OPPRESSION AND MISMANAGEMENT ESPECIALLY IN CASE OF FAMILY OWNED CONCERNS.

An Overview:

Oppression and mismanagement is part and parcel of business. During the course of business, oppression of small/minority shareholders takes place by the majority shareholders who are in control of the company. Similarly, mismanagement of business is not uncommon. When we talk of mismanagement we mean mismanagement of resources. Mismanagement could mean siphoning of funds, causing losses due to rash decision, not maintaining proper records, not calling requisite meetings. Finer version of mismanagement could arise where the management does not act/react to a business situation leading to downfall of business.

The concept of oppression and mismanagement is more relevant or common to family owned concerns. The reasons are very obvious. Family owned concerns are owned by family members who over time develop vested interest in business - vested interest in their own heirs being the most common - thereby leading to oppression of other family members. Here typically, the controlling member of the family appropriates the family holdings by means of either a fresh issue or fraudulent transfers in his favor or reconstitutes the board in such a manner as to alienate the other family members. The result is the other family members get oppressed. Secondly, the family owned concerns are not professional managed and their system of functioning is usually personal. They lack probity and fair play. They generally do business in a manner where they begin to benefit personally to the exclusion of other members. This leads to oppression of other family members/mismanagement of companies.

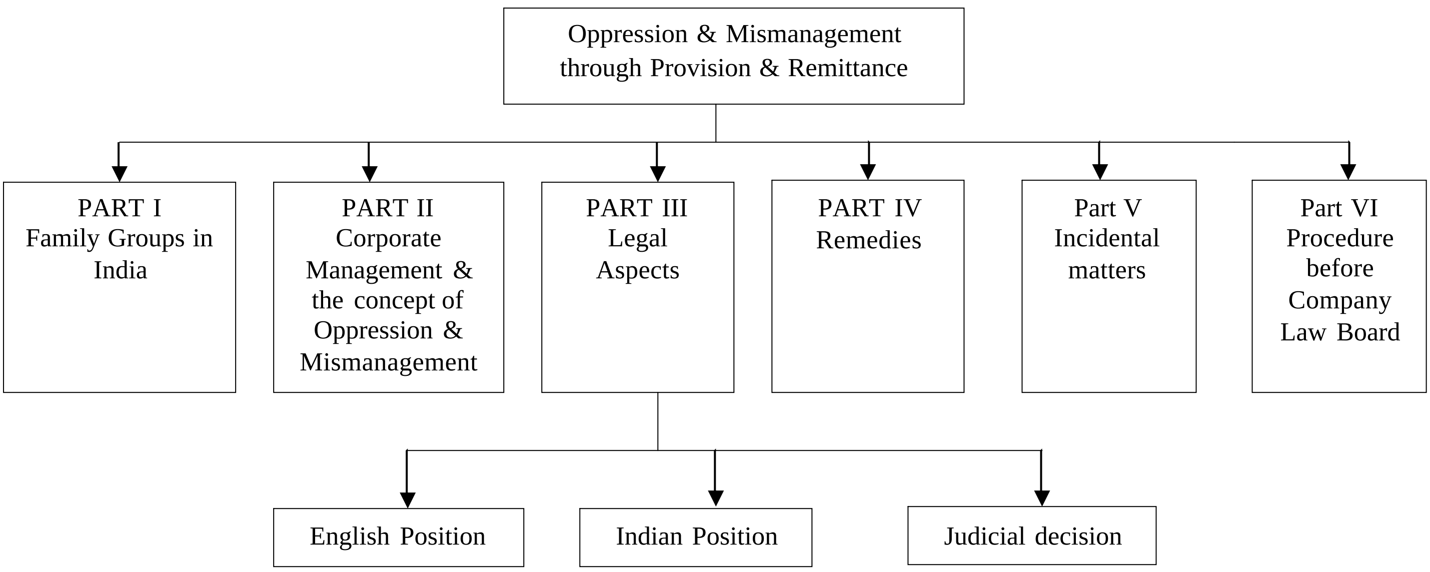
Oppression and mismanagement is less seen in professionally managed companies where managers work for "shareholders" and not for a particular group of members.
An analysis of the 50 top Economic Times ranked companies reveals that nearly 50% are still family owned. If PSU's are excluded from these top 50 companies, the percentage is 63%.

The reason for such high concentration of industries in families is that entrepreneurship in early years was highly personalised and did not get corporatised. As far as small and medium sizes companies, the family owned concerns are almost fully dominating the scene and professional management rarely exists.

These family owned concerns go through a lot of oppression and instances of mismanagement. The latest being the Bajaj family episode. Not to mention the incessant quarrel of Modi family, Ranbaxys, Pai, Chabaria etc.

This topic therefore becomes extremely important and is today a significant part of Company Law and Practice. Today, a very large number of cases dealt at Company Law Board are those pertaining to oppression and mismanagement, their prevention and remedies thereof which are covered by section 397 and section 398 Companies Act 1956.

