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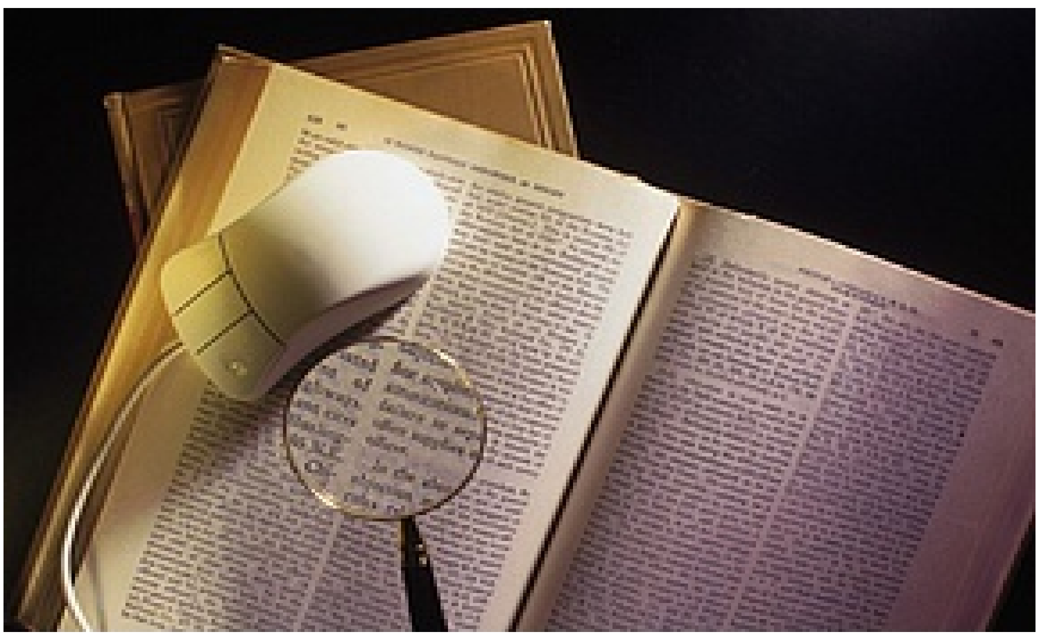

Research Paper on the Indian Companies Act, 1956

- Prevention of Oppression and Mismanagement

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Prevention of Oppression and Mismanagement

Premise:

The provisions relating to minority protection are contained in sections 397 to 408 of the Indian Companies Act, 1956 ('the Act') whereby the members are empowered to proceed against, if the affairs of the company are mismanaged or conducted in a manner prejudicial to public interest.

Section 397:

Section 397 recognizes the right of the minority shareholders to seek remedy against the oppression by the majority stakeholders.

Oppression:

- It must be established that the affairs of the company are being conducted –
  - in a manner oppressive to any member(s)
  - in a manner prejudicial to the company

- The oppression must affect a person in his capacity of being a member. For oppression of majority of directors or creditors over minority, relief cannot be taken u/s 397.

- The conduct of the company must indicate a continuous wrong. Also, the acts constituting oppression must continue till the date of making the application.

- The application must make out a prima facie that the decree of oppression is so severe that it is very fair and equitable for winding up of the company.

  The term "oppression" has not been defined in the Act. The conduct is generally said to be oppression only when it is burdensome, harsh and wrongful. As such, one has to go by the facts and circumstances of the case to arrive at a decision.

  A bonafide exercise of power given under the Act e.g. removal of director u/s 284 does not amount to oppression.

Judicial Decisions as to what amounts to oppression:

- ***There must be a visible departure from the standards of fair dealing.***
  - *Elder v. Elder and Watson Ltd. (1952) SLT 112*

- ***Forcing risky objects amounts to oppression***
  - *Re, Hindustan Co-op. Insurance Society Ltd. AIR (1961) Cal 443*

- ***Isolated acts do not amount to oppression***
  - *Needle Industries Ltd. (1981) 51 Comp Cas 743*

- ***Unwise acts do not imply oppression***
  - *Re, Five minutes Car Wash Services Ltd. (1966) 1 All ER 242*

Section 398:

Section 398 recognizes the right of the minority shareholders for claiming the relief from mismanagement.

Mismanagement:

The term 'mismanagement' has not been defined by the Act. It means some unfair abuse of power by the persons in charge of the management of the company. Where the company is run overriding the wishes and interest of majority shareholders involving the company into costly litigations, the management can be said to be prejudicial to company

An unwise and inefficient management does not amount to oppression, though it may amount to mismanagement under section 398.

