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JUDICIAL INTERVENTION IN CORPORATE AFFAIRS

by

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Joint stock business companies are now fairly old. They have a long history behind them.[1] Formation, administration and liquidation of such companies have from the very beginning been attended by public consequences. This is so because their capital stock is raised from the public in general[2] and they have "the enormous power to affect the lives of labourers and consumers."3 Naturally for the protection of these corporate constituencies, almost every aspect of the company's life has been made a matter of public gaze. Registration of principal documents at a public office "has been one of the main pillars of the company law structure."4 Similarly, company's relations with the contributors of its capital including debentureholders and creditors are one of the principal themes of the Companies Act. Some measure of protection is now afforded to corporate employees and consumers. All this creates an impression that perhaps business companies are under strict public control exercised through legislative and judicial institutions. But this is not precisely so. Both the legislature and courts have afforded to the corporate sector a fair measure of independence.

The courts have been particularly reluctant in probing into the business life of a company. On several occasions they deliberately shut their doors against those complaining of corporate abuses because they do not want to incur "the danger of having to run all corporations."5 Thus it is not very easy to secure the interposition of the court

between the shareholders and the managers of their company. Following are a few of the situations in which the court's intervention has been desired and has not been forthcoming.

1. If anything comes near to the contribution of "limited liability" to the growth of business, it is the transferability of shares. An investor in a joint stock company loses permanently his ownership of the money which he has handed over to the company. His only property is the right to dividend and the value which the stock market would place upon his shares. Market value depends, among many things, upon the ease of transfer. The Companies Act allows companies by their articles to place reasonable restrictions upon the right of transfer.[6] Articles usually leave the matter to the discretion of directors. The courts have persistently refused to interfere in the exercise of this descretion,7 except when caparice or lack of good faith is apparent on the face of the directors' refusal.8 The legislature attempted to remove the effect of this judicial reluctance by introducing s.111. This section enables the Central Government to direct registration of transfer. But no sooner the Central Government attempted to exercise this power that the Supreme Court intervened and held that the power was just like that of the court, that is to say, of judicial nature and could be exercised only in the circumstances in which the court could have exercised it, namely, when the directors' refusal is a capricious, corrupt or malafide. 9

2. Another ground on which shareholders have been seeking the help of the courts is their right to participate in further issues of capital. "Economic theory demands that business be run by the man who takes the profit."10 Company law follows this theory by making the shareholders" the ultimate and final authority within the corporate enterprise."11 But this theory is totally divorced from practice. Shareholders no longer hire their managers. It seems managers hire their capital.12 Shareholders are investors, "who for the most part do not wish to be bothered, except by dividents."13 This facilitates managerial self-perpetuation. The economic power of companies instead of democratising itself tends to concentrate in the hands of a few capitalist -turned

managers.[14] The Companies Act tries in many ways to strengthen the thinking shareholder voice in corporate control.[15] Section 81 of the Act is one of such provisions. This section enables a shareholder to maintain his voting strength by subscribing for a proportionate number of shares in further issues of capital. Formerly this right could be excluded by a simple majority of shareholders, but now a special resolution is necessary.[16] But even this is not likely to prove an effective protection in view of the fact that shareholder power these days resides in the managers. Hence the shareholders' right to equilibrium of voting power can be protected only by the court importing the fiduciary principle into the exercise of the power of excluding existing shareholders from participation in further issues.[17] But the Supreme Court refused to do so in the admirable opportunity that came before it in Shanti Prasad Jain v. Kalinga Tubes Co.[18]

3. Directors have generally been regarded as representatives, trustees and agents of the corporate body and not of the corporators. They owe all their duties to the mythical entity and none to its members. This enabled directors to conceal confidential information fromthe members about the company's potentialities and strike a deal for their shares.[19] But this was one occasion when the courts should have come out to rescue shareholders from manipulations by extending the concept of trusteeship and making the directors responsible not merely to the institution but also to those whose interests were affected by their decisions. A faint beginning has already been made and if the facts of Percival v. Wright[20] are repeated the result would probably be different both due to the statutory changes[21] and changed attitude of the courts.[22] Today directors cannot always act under the impression that they owe no duty to individual shareholders. But this rudimentary duty to them may remain as unenforceable as the social obligations of business unless it is clearly recognised that not merely the company but also all its members shall be the beneficiaries of the fiduciary obligation.[23]

