

Prevention of Oppression and Mismanagement (Sections 397 – 407)

Application to Tribunal for relief in cases of oppression (Section 397)

Question 1

The group of requisite shareholders under Section 399 filed a petition before the Company Law Board for relief against oppression. Meanwhile, a secured creditor filed a civil suit for winding up for non-payment of his debt. The shareholders contended that winding up proceeding should not be heard as the Company Law Board is seized of the petition under Section 397. Is there contention tenable?

What would be your answer, if in the said situation a composite petition (petition praying for relief against oppression as well petition for winding up) is filed in the Court of Law?

Answer

In *A.K. Puri vs. Devi Dass Gopal Kishan Ltd.*, (1995) 17CLA, the J&K High Court held that there was no conflict of jurisdiction with respect to Sections 397, 398 and Section 433. The court observed that there is no statutory provisions in the Companies Act which provides for stay of the winding up proceedings under Section 433 when the CLB was seized of a petition between the same parties under Section 397/398. In other words, there is neither explicit nor implicit to carry on the winding up proceedings even when the CLB was seized of the matter.

The question whether shareholders can file a writ petition for relief against oppression and mismanagement during pendency of proceedings before the CLB, the Supreme Court in *World-wide Agencies Pvt. Ltd., vs. Mrs. M.T. Desor* (1990) 67 CC. 607 held against such filing as a shareholder cannot be allowed to bypass the express provisions of the Companies Act.

Winding up petition as a creditor on ground of inability to pay debts is not a bar to admission of a composite petition under Section 397 and 398 by the same party in the capacity of a member. [*MMTC Ltd. vs. Indo French Biotech Enterprise Ltd* (2000)] 23 SCL 192 (CLB).

Question 2

What is meant by oppression? State whether the aggrieved party would succeed in obtaining relief from Company Law Board on the ground of oppression in the following cases:

- (i) *The majority of the Board of Directors override the minority directors and the minority directors apply to Company Law Board complaining oppression by majority directors.*
- (ii) *A petition by majority shareholders complaining oppression by minority shareholders.*

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Answer

Oppression: The term 'oppression' is not defined in the Companies Act. Oppression, according to the Dictionary meaning of the word, is any act exercised in a manner burdensome, harsh and wrongful. The meaning of the term 'oppression' was explained by Lord Cooper in the Scottish case of *Elder v. Elder and Watson Ltd*, as given below:

"The conduct complained of should be at the lowest involve or visible departure from the standards of fair dealing and a violation of the conditions of fair play or which every shareholder who entrusts his money to a company is entitled to rely.

- (i) **Oppression of a member as a director:** The oppression dealt with by section 397 is only oppression of members in their character as such; and it is only in that character they can involve section 397. The harsh treatment, for instance, of a member who is a director or other officer or employee, by the Board of Directors or management does not come within (section 397). It has been held in *Re. Bellador Silk Ltd.* that if the majority of the Board of Directors override the minority directors the latter cannot resort to section 397 and hence the minority directors will not succeed in getting relief from CLB on the ground of oppression.
- (ii) **Right not confined to minority:** According to section 399, the right to apply for relief under section 397/398 is given to 100 members or 1/10th of the total number of members or any member or members holding not less than 1/10th of the issued share capital of the company. There is nothing in this section which suggests even indirectly that unless the application is made by minority shareholders it is not maintainable. The right to apply is, therefore, not confined to oppressed minority of the shareholders alone. It was held by Calcutta High Court in *Re. Sindhri Iron Foundry (P) Ltd.* that the oppressed majority also might apply for relief under section 397. Therefore, the petitioners are likely to succeed in getting relief provided the other condition laid down in section 397 (i.e. that to wind up the company would unfairly prejudice such members, but that otherwise the facts would justify the making of a winding-up order on just and equitable ground) is satisfied, even though the Delhi High Court held a contrary view in *Suresh Kumar Sanghi v. Supreme Motors Ltd*,

Question 3

Messrs Ahimsa Private Limited was incorporated in the year 2001 under the Companies Act, 1956 by 3 brothers, namely, Amit, Anil and Akhlesh. All the three were Promoter-directors named in the Articles of Association and subscribed for 100 shares each in the company through Memorandum of Association. Thereafter, from time to time, further shares were allotted in proportion of one-third to each of them and in due course, the company started earning substantial profits. Due to greed of money, the two brothers, namely, Amit and Anil, joined hands together to assume complete control of the company, leaving their brother, Akhlesh in lurch. Both the brothers got further shares allotted to themselves, thereby their joint shareholding increased from 66 2/3% to 90%, while the shareholding of Akhelesh got

reduced from the erstwhile 33~~1~~/₃ to 10%. No notice of any Board Meeting was sent to Akhlesh, who was sidelined and was also removed as a Director.

