

Update

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A guarantor cannot be referred to arbitration on a dispute of non-payment of loans arising from a loan agreement the guarantor did not sign (Delhi High Court) (14 January 2020)

by Prerna Seerwani

STCI Finance Ltd. v. Shreyas Kirti Lal Doshi & another

Court: Delhi High Court | **Case Number:** CS (COMM) 528 of 2019 | **Citation:** 2020 SCC OnLine Del 100 | **Bench:** V Kameswar Rao J | **Date:** 14 January 2020

A. The background

STCI Finance, the plaintiff, had given loans to a company called Shrenuj Investments and Finance Pvt. Ltd. (“Shrenuj”) under two Loan Facility agreements. The loan was guaranteed by the defendants, the Directors of Shrenuj, under two Deeds of Guarantee. The Directors were not parties to the Facility Agreements. The Facility Agreements had an arbitration clause, the Deeds of Guarantee did not.

On default, STCI commenced arbitration against Shrenuj under the second Facility Agreement.^[1] [1] After adjustment of proceeds from the sale of pledged shares as well as amount paid, the loan account under the first Facility Agreement was closed. [Show More](#) It also brought this suit against the Directors under the Deeds of Guarantee. The Directors filed an application under Section 8 of the Arbitration and Conciliation Act, 1996 (“ACA”) to refer the matter to arbitration.^[2] They argued that both matters had the same cause of action and set of documents, there was commonality of subject matter and all transactions were composite. [2] Section 8: – Power to refer parties to arbitration where there is an arbitration agreement— (1). A judicial authority, before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party to the arbitration agreement or any person claiming through or under him, so applies not later than the date of submitting his first statement on the substance of the dispute, then, notwithstanding any judgment, decree or order of the Supreme Court or any Court, refer the parties to arbitration unless it finds that prima facie no valid arbitration agreement exists. (2). The application referred to in sub-section (1) shall not be entertained unless it is accompanied by the original arbitration agreement or a duly certified copy thereof. [Show More](#)

Kameswar Rao J considered the matter and dismissed the application.

B. The court’s reasoning

This is how the court arrived at its conclusions: –

- a. The Facility Agreement contains an arbitration clause. There is no arbitration

- clause in the Deeds of Guarantee.
- b. The Facility Agreement refers to the Deed of Guarantee, but they do not come under the definition of “facility document”. Mere reference does not mean that Deeds of Guarantee which were executed separately will form a part of Facility Agreement.
 - c. The intention of the parties to execute the Deeds of Guarantee was to guarantee the loans given by Shrenuj in their personal capacity.
 - d. Thus, the arbitration clause of the Facility Agreement does not apply on parties to Deeds of Guarantee. The relationship between the parties shall be regulated strictly in accordance with the terms of Deeds of Guarantee.
 - e. The following authorities were referred: –
 - i. *R. Engineers and Contractors v. SomDatt Builders Ltd.*,^[3] ^[3] *M.R. Engineers and Contractors v. SomDatt Builders Ltd.*, 2009 7 SCC 696. Show More where the Supreme Court held that Section 7(5) ACA^[4] ^[4] Section 7 (5): 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. Show More makes it clear that mere reference to a document cannot have the effect of incorporating the arbitration clause, and, also the reference should be such that it shows the intention to incorporate the arbitration clause. V.K. Rao J. held there is nothing in Deeds of Guarantee to show the parties’ intention to incorporate the arbitration clause of the Facility Agreement.
 - ii. *Sunil Nanda v. L & T Finance*^[5] ^[5] *Sunil Nanda v. L & T Finance* 2014 SCC Online Del 1057. Show More and *STCI Finance Limited v. Sukhmani Technologies Pvt. Ltd* ^[6] ^[6] *STCI Finance Limited v. Sukhmani Technologies Pvt. Ltd* 235 (2016) DLT 150. Show More — In *Sunil Nanda*, where an “identical issue arose for consideration”, it was held that the arbitrator was wrong in binding the guarantor in the award passed by him. In *STCI*, even though various other agreements were executed between the parties, it was held that only the signatories were bound by the loan facility agreement containing arbitration clause.
 - iii. *N. Prasad, Hithek Industries Ltd. v. Monnet Finance Limited*^[7] ^[7] *S.N. Prasad, Hithek Industries Ltd. v. Monnet Finance Limited* 2011 1 SCC 320. Show More where the contention that the non-signatory guarantor should be compelled to join the arbitration since its liability was joint and several with the principal borrower was rejected.
 - iv. *MSTC Ltd. v. Omega Petro Products*^[8] ^[8] *MSTC Ltd. v. Omega Petro Products* 2018 SCC Online Bom 487. Both *M.R. Engineers* and *S.T. Finance* were followed by *S.C. Gupte, J.* The three conditions set out in *M.R. Engineers* were followed, namely,; (i) clear reference to the document contained in the arbitration clause; (ii) such reference indicating an intention to incorporate the arbitration clause, and (iii) the arbitration clause being appropriate or capable of being applied in respect of all disputes under the referring contract and not being repugnant to any term of that contract. Show More where it was held that the main loan agreement and the deed of guarantee although linked, are independent contracts, and thus the arbitration clause of the main contract / loan agreement needs to be specifically incorporated.^[9] ^[9] In *SMS Tea Estates v . Chandmari Tea Company* 2011 14 SCC 66, the Supreme Court held that even if multiple agreements have been entered into between parties; arbitrator can only be appointed with regard to the disputes relating to agreement containing arbitration clause. Show More
 - f. The court then held that the Supreme Court’s judgment in *Chloro Controls India Pvt. Ltd. v. Severn Trent Water Purification (Chloro)*^[10] (which the defendants were relying on) is distinguishable on facts. In *Chloro* there was a

joint venture agreement interlinked with other supplementary agreements. The court there said that a non-signatory can be referred to arbitration without prior consent if the transaction is of a composite nature where the performance of the principal or the mother agreement may not be feasible without the aid, execution and performance of supplementary agreement or ancillary agreements for achieving the common object, and collectively having a bearing on the dispute. [10] *Chloro Controls India Pvt. Ltd. v. Severn Trent Water Purification* 2013 1 SCC 641. [Show More](#)

The court noted that STCI Finance had already earlier distinguished Chloro. The court “agree[d] with the distinction drawn by the court.”

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