This paper covers the various aspects of oppression and mismanagement, the prevention and remedies thereof.



<u>Part I - Family Groups in India</u>

The early dawn of industrialization in 1950/60's was fraught with non availability of resources with promoters. Very few promoters had the resources to set up medium sized projects let above large projects. Although the industrial policy resolution of 1956 contemplated diffusion of ownership from control, practically this was not possible. Few families, who had resources, set up industries. The names of Tatas, Birlas, Modis, Dalmias were on the forefront. The government policy helped create monopolies, which helped these families create large capital formation in their hands. Consequently, this entrenched "family owned" business in India.

Even today, after liberalization from 1984 onwards (the Rajiv Gandhi era) and after 18 years we find that family owned business are well entrenched. Take the 50 most admired companies from the list of Economic Times 500 and one will find that nearly 50% are still family owned.

List:

SR. NO.	COMPANY	FAMILY OWNED	NON FAMILY OWNED
1.	HINDUSTAN LEVER		✓
2.	WIPRO	✓	
3.	RELIANCE INDUSTRIES	✓	
4.	OIL & NATURAL GAS CORPN		✓
5.	INFOSYS TECHNOLOGIES		✓
6.	ITC		✓
7	RELIANCE PETROLEUM	✓	
8	INDIAN OIL CORPORATION		✓
9	STATE BANK OF INDIA		✓
10	MAHANAGAR TELEPHONE NIGAM		✓
11	SATYAM COMPUTER SERVICES	✓	
12	BHARAT PETROLEUM CORPN		✓
13	RANBAXY LABORATORIES	✓	
14	HOUSING DEVELOPMENT FINANCE CORPN.		✓
15	HINDUSTAN PETROLEUM CORPN		✓
16	HCL TECHNOLOGIES	✓	
17	DR. REDDY’S LABORATORIES	✓	
18	GAS AUTHORITY OF INDIA		✓
19.	CIPLA	✓	
20.	HDFC BANK		✓
21.	HERO HONDA MOTORS	✓	
22.	ZEE TELEFILMS	✓	
23.	HINDALCO INDUSTRIES	✓	
24.	LARSEN & TOUBRO		✓
25.	VIDESH SANCHAR NIGAM LIMITED	✓	
26.	NESTLE INDIA		✓

27.	BAJAJ AUTO	✓	
28.	NATIONAL ALUMINUM COMP.		✓
29	BHARAT HEAVY ELECTRICALS		✓
30.	ICICI		✓
31.	TATA IRON & STEEL CO.	✓	
32.	TELCO	✓	
33.	GUJARAT AMBUJA CEMENTS	✓	
34.	BSES		✓
35.	SUN PHARMACEUTICALS INDS	✓	
36.	ASSOCIATED CEMENT COMP.	✓	
37.	NEYVELI LIGNITE CORPN		✓
38.	GRASIM INDUSTRIES	✓	
39.	GLAXOSMITHKLINE PHARMA		✓
40.	TATA POWER COMPANY	✓	
41.	CASTROL INDIA		✓
42.	ICICI BANK		✓
43.	STEEL AUTHORITY OF INDIA		✓
44.	NIRMA	✓	
45.	COLGATE-PALMOLIVE (INDIA)		✓
46.	DABUR INDIA	✓	
47.	CORPORATION BANK		✓
48.	DIGITAL GLOBALSOFT		✓
49.	INDIAN PETROCHEMICALS CORPN	✓	
50.	ASIAN PAINTS (INDIA)	✓	

Not that family owned companies are bad. They too do have many positive points. The relationships and bonding helps in growth. The respect for elders being paramount helps monitor decipiline and curbs rash decisions. Lastly, the family decisions/burden of family helps these family concerns to take a conservative view vis-à-vis high-risk ventures. The same family owned concerns also have several negative features. The curbing of growth and frustrations of younger generation being foremost. There is a friction between younger and elder generations. There is friction between families due to partial conduct of certain family members. The father wants his son to takeover certain business irrespective of the other family members. All these friction lead to oppression in some form or the other besides mismanagement. Most of these feuds have landed for remedy before Courts/Company Law Board and section 397/398 contained in Chapter VI Companies Act 1956 has played a crucial role in prevention and remedying the situations.

The small and medium companies are most affected as they are by and large all family owned. No statistics of such companies is available but the percentage is extremely high.

<u>Part II - Corporate management and the concept of oppression and mismanagement</u>

How do companies run? Who runs them? Do majority shareholders run the company or do directors run the company? How then do majority shareholders oppress the minority? These questions need to be answered to understand the concept of oppression and mismanagement.
Business as a whole runs on several levels. There is operational staff, middle management and the overall suspension is in the hands of the board of directors. Therefore it is the board of directors who run companies. They are distinct from the majority shareholders. Majority shareholders therefore do not run companies. If majority shareholders do not run companies then how can they oppress the minority? How can they (majority shareholders) mismanage the company?