Aggrieved by the decisions taken by; his two brothers at his back, Akhlesh seeks your advice for taking out appropriate proceedings before the court or judicial authority of competent jurisdiction. Also suggest the nature of reliefs he may claim while filing his case.
(November 2006)

Answer

Under Section 397 of the Companies Act, 1956 on an application by any member of a company, the Company Law Board (Tribunal as per amended provision which has not come into force) is of the opinion that –

- (i) the company's affairs are being conducted in a manner which is prejudicial to public interest or in a manner oppressive to any member(s); and
- (ii) to wind up the company would unfairly prejudice such member(s), but that otherwise the facts justify winding up of the company on just and equitable ground,

The CLB may, with a view to bringing to and end the mattes complained of, make such order as it thinks fit.

As per section 399, a member holding 10% shares is entitled to file such a petition.

In the present case, Mr. Akhlesh was holding 33~~1~~/₃ shares in the company which is nothing but a quasi partnership and was participating in the management. By further allotment of shares in a clandestine manner and without the consent of Mr. Akhlesh, his shareholding was reduced to 10% while the shareholding of his brothers stood at 90%. This is a serious act of oppression of Akhlesh, a minority shareholder. On similar facts, it was held by Supreme Court in *Dale & Carrington Inv't. Private Ltd. Vs. P.K. Prathpan, (2004) 122 Comp cases 175(SC)* that assuming meetings of board of directors did take place, the manner in which the shares were issued in favour of R without informing other shareholders about it and without offering them to any other shareholder, was totally mala fide and the sole object of R in this was to gain control of the company by becoming a majority shareholder. This was clearly an act of oppression on the part of R. The only relief that has to be granted in the present case was to undo the advantage gained by R through his manipulation and fraud. The allotment of all the additional shares in favour of R had to be set aside.

Section 397 protects the rights of shareholders and not as a director. It has, however, been held by CLB in a number of cases that in a family company like the present one, removal of the promoter-director is also an act of oppression.

In the facts and circumstances of this case, Akhlesh is advised to file a petition under Section 397 of the Act. Being a 10% shareholder he is entitled to file the petition, before the Principal Bench of Company Law Board at New Delhi. He may seek the following reliefs:

- (i) the alleged allotment of further shares be declared null and void and set aside;

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- (ii) the alleged removal of the petitioner, Mr. Akhlesh be declared as null and void and set aside;
- (iii) The Board of Directors be re-constituted with the petitioner and his two brothers and an independent person, as the Chairman of the board of directors to be appointed by the Company Law Board with casting vote;
- (iv) the petitioner may be appointed as Managing director of the company having substantial powers of management.

Question 4

State the conditions which must be satisfied before filing a petition under Section 397 of the Companies Act, 1956 for prevention of oppression. (CA Final, New Course, May, 2009)

Answer

The conditions which are required to be satisfied before filing a petition under Section 397 of the Companies Act, 1956 can be enumerated as follows:

- (i) An application under the said Section 397 can be made only by the members. In the case of a company having share capital minimum one hundred members or one-tenth of total number of member of the company, whichever is less; or a member or members holding not less than 10% of the paid up capital of the company can file such petition . In case of a company not having share capital, minimum one-fifth of the total number of members of the company is required for the purpose. However, Central Government may authorise any lesser number of members to file such petition.
- (ii) It must be established that the affairs of the company are being conducted in a manner (a) oppressive to any member/members of the company or (b) prejudicial to public interest.
- (iii) The oppression complained of must affect a person in his capacity as a member of the company. Rights and interests as a member of a company can only be agitated and not in relation to any commercial relation that a member has with the company as was decided by the Company Law Board in the case of *Anil Gupta vs. Mirai Auto Industores Ltd. [(2003)113 COMP. CAS.63]*.
- (iv) The acts complained of must be continuing acts of oppression. The acts constituting oppression must continue till the date of making the application.
- (v) The applicant must make out a prima facie case that the degree of oppression is so severe that there is just and equitable ground for winding up of the company. But at the same time, it must also be established that the winding up of the company would not unfairly prejudice the applicant.
- (vi) It may be noted that expression "issued share capital" in section 399(1) includes both the preference and equity share capital.