Section 398 may be invoked in either of the following two situations:

A. The affairs of the company are being conducted in a manner which is
- Prejudicial to the public interest
- Prejudicial to the interests of the company

B. That due to a 'material change' in the management or control of the company, it is likely that the affairs of the company will be conducted in a manner
- Prejudicial to the public interest
- Prejudicial to the interests of the company

For the purpose of section 398, 'material change' will be deemed to have taken place if there is an alteration in –

- *Company's Board of Directors or*
- *Manager or*
- *Ownership of company's shares or*
- *Membership of co. (if it has no share capital) or*
- *Any other manner but not by way of changes brought by or in interests of creditors, debenture holders or any class of shareholders.*

- The mismanagement should be present and continuous i.e. charges of mismanagement even if proved in the past are not enough to establish an existing injury to the company or public interest.

Judicial Decisions as to what amounts to Mismanagement:

- ***Sale of company's assets at lower prices without complying with section 293 amounts to mismanagement*.**
  - *Re, Malayalam Plantations (India) Ltd. (1991) 5 Corp LA 361*

- ***Violation of the conditions of the memorandum amounts to mismanagement.***
  - *S.M Ramakrishnarao v Bangalore Race club Ltd. (1970) 40 Comp Cas 674*

- ***Prejudices to the interest of the company due to internal disputes is mismanagement.***
  - *Suresh kumar Sangi v Supreme Motors Ltd. (1983) 54 Comp Cas 235*

For the oppression or mismanagement in company's affairs, the requisite number of members can apply to the Company Law Board.

Requisite number of shareholders:

Section 399 of the Act specifies the requisite number of members for making the application to the Company Law Board.

- For a company having a share capital, requisite number is lower of –
    - 100 members
    - $1/10^{th}$ of the total number of members
    - $1/10^{th}$ of issued share capital of the company

- For a company not having the share capital, requisite number of members means 1/5th of the total number of its members.

Application to the Company Law Board

- The application can be made either by the requisite number of shareholders or by central government. Any one member may make an application on behalf of all members by obtaining the proper authorization.

- The application has to be made in Form No. 1 in Annexure II of the Company Law Board Regulations along with the prescribed documents and requisite fee.

- A preference shareholder, being a member, is also entitled to make the application. The applicants must have paid all calls and sums due.

- The requirement as to minimum shareholding is to be satisfied only while filing the application.

- The Company Law Board shall give the notice to the central government of every application made to it under section 397 & 398.

- Section 399 neither disentitles a majority of members for claiming relief from oppression and mismanagement, nor requires that application shall be made by the minority shareholders only.

Orders by the Company Law Board:

Where an application is made to the Company Law Board complaining oppression and on being satisfied that the affairs are conducted in an oppressive manner, it can order for the following:

- Section 402: Specific Powers:
    - Regulation of the conduct of Company's affairs in future
    - Purchase of shares or interests of a member
    - Termination / Modification of agreement with director / manager
    - Termination / modification of an agreement with 3^{rd} parties after proper notice to it.
    - Setting aside fraudulent preference
    - Any other matter that the Company Law Board finds just and equitable
- Section 403: Powers to make the interim orders for regulating the company's affairs
- Section 404: Power to alter memorandum or articles
- Penalties are leviable on falsification of books or any fraudulent conduct

Other Judicial Provisions - Section 408:

- Section 408 empowers the Central Government to issue the directions pertaining to:
  - The appointment of such number of additional directors as it deem fit to safeguard the interests of the company
  - Amendment in the company's Articles of Association to make the fresh appointment of directors in pursuance thereof
  - The appropriate conduct of its affairs including the removal of existing auditor and appointment of another auditor in his place

- The Company Law Board has no sou motu power to pass an order. It can only do so if:
  - a reference is made by the Central Government or,
  - an application is made by not less than 100 members or,
  - an application by members holding 1/10th or more shares.

- Also, the Company Law Board must be satisfied that the affairs of the company are carried in a manner prejudicial to the company or members and it is necessary to appoint a person to prevent the mismanagement and safeguard the member's interest.

- The Director so appointed is in the same position as any other director except that he will not be reckoned in 2/3rd or any proportion thereof. Also, he will not require the qualification shares and shall be removed only by the Central Government and shall not retire by rotation.

- Further, up till the time such additional director holds the office, the changes in the BoD shall have to be confirmed by the Company Law Board.

Section 408 over-rides the entire Companies Act, 1956.

Section 409:

- Section 409 gives the resort to the management of the company to prevent the well –run companies from passing into the hands of people having prejudicial interests in company's affairs.

- Director(s) / manager(s) can make the application to the Company Law Board stating that the likely change in the BoD would affect the company prejudicially.

- On enquiry and being satisfied about the situation, the Company Law Board can pass an order stating that the change in BoD can be effected only by their approval.

- The above provisions of section 409 are not applicable to a private company, not being the subsidiary of a public company.