In a corporate democracy majority rules. This has long been recognised in a landmark ruling *"Foss v Harbottle (1843) 2 Hare 461* which is popularly recognised as the Rule in Foss v Harbottle or rule of majority.

The directors are elected by the majority shareholders and therefore the directors become an instrument in the hands of majority shareholders. Mismanagement therefore occurs through this instrumentation. As far as oppression is concerned, the majority shareholders are required to respect the rights of minority shareholders. Whenever the rights of minority shareholders are violated it leads to oppression.

But the law or should we say Company law does not allow this majority to trample upon the rights of the minority or to indulge in mismanagement due to a brute majority. And to prevent this oppression and mismanagement the law has carved an exception to this rule in Foss v Harbottle.

The rights of minority shareholders referred to earlier refer to the **legal rights** of the minority shareholders. They are found throughout the Companies Act 1956.

List of some of these rights are enumerated below:

Rights of shareholders:

Section 17	Special resolution is required for changing the registered office from one state to another and for changing the objects of the company.
Section 21 & 22	Changes of name of company requires a special resolution.
Section 31	Alteration of articles can be done through a special resolution.
Section 39	Members are entitled on payments of a fee to copies of memorandum and articles of association and agreement and resolution referred to in section 192.
Section 79	Issue of shares at discount should be authorised by the resolution of the general meeting.
Section 79 A	Issue of sweat equity shares should be authorized by special resolution in general meeting.
Section 81	When further shares are offered to persons other than the existing shareholders a special resolution should be passed to that effect.
Section 87	An equity shareholder has a right to vote on every resolution placed before the company and his voting right on a poll is in proportion to his share of the paid up equity capital.
Section 94	Alteration of share capital requires consent of shareholders in general meeting.
Section 100	Reduction of share capital requires passing of a special resolution.
Section 106	The rights attached to one class of shareholders can be varied with the consent in writing of holders of not less than three-fourths of such holders.
Section 107	The shareholders who are against the reduction of share capital and who did not vote in favour of the resolution under section 100 can apply to the court for cancellation of reduction (not less than ten per cent shareholders).
Section 113	Share allotment letters and share certificates should be delivered to the shareholders within three months of allotment and within two months of the registration of transfers.
Section 118	Copies of trust deeds for securing debentures should be forwarded to any member (apart from the debentures-holders).
Section 144	Copies of instruments creating charges and register of charges kept at the company can be inspected by any member.
Section 149	A public company formed after the 1956 Act should not commence other objects referred to under section 13(1) (d) (i) unless a special resolution is passed.
Section 163	The register of member, index of registers, certificates, documents, etc. can be kept away from the registered office within the same city etc. if it is so approved by the special resolution. The index, registers, returns, etc. should be open to the inspection of any member or debenture holder or any other person and extracts can be taken therefrom.
Section 165	Members of public companies are entitled to statutory reports and to the right of approval thereof at the statutory meeting.
Section 166	The annual general meeting should be held in each year and the gap between two such meetings should not exceed fifteen months.
Section 172	Members are entitled to notice of every meeting of the company.
Section 179	Members can demand a poll in accordance with this section.
Section 183	A member need not use all his votes in the same way.
Section 188	A member holding atleast 1/20 total voting power or not less than hundred members can direct the company to circulate resolutions.
Section 196	A member can inspect the minutes of proceedings of general meeting and he is entitled to be furnished within a week with a copy of minutes on payment of a fee.
Section 210	The balance sheet and profit and loss account should be laid before the annual general meeting.
Section 217	Board's report should be attached to every balance sheet laid before the annual general meeting.
Section 219	A copy of every balance sheet and profit and loss account, auditor's report, board's report should not less than 21 days before the annual general meeting be sent to every member.
Section 224	Auditor's (other than first and casual auditors) should be elected by members at annual general meetings.
Section 225	Special notice is required of a resolution at an annual general meeting appointing as auditor a person other than the retiring auditor.
Section 235	Members holding not less than one tenth of total voting power or not less than 200 members may appeal to the Company Law Board for investigation of the affairs of the company.
Section 255	Not less than two thirds of the total number of directors of a public company should be appointed at general meetings.
Section 258	The board of directors can be increased or reduced by an ordinary resolution.
Section 284	Special notice shall be required of any resolution to remove a director.

Section 293	The board of directors cannot, except with the consent of the general meeting: 1. Sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company. 2. Remit or give time for the repayment of any debt due by a director. 3. Invest the amount of compensation received in respect of compulsory acquisition. 4. Borrow moneys in excess of the aggregated capital and free reserves. 5. Contribute to charitable or any other funds in excess of 50000 rupees or five per cent of the average net profits during the immediately preceding three financial years, whichever is higher.
Section 294	Appointment of sole selling agents is subject to the consent of the general meeting held after the appointment.
Section 301	The register of contracts can be inspected by members extracts taken and a copy thereof required by them on payment of a fee.
Section 302	Members are entitled to details of terms of contracts or variation in regard to the appointment of managing director/manager.
Section 304	The register of directors can be inspected by any member.
Section 307	The register of directors' shareholding should be open to inspection of any member during business hours.
Section 309	The remuneration payable to directors including the managing and wholetime directors by public companies is subject to the approval of members.
Section 314	The appointment of a relative or partner to office of profit is subject to approval of members by way of special resolution.
Section 323	The memorandum can be altered so as to render unlimited liability of directors' if so authorized by special resolution.