Question 5

The profits of MJR Company Limited for the financial year 2009-2010 fell considerably due to recession. The Board of Directors of the company, therefore, bonafide did not recommend any dividend for the year. At the Annual General Meeting of the company, a group of shareholders/members objected to the Board's decision and wanted the Board to make recommendation for dividend.

On refusal by the Board, the members, who feel oppressed by the Board's decision to skip the dividend, move to the Company Law Board/Tribunal and complain against the Board on the ground of oppression and mismanagement.

Examining the provisions of the Companies Act, 1956, decide:

- (1) *Whether the members contention shall be tenable?*
- (2) *Whether the act of Board of Directors not to recommend any dividend shall amount to oppression and mismanagement?* **(May, 2010)**

Question 6

60% shares of Indo-French Ltd. are held by French Group and balance by an Indian Group. As per articles of association of the company both groups had equal managerial powers. The relationship between the two groups soured and the operations of the company reached a deadlock. The Indian Group approached the Company Law Tribunal (Company Law Board till Company Law Tribunal becomes functional, referred to as CLB hereinafter) for action against the French Group for oppression. Based on these facts, you are required to decide, with reference to the provisions of the Companies Act, 1956 and/or the decided case laws, the following issues:

- (i) *Whether the contention of oppression against the French Group by the Indian Group is tenable?*
- (ii) *What are the powers of the CLB in this regard?* **(May 2007)**

Answer

- (i) Section 397 of the Companies Act, 1956 deals with the remedy in a situation when the affairs of the company are being conducted in a manner oppressive to a shareholder or shareholders. This means that some of the shareholders must be in such a position that they can be oppressed by other shareholders or the management. In the present case as given in the question, both the Indian Group and the French Group are equally strong and none is able to oppress the other. The situation stated in the question is a deadlock but it can not be termed as oppression. Since it is not a case of winding up of the company, the relief under the said section 397 is not available to the Indian Group. [*Gnanasambandam v. Tamilnad Transporters (Coimbatore) p. Ltd. (1971) 41 Comp. Cas. 26*] In view of the position discussed, the contention of the Indian Group is not tenable.

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- (ii) The powers of the Company Law Tribunal (Company Law Board till National Company Law Tribunal becomes functional) referred to as CLB hereinafter) under the provisions of section 397 of the Companies Act 1956, are discretionary in character. Apart from the general powers envisaged therein, the CLB under section 402 (b) of the said Act, may order the purchase of the shares of one group by the other group. In the case of *Yashovardhan Saboo Vs. Groz Beckert Saboo Ltd.* 1933 1 Comp. L.J. 20, the presiding officer ordered the foreign group to buy out the shares of the minority group at the fair price with deadlock and the matters are not sorted out by any other means, an order for winding up of the company may also be made under the just and equitable clause, [*Kishan Kumar Ahuja Vs. Suresh Kumar Ahuja*]. Thus, if the Indian Group of the French Group fail to buy out the shares of the other group, the CLB may order the winding up of the company.

Question 7

Certain Members of MDV Company Limited having share capital feel that the affairs of the company are being mismanaged by Directors. Members therefore, decide to move the Company Law Board, complaining the mismanagement of company affairs by Directors of the Company. Examine the provisions of the Companies' Act, 1956 and state

- (i) *Whether members are entitled to complain the Company Law Board.*
- (ii) Whether the following acts of the Board, of Directors amount to mismanagement:
- (A) Continuation of Directors in their office after expiry of their tenure and infighting continues among them.
- (B) Non-declaration of dividend when it does not lead to devaluation of shares.

(CA Final, New Course, November, 2010)

Answer

Section 398 of the Companies Act, 1956 provides that a requisite number of members of the company as laid down in Section 399 may apply to Company Law Board for appropriate relief on the ground of mismanagement of the company.

Conditions Precedent:

Section 398 can be invoked in either of the two circumstances:

- (a) that affairs of the company are being conducted in a manner prejudicial to the interests of the company [Section 398(1)(a)]; or
- (b) that a material change has taken place in the management or control of the company and as a consequence the affairs of the company may be conducted in a manner prejudicial to the public interest or in a manner prejudicial to the interests of the company [Section 398(1)(b)].

