

Enforceability of Award on Third Parties

Facts:

1. A is a Private Limited Company which owns a property (**Said Property**).
2. All the shares of A are held by members of the same family and A has granted diverse tenancies in favour of the diverse members of the said family (**Tenants**),
3. The Tenants occupy diverse portions of the Said Property as tenants of A but they are also shareholders of A.
4. Some of the Tenants are even directors of A.
5. A has engaged B to develop the Said Property on terms and conditions recorded in an agreement (**Development Agreement**) and such development is contemplated in two phases. In the first phase a building is to be constructed on the lawn portion (**Said Building**) and the Tenants of A are to be shifted to the Said Building by vacating the existing building and then the existing building is to be demolished and the second phase is to be constructed. The obligation to deal with the Tenants and cause them to vacate the existing building and shift to the Said Building has been agreed to be undertaken by A in the manner mentioned in the Development Agreement.
6. Terms and conditions with regard to the vacating of the Tenants and their occupation of the Said Building have also been recorded under several agreements between A of the one part and each of the Tenants of the other part (**Tenant Co-operation Agreements**) but the Tenant Co-operation Agreements are prior to the date of the Development Agreement.
7. X is the sole arbitrator under each of the Tenant Co-operation Agreements.
8. Pursuant to the Development Agreement B has constructed the Said Building and requested A to take possession but such possession is not being taken and several disputes have arisen.
9. The said disputes have been referred to an arbitral tribunal comprising of X Y and Z and the proceedings are in an advanced stage but no award has yet been made.

Queries:

1. Can an award passed in the pending arbitration between A and B bind the Tenants?
2. Is the fact that X is the sole arbitrator under the Tenant Co-operation Agreements and also one of the members of the arbitral tribunal under the Development Agreement of any importance or relevance in this regard?

Opinion:

1. It is a well-settled principle of law that a stranger is not bound by an arbitration award in the absence of a special contract entered into with the stranger. An award would also be void if it directs specific performance of things which are impossible to perform. In the instant case, the Tenants are not a party to the arbitration agreement between A and B and hence the award directing specific performance of contract between A and B which involves inter alia shifting of the Tenants by A, suffers from the principle of impossibility of performance in as much as the Tenants are refusing to shift and they cannot be compelled to shift by virtue of the award passed in the arbitration proceeding between A and B. This will eventually render the award void.
2. However, considering the fact that A is the owner-company and the Tenants are its directors and shareholders, by applying the doctrine of lifting of corporate veil, the Tenants (directors and shareholders of A) can be compelled and made bound by the award although the Tenants are not a direct party to the arbitration agreement. It has been observed in *LIC -v- Escorts Limited*¹ that a company has an independent and legal personality distinct from the individuals who are its members but the corporate veil may be lifted, the corporate personality may be ignored and the individual members recognised in certain exceptional circumstances such as impugned conduct and the effect on parties who may be affected. It has been observed in *Indian Oil Corporation Limited -v- Chief Inspector of Factories*² that it has to be seen who has the 'ultimate control' over the affairs of the company. All the activities of the company are carried out by the shareholders and directors with a corporate mask. It has further been held in *Tata Engineering & Locomotive Company Limited -v- State of Bihar*³ that where the courts are able to ignore the corporate entity and to treat the individual shareholders as liable for its acts, the same course can be adopted. Where fraud is intended to be prevented, the veil of a corporation is lifted by judicial decisions and the shareholders are held to be the persons who actually work for the corporation. In *Delhi Development Authority -v- Skipper Construction Company Limited*⁴ the Supreme Court observed that the concept of corporate entity was evolved to encourage and promote trade and commerce but not to commit illegalities or to defraud people. Where, therefore, the corporate character is employed for the purpose of committing illegality or for defrauding others, the court would ignore the corporate character and will look at the reality behind the corporate veil so as to enable it to pass appropriate orders to do justice between the parties concerned. In the instant case the owner company A is a cloak behind which lurks the directors and the shareholders, the Tenants.
3. Moreover, in *Gobardhan Das -v- Lachhmi Ram*⁵ it is held that an award ought to determine and dispose of the controversy submitted so thoroughly that there cannot be any scope for future litigation. In the instant case, even if the immediate disputes between A and B are taken care of, the scope of future litigation remains open in as much as one of the obligations of A under the contract between A and B is to deal with the Tenants who are not parties to the arbitration agreement and hence not bound by the award. Thus by combining the principals of lifting of corporate veil and complete

disposal of subject matter of controversy, the award made by X, Y and Z can compel the Tenants to obey and carry out the directions contained in the award.

4. In *Ram Dutt Ramissen -v- Sassoon & Co.*,⁶ it has been held that to make an award binding upon a stranger, there should be a clear and unambiguous agreement to that effect. Further, ordinarily an award does not affect the rights of a stranger or bind the stranger but an award against a stranger can be admissible in evidence. A stranger against whom the award is not admissible in evidence however may be bound by the award by subsequent conduct and acquiescence. In this case, the Tenants, as shareholders of A, have acquiesced to the dealings of A and B and thus should be bound by the award made in the arbitration proceeding between A and B.

¹ (1986) 1 SCC 264, AIR 1986 SC 1370

² (1998) 5 SC 738

³ AIR 1965 SC 40

⁴ (1996) 4 SCC 622

⁵ AIR 1954 SC 689

⁶ AIR 43 Cal 77