"Oppression" or denial of these legal rights would give rise to a situation where the minority shareholder could approach the Company Law Board for appropriate relief. Therefore the majority is required to be on guard lest the minority has grievances in exercise of their rights. Section 397 in case of oppression would then assist the minority shareholders to rectify the situation. "Mismanagement" does not essentially cover the violation of legal rights. It covers issues of proprietary, transparency and financial uprightness. These are not well defined and depend upon situation to situation. Majority indulging in gross mismanagement open themselves to action under section 398. Usually, it is seen that that "oppression" and "mismanagement" takes place almost simultaneously in family owned concerns leading to presentation of composite petitions under section 397 and 398.

There are issues of oppression of directors; i.e. the majority shareholders infringe the rights of directors. E.g. agenda of directors is not regularly sent to a director or deliberate denial of common facilities to a few directors, say car. Strictly speaking, oppression of directors is not covered by section 397/398 and the directors have no recourse to this section. However, members could take up their case under "mismanagement" in a petition under section 398 but directors are incapable of doing so. This is a vital distinction between oppression of directors *per se* and oppression of members.

Part III - Legal aspects

English position:

The topic of oppression and mismanagement and its prevention would be incomplete unless the position under English Companies Act is appreciated. The Indian law is substantially based on the English law. The relevant section under the English Companies Act 1948 is section 210.
It may be noted that the English Companies Act 1948 (section 210) was repealed by 1980 Act (section 75) and further repealed by the 1985 Act (section 459 - 461). The Indian law contained in sections 397/398 is built upon and comparable with section 210 English Companies Act 1948. Further development in English Companies Act where section 75 has repealed section 210 and where the words "oppression" have been replaced by "unfairly prejudicial" have not occurred in the Indian Companies Act. **In view of this the English judgement delivered from 1980 onwards will have to be looked at with caution even for their persuasive value.**

Section 210 of Companies Act 1948 had incorporated the principle of minority protection (i.e. on exception to the "Foss v. Harbottle"). As already stated, the rule in Foss v. Harbottle places the majority in such a strong position and that minority shareholders would be at serious disadvantage if the exception was not allowed.

The leading cases, most often quoted by Indian Laws where minority actions was brought successfully.
a) *Meyer v. Scottish Cooperative Wholesale Society Ltd. (1954) SC 381.*
b) *Elder v. Elder and Watson (1952) SC 49.*
c) *In Re H R Harmer Ltd. (1959) IWLR 62.*
d) *Five Minute Car Wash Services Ltd. (1966) IWLR 715 Ch D.*
e) *In Re Jermyn Street Turkish Baths Ltd. (1971) WILL 1042 (CA).*
f) *Yenidge Tobacco Co. Ltd. (1971) I WLR 1042 (CA)*
g) *Loch V. John Blackwood Ltd. (1924) AC 783.*
h) *Clemens v. Clemens (1976).*
i) *Daniels v. Daniels (1978).*
j) *Ebrahimi v. Westbourne Galleries Ltd. (1973) AC 360.*

Two judgements need specific mention:
In Scottish Cooperative Wholesale Society Ltd. oppression was defined where the majority exercised their authority in a manner " burdensome, harsh and wrongful". This definition of oppression was to serve as a benchmark for many a cases.

The Ebrahimi's case upheld the concept of quasi partnership in case of private companies and family owned companies and the remedy was akin to dissolution of the firm. Oppression was observed where two partners in a partnership firm incorporated into a private company fell out and one of the partners ousted the other. The Court held that the principles of partnership clearly applied and even though the ouster was perfectly legal it lead to oppression of as is a dissolution of firm took place.

Indian position

The Indian position is substantially contained in section 397, 398 and 399 of the Companies Act 1956.

Section 397:
Application to Company Law Board for relief in cases of oppression:

1. Any members of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members (including any one or more of themselves) may apply to the Company Law Board for an order under this section, provided such members have a right so to apply in virtue of section 399.

2. If, on any application under sub-section (1) the Company Law Board is of opinion -
   (a) That the company's affairs are being conducted in a manner prejudicial top public interest or in a manner oppressive to any 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 Company Law Board may with a view to bringing to an end the matters complained of make such order as it thinks fit.

Section 398:

Application to Company Law Board for relief in cases of mismanagement:

1. Any members of company who complain-

   (a) That the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company, or

   (b) That 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 managers 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 public interest or in a manner prejudicial to the interest of the company.

may apply to the Company Law Board for an order under this section, provided such members have a right so to apply in virtue of section 399.