Considering the above, the questions as asked can be answered as under:

1. Continuation of directors in their office after the expiry of their term and infighting among

them has been held to be the act of mismanagement. (*Ranjan Dutta vs. Bhola Nath Paper House Ltd. (1983)*).

2. Non-declaration of dividend when it does not lead to devaluation of shares is not an act of mismanagement. (*V.J. Thomas Vettom vs. Kuttanad Rubber Co. Ltd. (1984)*).

Right to apply under sections 397 and 398 (Section 399)

Question 8

- (i) *ABC Private Limited is a company in which there are eight shareholders. Can a member holding less than one-tenth of the share capital of the company apply to the Company Law Board for relief against oppression and mismanagement?*
- (ii) *It is alleged by said member that the Directors of the Company have misused their position in making certain inter-corporate deposits which are against the interests of the company. Will the Company Law Board entertain application containing such allegation in the case of a private company?* **(May, 2000)**

Answer

- (i) Under Section 399(1)(a) of the Companies Act, 1956, in the case of a company having share capital, the following member(s) have the right to apply to the Company Law Board under Section 397 or 398:
 - (i) Not less than 100 members of the company or not less than one-tenth of the total number of members, whichever is less; or
 - (ii) Any member or members holding not less than one-tenth of the issued share capital of the company provided the applicant(s) have paid all the calls and other sums due on the shares.

In the given case, since there are eight shareholders. As per (i) above, 10% of 8 i.e. 1 satisfies the condition. Therefore a single member can present a petition to the Company Law Board (CLB), regardless of the fact that he holds less than one-tenth of the company's share capital.
- (ii) As regards the proprietary rights in inter-corporate loans by a private company, they are not closely regulated by Company Law as in the case of public companies. Though the Board of Directors are the best to judge and to take a commercial decision in this regard, if it is *mala fide*, it should be looked into. Therefore the CLB can look into the allegation lodged by the member.

Question 9

A group of shareholders of Deceptive Duplicating Machines Ltd. filed an application before the Company Law Board alleging various acts of fraud and mismanagement by Mr. Unscrupulous, the Managing Director, and his associates. During the course of hearings before the CLB, it was contended on behalf of the company that the alleged transactions had taken place long ago and that the Managing Director, who was responsible for such actions had already been

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removed and that there is no case before the CLB to interfere in the working of the company. The contention of the Applicants on the other hand is that though the fraudulent nature of the transactions is a thing of the past and though the Managing Director had been removed, yet the management of the company is still controlled by the henchmen of Mr. Unscrupulous. Discuss the powers of the Company Law Board in support of your answer. (May, 2001)

Answer

The power available to the shareholders to seek relief or remedy from the acts of oppression and mismanagement as stated in Sections 397 and 398 of the Companies Act, 1956 can be invoked only when the affairs of the company are being conducted in a manner oppressive to shareholders or prejudicial to the interest of the company. Thus at the time of making an application, there must be a continuing course or conduct of the affairs of the company, which is oppressive to any shareholder or shareholders or prejudicial to the interest of the company. It is this course of oppressive or prejudicial conduct which can be made the subject matter of a complaint in the application to CLB. The forgoing provisions of law (Section 397 & 398) do not confer any power on the Company Law Board to set aside or interfere with past and concluded transactions between the company and the shareholders or third parties which are no longer continuing wrongs or to award a compensation in respect of such concluded transactions. (*Seth Ganpatram Vs. Shri Satyaji Jubilee Cotton and Jute Mills Company Ltd. (1964) 34 comp. Case 777*). However, there are two exceptions to the above said general rule. The first one is provided in Section 402(f) which enables CLB to set at naught transactions amounting to fraudulent preference effected within 3 months before the date of application under Sections 397 and 398, even though they are no long continuing wrongs. The second one is provided in Section 406 which enables the CLB, on an application under Sections 397 and 398, to book delinquent directors, managers and other office bearers of the company and to enforce the company's claim against them if they have misapplied or retained the company's money or have committed any misfeasance or breach of trust in relation to the company. It is necessary for the petitioners to establish that the matter complained falls under either of these exceptions and mere statement that the management of the Company still controlled by the Hechmen of Mr. Unscrupulous is not enough.

