



Karnataka High Court holds that sub-contractors, though not parties to main contract, are entitled to invoke arbitration¹

Brief Facts

The Hon'ble Karnataka High Court has passed a common order in proceedings where M/s Siddharth Infotech Pvt. Ltd. ("Petitioner No. 1") and Everonn Education Ltd. ("Petitioner No. 2") in separate Writ Petitions had challenged the arbitrary rescission of the contract dated 22 July 2011 ("Agreement"), whereby the Government of India, State of Karnataka and six other Respondents violated Article 14 of the Constitution.

The Agreement was between Government of Karnataka through Commissioner for Public Instructions and M/s Karnataka State Electronics Development Corporation ("KEONICS") for modernising computer infrastructure in schools under a scheme approved by the Government of Karnataka ("GoK"). The Agreement expressly permitted KEONICS to appoint sub-contractors and consortium partners. Petitioner No. 2 formed a consortium which became the subcontractor of KEONICS for supply and maintenance of computer hardware and materials. Both Agreements had arbitration clauses. The Petitioners furnished Performance Bank Guarantees to the GoK to secure advance payment, however such payment was never made for two years. Petitioner No. 1 entered the consortium in 2015. Thereafter, the GoK passed order dated 5 July 2016 ("Order") terminating the project on grounds of delay, and directing return of the Petitioners' Bank Guarantees. However, *vide* communication dated 30 July 2016, the GoK reversed its stand

and decided to withhold the Bank Guarantees worth Rs. 22,43,15,270.

Thus, the Petitioners challenged the rescission of the Agreement by the GoK, as well as its Order withholding the Petitioners' Bank Guarantees. The two Writ Petitions were heard analogously and decided by a common order due to common questions of law and fact.

Issue

Whether the Petitioners, being non-parties to the Agreement, have the authority to invoke the arbitration clause contained therein?

Judgment

The Petitioners argued that being non-parties to the Agreement, they had locus to file the writ petitions instead of pursuing arbitration proceedings since the instant case was one of violation of Article 14 of the Constitution. Petitioner No. 1 also argued that since it was not the principal consortium member, it was not party to any Contract with the GoK or KEONICS and therefore could not initiate arbitration proceedings.

The Court noted that it was a settled proposition of law that writ jurisdiction cannot ordinarily be invoked if an arbitration clause exists, and that if the facts involve disputed questions of fact, parties should be relegated to arbitration.

Referring to the Supreme Court case of *Chloro Controls India Pvt. Ltd.*² wherein it was held

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that arbitration could be possible between the signatory to an arbitration agreement and a third party, especially when the claimant has succeeded by operation of law to the rights of the named party in the contract, the Hon'ble High Court held that the Petitioners have stepped into the shoes of the subcontractors and are parties to the Agreement although not named in it. The rights of the named party have devolved on the Petitioners by operation of law and therefore, the Petitioners have the authority to invoke the arbitration clause. In coming to this conclusion, the Court considered the fact that under the Agreement, KEONICS had express authority to appoint sub-contractors, and that the Petitioners' Bank Guarantees had been accepted by the GoK.

Analysis

The Hon'ble High Court, after the narration of facts, had to deal with two issues, namely that: (i) the Petitioners were not parties to the main Agreement between the GoK and KEONICS; and (ii) that even in the sub-contract, only Petitioner No. 1 was a signatory and that

too in the capacity of a consortium leader, and Petitioner No. 2 was not a signatory to any contract. In referring the Petitioners to arbitration, the Court has diluted the principles of privity of contract and allowed a sub-contractor to take recourse to arbitration against the owner/principal employer. The principles enunciated in the present case may have far reaching implications in other multi-tier contracts such as construction contracts and change the contractual liabilities between owners, contractors and sub-contractors who enter into agreements containing an arbitration clause.

Although not referred to, this judgment is in line with the recent Supreme Court decision in **Ameet Lalchand Shah v. Rishabh Enterprises**³ where it was held that interconnected agreements with a similar underlying commercial purpose would bind all the parties to the agreements, even though one of the agreements might be lacking an arbitration clause, or an entity is not party to all such agreements.

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1 Authored by Siddhartha Datta, Partner, and Surabhi Binani, Associate; **M/s Siddharth Infotech Pvt Ltd v. Government of India & Ors.**, WP No. 56088 of 2016 & WP No. 1982 of 2018, Karnataka High Court, judgment dated 11 September 2019.

Quorum: Alok Aradhe, J.

2 (2013) 1 SCC 641, para 70.

3 (2018) 15 SCC 678, para 25.

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