OPPRESSION AND MISMANAGEMENT
HOW TO READ THIS TOPIC?

1. Understand the ‘rule of majority’ first- that company being similar to a democratic set up is run by the rule of majority

2. Then understand the exceptions to it- i.e. when can the court reject this rule of majority

3. And then come to oppression and mismanagement as an exception to the rule of majority

4. All the sections from 241 to 246 take care of the circumstances where there is oppression and mismanagement in the company
Meaning of oppression

The term ‘oppression’ has been explained by Lord Cooper in Elder v. Elder & Watson Ltd. [1952 SC 49 (Scotland)] as, “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 fair play on which every shareholder who entrusts his money to the company is entitled to rely.”
Meaning of mismanagement

• Mismanagement is said to be done if the affairs of the company are being conducted in a manner prejudicial to the interests of the company; or

• a material change (not being a change brought about by, or in the interests of, any creditors including debenture holders, or any class of shareholders, of the company) has taken place in the management of control of the company, whether by an alteration in its Board of directors, or if its managing agent or secretaries and treasurers, or in the constitution or control of the firm or body corporate acting as its managing agent or secretaries and treasurers, or in the ownership of the company’s shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to the interests of the company.
Why provisions for preventing oppression and mismanagement are required?

- Protection of rights of minority shareholders
- Proper balance of rights of majority and minority shareholders
- Management of company is based on ‘Majority Rule’ (explained in coming slides) - so prevent the abuse of power by majority
MAJORITY RULE - THE RULE OF FOSS V. HARBOTTLE (1843)

Facts-
- directors made a fraudulent and illegal transaction that caused company certain loss (sold their own land to the company at a higher price and also raised money not authorised by their powers)
- Minority shareholders brought an action against the directors to make good that loss
- Company in a general meeting by majority decided to not take an action against the directors

Decision-
- The court dismissed the action of minority shareholders and decided that they are bound by the decision of the minority
- Proper plaintiff in such case is the company itself and only it can file an action
- Thus, court laid down the ‘majority rule’
Other case with application of majority rule

**Burland v. Earle (1902)** - held- if the directors invest the profits in certain ways instead of paying dividend to the shareholders, individual shareholders cannot approach the court for the redress, only the company can bring an action.
Advantages of the rule:

- Recognition of separate personality of the company
- Need to preserve right of majority to decide
- Easy decision making
- Multiplicity of suits avoided
- Litigation at the suit of a minority futile if majority do not with it
Exceptions to the rule of majority

Based upon the principle of natural justice and fair play, the exceptions of Foss v. Harbottle are:

1. Ultra vires acts

When the majority is not acting within its powers, the rule of majority shall not prevail

But the plaintiff’s conduct must also be proper

CASE-

A. Ashbury case- where the resolution passed by the majority shareholders to ratify the ultra vires transaction was disregarded
Ultra vires exception contd...

The plaintiff, who was a shareholder of a respondent company, complained about several investments being made by the company without adequate security, which was contrary to the memorandum and therefore, sought a permanent injunction against the company making any such further investments.

The court ruling for the plaintiff said that even though in matters of internal management, the company was the best judge and the rule was that the court should not interfere, application of assets of a company was not merely a matter of internal management. In the instant case, the company directors were acting ultra vires and therefore, a single shareholder was eligible to bring an action against the company.
Other exceptions:

- Fraud on minority

  Discriminatory action viz. the majority shareholders given an advantage over the minority shareholders

  The fraud must involve an unconscionable, unreasonable or unscrupulous use of majority’s power resulting in gross loss or unfairness to minority shareholders

  Thus, the majority power must be exercised in good faith for the benefit company as a whole
Other exceptions contd..

• Acts requiring special majority
When according to the AOA, special resolution is required but the act is purported to be done by ordinary resolution, the same can be challenged.

• Wrongdoers in control
When an obvious wrong is done to the company but the majority shareholders do not permit an action to be taken against them.

• Individual membership rights
Every shareholder has certain rights against the company like right to vote, right to have vote recorded, right to stand for election as director of the company etc. If any such right is infringed, single shareholder can file an action.

• Oppression and mismanagement
Section 241- Application to Tribunal for relief in cases of Oppression etc.

• Acts that amount to oppression and mismanagement:
  • the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company (OPPRESSION)
  • the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the BOD, or manager, or in the ownership of the company’s shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members (MISMANAGEMENT)
Section 241 contd...

• If any of the previous acts is committed u/s 241(1)- any member of the company can make an application to the Tribunal u/s 244 for an order

• Central Government may also apply u/s 241(2)- if in its opinion affairs of company are being conducted in a manner prejudicial to public interest
Section 241(3)

• For CG to form an opinion, it thinks that there exists following circumstances:
  
  • any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith **guilty** of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law or of **breach of trust**
  
  • the business of a company **is not or has not been conducted and managed by such person** in accordance with **sound business principles or prudent commercial practices**
  
  • a company **is or has been conducted and managed by such person** in a manner which is **likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains**
  
  • the **business of a company** is or has been **conducted and managed by such person** with intent to **defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest**
Section 241(4) and (5)

• The person against whom a case is referred to the Tribunal under sub-section (3), shall be joined as a respondent to the application

• Every application under sub-section (3)—

• (a) shall contain a concise statement of such circumstances and materials as the Central Government may consider necessary for the purposes of the inquiry; and

• (b) shall be signed and verified in the manner laid down in the Code of Civil Procedure, 1908, for the signature and verification of a plaint in a suit by the Central Government
When an application is made u/s 241 and tribunal is of opinion that:

a. the company’s affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; 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,

• It may make any order that it thinks fit
Other orders that Tribunal may pass- u/s 242(2)

(a) the regulation of conduct of affairs of the company in future;

(b) the purchase of shares or interests of any members of the company by other members thereof or by the company;

(c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

(d) restrictions on the transfer or allotment of the shares of the company;

(e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

(f) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e):

Provided that no such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;

(g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;
Other orders contd...