Question 10

M/s Continuous Conflicts Ltd. is a company controlled by two family groups. The first family group has four directors, namely, Mr. A, Mr. B, Mr. C and Mr. D on the board of directors. The second family group has two representatives Mr. X and Mr. Y on the board. Because of internal family troubles, the first group, by virtue of its majority shareholding removed both Mr. X and Mr. Y as the directors of the company. Aggrieved by this action the second group is planning to move an application before the Company Law Board. You have been approached for advice. Advise as to the eligibility restrictions regarding filing the application and the chances of getting relief from the Company Law Board, assuming that there is no other material on record in support of oppression of the minority group (May, 2002)

Answer

The management of any company registered under the Companies Act, 1956 is based on the principle of majority rule and the voting power of every member depends upon the number of shares held by them. Thus one single individual holding the majority shares can overrule the views of the other members who may be more in numerical numbers but not in voting power. However, certain rights have been given to minority shareholders who complain that the affairs of the company are being conducted in a manner oppressive to any member or members. In such an event, the minority shareholders can apply to the Company Law Board for relief against oppression and mismanagement. The eligibility restriction for filing an application to the Company Law Board is contained in Section 399 of the Companies Act. According to the said section, the application to CLB can be made in the case of a company having share capital, by not less than one hundred members or not less than one-tenth of the total number of members whichever is less or members holding not less than one-tenth of the issued share capital provided, the applicants have paid all calls and other dues on their respective shares. In the case of a company not having the share capital, the application can be filed by members holding not less than one-fifth of the total number of members.

In the present case the majority group have removed the minority directors from the board. The election and removal of directors is the prerogative of the members and such an act cannot be per se treated as oppressive to the minority shareholders, unless there is an allegation of mismanagement to the detriment of the shareholders. The application under section 397/398 requires to prove oppressive conduct to their members in their capacity as members. Thus the minority group consisting of two directors Mr. X and Mr.Y will not be able to successfully prosecute the case against the majority directors in the absence of any material or record in support of oppression and mismanagement of the minority group.

Question 11

There are eight shareholders in M/s Supra Private Ltd. Mr. Shyam who is holding less than one-tenth of the Share Capital of the company seeks your advice whether he can apply to the Company Law Board for relief against oppression and Mismanagement. Advise.
(November, 2002)

Answer

Petition to Company Law Board

Under Section 399 (1) (a) of the Companies Act, 1956, in the case of a company having share capital, the following members have right to apply to the Company Law Board under Section 397 or 398.

- (a) Not less than 100 members of the company or less than one-tenth of the total number of members, whichever is less; or
- (b) Any number of members holding not less than one-tenth of the issued share capital of the company provided that the applicants have paid all calls and other sums due on their respective shares.

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In the instant case, since there are eight share holders, as per (b) above, 10% of 8, i.e. 1 satisfies the condition laid down in section 399 mentioned above. In view of this Mr. Shyam can present a petition to the Company Law Board, regardless of the fact that he hold less than one-tenth of the Company's share capital.

Further, a single member can present a petition to the Company Law Board under section 401 of the Act, if authorised by the Central Government.

Question 12

A group of shareholders of Badwill Machineries Ltd. filed an application before the Company Law Board (CLB) alleging various acts of fraud and mismanagement by Mr. Bigfish, the Managing Director of his associates. During the course of hearing before the CLB, the authorised representative of the said company contended that the alleged transactions had taken place several years ago and the company has already removed the Managing Director, who was responsible for such transactions and hence there is no case before the CLB to interfere in the working of the company. Against the submissions on behalf of the company, the applicants submitted that although the fraudulent transactions were done in past and the Managing Director has been removed, but the company is still controlled by the persons, who are in league with the erstwhile Managing Director and are working as his henchmen.

State the merits of the applicants' arguments and the powers of the CLB. (November, 2003)

Answer

The power available to the shareholder to seek relief or remedy from acts of oppression and mismanagement as stated in section 397 and 398 of the Companies Act, 1956 can be invoked only when the affairs of the company are being conducted in a manner oppressive to the shareholders or prejudicial to the interest of the company. Thus at the time of making an application, there must be a continuing course or conduct of the affairs of the company, which is oppressive to the shareholders or prejudicial to the interest of the company.

It is this course of oppressive or prejudicial conduct which can be made subject matter of a complaint in the application to the Company Law Board (CLB). The provisions of sections 397 and 398 of the Companies Act, 1956 do not confer any power on the CLB to set aside or interfere with the past and concluded transactions between the Company and the shareholders or third parties which are no longer continuing wrongs or to award a compensation in respect of such concluded transactions [*Seth Ganpatram vs. Shri Satyaji Jubilee Cotton and Jute Mills Co. Ltd. (1964) 34 Company Cases 777*].

