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OPPRESSION AND MISMANAGEMENT

by

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I

As a democratic country, so in a company, the normal rule is of the supremacy of the majority. The Company is managed by those controlling the majority of shares, and the directors are elected by them, and they pass the resolutions as how the company should be generally conducted, pass the annual accounts of the company, and appoint auditors, etc., at the annual general meeting of the company. That is the rule laid down in the well known case of Foss v. Harbottle.[1]

Later on, exceptions have come to be recognised by the courts in cases like fraud on the minority of Shareholders, etc. That is to say, this aspect of the law is looked upon as one belonging to shareholder's right. Each shareholder has certain rights given to him under the Company Law and he is generally bound by the wishes of the majority of the members of the company and he is a part of that organisation. But in some cases the majority decisions may be harsh on the minority shareholders and the majority may try to override their wishes by means of their numerical superiority. In order to obviate certain hardships where a fraud on the minority is sought to be perpetrated, the courts have come to recognise exceptions to the rule of supremacy of the majority laid in the above cited case of Foss v. Harbottle.

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1. (1843) 2. Hare. 461.

II

Section 397 of the Companies Act is new provision which came for the first time in the Indian Companies Act, 1913 as section 153-c. That section was based on section 210 of the English Companies Act, 1948 which was introduced therein for the first time on the recommendation of Cohen Committee (1945). The purpose of introducing section 210 in the English Companies Act was to give an alternative remedy to winding up in case of mismanagement and oppression. The law always provided for winding up, in case it was just and equitable to wind up a company. However, it was being felt for some time that though it might be just and equitable in view of the manner in which the affairs of a company were conducted to wind it up, it was not fair that the Company should always be wound up for that reason, particularly when it was otherwise solvent. In many cases the winding up of the company would not benefit the minority shareholders, since the break-up value of the assets may be small, or the only available purchaser may be that very majority whose oppression had driven the minority to seek redress. In an attempt to meet such cases, it was recommended that the court should have power to grant an alternative remedy to winding up. That is why section 210 was introduced in the English Act to provide an alternative remedy where it was felt that though a case had been made out on the ground of just and equitable cause to wind up a company, it was not in the interest of the shareholders that the company should be wound up and that it would be better if the company was allowed to continue under such directions as the court may consider proper to give. That is the genesis of section 153-C in the 1913-Act and section 397 in the Act.

The provisions have again been amended in 1963 when the scope of sections 397 and 398 has been windened. Instead of confining them only to cases of oppression and mismanagement, the scope of these sections now includes cases where the affairs of the company are being conducted in a manner prejudicial to public interest, as it has come to be realised that public interest, is also of paramount importance and the ultimate aim of good company management should be ultimate public good to the community at large.

Sections 397 reads thus:

"Application to court for relief in cases of oppression: (1) Any members of the company who complain that the affairs of the company are being conducted in a manner oppressive to any member or members (including anyone or more of themselves) may apply to the court for an order under this section, provided such members have a right so to apply in virtue of section 299.

(2) If, on any application under sub-section 1, the court is of opinion: (a) that the company's affairs are being conducted in a manner oppressive to member or members; and (b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up; the court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit."

This section gives a right to members of a company who comply with the conditions of Section 399 to apply to the court for relief under section 402[1] of

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1. Section 402 defines the powers of the court. This section provides that, without prejudice to the generality of the powers of the court, any order under section 397 or 398 may provide for:

   (1) The regulation of the conduct of the company's affairs.

   (2) The purchase of the shares or interest of any members of the company by other members or by the company.

   (3) In the case of a purchase of its shares by the company, the consequent reduction of its share capital.

   (4) The termination, setting aside or modification of an agreement between the company and managing director, or any other director, the managing agent, the secretaries and the treasures and the manager.

contd...

the Act or such other relief as may be suitable in the circumstances of the case, if the affairs of a company are being conducted in a manner oppressive to any member or members including any one or more of those applying.