2. If, on any application under sub-section (1) the Company Law Board is of opinion that the affairs of the company are being conducted as aforesaid or that by reason of any material change as aforesaid in the management or control of the company, it is likely that the affairs of the company will be conducted as aforesaid, the Company Law Board may, with a view to bringing to an end or preventing the matters complained of or apprehended, make such order as it thinks fit

Section 399

Right to apply under sections 397 and 398 -

(1) The following members of a company shall have the right to apply under section 397 or 398: -

(a) in the case of a company having a share capital, 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 any member or members holding not less than one-tenth of the issued share capital of the company, provided that the applicant or applicants have paid all calls and other sums due on 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.

(2) For the purposes of sub-section (1), where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

(3) Where any members of a company are entitled to make an application in virtue of sub-section (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.

(4) The Central Government may, if in its opinion circumstances exist which make it just and equitable so to do, authorize any member or members of the company to apply to the Company Law Board under section 397 or 398, notwithstanding that the requirements of clause (a) or clause (b), as the case may be, of sub-section (1) are not fulfilled.

(5) The Central Government may, before authorizing any member or members as aforesaid, require such member or members to give security for such amount as the Central Government may deem reasonable, for the payment of any costs which the Company Law Board dealing with the application may order such member or members to pay to any other person or persons who are parties to the application.

Analyses:

Analysing sections 397 and 398:

Section 397(1) (a)

affairs are being conducted

Prejudicial to public interest
Or

Oppressive to any members

And

That facts would justify winding up of company under " just and equitable ground".

Section 398 (1) (a)

affairs are being conducted

Prejudicial to public interest

Or

Prejudicial to interest of companies

Section 398 (1) (b)

material change in management has taken place and it is likely that affairs are being conducted.

Prejudicial to public interest

Or

Prejudicial to interest of companies

Complainant shareholders must comply with sector 399 requirement.

Broadly, oppression of member is covered by section 397 and mismanagement is covered by section 398. Analysing the two limbs of section 397, members with requisite majority can apply where affairs are being conducted in a manner, which is oppressive to them. The second limb requires justification that the conditions exist for ordering winding up on "just and equitable" grounds but such ordering would unfairly prejudice the members. Both these limbs need to be satisfied for invoking the provisions of oppression under section 397. Where only one limb is satisfied, Courts/Company Law Board would be hesitant in granting relief. This was held in *Bengal Laxmi Cotton Mills (1965) 35 Comp. Cases 187 (Cal), N. K. Prasad v. Andhra Bank Ltd. (1983) 53 Comp. Cases 73 (AP).*

Analysing the limbs of section 398 where affairs are being conducted prejudicial to interest of company or where change in management has occurred and it is likely that affairs would be conducted in a manner prejudicial to interest of company, section 398 could be invoked. In brief, mismanagement of companies or likely mismanagement of companies would be covered. Thus where mismanagement is already occurring section 398(1) (a) comes into play. But where the shareholders fear that due to change in management, mismanagement is likely to occur section 398 (1) (b) comes to play. It may be seen that invoking section 398 (1) (b) is extremely difficult and rare. In any case what would be the relief prayed for?

There is a limb in section 397 and 398 which provides relief where affairs are being conducted prejudicial to public interest. Here it must be stated that this is again difficult to show and cases have by and large been rare and difficult to prove.

To invoke section 397/398 and claim relief it is required to show that "affairs" "are being conducted" in a manner which causes oppression/mismanagement. What are the "affairs" being referred to? What is the exact meaning of "are being conducted"?

"Affairs" are not separately defined in the Companies Act 1986 or in these sections 397/398. As per the dictionary meaning, it would refer to the day to day concerns of an organisation.

"Are being conducted" would denote that the actions are "presently happening". Since the section does not use the expression "affairs are conducted" or "affairs have been conducted" Court have interpreted it to support the following positions:

1. that there should be a series of actions and they should continue upto the date of petition.

2. that a single act of oppression is enough and such action need not be continuing upto the date of the petition but the effect is felt even upto the date of petition.

Finally, to qualify for making an application under section 397/398, the provisions of section 399 would have to be complied with:

a. in the case of a company having a share capital, 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 any member or members holding not less than one-tenth of the issued share capital of the company, provided that the applicant or applicants have paid all calls and other sums due on 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.

Sub-section (2) provides that where any share or shares are held by two or more persons jointly, they shall be counted only as one member. Sub-section (3) provides that where any members are entitled to make an application, any one or more of them having obtained the consent in writing of the rest, may make the application on behalf of all of them.