However, the above mentioned general rule is subject to following exceptions:

- (i) As per clause (f) of section 402 of the Companies Act, 1956, the CLB can set aside 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 sections 397 and 398 of the said Act, even though they are no longer continuing wrongs.

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- (ii) As per provisions of section 406 read with Schedule XI to the Companies Act, 1956, the CLB, on an application made to it under sections 397 and 398 of the said Act, has power to book the delinquent directors, managers and other office bearers of the company and to enforce the company's claim against them if they have misplaced or retained the company's money or have committed any misfeasance or breach of trust in relation to the company.

In the light of the above legal position, it is necessary for the petitioning shareholders to establish that the subject matter of the complaint falls within the scope of any of the above mentioned exceptions and a mere allegation that the affairs of the company is still controlled by the persons who are in league with the erstwhile Managing Director and are working as his henchmen is not sufficient.

Question 13

M/s. City Hospital Private Ltd. has two groups of Directors. A dispute arose between the two groups out of which one group controlled the majority of shares. A very serious situation arose in the administration of the company's affairs when the minority group ousted the lawful Board of Directors from the possession and control of the management of the company's factory and workshop. Books of account and statutory records were held by the minority group and consequently the annual accounts could not be prepared for two years. The majority group applied to the company law board for relief under sections 397 and 398 of the Companies Act. You are required to decide with reference to the provisions of the said Act, the following issues:

- (i) *Can majority of shareholders apply to the Company Law Board for relief against the oppression by the minority shareholders?*
- (ii) *Whether Company Law Board can grant relief in such circumstances. (November 2007)*

Answer

- (i) The case started in the question relates to the provisions of sections 397 and 398 of the companies Act, 1956 with regard to remedy available to majority shareholders.

Where the majority is prevented from protecting itself by controlling the directors at general body meetings, the majority becomes an artificial minority entitled to claim protection under Section 397 and 398 (*V. Sebastean, Dr V City Hospital (Pvt.) Ltd. (1985) 57 Comp. case 453 (Ker)*). Thus the remedy under Section 397 and 398 is confined not to an oppressed minority of the shareholders alone; an oppressed majority may also apply to the Company Law Board against their oppression from the side minority shareholders. In *Sindhri Iron Foundry (Pvt.) Ltd. Re (1963) 78 E. to N. 118*, issue and allotment of a number of shares in a company whereby an admitted majority of shareholders was reduced to a minority was struck down. While granting relief to a majority group, Mitra J observed in their case;

"If the Court (now the Company Law Board) finds that the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, that two

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different registered offices at two different addresses have been set up, that two rival boards are holding meetings, that the company's business property and assets have passed into hands of unauthorized persons who have taken wrongful possession and who claim to be the shareholders and directors, there is no reason why the Court (now the company Law Board) should not make appropriate orders to put an end to such matters".

- (ii) **Relief by the Company Law Board:** The Company Law Board may give relief if it is of opinion:
1. that the company's affairs are being conducted (a) in a manner prejudicial to public interest, or (b) in a manner oppressive to any member or members;
 2. that the facts justify the compulsory winding up order on the ground that it is just and equitable that the company should be wound up;
 3. that to wind up the company would unfairly prejudice the applicants.

On being satisfied about the above requirements, the Company Law Board may pass such order as it thinks fit with a view to bring an end to the matters complained of this provision would help salvage an otherwise sound concern which would have been, but for this principle, forced to into winding up.

Question 14

The issued, subscribed and paid-up share capital of ABC Company Limited is ₹ 10 lakhs consisting of 90,000 equity shares of ₹ 10 each fully paid up and 10,000 preference shares of ₹ 10 each fully paid up. Out of the members of company, 400 members holding one preference share each and 50 members holding 500 equity shares applied for relief under Sections 397 and 398 of the Companies Act, 1956. As on the date of petition, the company had 600 equity shareholders and 5,000 preference shareholders.

State with details whether the above petition under Section 397 and 398 is maintainable. Will your answer be different, if preference shareholders have subsequently withdrawn their consent?

(May, 2004, May 2009)

Answer

As per section 399 of the Companies Act, 1956, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

100 members; or

1/10th of the total number of members; or

Members (including equity shareholder as well as preference shareholder) holding not less than 1/10th of the issued share capital of the company.

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The consent to be given by shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by shareholder during the course of proceedings does not affect the maintainability of the application.