Section 397 of the Act undoubtedly empowers that court to make such orders "as it thinks fit" but only "with a view to bringing to an end the matters complained of."

The matters complained of must be proved to establish:

(a) that the companies affairs are being conducted in a manner prejudicial to public interest or members; and (b) that to wind up the company would unfairly prejudice such a member or members but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up. 1

It is, therefore, an essential pre-requisite for a petitioner under section 397 of the Act to prove that; apart from any prejudice to the interests of members, a winding up order would be justified in equity. Although, grounds of justice and equity elude categorisation and must necessarity be left to be decided on the particular facts of each case, yet,well recognised tests have to be applied in deciding what they are. And, the language used in section 397 indicates that just and equitable grounds for a winding up must not only exist, but they must be sufficiently compelling so as to justify a winding up order.

.... (5) The termination, setting aside or modification of any agreement with any person, provided due notice has been given to him and his consent obtained.

(6) Setting aside of any fraudulent preference made within three months before the date of the application.

(7) Any other matter for which, in the opinion of the court, it is just and equitable that provision should be made.

1. R.S. Mathur v. H.S. Mathur (1970)1. Comp.L.J.35.

IV

'Oppression' and 'mismanagement' have not been defined in the Act. Therefore, we have to look to the meaning given to them in the various judicial pronouncements. The first decision in which the word 'Oppression' was used in connection with management of the affairs of a company, is that of Cook v. Deeks.[1] In this case three directors of a company carrying on business as contractors obtained a contract in their own names to the exclusion of the company in circumstances which amounted to a breach of trust on their part and constituted them trustees of its benefits on behalf of the company. By their votes as holders of a majority of the shares they passed a resolution at a general meeting declaring that the company had no interest in the contract. Allowing the appeal of the minority shareholders the Judicial Committee observed (page 564) that "even supposing it be not ultra-vires of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. This would be to allow a majority to oppress a minority.

In Elder v. Elder and Watson Ltd.,[2] Lord Cooper has explained the meaning of the term 'Oppression' in these words:

> "The phrase oppressive to some part of the members acquires a certain colour from its collocation as 'intent to defraud', 'fraud', 'misfeasance or other misconduct', and the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fairplay on which every shareholder who entrusts his money to a company is entitled to rely."

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1. L.R. (1916) 1, A.C. 554

2. 1952 S.C. 112.

Viscount simonds in the House of Lords case of Scottish Co-operative Whole Sale Society Limited v. Mayer [1] adopted the meaning of 'oppression' as "burdensome" "harsh" and "wrongful" taking the dictionary meaning meaning of the word. His Lordships approved of the views of Lord Cooper that section 210 warranted the court in looking at the business realities of a situation and not to confine itself to a narrow legalistic view.

In Harmer's case [2], it was held that "the word oppressive meant burdensome, harsh and wrongful". Explaing the scope of section 210, it was observed that the result of application under section 210 in different cases must depend on the particular facts of each case; the circumstances in which oppression may arise being so infinitely various that it is impossible to define them with precision. The circumstances must be such as to warrant the inference that "there had been, at least, an unfair abuse of powers and an impairment of confidence in the probily with which the company's affairs are being conducted, as distinguished from were resentment on the part of a minority at being outvoted on some issue of domestic policy. The phrase 'oppressive to some part of the members' suggests that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every share holder who entrusts his money to a company is entitled to rely. But apart from this, the questionof absence of mutual confidence per se between partners, or between two sets of share-holders , however, relevant to a winding up seems to have no direct relevance to the remedy granted by section 210. It is oppression of some part of the shareholders by the manner in which the affairs of the company are being conducted that must be averred and proved. Mere loss of confidence or pure dead-lock does not come within section 210. It is not lack of confidence between shareholders per se that brings section 210 into play, but lack of confidence springing from oppression

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1. L.R. (1959) A.C. 324:(1958) 3 All.E.R. 66.