Judicial decision:

On analysing these sections it will be seen that to constitute "oppression" and "mismanagement" facts of case would be relevant and the result of a complaint would depend on situation to situation. What would be "oppression" in one situation may not be in another. Example -Increase in Share Capital by way of rights issue is not oppression at all but where the rights issue is done in a situation where there is no need of finances and knowing that minority shareholders are facing financial difficulties would definitely constitute oppression. Given below are some of the judicial decisions, which could have persuasive values:

a. **Single act can constitute oppression**:

A single act of oppression which has its continuous impact could also constitute oppression. Therefore, "affairs are being conducted" has been judicially interpreted to include past and concluded acts which has a continuous impact as held in *Sindhri Iron Foundry (P) Ltd. (1964) 34 Comp. Cases 510.*

A single act was capable of causing perpetual damage like removal from directorship and allotment of new shares was held to be oppressive in *Tea Brokers Pvt. Ltd. v. Hemendra Prasad Baroah (1998) 5 Comp. LJ. 463 (Cal).*

b. **Acts have to be considered as part of a consecutive story**:

Events of oppression have to part of consecutive story and not in isolation to constitute "oppressive" conduct of the majority as held in *Shanti Prasad Jain v. Kalinga Tubes Ltd. (1965) 35 Comp. Cases 351; Needle Industries (India) Ltd. and Others v. Needle Industries Newey (India) Holding Ltd. (1981) 51 Comp. Cases 743; G. Kasturi v. N. Murali (1992) 74 Comp. Cases 661 (Mad).*

c. **Acquisition of shares in market cannot constitute oppression:**

Acquisition of shares in the market cannot constitute oppression to minorities as held in *Mohta Bros. (P) Ltd. v. Calcutta Landing and Shipping Company Ltd. and Others (1969) 2 Comp. LJ. 157 (Cal).*

d. **Lack of transparency, probity and fairness to gain majority control constitute oppression:**

In *Hemant Vakil and other v. RDI Print and Publishing (P) Ltd. (1993) 2 Comp. LJ. (CLB)* group of shareholders gained management control by lack of transparency, probity and fairness where they increased the shareholding which was set aside and it constituted oppression.

e. **Issue/Allotment of shares - majority reduced to minority:**

One of the ways a group of shareholders oppress other groups is to issue and allot shares to themselves in an illegal manner. Courts/Company Law Board has been very critical of these actions and has consistently held these to be oppressive in nature. These allotments have been set aside and status quo ante restored. *Mrs. Rashmi Seth v. Chemin (India) Pvt. Ltd. (1992) 3 Comp. Cases LJ. 89 (CLB).*

f. **Termination of distributorship agreement in which a shareholder is interested:**

The Company Law Board in *M. L. Thukral v. Kone Communication Ltd. (1996) 86 Comp. Cases 643 (CLB)* refused to interfere in a matter concerning termination of distrbutorship agreement which it felt was the powers of Board of Directors and outside the purview of section 397/398.

Similarly, in *Karedla Suryanarayana v. Ramdas Motor Transport Ltd. (1999) 98 Comp. Cases 518 (CLB).* Company Law Board held that appointment of dealers is within the ambit of the Board of Directors powers and outside the purview of section 397/398.

g. **Acts in Contravention of Law:**

ILLEGAL, INVALID and IRREGULAR acts by themselves, unless they are oppressive to any shareholders or prejudicial to the interest of the company cannot be set aside in a petition under section 397/398. This has been held in a number of cases of Courts and Company Law Board. *Seth Mohanlal Ganpatram v. Shri Sayaji Jubilee Cotton & Jute Mills Co. Ltd. (1964) 34 Comp. Cases 777 (Gujarat); Kuldip Singh Dillon v. Paragon Utility Finances Pvt. Ltd. (1988) 64 Comp. Cases 19 (P & H); Allianz Securities Ltd. v. Regal Industries Ltd. (2000) 25 SCL 349 (CLB).*

h. **Omission to give notice and short notice of meeting:**

One of the commonest types of oppression/mismanagement is not sending notices to share holders/directors and passing resolutions thereat. These have by and large being held to be "oppressive" to members and constitute mismanagement of companies. It will be interesting to note that "proofs" of sending notices by "UPC" were not relied upon by the Company Law Board as circumstances clearly pointed out to the contrary. The Company Law Board gave directions to end this oppression/mismanagement.

Allianz Securities Ltd. v. Regal Industries Ltd. (2000) 37 CLA 250 (CLB).
Kamal K. Datta (Dr.) v. Rubu General Hospitals (2000) 36 CLA 214 (CLB).

But Company Law Board, in *Shantidevi P. Gaikwad v. Sangramsingh P. Gaikwad (1996) 1 Comp. LJ. 72 (Gujarat)* and *Farat Shiekh v. Esemen Metala Chemicals Pvt. Ltd. (1996) 87 Comp. Cases 290 (CLB)* held that the provisions in the act regarding length of notice are directory and not mandatory and giving of shorter notice will not invalidate the meeting or cause oppression.

i. **Issue of further capital and irregularity thereat:**

The issue of further capital and impropriety in these issues has given rise to a lot of litigation under section 397/398. The Supreme Court in *Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holdings Ltd. (1981) 51 Comp. Cases 743 (SC)* held that where a group incidentally got control was not abuse of fiduciary powers of the directors but what would be objectionable would be the use of such powers merely for an extraneous purpose of gaining control. This case acts as a benchmark for many cases.