In the question above, the shareholding pattern of the company is as follows:

₹ 9,00,000 equity share capital held by 600 members.

₹ 1,00,000 preference share capital held by 5,000 members.

₹ 10,00,000 total share capital held by 5,600 members.

The application alleging oppression and mismanagement has been made by the members as follows:

(a) Number of members making the application:

- Preference shareholders 400
- Equity shareholders 50
- Total members 450

(b) Amount of share capital held by members making the application:

- Preference share capital ₹ 4,000 (400 preference shares of ₹ 10 each)
- Equity share capital ₹ 5,000 (500 equity shares of ₹ 10 each)
- Total capital ₹ 9,000

The application shall be valid if it has been made by the lowest of the following:

100 members

560 members (being 1/10th of 5,600)

Members holding ₹ 1,00,000 share capital (being 1/10th of ₹ 10,00,000)

As it is evident, the application made by 450 members meets the eligibility criteria specified u/s 399; therefore, the application is maintainable.

Such application shall remain valid despite the fact that some of the applicants have withdrawn their consent.

Question 15

A group of members of XYZ Limited has filed a petition before the Company Law Board alleging various acts of oppression and mismanagement by the majority shareholders of the Company. The Petitioner group holds 12% of the issued share capital of the Company. During the pendency of the petition, some of the petitioner group holding about 5% of the issued share capital of the Company wish to disassociate themselves from the petition and they along with the other majority shareholders have submitted before the Company Law Board that the petition may be dismissed on the ground of non-maintainability. Examine their contention having regard to the provisions of the Companies Act, 1956.

(November, 2009)

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Answer

The argument of the majority share holders that the petition may be dismissed on the ground of non-maintability is not correct. The proceedings shall continue irrespective of withdrawal of consent by some petitioners. It has been held by the Supreme Court in *Rajmundry Electric Corporation vs. V. Nageswar Rao*, AIR (1956) SC 213 that if some of the consenting members have subsequent to the presentation of the petition withdraw their consent, it would not affect the right of the applicant to proceed with the petition. Thus, the validity of the petition must be judged on the facts as they were at the time of presentation. Neither the right of the applicants to proceed with the petition nor the jurisdiction of Company Law Board to dispose it of on its merits can be affected by events happening subsequent to the presentation of the petition.

Oppression & Mismanagement: Under Sections 397 and 398 of the Companies Act, 1956, members may apply to the Company Law Board/Tribunal in cases of oppression and mismanagement. However, bona fide decisions consistent with the company's memorandum and articles are not to be equated with mismanagement even if they turn out to be wrong in the circumstances or these cause temporary losses. The Court will not permit the machinery created by the sections to be used by the minority for compelling the majority to come to terms, where the company is honestly managed. Directors' bona fide decision not to declare dividend and to accumulate available profits into reserves is not mismanagement. (*Thomas Vettom (V.J.) vs. Kuttanad Rubber Co. Ltd.* (1984) 56 Com. Cases 284 (Ker)).

Thus in the given case, the group of shareholders/members who complain to CLB/Tribunal against the decision of the Board not to declare any dividend and to accumulate available profits into reserves, would not succeed, as the act of directors does not amount to mismanagement. Furthermore, the shareholders cannot compel the Board to recommend a dividend. The Board's recommendations are placed in the general meeting. The general meeting can reduce the dividend, but cannot even increase the dividend as recommended by the Board. Therefore, the shareholders/members cannot compel the company to declare dividend and cannot charge the directors with oppression or mismanagement.

Applying the above, answers to the question shall be as under:

- (1) The contention of shareholders/members shall not be tenable.
- (2) The act of the Board of Directors who acted bona fide, not to recommend any dividend shall not amount to oppression or mismanagement.

Question 16

A group of shareholders holding more than 15% of the issued capital of M/S Defraud Ltd. have filed a petition before the Company Law Board alleging various acts of illegal, invalid and irregular transactions entered into in the name of the Company. Examine the merits of the petition in the light of the judicial pronouncements made in this regard. (November 2009)

Answer

A group of shareholders of M/s Defraud Ltd. must hold more than 15% of the issued share capital of the Company or satisfy other requirements under Section 399(1) of the Companies Act, 1956. Since the group holds 15% of the issued capital they are entitled to file a petition before the Company Law Board under sections 397 and 398 of the Companies Act, 1956 by alleging 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 of the Company. There are however, several judicial pronouncements according to which mere illegal, invalid or irregular acts by themselves do not constitute a ground for invoking the provisions of Section 397 unless it is proved that they are oppressive to any shareholder or prejudicial to the interest of the Company or to the public interest. [*Sheth Mohanlal Ganpatram vs Shri Savaji Jubilee Cotton and Jute Mills Company Ltd.*] Thus in the present case, the petition filed by the group of shareholders will fail unless they can prove to the satisfaction of the Company Law Board that the acts complained of in the petition are oppressive and prejudicial to the interest of the Company and the public interest. And that to wind up the Company would unfairly prejudice such member or members, but that otherwise those 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.

