

Dispute Resolution Hotline

December 04, 2008

SUPREME COURT DIRECTS DIRECTOR TO ARBITRATION

The Supreme Court of India (“**Supreme Court**”) in a recent decision dated November 6, 2008, in the matter of M/s. Comed Chemicals Ltd (“**Applicant**”) Vs. C.N. Ramchand (“**Respondent**”) in Arbitration Petition No. 17 of 2008, (<http://judis.nic.in/supremecourt/qrydisp.aspx>) expounded upon the applicability of the Arbitration & Conciliation Act, 1996 (“**Act**”), and held that where a director of a company performed functions which were inextricably linked with functions which could be undertaken by a businessman or by a company and which activities formed an integral part of the director’s activities, any dispute between them would be considered as commercial in nature and capable of being arbitrated, notwithstanding the existence of a master-servant relationship, if any.

FACTS OF THE CASE

The Applicant was in the business of chemicals in the field of bio-technology. With a view to expand its business operations, the Applicant incorporated a subsidiary called Comed Biotech Ltd. (“**Subsidiary**”). The Applicant had appointed the Respondent for the development of products in the field of bio-industries and manufacturing and marketing of such products. Pursuant to various meetings and negotiations, terms and conditions were finalized and the Respondent was appointed as Director (Technical) by the Applicant pursuant to a Memorandum of Understanding (“**MOU**”).

The Applicant alleged that the Respondent did not take interest in work and inter alia failed to attend board meetings. Accordingly, disputes arose between the parties and the Applicant invoked the arbitration clause in the MOU. As the parties were unable to agree upon an arbitrator, the Applicant filed an Arbitration Application under Section 11 of the Act in the High Court of Gujarat for appointment of an arbitrator. However, the Respondent *inter alia* contended that since he is a British National, the present dispute would be an ‘*international commercial arbitration*’ as defined in Section 2(1)(f) of the Act. The Applicant accordingly withdrew the petition and filed the same before the Supreme Court.

Before the Supreme Court, the Respondent argued that as he was an employee of the Applicant-company, the relationship created was that of a master and servant, and therefore no commercial dispute was involved rendering the dispute incapable of being arbitrated.

JUDGMENT:

The Supreme Court, after considering the legal position and facts of the case held that the functions to be performed by the Respondent were of a dual capacity, i.e. (i) as an employee, and (ii) as a director. In the latter capacity, he was the Chief Executive Officer of the Subsidiary and had to look after all operational matters. The functions performed by him were supervisory in nature and he was involved in policy making decisions and therefore, this part of the relationship being commercial in nature, any dispute between them would be arbitrable.

The Supreme Court further held that the application filed by the Applicant must be allowed by holding that the case was covered by clause 2(1)(f) of the Act, i.e. international commercial arbitration, and proceeded to appoint a sole arbitrator to decide the dispute between the parties.

The Supreme Court, relying on its earlier decision in *R.M Investment & Trading Co. Pvt. Ltd. v. Boeing Co. and Anr*¹ reiterated that even though the Respondent was a director, functions performed by him were supervisory in nature and he was involved in policy making and any dispute between the Respondent and the Applicant would be considered as commercial in nature and therefore should be subject to arbitration.

The Supreme Court in the instant case relied on the principle as evolved in the case of *Lee v. Lee's Air Framing Ltd*² that a director is a controller of the company's affairs and is not a mere servant of the company. Such director may have to work also as an employee in a different capacity. The Supreme Court also relied on a recent case of *Citibank N.A. v. TLC Marketing PLC and Anr*³ wherein it was held that a commercial contract must be broadly construed with a view to give efficacy to such contract rather than to invalidate it. The Supreme Court, placing reliance on its earlier decisions, observed that “...while construing the expression “commercial” in Section 2 of the Act it has to be borne in mind that the Act is calculated and designed to subserve the cause of facilitating international trade and promotion thereof by providing for speedy settlement of disputes arising in such trade through arbitration and any expression or phrase occurring therein should receive, consistent with its literal and grammatical sense, a liberal construction.”

ANALYSIS AND IMPLICATIONS:

The decision of Hon'ble Supreme Court in the present case reiterates the proposition that by virtue of the fiduciary duties and responsibility conferred on a director, the director becomes an integral part of the management and is also instrumental in framing the policies and procedure for the company and thus cannot be merely a servant of the company. Further, even if the director is discharging the functions of an employee pursuant to an agreement, such

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agreement should be construed liberally and in a manner which would be in furtherance and promotion of international trade and enable a speedy settlement of disputes. Vikram Shroff, head of the firm's Human Resources Law practice, states that "the labour laws allow industrial disputes to be resolved through arbitration although those laws largely apply to 'workmen', which *inter alia* excludes managerial level employees. The Supreme Court decision helps reaffirms the position that it is possible to resolve disputes with directors through arbitration, assuming the parties have agreed to such an arrangement." Thus it may be said that any dispute between the company and its director or its employee, which arises out of a contract for service would be a commercial dispute and would be arbitrable if the same is provided in the contract.

- **Vedant Shukla, Sahil Kanuga & Vyapak Desai**

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1. **(1994) 4 SCC 541**
 2. **1961 AC 12**
 3. **(2008) 1 SCC 481**
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