pvt. Ltd. v. Som Datt Builders Limited* (2009) 7 SCC 696 in support of the contention that unless an arbitration agreement was specifically incorporated by reference in a contract between the parties, the parties would not be bound by the arbitration agreement.

Reasoning and Conclusion

18. The Facility Agreement has been executed by STPL and STCI. Although, respondent no. 2 has signed the agreement but the same is only in his capacity as an authorised signatory of STPL. Thus, only STCI and STPL are parties to the loan facility agreement. The Share Pledge Agreements were executed by STPL as well as respondent nos. 2 to 5 on the same date. Apart from the aforesaid agreement, other deeds such as irrevocable demand promissory notes, continuing security letter, irrevocable power of attorneys, undertaking/indemnity declaration etc. were also signed. Respondent nos. 2 and 3 also signed deeds guaranteeing the repayment of loan advanced by STCI to STPL. Admittedly, the Facility Agreement includes an arbitration clause, however, other deeds such as deeds of guarantee do not contain any arbitration clause. The limited question to be addressed is whether respondent nos. 2 to 5 are bound by the arbitration clause under the Facility Agreement.

19. Undisputedly, the Facility Agreement is only executed between STCI and

STPL. This is clear from the description of the parties. STPL is referred to as a "Borrower" which would also include "its successors and permitted assigns". Article 1.5 of the Facility Agreement defines borrower to mean:

"Borrower(s) includes a Co-Applicant or Co-Applicants and its/their respective successors (in the case of corporate bodies)/heirs, legal representatives, executors and administrators (in the case of an individual)/partners of the said firm for the time being and from time to time survivor or survivors of them and the legal representatives, heirs, executors and administrators of each partner (in the case of a partnership firm) and permitted assigns."

20. Article 21.12 (ii) of the Facility Agreement is the arbitration clause, which read as under:-

"21.12 (ii) Arbitration

(a) If any dispute or difference arises between the Parties hereto during subsistence of this Agreement or thereafter, in connection with the validity, interpretation, termination, implementation or alleged breach any provision of this Agreement or regarding any question relating hereto the Parties hereto shall endeavour to settle such dispute or difference amicably. In the event that they are unable to agree to an amicable solution to the dispute or difference within a period of 30(thirty) days, from rising of the dispute or difference, such dispute of difference shall be decided by a sole Arbitrator appointed by STCI. The cost of arbitration shall be borne by the Borrower.

(b) The arbitration proceedings shall be governed by the provisions of (Indian) Arbitration and Conciliation Act, 1996. The place of the arbitration shall be New Delhi. The proceedings of arbitration shall be in the English language."

21. It is clear from the plain language of the said clause that only the parties to the Facility Agreement have agreed to refer their disputes to arbitration. Clearly, no other person, other than the parties to the Facility Agreement would be bound by the arbitration clause unless such agreement is inferred from the language of any deed or the document executed by that person.

22. Mr. Gupta, learned Senior Advocate for STCI has laid heavy reliance on clause 1.15 of the Facility Agreement, which reads as under:-

"1.15 "Facility Document" means each of the following:

- (a) Letter of Intent
- (b) This Facility Agreement
- (c) Share Pledge Agreement
- (d) Power of attorney
- (e) Demand Promissory Note

(f) Continuing Security Letter

(g) Deed of Guarantee

(h) Board Resolution

(i) Any other deed, document or writing as may be prescribed by STCI"

23. In my view, the said clause is not relevant as even though the facility document may include by incorporation other agreements and deeds, the same does not mean that the terms of the Facility Agreement have also to be read in the separate agreements included within the scope of the expression "Facility Document" as used in the Facility Agreement. The import of clause 1.15 in the context of the arbitration clause, at best, is that the disputes between the parties to the Facility Agreement - which means STPL (the borrower) and STCI - relating to the agreements referred to in the said clause 1.15 would also be decided by arbitration. The expansive definition of the expression "Facility Document" does not mean that the arbitration clause would also bind persons other than the parties to the Facility Agreement. Thus, the question whether the disputes between STCI and respondent nos. 2 to 5 are also to be decided by Arbitration has to be answered by ascertaining the true meaning of the documents executed by the said respondents. If the language of the said documents indicates that the said respondents have agreed to incorporate the arbitration clause in the Facility Agreement by reference in their respective agreements, then plainly, STCI must succeed in its claim that respondents are bound by that clause; and, the question whether there exists an arbitration agreement between STCI and the respondents, must be answered in the affirmative.

24. Section 7 of the Act defines an arbitration agreement. Section 7(5) of the Act expressly provides that "the reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract."

