

Dispute Resolution Hotline

June 27, 2017

DELHI HIGH COURT: FAILURE TO MEET THE CONTRACTUAL OBLIGATIONS IS NO GROUND FOR LIFTING THE CORPORATE VEIL

- Delhi High Court holds that mere failure of a corporate entity to meet its contractual obligations is no ground for piercing the corporate veil.
- the arbitral tribunal is a creation of limited jurisdiction, and does not have the power to pierce the corporate veil.
- the arbitration agreement can be extended to non-signatories only if: (a) the court comes to the conclusion that there is an implied consent; and (b) there are reasons to disregard the corporate personality thus, making the shareholder(s) answerable for the obligations of the company.
- Held that the decision of the arbitrator falls foul of the fundamental policy of Indian law that recognizes that a company is an independent juristic person.

A single judge bench of High Court of Delhi ("**High Court**") in *Sudhir Gopi ("Petitioner") v. Indira Gandhi National Open University and Ors ("Respondent / IGNOU")* held that the decision of arbitral tribunal to pierce the corporate veil is flawed and falls foul of the fundamental policy of Indian law that recognizes that a company is an independent juristic person.

BRIEF FACTUAL BACKGROUND

Universal Empire Institute of technology ("**UEIT**") entered into an agreement with IGNOU on 16 November 2005 wherein UEIT agreed to act as a partner institute of IGNOU, and run a centre in Dubai. The Petitioner was the Chairman and Managing Director of UEIT. Subsequently, a dispute arose between the parties, and IGNOU terminated the agreement with UEIT, invoked arbitration and claimed USD 14, 48,046 in aggregate which included USD 5,00,001 as loss of goodwill.

During the course of the arbitral proceedings, the arbitral tribunal directed UEIT to file a statement clarifying the nature and character of UEIT and whether the signatory of the reply (Mr Gopi i.e. the Petitioner) was authorized to represent UEIT. Thereafter, UEIT confirmed that the Petitioner was representing UEIT as its Managing Director in terms of resolution passed by UEIT authorizing him to do so. It appears that the Petitioner was not made a party to the proceedings. UEIT further clarified that the reply was filed by the Petitioner in his capacity as a Managing Director, and not in his personal capacity.

The Arbitral Tribunal held that the Petitioner and UEIT are jointly and severally liable, and directed them to pay USD 6,64,070 to IGNOU with the interest of 12% per annum, as well as cost of proceeding.

CONTENTION OF THE PARTIES

Petitioner:

The Petitioner contended that:

- an arbitral tribunal does not have the power to proceed against any person who was not a signatory/ party to the arbitration agreement;
- the impugned award was without jurisdiction to the extent that Petitioner was also made liable for the awarded amounts;
- Petitioner had preferred the counter claims on behalf of UEIT and not in his personal capacity.

Respondent:

The Respondent contended that:

- the Petitioner held 99 shares out of [100] shares issued by UEIT, and was the sole person in charge of running its affairs.
- the Petitioner was running the business under the facade of UEIT and essentially there was no difference between Petitioner and UEIT.
- the Petitioner had filed counter claims jointly with UEIT, and his consent to arbitrate must be inferred.
- The decision of the Tribunal to hold that the Petitioner is an alter ego of UEIT could not be faulted.

JUDGMENT

As per Section 7(3) of the Arbitration and Conciliation Act, 1996 ("**Act**"), an arbitration agreement must be in writing. The High Court, in the present case, held that the Agreement was not signed by the Petitioner in his personal

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capacity. None of the communications produced provided a record of an agreement between the Petitioner and IGNOU to arbitrate. The Court observed that the arbitral tribunal, being a creature of limited jurisdiction, has no power to extend the scope of the arbitral proceedings to include persons who have not consented to arbitrate¹.

The High Court relied on ***Chloro Controls India Private Limited v. Severn Trent Water Purifications Inc. & Others: 2013 (1) SCC 641***, and opined that the arbitration agreement can be extended to non-signatories in limited circumstances; *first*, where the Court comes to the conclusion that there is an implied consent and *second*, where there are reasons to disregard the corporate personality of a party, thus, making the shareholder(s) answerable for the obligations of the company.

The High Court observed that in case of implied consent, the consent of non-signatory (ies) to arbitrate is inferred from the conduct and intention of the parties. Therefore, where it is apparent that the non-signatory (ies) intended to be bound by the arbitration agreements, the Courts have referred such non-signatories to arbitration. Further, the High Court observed that the corporate personality may be disregarded where a corporate form is used to perpetuate a fraud, to circumvent a statute or other misdeeds. In such instances, the Courts have disregarded the corporate facade and held that the shareholders/ directors (the alter egos) accountable for the obligations of the corporate entity².

The High Court observed that there is no requirement to get into the merits of the dispute in view of the fact that arbitral tribunal cannot lift the corporate veil. Notwithstanding the same, the High Court examined the facts and circumstances of the present case and observed that:

- The arbitral tribunal has lifted the corporate veil only for the reason that UEIT's business was being conducted by the Petitioner who was also the beneficiary of its business being the absolute shareholder of UEIT.
- Mere failure of a corporate entity to meet its contractual obligations is no ground for piercing the corporate veil.
- Although the arbitral tribunal has mentioned in passing that UEIT was used for improper purpose, however, there is no foundation for such observation.
- It was never IGNOU's case that UEIT was set up or used to perpetuate a fraud on IGNOU and at any rate, no particulars - that are required to be pleaded to set up a case of fraud - to indicate that a fraud had been perpetrated were pleaded by IGNOU.
- The decision of the arbitral tribunal to pierce the corporate veil is fundamentally flawed, and falls foul of the fundamental policy of Indian law that recognizes that a company is an independent juristic person.

ANALYSIS

This is a welcome judgment which provides a good jurisprudence on two important issues: (a) when can non-signatories to an arbitration agreement be joined as parties to an arbitral proceedings; (b) who and when can the corporate veil of a company be pierced to implead the officials responsible towards the company.

The High Court has correctly reasoned that arbitral tribunal being the creation of a contract cannot be vested with the power to pierce the corporate veil. If the arbitral tribunals are allowed to pierce the corporate veil, there are chances of abuse, as nearly in every case the parties would seek piercing of the corporate veil. Even the ruling that corporate veil should be pierced only in rare cases i.e. where a corporate form is used to perpetuate a fraud is a sound decision. The power to pierce the corporate veil should be sparingly used, and the concept that the company is an independent juristic person should be upheld.

The other interesting finding from this judgment is that separate legal personality of corporate bodies has been classified to come under fundamental policy of Indian laws and cannot be violated. Therefore, one should be mindful as any arbitral awards may be set aside on this ground.

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You can direct your queries or comments to the authors

¹The High Court relied on Oil and Natural Gas Corporation Ltd v. Jindal Drilling and Industries Limited: 2015SCC Online Bom 1707, Great Pacific Navigation (Holdings) Corporation Limited v. M V Tongli Yantai: 2011 Law Suit (Bom) 2095, Balmer Lawrie & Company Ltd. v. Saraswathi Chemicals Proprietors Saraswathi Leather Chemicals (P) Ltd: EA (OS) No. 340/2013 in Ex. P. 280 / 2012, decided on 17.03.2017. The High Court also referred to the decision of Supreme Court in *Indowind Energy Limited v. Wecare (India) Limited: 2010 (5) SCC 306*.

²While coming to this conclusion, the High Court also referred to the judgment of Chloro Controls India Private Limited v. Severn Trent Water Purifications Inc. & Others 2013 (1) SCC 641

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