Question 17

A group of shareholders consisting of 25 members decide to file a petition before the Company Law Board for relief against oppression and mismanagement by the Board of Directors of M/s Fly By Night Operators Ltd. The company has a total of 300 members and the group of 25 members holds one –tenth of the total paid –up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is the due to mismanagement by the board of directors, the company is incurring losses and the company has not declared any dividends even when profits were available in the past years for declaration of dividend. Advise the group of shareholders regarding the success of (i) getting the petition admitted and (ii) obtaining relief from the Company Law Board.

Answer

Section 399 of the Companies Act, 1956 provides the right to apply to the Company Law Board for relief against oppression and mis-management. This right is available only when the petitioners hold the prescribed limit of shares as indicated below:

- (i) In the case of company having a share capital, not less than 100 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(s) have paid all calls and other dues on the shares.
- (ii) In the case of company not having share capital not less than one-fifth of the total number of its members.

22.16 Corporate and Allied Laws

Since the group of shareholders do not number 100 or hold 1/10th of the issued share capital or constitute 1/10th of the total number of members, they have no right to approach the CLB for relief. However, the Central Government, if it is of the view that circumstances exist which make it just and equitable so to do, may authorize any member(s) to apply to the CLB (Section 399(4)). So, members may approach Central Government to authorize them to approach CLB in spite of deficiency in numbers.

As regards obtaining relief from CLB, continuous losses cannot, by itself, be regarded as Oppression (*Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth*).

Similarly, failure to declare dividends or payment of low dividends also does not amount to oppression. (*Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd.*).

Thus the shareholders may not succeed in getting any relief from CLB.

Question 18

The Managing Director of BM Technologies Limited, a listed company having a large number of shareholders and employees, has confessed at the board meeting of the company that he has indulged in large scale manipulation of accounts during the last three years on account of which the financial position of the company has been adversely affected. The Central Government proposes to appoint its nominees as Directors of BM Technologies Limited to safeguard the interests of the company. Examine with reference to the provisions of the Companies Act, 1956 whether the Central Government has any 'Suo Motu' power in this regard. Explain the powers which can be exercised by the Central Government with regard to the affairs of the company when its nominees are appointed as directors of the company.

(November, 2010)

Answer

Power of Central Government to prevent oppression or mismanagement: The Central Government is empowered to appoint its nominees as directors of a Company to effectively safeguard the interest of the Company or its shareholders or the public interest. But such power cannot be exercised by the Central Government on its own. The Central Government has to make a reference to the Company Law Board and if the Company Law Board is satisfied that the affairs of the Company have been conducted in a manner oppressive to any member of the Company or in a manner prejudicial to the interests of the Company or to public interest, it may pass an order asking the Central Government to appoint nominees or directors for a period not exceeding three years. There is no limit as to the number of directors that can be appointed. The Company Law Board may also pass similar orders on an application not less than 100 numbers or members holding with less than one tenth of the total voting price. Hence as Central Government has no suo motu power to appoint additional directors in B.M. Technologies Ltd. and it can do so only on an order passed by CLB in this regard.

Notwithstanding anything contained in the Companies Act or in any other law for the time facing in force, where any person is appointed by the Central Government to hold office as

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director, Section 408 (6) empowers the Central Government to issue such directions to the company as it may consider appropriate in regard to its affairs. Such directions may include directions to remove an auditor already appointed and to appoint another auditor in his place or to alter the articles of the company. When such directions are given the appointment, removal or alteration, as the case may be shall be deemed to have come into effect as if the provisions of the Companies Act in this behalf have been complied without requiring any further act or thing to be done. Though these powers are substantial, yet the same do not empower the Central Government to interfere in the day to day management of the company.

Further, Section 408(7) empowers the Central Government to require the persons appointed as directors to report to the Central Government from time to time with regard to affairs of the company.