In following cases, where minority has been converted to majority by way of new issues, the same is liable to be set aside on grounds it was unfair, manipulative and oppressive.
R. N. Jalan v. Decan Enterprise Pvt. Ltd. (1992) 75 Comp. Cases 417 (AP) .
Rashmi Seth (Mrs.) v. Chemon (India) Pvt. Ltd. (1995) 82 Comp. Cases 563 (CLB).
C. N. Shetty v. Hillick Hotels (P) Ltd. (1996) 87 Comp. Cases (AP) affirmed by Division bench in (2000) 1 Comp. LJ. 181 (AP).

Most private companies to preserve their relationship provide in the articles or by way of separate agreements that any new issue of shares shall be offered to equity shareholders. Where such a provision exists issuing such shares to outsiders in violation of the articles/agreements would constitute oppression. *Akbarali A. Kalvert v. Konkan Chemicals P. Ltd. (1997) 88 Comp. Cases 245 (CLB).*

Rights issue, per se cannot cause oppression, as they are fair to all shareholders. But the Company Law Board in a very rare judgement in *Standard Industries Ltd. v. Mafatlal Services Ltd. (1994) 80 Comp. Cases 764 (CLB)* held that since 48% shareholders were opposed to the move, the same is oppressive. This judgement covered several complicated facts and does not lay down the law. But even otherwise, one may respectfully differ from the view of Company Law Board.

j. **Increase in directorship/Removal from directorship:**

One of the common ways of controlling the board is to induct directors pertaining to one group. Similarly removal of directors pertaining to the other group is common. Here Courts/Company Law Board has consistently held that where is written agreements/oral understanding amongst the family members or groups, any new appointment or removal, which disturbs the parity amongst the family members or groups was held to be "oppressive" and liable to be set aside. This is inspite of the fact that proper procedure for appointment and removal under section 284 Companies Act 1956 has been followed. Courts/Company Law Board have time and again relied upon the principle of "quasi-partnership" as far as family owned private companies are concerned were participation of family members in the business is part and parcel of the management setup. But not all increase or removal of directors has been held to oppression.

Vijay Krishnan Jaidka v. Jaidka Motor Co. Ltd. (1997) 1 Comp. LJ.268 (CLB)
Vinod Kimar Mittal v. Kaveri Lime Industries (200) 100 Comp. Cases 66 (CLB)
Tea Brokers P. Ltd. v. Hamendra Prasad Baroah (1998) 5 Comp. LJ. 463 (Cal)
Naresh Trehan v. Hymatic Agro Equipments Pvt. Ltd. (1997) 97 Comp. Cases 561 (CLB)
Dipak G.Mehta v. Anupar Chemicals India Ltd. (1999) 98 Comp. Cases 575 (CLB)
Prasadachandran Nair (T.V.) V. Anandamdiram Hotels Pvt. Ltd. (2000) 2 Comp. LJ. 120 (CLB).
T. M. Paul (Dr.) v. City Hospitals Pvt. Ltd. (2000) 2 Comp. LJ. 84 (CLB)

k. **Transfer of shares in violation of pre-emptive rights:**

Family owned companies generally provide in the articles for pre-emptive rights. Here, any family member/group wishing to sell their holdings is required to sell their holding to the continuing family members. Courts/Company Law Board has consistently held that violation of pre-emptive rights constitute oppression.

M. M. Dua v. India Dairy & Allied Industries Pvt. Ltd. (1996) 86 Comp. Cases 657 (CLB).

<u>Part IV: Remedies:</u>

The Courts/Company Law Board have been given very wide powers under section 402 to deal with applicants under section 397/398 so as to bring an end to the oppression or mismanagement complained of. This covers giving directions for conduct of companies affairs, purchase of shares, termination of various agreements, setting aside any allotments, setting aside removal of directors, quashing appointment od new directors and any other order that is necessary to end oppression and mismanagement. The remedies generally are:

a. Purchase of shares of the minority shareholders by the majority as per independent valuers report.

b. Suspension of Board of Directors and fresh election under Company Law Board appointed chairman.

c. Appointment of an administrator until fresh elections under Company Law Board appointed chairman.

d. Recommend winding up of the company.

The other powers of the Company Law Board include passing of an interim order under section 403 and alter the memorandum and articles of association under section 404.

<u>Part V -Incidental matters:</u>

a. **Arbitration clauses in agreements/articles of association:**

The effect of an arbitration clause in agreements/articles is different under the Arbitration and Conciliation Act 1996 from that under the preceding Arbitration Act of 1940. Under the old Act, the Court/Company Law Board had discretion either to stay the legal procedings and to refer the parties to arbitration or to continue the proceedings. Under the 1996 Act there is no such discretion. The parties are bound to their arbitration agreement and the Court has no discretion to relieve them off it.