25. In *M.R. Engineers and Contractors* (supra), the Supreme Court explained the scope of Section 7(5) of the Act in the context of a question whether an arbitration clause contained in a main contract would stand incorporated by reference in a sub-contracts where the sub-contracts provided that it "shall be carried out on the terms and conditions as applicable in the main contract". The Supreme Court explained that:

"15. Section 7(5) therefore requires a conscious acceptance of the arbitration clause from another document, by the parties, as a part of their contract, before such arbitration clause could be read as a part of the contract between the parties. But the Act does not contain any indication or guidelines as to the conditions to be fulfilled before a reference to a document in a contract, can be construed as a reference incorporating an arbitration clause contained in such document, into the contract. In the absence of such statutory guidelines, the normal rules of construction of contracts will have to be followed.

33. An arbitration clause though an integral part of the contract, is an agreement within an agreement. It is a collateral term of a contract, independent of and distinct from its substantive terms. It is not a term relating to "carrying out" of the contract. In the absence of a clear or specific indication that the main contract in entirety including the arbitration agreement was intended to be made applicable to the subcontract between the parties, and as the wording of the subcontract discloses only an intention to incorporate by reference the terms of the main contract relating to execution of the work as contrasted from dispute resolution, we are of the view that the arbitration clause in the main contract did not form part of the sub-contract between the parties."

26. It can hardly be disputed that the Share Pledge Agreement and deeds of guarantee executed are inextricably linked with loan extended by STCI to STPL. Indisputably, STCI had extended loan on the terms and conditions as agreed to by the respondents, which included the obligations as accepted by the respondents in terms of various deeds and agreements executed by them. However, since the agreements executed by the respondent nos. 2 to 5 do not include an arbitration clause, it cannot be held that the said respondents had agreed that their disputes with STCI be also referred to arbitration.

27. It is relevant to note that Article 1.24 of the Share Pledge Agreement specifically records that "Article-1 of the Facility Agreement is incorporated into this Agreement as if set out in full and as if references to "this Agreement" were references to this Agreement". Thus where the parties to the Share Pledge Agreement desired to incorporate the terms of Facility Agreement, they had provided for the same. Thus, the obvious inference that can be drawn is that the parties did not agree that the disputes between the parties to the Share Pledge Agreement be decided by arbitration.

28. As explained by the Supreme Court in *M.R. Engineers and Contractors* (supra) an agreement to refer disputes to Arbitrator is an independent and a separate agreement and unless it is ascertained that the parties had agreed to refer disputes to arbitration in terms of a separate arbitration agreement, the same cannot be considered as incorporated by reference.

29. The decision in the case of *Chloro Controls (I) P. Ltd.* (supra) must also be understood in the context as explained by the Supreme Court. In that case, the Court had held that a non-signatory or a third party could be subjected to arbitration without their prior consent but this would only be in exceptional cases. It would be essential for the Court to ascertain that there was a clear intention of the parties - both the signatory as well as non-signatory - to resolve the disputes by arbitration. The Supreme Court further explained that the Court would examine the exceptions on the touchstone of the direct relationship to the party signatory to the arbitration agreement, direct commonality of the subject matter and the agreement between the parties being a composite transaction.

30. The Court had further explained that a transaction would be of a composite nature where performance of a mother agreement would not be feasible without aid and performance of supplementary or ancillary agreements. Above all, the Court had emphasised that the intention of the parties to refer all disputes between all parties to the Arbitral Tribunal would be one of the determinative factors.

31. The question whether an arbitration clause could be extended to a non-signatory has arisen mainly in the context of a non-signatory party "claiming" through or under a signatory party. In this context, the Courts have expanded the scope of an arbitration agreement to also include non-signatories and have held that non-signatories claiming through or under a signatory could compel the other signatory party to arbitrate the subject disputes. This is quite different from a signatory proceeding against a non-signatory by claiming the non-signatory to be connected with the transaction with the non-claimant signatory party. In the former case, there is no dispute that the person being proceeded against in arbitration has consented that the subject disputes be decided by the arbitration. In such cases, the Courts would stretch to ensure that such party does not avoid its contractual commitment to have the subject disputes decided by arbitration. By seeking a reference to arbitration, either under Section 45, 11 or 8 of the Act, a non-signatory party has voluntarily committed, to have the subject disputes decided by Arbitration. Thus, the fundamental condition of consent of both parties is met. However, compelling a non-signatory to subject itself to a claim in arbitration is significantly more difficult. In such cases, the Courts must come to a clear conclusion that the non-signatory party has agreed to arbitration.

