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DIRECTORS - CONTROL OF SHAREHOLDERS

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INTRODUCTION

Directors are given certain powers statutorily under the Companies Act, 1956. The sphere of their action is wide enough. They can give legal colour to their actions and at the same time abuse their powers under the legal camoflouge. The companies Act of 1956 has not placed many felters on the directors, nor has it given sufficient powers to Shareholders to control effectively the actions of directors. There should be counter checks also to prevent shareholders, from harassing the honest directors and maintaining the cordinal principle of company law namely the supremacy of the majority. These aspects of the company law may be classified under the "unreformed company law." Under the conditions prevailing in India, it can be said that "the company Law is dangerously out of tough with reality" and a tighter social control has to be introduced in the working of the company Law and a change in 'the Philosophy of the company Law' is absolutely necessary and in this it is better we formulate our own guide lines than to ape and copy the developments in the English Law.

PROBLEM

The problem may be stated as follows. How can the shareholders effectively control the directors so that the directors always act 'in the interests of the company'. This can be tackled from various angles. (1) breaches of duty committed due to 'bad faith' or Malafide acts. (2) acts done for collateral purpose. (3) mismanagement. (4) Oppression (5) negligence (6) misfeesance.

Rule in Foss v. Harbottle.[1] It is well known that the rule in Foss v. Harbottle lay down that the court will not interfere at the instance of the minority when the majority has power to do an act. The more important dictum of the court should not be overlooked, "if justice demands the technicalities of company Law cannot prevail." "It is incongrous that it is often only when the company is in its dying throes that it is able to break the directors' strangle hold on its litigation machinery and impeach the cause of its demise."[2] Only when the matter comes up before the court, the situation can be rectified but it may be too late to grant any adequate relief.

FIVE PRINCIPLES

Five principles[3] of Company Law may be stated as follows: (1) The memorandum and articles constitute a statutory contract and therefore each individual member can sue to assert his personal rights qua member. (2) He cannot sue, however where the matter is within the control of an ordinary majority in general meeting by the reason of the rule in Foss v. Harbottle. (3) Although the residual powers of control are still regarded by courts as belonging to the general meeting, nevertheless when the articles delegate powers to directors the general meeting cannot interfere with the exercise of those powers. (4) The shareholders' personal right of action probably extends to a right to have the constitution generally observed. (5) The individual shareholders can bring in representative form a corporate or derivative action to protect his company's rights against wrong doers who are in control and have committed fraud.

BAMFORD V. BAMFORD[4]

In this case the right of a minority shareholders to sue where the directors are alleged to have acted for a collateral purpose against a prospective take over, was considered. Harman L.J. considered it a 'tolerably plain case' because it was 'trite Law' and 'a common.place of company Law' that absolution and forgiveness of their sins could be obtained by directors through ratification at a general share-holders' meeting by ordinary resolution after full dischosure whether the sins were lack of a quorum at a director's meeting, defects in their appointment or the fact that they were actuated by unproper motives.

RE INTRODUCTIONS LTD.[5]

A Bank lent money to a company on the security of debentures knowing that the money was for its main business, pig breeding and that its stated objects did not include that business or anything remotely like it. The objects included a sub-clause namely 'to borrow or raise money in such manner as the company shall think fit....' and the objects were each 'independent objects? The pig breeding business was a 'disastrous failure.' It was held by Buckley J. that the sub-clause was not a seperate object and that the banks loan was ultravires and the debentures were void. The court of Appeal upheld his decision. Harman L.J. observed "a power or object conferred on a company to borrow cannot mean something in the air; borrowing is not an end in itself and must be for some purpose of the company; and as this borrowing was for an ultravires purpose that is an end of the matter".

HOGG V. CRAMPHORAN LTD.[6]

Bamford v. Bamford is a case parallel to Hogg v. Cramphorn Ltd. In that case it was demonstrated that enenthough a minority shareholder could sue to challenge acts of directors for collateral purpose (the issue of new shares to retain control for the directors) his action might be ultimately defeated because the court would send the matter back for a decision by the general meeting. In Bamford's case directors issued ordinary shares previously unissued according to the express power given in the articles. Two shareholders alleged that the directors had not exercised the power bonafied in the best interests of the company. At a general meeting the issue of the share was approved but plaintiff alleged that such a ratification was invalid.