Accordingly, in *Naveen Kedia v. Chennai Power Generators Ltd. (1999) 95 Comp. Cases 640 (CLB)* held that proceeding under section 397/398 are affected by the 1996 Act and are liable to be stayed and the matter referred compulsorily to arbitration.

Therefore, whenever an agreement or the articles provide that the matter would be decided by arbitration - the matter could be issue of shares, issues of directorship etc. - the Company Law Board would have no option under 397/398. The Board would be bound to refer the parties to arbitration in view of section 8 of the Arbitration and Conciliation Act 1996. *Escorts Finance Ltd. v. V. G. R. Solvents and Allied Industries Ltd. (1999) 96 Comp. Cases 329.*

A slightly contrary view has been taken in Suresh Kumar *Jain v. Hindustan Ferro Industries ltd. (1999) 96 Comp. Cases 507 (CLB)* where the Court examines the effect of section 8 of the Arbitration and Conciliation Act 1996 on proceedings under section 397/398. The Company Law Board held that the 397/398 petition is liable to be stayed and matter referred to arbitration only where an application for stay is made in the first hearing and not thereafter. Once hearing begins the right to seek reference under arbitration is deemed to be waived. Similar decision on this point is *VLS Finance Ltd. v. Sumair Hotels ltd. (2000) 28 SCL 253 (Delhi).*

b. **Applicability of Limitation Act:**

The Limitation Act of 1963 is not applicable to proceedings before Company Law Board as held in *Mahendra Singh Maniar v. Lake Palace Hotels & Motels Pvt. Ltd. (1997) 4 Comp. LJ. 440 (CLB).*

c. **Members right of inspection of Books of Accounts:**

One of the issues which has handicapped minority shareholders to prove mismanagement/oppression is lack of concrete information. Obviously, the records are in control of the management making it difficult for the minority shareholders (who are not in management) to prove their point. The Court/Company Law Board have consistently rejected petitions for lack of conviction and lack of credible documents/information.

Most of this information required by minority shareholders is directly available from accounts.

Members have no right under the Company Law to inspect the books of accounts. The *Calcutta High Court in Mohta Bros. (Pvt.) Ltd. v. Calcutta Landing & Shipping Company Ltd. (1970) 40 Comp. Cases 119* held that when the complainants are unable to produce evidence in petition under section 397/398, the Courts would not come to the rescue of the petitioners and order inspection of books of accounts by the petitioners.

Part VI - Procedure before Company Law Board

Petition to exercise powers in connection with prevention of oppression is to be made before the Principal Bench, New Delhi/Additional Principal Bench at Chennai (for Southern Region, w.e.f. 14.12.2000) of the Company Law Board in Form No. 1 of Annexure II to CLB Regulations, 1991 with a fee of Rs. 5,000 [w.e.f. 1-4-2000] and accompanied by the following documents:

(1) Document and /or other evidence in support of the statements made in the petition, as are reasonably open to the petitioner (s).

(2) Documentary evidence in proof of the eligibility and status of the petitioner (s) with the voting power held by each of them.

(3) Where the petition is presented on behalf of members, the letter of consent given by them.

(4) Statement of particulars showing names, addresses, number of shares held and whether all calls and other monies due on shares have been paid in respect of members who have given consent to the petition being presented on their behalf.

(5) Where the petition is presented by a member or members authorised by the Central Government under section 399 (4) the order of the Central Government authorising such member or members to present the petition shall be similarly annexed to the petition.

(6) Affidavit verifying the petition.

(7) Bank draft evidencing payment of application fee.

(8) Memorandum of appearance in Form No. 5 of Annexure I with copy of the Board Resolution or the executed Vakalatnama, as the case may be.

(9) Three spare copies of the petition.

Secretarial action points for application to the Company Law Board for relief in case of oppression and mismanagement.

1. Ensure that the application to the Company Law Board for relief is made in the circumstances specified in section 397 or 398.
2. Ensure that the application is made by the following persons:-
   (a) In case of a company with share capital, at least 100 members or at least one-tenth of the total numbers of members, whichever is less, or any member or members holding at least one-tenth of the issued capital of the company.

(b) In case of a company without share capital, at least one-fifth of the total number of members.

(c) Any member or members authorised by the Central Government.

3. Ensure that any member or members is authorised to make application on behalf of others.

4. Make the applications in Form 1 in Annexure II of the Company Law Board Regulations, 1991 to the Company Law Board, Principal Bench, New Delhi.

5. Ensure that all the documents mentioned in the said Regulations are attached to the petition, and the petition is verified by an affidavit in accordance with Regulation 14 of the said Regulations and the requisite fee is paid.

6. Serve a copy of the petition to the concerned Regional Director, Department of Company Affairs, and ROC before filing it with the Company Law Board [Regulation 14 (3)].

Secretarial practice notes: Relief in case of oppression:

Check whether the Company Law Board had issued any order under this section? If so ensure the compliance of such order.

Documents involved: Company Law Board Order.