2. Re. H.R. Harmer Ltd.(1958) 3. All.E.R. 689. (1959) 1. W.L.R. 62.

of a miniority by a majority in the management of the company's affairs, and oppression involved atleast an element of lack of probity or fair dealing to a member in the matter of his proprietary rights.

These observations made in English cases were cited with approval by the Supreme Court, in Shanti Prasad Jain v. Kalinga Tubes Ltd.,[1] while explaining the Scope of Sections 397 and 398 of the Companies Act. It was observed, in this case that it is not enough to show that there is just and equitable cause for winding up the company, though that must be shown as preliminary to be application of Section 397. It must further be shown that the conduct of the majority share holders was oppressive to the minority as members and this requires that events have to be considered not in isolation but as a part of consequitive story. There must be continuous acts on the part of the majority shareholders, continuing up to the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some part of the members. The conduct must be hurdensome, harsh and wrongful and mere lack of confidence between the minority and majority shareholders would not be enough unless the lack of confidence springs from oppression of a minority by a manority in the management of the company's affairs, and such oppression must involve alteast an element of lack of probity or fair dealing to a member in the manner in the matter of his proprietary rights as a shareholder.

The question, whether a single wrongful act could amount to oppression within the meaning of Section 397 or it required a continuous and persistent oppressive conduct, was raised in Sindri Iron Foundry (P) Ltd.[2] It was held by the court that the law does not contemplate that a petitioner who is otherwise entitled to relief under section 397 must be able to show that there has been continuous course of oppressive conduct over a period of time before he can obtain relief under this section. If that is what is required by section 397, it may very well be that by the time the petitioner becomes eligible to come to the court for relief, there may be nothing left in the assets of the

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1. A.I.R. 1965 S.C. 1535.

2. 68 C.W.N. 118.

company and the court will be completely powerless to give him any relief what soever. It was observed that if the court is satisfied that the conduct arising from a single wrongful act is such, that its effect will be continuous course of oppression and there is no prospect of remedying the situation by the voluntary act of the party responsible for the wrongful act, the court is entitled to interfere by appropriate order under section 397 of the Act.

A similar view has been taken by Mitter J. in Ramashanker Prasad v. Sindri Iron Foundry (P.) Ltd.[1] It was observed that it is not necessary that the petitioner who comes to court from redress under section 397 should have submitted himself to oppression over a period before he can invoke the powers of the court. If the oppression is of a short duration but is of such a lasting character that redress is impossible by calling board meetings or general meetings of the company, a case of intervention under section 397 is made out.

V

Another important question which has come before the courts is whether the application is maintenable under section 397 and 398 by the petitioner who claims to control a majority of shares of the company? This question was raised in Sindri Iron Foundary (P) Ltd.[2] The Calcutta High Court reviewed the English Law in this respect and came to a conclusion that Indian Law on this point is not the same as English Law and under Indian Law there was nothing to show that sections 397 and 398 applied to application by the minority group only. In the case of companies functioning normally under the doctrine of majority rule, it is the oppressed minority who comes to court for relief. The majority seldom, if ever, has the occasion to come to court for relief because it can always have things done in its own way. But there may be cases, when the real majority is rendered ineffective by the wrongful acts and manoeuvers of a minority. The situation may be such that remedy cannot be obtained by the operation of the machinery in the domestic forum. In such cases it is the duty of the courts to intervene.

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1. (1966) 1. Comp.L.J. 310 at 335.

2. 68 C.W.N. 118.