(h) removal of the managing director, manager or any of the directors of the company;

(i) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);

(k) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;

(l) imposition of costs as may be deemed fit by the Tribunal;

(m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.
• Certified copy of the order of the Tribunal u/s 242(1) shall be submitted by the Company with the Registrar within 30 days of the order of Tribunal

• Tribunal can pass interim orders as well if it thinks fit

• Tribunal shall record its decision stating therein specifically as to whether or not the respondent is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company

• Where an order of the Tribunal under sub-section (1) makes any alteration in the MOA or AOA of a company, then, notwithstanding any other provision of this Act, the company shall not have power, except to the extent, if any, permitted in the order, to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order, either in the MOA or in the AOA.
• EFFECT OF THE ALTERATIONS MADE BY THE ORDER- the alterations made by the order in the MOA or AOA of a company shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act and the said provisions shall apply accordingly to the memorandum or articles so altered

• A certified copy of every order – A) altering, or B) giving leave to alter, a company’s memorandum or articles, shall within thirty days after the making thereof, be filed by the company with the Registrar who shall register the same

• CONTRAVENTION- If a company contravenes the provisions of sub-section (5), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both
Right to apply u/s 241- given under Section 244

(1) The following members of a company shall have the right to apply under section 241, namely:—
(a) in the case of a company having a share capital,
(1) not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, OR
(2) any member or members holding not less than one-tenth of the issued share capital of the company,
subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members:

Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b) so as to enable the members to apply under section 241.

If shares are jointly held by two or more persons- Explanation.—For the purposes of this sub-section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

(2) Where any members of a company are entitled to make an application under subsection (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.
CASES ON OPPRESSION AND MISMANAGEMENT

1. An attempt to force new and more risky objects upon an unwilling minority may in circumstances amount to oppression

e.g. insurance business of a company was acquired by the LIC. The compensation paid by the LIC was not distributed by the directors amongst the shareholders but without calling a meeting passed a special resolution and changed the objects of the company.

This was held to be oppression (Hindustan Co-operative Insurance Society Ltd., Re- 1961)
2. An attempt to deprive a member of his ordinary membership rights is an oppression

In Mohan Lal Chandumall v. Punjab Co. Ltd. (1961)- public company amended its AoA under a statutory direction in such a manner as to deprive its non-trading members of their rights to vote, to call meetings, to elect directors and to receive dividends, Held to be oppression
3. Unjust or harsh or tyrannical

Scottish Co-operative Wholesale Society v. Meyer (1958)

Facts - Scottish society (a private limited company) - created a subsidiary company to enter into the rayon industry

When the need of subsidiary company ceased to exist, society adopted the policy of running down the business which reduced the value of shares

Earlier, the society having made use of the subsidiary company’s knowledge and trade secrets, etc. wanted to buy out the minority shareholding and offered a price which was not acceptable to the minority.

Minority shareholders and managing director of the subsidiary company pleaded ‘oppression’
Scottish case contd...

Court- held it to be oppressive- burden, harsh and wrongful- lack of fair dealing

Whenever a subsidiary company is formed with independent minority of the shareholders, the parent company must accept as to deal fairly with its subsidiary, no matter the business is the same

Otherwise, the minority shareholders in the subsidiary company may use the provisions of the Act to protect themselves against exploitation by the majority- shareholding parent company
4. Not conducting the affairs of the company as per the provisions of the Companies Act is oppression/mismanagement

5. Minor acts of mismanagement are not to be regarded as oppression - like differences in management

Shanti Prasad Jain v. Kalinga Tubes (1965)

Facts - private company having 3 groups of shareholders - petitioner and 2 respondents - having equal shareholding
The shareholders agreed in writing that they shall maintain this equilibrium.

But to obtain loan facilities, the company was converted in a public company.

Petitioner suggested that they should be distributed amongst existing shareholders to maintain the proportion of the shares held by them.

But the majority decided to issue shares in public.

Held- private agreements between the parties to maintain the equilibrium was not binding on the company.

A private agreement does not create a right in favour of the petitioner.

Mere lack of confidence is not enough to constitute oppression.
Needle Industries (India) Ltd. v. Needle Industries Norway (India) Holding Ltd. (1981)

facts- a directive by RBI required the companies to reduce the foreign shareholding to 40%.

The directors to increase the Indian shareholding and reduce the foreign shareholding- they issued more shares. According to the policy of the company the issue should be first offered to the existing members. A notice must be issued in this regard.

The directors in this case, allegedly, intentionally did not provide the foreign shareholders a notice on time because of which they could not attend the meeting and hence, could not buy the new issue.

The court did not held it to be an act of oppression as even when the notice would have been served on time, the company could not have allotted them the shares as that would have amounted to the breach of RBI directive.
Power to grant relief even if there is not oppression

- Court does have the power to make an order even if it finds out that there is no oppression

- **Radharamanan (M.S.D.C.) v. Chandrasekara Raja (M.S.D.)- 2008**
  - Son and father had equal shareholding in the company and.
  - Father alleged acts of oppression on the part of son
  - The court held that there was no oppression
  - But the court ordered the son to buy the shares held by the father at a value determined by the Chartered Valuer.
Links

- https://taxguru.in/company-law/oppression-mismanagement.html