32. In *Chloro Controls (I) P. Ltd.* (supra), the Supreme Court had referred to the text in *Law and Practise of Commercial Arbitration in England* (Second Edition) by Sir Michael J. Mustill. The relevant extract from the decision of the Supreme Court is as under:-

"65. Normally, arbitration takes place between the persons who have, from the outset, been parties to both the arbitration agreement as well as the substantive contract underlining that agreement. But, it does occasionally happen that the claim is made against or by someone who is not originally named as a party. These may create some difficult situations, but certainly, they are not absolute obstructions to law/the arbitration agreement. Arbitration, thus, could be possible between a signatory to an arbitration agreement and a third party. Of course, heavy onus lies on that party to show that, in fact and in law, it is claiming "through" or "under" the signatory party as contemplated under Section 45 of the 1996 Act. Just to deal with such situations illustratively, reference can be made to the following examples in *Law and Practise of Commercial Arbitration in England* (Second Edn.) by Sir Michael J. Mustill:

1. The claimant was in reality always a party to the contract, although not named in it.

2. The claimant has succeeded by operation of law to the rights of the named party.

3. The claimant has become a part to the contract in substitution for the named party by virtue of a statutory or consensual novation.

4. The original party has assigned to the claimant either the underlying contract, together with the agreement to arbitrate which it incorporates, or the benefit of a claim which has already come into existence."

33. The decision of the Bombay High Court in *M/s Sahyadri Earthmovers (supra)*, is distinguishable as in that case, the Court had come to an affirmative conclusion that the loan agreement, which contained the arbitration clause, had been made a part and parcel of the deed of guarantee. In view of the clear explanation of law by the Supreme Court in *M.R. Engineers and Contractors (supra)*, unless the Court finds that the terms of the arbitration agreement - which is a separate and independent agreement - have been incorporated by way of reference in an agreement between the parties, the parties cannot be referred to arbitration. Similarly, in *Canbank Financial Services Ltd. (supra)*, the Court had come to a conclusion that there was a clear reference to the lease agreement in the deed of guarantee and it was specifically recorded that the guarantor had requested the claimant (lessor) to give the equipment described in the lease agreement on lease to the lessee. In the facts of that case, the Court came to the conclusion that the arbitration clause under the lease agreement was specifically incorporated in the deed of guarantee.

34. The agreement to stand as a surety for due performance of the contract between the principal debtor and the lender although linked to the principal contract is, nonetheless, an independent contract.

35. Mr. Gupta has been unable to point out any clause of the respective agreements executed by the respondents which would indicate that they had agreed for reference of the disputes to arbitration. In view of the law as explained in *M.R. Engineers and Contractors (supra)*, this Court is unable to accept that respondent nos. 2 to 5 had agreed to be bound by the arbitration clause under the Facility Agreement.

36. In *S. N. Prasad v. Monnet Finance Ltd. and Ors.*: (2011) 1 SCC 320, the Supreme Court rejected the contention that since the liability of the principal debtor and guarantor was joint and several and, therefore, the guarantors should also be compelled to join the arbitral proceedings even though they were not the signatories to the loan agreement which contained the arbitration clause. The relevant extract of the said judgment is reproduced below:-

"21. The first respondent contended that the appellant having agreed to be a guarantor for the repayment of the loan, cannot avoid arbitration by contending that he was not a signatory to the loan agreement containing the arbitration clause. It was submitted that the liability of the principal debtor and guarantors

was joint and several and therefore there could be only one proceeding against all of them; and that if the contention of the appellant was accepted, it would necessitate two proceedings in regard to the same loan transaction and same cause of action, that is, an arbitration proceedings against the borrower and one of its guarantors (Respondents 2 and 3) and a separate suit against the other guarantor (appellant). It was further submitted that multiple proceedings may lead to divergent findings and results, leading to an anomalous situation.

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24. The apprehension of the first respondent that an anomalous situation may arise if there are two proceedings (one arbitration proceedings against the borrower and one guarantor and a suit against another guarantor), is not a relevant consideration as any such anomalous situation, if it arises, would be the own making of the first respondent, as that is the consequence of its failure to require the appellant to join in the execution of the loan agreements. Having made only one of the guarantors to execute the loan agreements and having failed to get the appellant to execute the loan agreements, the first respondent cannot contend that the appellant who did not sign the loan agreements containing the arbitration clause should also be deemed to be a party to the arbitration and be bound by the awards. The issue is not one of convenience and expediency. The issue is whether there was an arbitration agreement with the appellant."

37. This Court finds no infirmity with the view expressed by the Arbitrator and the appeal is, accordingly, dismissed. The pending application stands disposed of.