Plowman J. assumed for the purpose of the preliminary issue that the allegation was correct that the directors did not exercise their power of allotment benafide in the interests of the company, but the assumption was that the board exceeded its powers and not that it acted malafide. The logic of both the Hogg and Bamford judgments is that the minority shareholder may file a suit despite the fact that the directors owe their duties only to the company and not to the shareholders. Plowman J. stated that the articles of a company constitute a contract binding on the company and all its members and each member is entitled as against the company and every other member to require that the affairs of the company shall be conducted according to the articles for the time being in force. This proposition demonstrates that the plaintiffs are suing in respect of their own individual contractual rights and that the rule in Foss v. Harbottle is therefore excluded. This constitutes an enlargement of the minority's contractual rights by adding principle (iv) to principle (1). Bamford's case added further authority to the view that principle (iv) is correct. If ratification were not to take place the minority plaintiff might now have a new opportunity to stop managerial improprieties, and may be allowed locus standii to prevent breaches which involve 'secret profits' or indeed the breach of any fidiciary duty.

AMERICAN AUTHORITY

7

Hawkes v. Oakland lays down the basic principles of American rule in the modern farm. Ultravires acts or any farm of frandulent conduct which oppressed the minority directly in respect of their rights as shareholders or indirectly by defrauding the corporation are brought within the rule justifying the interference by the court. These grievances must exist as the foundation of the suit but in addition the plaintiff must show that he has exhausted all means of redress within the corporation. The American rule lay down that the minority must first demand from the directors redress for their grievances before coming to court. American 'requirement of demand' does not apply to shareholders' actions to enforce their own rights under the statute. It is confined to minority actions for wrongs to their corporations.

COMMITTEE REPORTS

The Jenkins committee report on Company Law in England recommended that the court should have discretion to allow minority action in the name of the company against directors others for any breach of duty. In this the Jenkins committee has learnt from American experience.8 The Lawrence committee in Ontario has recommended that subject to certain procedural safeguards against actions in bad faith, a shareholder should be able to maintain an action in a representative capacity for himself and all other shareholders of the company suing for and on behalf of the company to enforce any rights, duties or obligations owed to the company which could be enforced by the company.

SUGGESTIONS

The Companies Act of 1956 has laid down some remedies to control the directors and to protect the interests shareholders' and to punish fraudulent acts of the officers of the company. To prevent the fraud by the Officers of the company including the directors and to control the directors some suggestions are submitted in this paper taking into consideration the conditions existing in India namely (a) majorities in meetings of a company are manipulated by directors (b) the shareholder is indifferent (c) the directors are 'big shots' and shareholders are afraid to comment or criticise their actions (d) Selfishness of the shareholders generally makes cooperation impossible (e) most of the frauds are discovered only after the factor in the course of winding up (f) the evidence may not be available to a shareholder.

Having in view the above, the following suggestions may be considered.

1. Actions which are not purely personal but complain of acts of directors of Officers of the company which are not in the interests of the company must be permitted.

2. Duties of the directors must be laid down clearly and must be made more onerous. An objective test for the duty of care is preferable, so that only persons with special qualifications may be the directors.

3. An Ombudsman for every region may be statutorily appointed so that any person or a member or an employee of the company may give information of fraud or acts not in the interests of the company. The Ombudsman may move the central Government or take such steps or advise the shareholders as he thinks fit. This may prevent frauds at an early stage.

4. The official liquidator may be given power to take appropriate actions to prevent fraud and consequent collapse of the company on the complaint by any person including a shareholder.

5. A Vigilance cell consisting of 5 or more shareholders may be statutorily appointed by election or nomination to be C.I.Ds. over the activities of the directors.

6. Effective social control on the working of the companies may be introduced as in the case of insurance companies under the 1968 Amending Act for eg ;(a) power to call for the meeting of the board of directors. (b) to send special nominees to attend, watch and report on the meeting of directors. (c) to give directions, a special officer may be appointed as the comptroller of companies.

7. The expressions 'in the interests of company' may be well defined.

8. The expression 'Company fraud' may be well defind.

9. The ethical rules may be ommitted in the companies Act and a general objective test for the standard of morality may laid down.

10. The terms 'oppression' and mismanagement must be defined precisely and liberal rules must be laid down suitable to Indian consitions.

REFERENCES

* Lecturer, Andhra University, Waltair

1. (1843) 2 Hare 467.

2. Vol. 32, Modern LAW REVIEW P.512 (extensively quoted).

3. Vol. 31, Modern LAW REVIEW P. 688 (-do-

4. [1969] 2 W.L.R. 1107.

5. [1969] 1 All. E.R. 887.

6. [1967] Ch. 254.

7. 104 U.S. 450.

8. Vol. 28, Modern LAW REVIEW P.328.