Sections 397 and 398 no where prescribe that the application under the two Sections can be made only by a minority group. Nor do they prescribe that a majority group can under no circumstance come to court for redress, whatever may be the extent of the injury suffered by the company as a result of the activities of such a group. Both the Sections are in Chapter of the Act and the heading of the Chapter is "Prevention of Oppression and mismanagement." The opening words of both the Sections 397 and 398 are "any members of a company who complain etc." Section 399 of the Act lays down conditions to ensure that application is made or supported by a minimum number. To say that application can never be made by a majority, would amount to reading into the section 399 some thing which is not there. There is no limit imposed on the maximum. Moreover in section 210 of the English Act, the word 'minority' is clearly mentioned at the head of the section itself. But there is no such limitation in the Companies Act, 1956. In view of these facts, there is no reason why in an appropriate case, if the Court is satisfied about acts of oppression or mismanagement, relief cannot be granted even if the application is made by the majority, who have been rendered completely ineffective by the wrongful and ultravires acts of a minority group.1

On the facts of the case of Sindri Iron Foundry (P) Ltd.,2 it was held that if the court finds that the company's interest is being seriously prejudiced by the activities of one or other group of shareholders; that two different registered offices at two different addressed have been set up; that two viral Boards are holding meetings; that the company's business, properly and assets have passed into the hands of unauthorised persons who have taken wrongful possession and who claim to be shareholders and directors; that the bank accounts of the company have been practically frozen, there is no reason why the court should not make appropriate orders to put an end to such matters.

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1. In re: Sindry Iron Foundry (P) Ltd. 68 C.W.N. 118.

2. Ibid.

A similar view has been taken by Mallick. J., in Albert David Ltd. case.[1] In this case the majority group was unable to obtain management and control of the company's affairs by reason of the improper conduct of the rival group of directors. The directors who were in minority managed to remain in control of the management, after wrongfully taking possession of the company's business and factory and it was the majority group who came to court for relief under section 397 and 398 and it was in these circumstances, Mallick.J., held that the court should make an order under section 397 and 398 of the Act and accordingly an Administrator was appointed.

A different view was, however, taken by Ramaswami.J. in K.R.S.N. Iyenger v. T.A. Mani and others.[2] It was held in this case that section 397 provides for remedy for the oppression of minority on lines of Section 210 of the English Act.

Again in Ramashanker Prasad v. Sindri Iron Foundry (P) Ltd.,[3] (which was a case on appeal from the case of In re: Sindri Iron Foundry (P) Ltd. 68 CWN 118) relying on the English cases and Shanti Prasad Jain's case,[4] it was argued that the right to apply under sections 397 and 398 must be confined to cases where complaint is made by a minority against the majority and not vice-versa. Justice Mitter rejecting the above contention held that so far as English Section and English cases are concerned, the judges have correctly laid down that the right is given to minority. It was pointed out that so far as English section is concerned, it has the heading 'minorities' which affords some due to its interpretation . The English Act does not contain a section like section 399 of the Indian Act which is code by itself as to the qualification necessary for application under sections 397 and 398. Section 399 was only aimed at fixing the lower limit and not the upper limit as to the qualification for relief and if the object of the section be to prevent a mischief and to remove oppression and mismanagement of the company, there was no reason for implying an upper limit so as to bring the section in line with the English section. If the section is of a remedial nature, its proper construction should be to give the words used their widest amptitude.

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1. In re: Albert David Ltd. 68 C.W.N. 163.

2. A.I.R. 1960 Mad. 338.

3. (1966) 1. Comp.L.J. 310,335.

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As regards the observations made by the Supreme Court in Shanti Prasad Jain's case, it was correctly observed that "no doubt in Shanti Prasad Jain's case, the Supreme Court referred extinsively to the English decisions and observed more than once that it was the minority which had the right to complain of oppression by majority. But Shanti Prasad Jain's case was one of complaint by a minority and the court was not called upon to go into the question as to whether a majority which had been paralysed by the wrongful acts of a minority could seek the protection of the court under that section. 1

Agreeing with Justice Mitter, Justice Brijesh look a similar view and observed that "to read the Supreme Court decision in Shanti Prasad Jain v. Kalinga Tubes Ltd.[2] to mean that section 397 avails the minorities only is to read it divorced from its facts and to read, too much more than what the decision bears. The Supreme Court was not called upon to lay down the law on the point: whether or not section 397 avails the minorities only, and not the majorities. And it did not lay down the law at that either. The observations their Lordships made must be tuned to the facts before them. And one important fact was that the appellant before their Lordships was a minority shareholders. 3

