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Debentures

Definition

Companies have frequently to borrow large sums of money. The loan requirement of a company may not, therefore, be met by a single lender. The loan may have to be split into several units. One very convenient method of doing so is to borrow by issuing debentures. Suppose, for example, the sum to be borrowed is one lakh rupees. It may be divided into one thousand units each of the value of hundred rupees. A lender may purchase as many units as he pleases. The company will certify the number of units he holds and that is the concept of a debenture. A debenture is, therefore, a certificate of loan issued by a company. It is a type of security.[1]

The term "debenture" has, however, been found to be something very difficult to define. The Act in Section 2(12) contains only this definition: "Debenture includes debenture stock, bonds and any other securities of a company whether constituting a charge on the company's assets or not." CHITTY J defined it in these words: "Debenture means a document which either creates a debt or acknowledges it, and any document which fulfils either of these conditions is a debenture."[2] According to Topham: "Debenture is a document given by a company as evidence of a debt to the holder usually arising out of a loan and most commonly secured by charge."[3]

As a matter of fact, the term does not have any precise legal meaning. The term as used in the modern commercial parlance is of extremely elastic character.[4] Indeed no definition can help in all cases to know whether a particular document issued by a company is a debenture or not. "We must look at the substance of the instrument itself and without the assistance of any precise legal definition, form the best opinion we can whether the instrument is or is not a debenture."[5] The Bombay High Court appears to have acted on this principle in deciding *Laxman Bharamji* v *Emperor*:[6]

> The main business of a private company was to sell what were called "Patron Bonds" and to invest the money realised by the sale of those bonds. The form of the bond bore a serial number. It acknowledged a debt; it was

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1 A company may issue debentures convertible into shares either fully (FCDs) or partly (PCDs). For rules and regulations to be observed in this connection *see* Section F of SEBI Guidelines for Disclosure and Investor Protection on issue of convertible and non-convertible debentures.

2 In *Levy* v *Abercorris Slate & Slab Co*, (1887) 37 Ch D 260, 264.

3 Topham's COMPANY LAW 168 (12th Edn). *See* also speech of Viscount MAUGHAM in *Knightsbridge Estates Ltd, Re*, 1940 AC 613, where all the important definitions have been considered. *See* also VYAS J in *Madanlal* v *Changdeo Sugar Mills*, AIR 1958 Bom 491, 496.

4 *Chief Controlling Revenue Authority* v *State Bank of Mysore*, AIR 1988 Kant 1: (1989) 65 Comp Cas 427 FB. A detailed discussion about the nature of a debenture is to be found in *Narendra Kumar Maheshwari* v *UOI*, [1989] 2 Comp LJ 95.

5 CHITTY J in *Levy* v *Abercorris*, *supra*, fn 2, cited in *Laxman Bharmaji* v *Emperor*, AIR 1946 Bom 18: 223 IC 110.

6 *Supra*. S. 122 says that a contract to subscribe for the company's debentures may be specifically enforced.

one of a series; it bore the company's seal; it provided for the payment of interest by determining the lucky numbers. The court observed: "The main features which in our opinion tend conclusively to show that these 'Patron Bonds' are debentures are the acknowledgement of debt, the promise to return it, the fact that they form a series bearing consecutive numbers."

Usual Features

As it appears from the above case the usual features of a debenture are as follows:

In the first place, a debenture is usually in the form of a certificate issued under the seal of the company.[7] Secondly, the certificate is generally an acknowledgement of indebtedness. In the striking words of POLLOCK MR:[8]

> But whatever be the characteristics which you would expect to find in debentures, the root meaning of the word is indebtedness; that it does record an indebtedness.

"Further, a debenture usually provides for the payment of a specified principal sum at a specified date." But that is not essential. A company may issue perpetual debentures with no undertaking to pay. For Section 120 provides that debentures, are not invalid simply because "they are made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long".[9] Then again a debenture usually provides for payment of interest until the principal sum is paid back. But this again is not essential. Interest may be made payable subject to contingencies of uncertain nature.[10]

Thirdly, a debenture is as a rule one of a series, yet a single debenture is not uncommon. "There may be a single debenture issued to one man." Lastly, a debenture generally creates a charge on the undertaking of the company, or on some class of its assets or on some part of its profits. Again this is not an essential element. A debenture which creates no such charge is perfectly valid.[11]

FLOATING CHARGE

It is usual, though not essential, for debentures to create a charge on the company's assets. The charges which a company may create on its assets are of two kinds, namely:

1. Fixed charge, and

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7 The case of *British India Steam Navigation Co* v *Commissioners*, (1881) 7 QBD 165, however, shows that a seal is not necessary. There, a debenture certificate which was merely signed by two directors and did not bear the company's seal was held valid.

8 In *Lemon* v *Austin Friars Investment Trust*, [1926] Ch 1: 133 LT 790.

9 *See* also *Knightsbridge Estates Ltd* v *Byrne*, 1940 AC 613: 109 LJ Ch 200: 162 LT 388: 56 TLR 652: [1940] 2 All ER 401 HL.