4. The general principle relating to the conduct of corporate litigation as against outsiders is that only the board of directors are competênt to decide whether or not the company should sue for a wrong done to it. But where the directors refrain from enforcing the company's right and it appears that their inaction is more due to malafides than sould commercial policy, the court will readily allow any shareholder to sue in the name of the company.24 But where a wrong is done by the corporate insider, the principle of Foss v. Harbottle applies.25 Ever since this decision, it has become axiomatic that all wrongs which can be confirmed by a majority of shareholders should not be made the subject of barren litigation at the instance of a shareholder. The court was afraid of its process being frustrated by a majority condoning the directors' frauds and that the court's attempt to settle majority and minority relations on such matters might mean an unwarranted interference in corporate affairs.26 The principle has been applied to a great variety of cases. It has been used to cover improper applications of corporate assets,27 negligent deals and deliberate delays which defeat the company's reasonable business opportunities,28 issue of further shares not in the interest of the company but only to keep directors in power by frustrating a take-over bid.29 Its latest applications are reflected in the decisions of the Court of Appeal in Hogg v. Cramphorn Ltd.30 and Bamford v. Bamford.31 Thus the rule is being constantly applied while the conditions in which it was laid down do not exist today. Its prime base is the authority of the general meeting to condone the directors' sins. But the general meeting today is not as real as it was in 1843. The modern shareholder has been described as an sbsentee owner[32] and a passive lender of money[33] whose only interest in the company is a reasonable return on capital. He always votes "yes" at the proxy machine. When directors have their conduct approved by the general meeting what happens is nothing more than the directors affirming their own conduct in the name of the general meeting. Their power to manipulate votes cannot be ignored. Thus the legitimacy for corporate decisions must be found in some other quarter than the ritualistic general meeting of shareholders.34 The courts must keep these developments in mind before shutting their doors to a minority shareholder's derivative action in a situation which is not covered by the traditional exceptions to Foss v. Harbottle.

These exceptions embody situations where managerial sins are so serious that they cannot be ignored even if they are affirmed by a majority of shareholders. But is there any remedy when their sins affect workers or consumers, rather than shareholders. Suppose that a motor company decides to reduce the strength of the tin used in manufacturing their car seriously affecting its durability and utility. Do consumers have any remedy? 35 Suppose again that an employee is subjected to hostile discrimination or action. Courts have always turned down the aggrieved employee's appeal on the simple grounds that there has been no breach of contract and that prerogative writs cannot be issued against private business. Even a government company is a private individual for this purpose.36

Thus company law is today beset with two cross developments. There is a growing pressure on the one hand to regard the company as a social organism or a tool for social ends and that the company is "a combined political, economic and social institution" with responsibility to all parties to industry.37 But, on the other hand, when an attempt is made to use the visitatorial jurisdiction of the court against public institutions, it is frustrated by identifying the company with the private individual.38

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FOOTNOTES

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1. The history of joint stock companies is traced in many learned works the latest among which is Leonard W. Hein: British Business Company; Its origins and Control, (1963-64) 15 Toronto L.J.134.

2. See, for instance, Woodrow Wilson; The New Freedom, (1968) Jaico, p. 27, where the former U.S. President traces the importance of the corporation to American people.

3. Joseph L. Weiner: The Berle Dodd Dialogue of the Concept of the Corporation, (1964) 64 Col. L.R.1458 quoting from Dodd's review of Dimock & Hyde: Bureaucracy and Trusteeship in Large Corporation, 9 U. Chi. L.R. 538 (1942).

4. The Rt. Hon. Lord Wilberforce: Law and Economics, (1966) Journal of Business Law, 301, 302.

5. Roscoe Pound: Visitatorial Jurisdiction over Corporations in Equity, (1936) 49 H.L.R. 365, 393.

6. S. 82, Of the Indian Companies Act, 1956.

7. See, for example, In re Smith & Fawcett Ltd., (1942) 1 Ch. 304 and Balwant Transport Co. Ltd. v. Deshpande, A.I.R. 1956 Nag. 20.

8. In re Greshame etc. Society (1872) 8 Ch. App. 452; Re Coal Port China Co. (1895) 2 Ch. 404; Re Bell Bros. (1891) 65 L.T. 245; Indian Chemical Products Ltd. v. The State of Orissa (1966) 2 Comp. L.J. 63 S.C.

9. Harinagar Sugar Mills v. Shyam Sunder Jhunjhunwala, A.I.R. 1961 S.C. 1669.

10. J.A.C. Hatherington: Fact and Legal Theory: Shareholders, Managers and Corporate Social Responsibility, (1969) 21 Stanford L.R. 248, 250.