It is submitted that the view express in Ramashanker Prasad v. Sindri Iron Foundry (P) Ltd., is better one. It is quite clear that a majority of shareholders and also a majority in the Board of a company may become absolutely powerless and ineffective by reason of the wrongful and ultra-vires acts of the rival group of minority shareholders. To hold that in such a case the court is powerless to interfere would be to defeat the very purpose for which the two sections have been introduced in the Companies Act.

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1. Rama Shanker Prasad v. Sindri Iron Foundary(P)Ltd. (1966) 1. Comp.L.J. 310, 336.

2. Ibid. - 349.

3. AIR 1965 S.C. 1535.

Past acts or transactions may either afford evidence of what may be reasonably apprehended in future or may have to be undone only to prevent or remove what had wrongfully originated in the past but continues to exist and provides a sustainable cause of action at the time when the petition is filed. 1

Purely punitive action, as distinct from preventive remedial action does not fall directly within the purview of these provisions although certain forms of punitive action, such as those mentioned in Schedule XI, which is applied by Section 406 of the Act to proceedings under section 397 and 398 of the Act, may indirectly result from them.2

Although the amplitude of the remedial powers of the court, under Sections 397 and 398, should not be curtailed in such a way as to hamper the jurisdiction to suppress the mischief aimed at, yet, the courts have to be careful and astute enough to prevent a misuse of the provisions of Section 397 and 398 by a party lest a remedy, proposed and adopted to overcome an alleged mischief becomes a source of greater oppression and harm than the one sought to be removed or prevented.

VII

Remedy under section 397 is limited not only to cases where the company is still in active business. The object of the remedy is to bring to an end the matters complained of that is "oppression" and this can be done even though the business of the company has been brought to a stand still.

In order to get relief under these sections, the act or acts complained of as oppressive must atleast be shown to have been designed to injure the petitioners in their rights as shareholders or show that the company was not being conducted efficiently in the interest of

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1. ibid.

2. R.S. Mathur v. H.S. Mathur, (1970) 1. Comp.L.J. 35.

3. In re: Hindustan Co-operative Insurance Society AIR 1961 Cal. 443.

the members as a whole. It must be shown that there has been oppression in a real sense of members qua shareholders and not merely a subordination of their wishes to the power of a voting majority.1

In Elder v. Elder and Watson,[2] the true grievance was that the two petitioners had lost the position which they formerly held as directors and officers of the company. It was held that section 210 was not intended to meet any such case, the 'oppression' required by the Section being oppression of members in their Character as such. Winding up on just and equitable ground cannot be ordered merely because of changes affected in the Board of directors or the dismissal of officers.

There is no limitation upon the power of the courts in proceedings under section 397 and 398 to enter into contested questions of fact. Indeed such restrictions upon the powers of the court would defeat the very object of a remedial power which can rarely be exercised without contest on facts. 3

There is no bar on the powers of the courts to grant relief under sections 397 and 398 even if all the relief which the petitioner claims can be properly granted in a suit. The possibility of a protracted litigation in which the company should be party between rival groups of directors, is itself a matter of serious prejudice to the company and is one of the major considerations for which the courts should exercise their powers under these sections, such litigation is mischief which is bound to be prejudicial to the interest of the company. The courts ought not to allow such litigation if it can be stopped in exercise of its powers under Sections 397 and 398. 4

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1. In re: Sindri Iron Foundary (P) Ltd. 68 CWN 118.

2. 1952 S.C. 112.

3. R.S. Mathur v. H.S. Mathur (1970)1. Comp.L.J. 35.

4. In. re: Sindri Iron Foundry (P) Ltd. 68 CWN 118.