10 *Lemon* v *Austin Friars Investment Trust*, [1926] Ch 1: 133 LT 790.

11 S. 2(12). S. 122 provides that a contract with a company to take up and pay for any debentures in the company may be enforced by a decree for specific performance. This provision became necessary because otherwise money lending transactions are not so enforceable. *Sewa Singh* v *Mukha Singh*, ILR 17 Lah 270: AIR 1936 Lah 727.

2. Floating charge.[12]

The normal concept of a mortgage is that it is created on some definite or specific assets. Such a mortgage is suitable for property which is more or less fixed. But it is quite impracticable where the assets to be charged are of circulating or liquid nature. Such assets keep changing and a fresh charge would have to be created every time they were turned over in the course of business. This would hinder business. Hence there was the necessity of a charge which would not paralyse the company's business and, at the same time, give a safe security to the moneylender. In the words of Gower:[13]

> The ingenuity of equity practitioners led to the evolution of an unusual but highly beneficial type of security known as the floating charge.

A simple illustration will explain this:

> A company borrows money on the security of its stock in trade. The charge created, though present and immediate, will not, however, get fixed on the stock. Rather it will keep floating over the changing stock in trade. And when the time comes for the lender to enforce his security he will do so by seizing whatever stock is then in the company's hands. When this happens, the floating charge becomes fixed or crystallised.

The validity of such a charge was clearly recognised in *Panama New Zealand & Australia Royal Mail Co, Re*:[14]

> A steamship company having power to do so issued mortgage debentures, charging the "undertaking and all sums of money arising therefrom", with repayment at a specified time of the money borrowed with interest in the meantime. Before the debentures became due the company was wound up. The debenture-holders wanted to enforce their security. The unsecured creditors disputed the validity of the charge on a fluid thing like the "undertaking of the company". But it was held that "the word 'undertaking' had reference to all the property of the company, not only which existed at the date of the debenture, but which might afterwards become property of the company. Debenture-holders, therefore, have a charge upon all the property of the company, past and future."

Thus, floating charge is a charge of ambulatory nature, floating with the property it is intended to cover. "It attaches to the subject charged in the varying conditions in which it happens to be from time to time."[15] "It is a charge which floats like a cloud over the whole assets from time to time falling within a generic description....."[16] It does not get attached to any specific property until it crystallises. In the meantime the company can use the assets charged in the ordinary course of its business.

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12 S. 124 provides that the word "charge" includes "mortgage".

13 THE PRINCIPLES OF MODERN COMPANY LAW, 78 (3rd Edn, 1969). *See* also Robert R. Pennington, *The Genesis of the Floating Charge*, (1960) 23 Mod LR 630.

14 (1870) 5 Ch App 318: 22 LT 424.

15 Lord MACNAGHTEN in *Govt's Stock Investment Co* v *Manila Rly Co*, [1897] AC 81, at 86: 75 LT 553.

16 Gower, THE PRINCIPLES OF MODERN COMPANY LAW, 78 (3rd Edn, 1969).

Characteristics of Floating Charge

The chief characteristics of a floating charge which distinguish it from a fixed charge were explained with remarkable clarity by ROMER J in *Yorkshire Woolcombers' Association Ltd, Re*:[17]

"A mortgage or charge by a company which contains the three following characteristics is a floating charge:

1. It should be a charge upon a class of assets both present and future.
2. The class of assets charged must be one which in the ordinary course of business of the company would be changing from time to time.[18]
3. It should be contemplated by the charge that until some step is taken by the mortgagee, the company shall have the right to use the assets comprised in the charge in the ordinary course of its business."

In *Indus Film Corporation Ltd, Re*:[19]

A film company borrowed a sum of money and declared a lien "on all our assets, including machinery, etc., now lying or that may be bought hereafter until repayment". This was held to be a floating charge as it covered assets, present and future, of extremely fluctuating nature and imposed no restriction on the use of them.

As against it, in *F. D. Jones & Co Ltd* v *Ranjit Roy*:[20]

By a deed a company had charged all its machinery, stock in trade and moveable effects, present and future. The deed provided that the "properties shall be in the lender's possession" which was actually given to him. This was held to be no floating charge as it took away the company's right to use the assets charged in the ordinary course of its business.

If the assets are withdrawn from the business and transferred to the lender's possession, there is, indeed, nothing over which the charge is to float. It immediately gets fixed on those assets.[21] A charge on book debts was held to be

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17 [1903] 2 Ch 284: 88 LT 811.

18 Where a charge was created on "fixed plant and machinery" which would have been a fixed charge, but since the company had no firmly fixed machinery, the charge was held to be in the nature of a floating charge. *Hi Fi Equipment (Cabinets) Ltd*, 1988 BCLC 65 Ch D. A construction company's washing machine which was in use at the site, being one fixed item and not likely to change, a charge on it was held to be a fixed charge. *Cosslett (Contractors) Ltd, Re*, (1996) 1 BCLC 407 Ch D.