11. Ibid.

12. James Burnham: The Managerial Revolution, London, (1942) and Horace B. Samuel; Shareholders' Money (1933) London.

13. J.A. Livingston: The American Stockholder, (1958) p.38 and Gilbert: Dividents and Democracy, 1956.

14. Emerson & Latham: Shareholder Democracy, (1954).

15. D.L. Mazumdar: Towards a Philosophy of the Modern Corporation, where the learned writer gives an account of all such provisions of the Act.

16. S. 81 (1A).
But where only an ordinary resolution has been passed, consent of the Central Government would be necessary which can be granted only when the resolution is in the best interest of the company. See Avter Singh: Preemptive Right of Shareholders: A Comparative Study, (1969) Shareholders Journal, 16.

17. There is nothing new in this demand. It has always been recognised that majorities may control but when they do so they have to act as fiduciaries. See Gower: Principles of Modern Company Law, (1957, 2nd ed.) the chapter on Controlling Shareholders' Duties.

18. (1965) 1 Comp.L.J. 193. For a criticism of this decision see P.S. Sangal: Abuse of Authority by a Majority Shareholder in a Company, (1964) 10 J.I.L.I. pp. 394-409.

19. The adverse effects of this rule upon economic have been pointed out by Rt. Hon. Lord Wilberforce in Law and Economics, (1966) Journal of Business Law, p. 307.

20. (1843) 2 Hare, 461; 67 E.R. 189.

21. Sections 319 to 321 of the Indian Companies Act, 1956.

22. Regal Hastings Ltd. v. Gulliver & Others, (1942) 1 All. E.R. 378.

23. Joseph L. Weiner: The Berle Dodd Dialogue of the Concept of the Corporation, (1964) 64 Colum.L.R. 1458. See also Goyder: The Responsible Company, (1961).

24. Marshall's Valve Gear Co. Ltd. v. Manning Wardley & Co. Ltd., (1909) 1 Ch. 276 and Glass v. Atkins, (1967) 65 D.L.R. (2d.) 501.

25. (1843) 2 Hare 461; 67 E.R. 189

26. See, for example, A.J. Boyle: Minority Shareholder in the Nineteenth Century, (1965) 28 Mod. L.R. 317; K.W. Wedderburn: Shareholders' Rights and the Rule in Foss v. Harbottle, (1957) Camb. L.J. 194 (1958) Camb. L.J. 93; A liberal Approach to Foss v. Harbottle, (1964) 27 Mod. L.R. 603.

27. Something of the sort was involved in Foss v. Harbottle itself.

28. Heyting v. Dupont, (1963) 1 W.L.R. 1192.

29. Bhajekar v. Shinkar, A.I.R. (1934) Bom. 243; Jhajaria Bros. v. Sholapur Spinning & Weaving Co., A.I.R. 1941 Cal. 420.

30. (1967) Ch. 254; (1966) 3 W.L.R. 995; 3 All. E.R. 420.

31. (1969) 2 W.L.R. 1107, criticised by K.W. Wedderburn in Unreformed Company Law, (1969) 32 Mod. L.R. 563.

32. Thorstein B. Veblen: Absentee Ownership and Business Enterprise, (1923).

33. Berle A.A. Jr.: Power Without Property, and The Twentieth Century Capitalist Revolution. The receding position of the shareholder was first convincingly demonstrated in Berle & Means: Modern Corporation and Private Property, (1932).

34. See O. Kahn-Freund: Company Law Reform, (1964) 9 Mod. L.R. 235, 245-46.

35. See Eugene v. Rostow: To Whom and for What End is the Corporate Management Responsible, in The Corporation in the Modern Society, Ed. Mason.

36. R. Lakshmi v. Neyveli Lignite Corporation Ltd. (1966) 1 Comp. L.J. 289; The Praga Tools Corporation v. C.A. Imanul, (1970) 1 Comp. L.J. 50,(S.C.). This identification of the Government company with the private individual has been criticised by Thurman V. Arnold in The Folklore of Capitalism, (1956) p. 193, where the learned writer says; "The Government found that by adopting the device of a government corporation it gave its activities a little of the freedom which was enjoyed by private corporations and escaped the rules and principles which hampered action when it was done by a government department instead of a government corporation. In other words, it gave the Government some of the robes of the individual."

37. Berle A.A. Jr.: Foreword to The Corporation in Modern Society, edited by Mason and Legal Problems of Economic Power, (1960) Colum. L.R. 4. D.L. Mazumdar: Companies and the Rule of Law included in the above cited book on Towards a Philosophy of the Modern Corporation.

38. Arnold; Folkore of Capitalism, p. 193.