19 AIR 1939 Sind 100: 181 IC 681.

20 AIR 1927 Cal 782: 103 IC 648. Whether a charge is of one kind or the other does not depend upon the labels attached by the parties. A charge over funds lodged in a bank described by the parties as a fixed charge was found indeed to operate as a floating charge, *ASRS Establishment Ltd Re*, affirmed by the Court of Appeal, July 20, 2000: (2000) 1 BCLC 727. The courts do not go by description of the parties. A charge on premises described as a fixed charge was found in substance to be a floating charge, *Westmaze Ltd, Re*, The Times, July 15, 1998 Ch D, following *Royal Trust Bank plc* v *National Westminster Bank*, [1996] BCC 613.

21 The following two cases are further illustrations. One is *Bank of Baroda* v *H. B. Shivdasani*, AIR 1926 Bom 427: 96 IC 417 A company gave to a bank as security for loan all its liquid assets including stock in process present and future stored in a godown the keys of which were delivered to the bank. The goods could be taken out under the bank's supervision, but the company was to maintain the goods at a value of 33-1/2 per cent above the amount due. This

floating charge where the company had the right to collect the debts and use the proceeds in the ordinary course of its business. The charged book debts were not under the control of the chargee to make it a fixed charge.[22] One distinguishing feature of a fixed charge from a floating charge is the degree of control over the property which the charge-holder exercises.[23]

Subsequent Mortgages or Charges

A floating charge also leaves the company at liberty to create subsequent specific mortgages of the same assets and ranking in priority to the floating charge.[24] Even if the creditor who takes subsequent specific mortgage has knowledge of the floating charge, he may have priority.[25] The company, may, however, be prohibited from creating subsequent specific mortgages. In such a case a creditor who takes a subsequent specific mortgage with notice of the prohibition shall not have priority over the floating charge.[26] Registration of the charge with the Registrar amounts to constructive notice of the charge under Section 126 of the Companies Act.

The decision of the Andhra Pradesh High Court in *State of Andhra Pradesh* v *Sri Raja Ram Janardhana*[27] is an illustration of the difference in the effects of a fixed and a floating charge.

> Certain mortgage debenture-holders had a specific charge on all the properties of a company. The company made a subsequent mortgage in favour of the State to secure a loan advanced under the State Aid to Industries Act. In the winding up of the company the question arose as to the priority between the two mortgages. Holding that the debenture-holders

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was held to be a mortgage of specific assets with a licence to the mortgagor to dispose of them in the course of its business subject to prescribed conditions.

The other case is *Tansukhrai M. Karundia* v *Official Liquidator of Andhra Paper Mills Ltd*, (1949) 2 MLJ 66. A creditor was given possession of the movables pledged to him and it was provided that as and when other properties were acquired, they would also stand pledged to him. The security was stated to be a continuing one. On default of payment, the lender had the right to sell. Though the debtor company was allowed to run its business, it was only run by the creditor as an agent under an irrevocable power of attorney. This was held to be no floating charge. The element of possession made it something wholly inconsistent with the concept of a floating charge. Looking at the degree of protection that a floating charge is capable of affording the Supreme Court emphasised in *Narendra Kumar Maheshwari* v *UOI*, [1989] 2 Comp LJ 95 that it affords a real protection. It is not illusory or an eyewash.

22 *Burmark Investments Ltd, Re*, [2000] 1 BCLC 353 NZCA: *Double Sprinters Ltd, Re*, [1999] 1 BCLC 220, here also the charge on book debts did not give the chargee the requisite degree of control over the charged items, the charge was a floating charge. To the same effect is *Agnew* v *Commr of Inland Revenue*, (2001) 3 WLR 454: (2002) 109 Comp Cas 184 (PC), a charge on book debts was held to be a floating charge though described in the terms of charge as fixed. The charger company had complete control over the debts.

23 *Ibid.*

24 *Wheatley* v *Silkstone Co Ltd*, (1885) 29 Ch D 715: 52 LT 798; *Florence, Land and Public Works Co, Re*, (1878) 10 Ch D 530; *Borax, Re*, [1901] 1 Ch 326. *Narendra Kumar Maheshwari* v *UOI*, [1989] 2 Comp LJ 95, *see* observations at 137.

25 *Hamilton, Re*, (1879) 12 Ch D 707.

26 *English & Scottish Mercantile Investment Co* v *Brunton*, [1892] 2 QB 700; *Wilson* v *Kelland*, [1910] 2 Ch 306: 103 LT 17; *Connolly Bros, Re*, [1912] 2 Ch 25: 106 LT 738; *Valletort etc., Re*, [1903] 2 Ch 654: 89 LT 60.

27 [1965] 2 Comp LJ 222.

were entitled to priority in preference to the claims of the Government, the Court said: "Where a particular property of the company is specifically charged in favour of the debenture-holders the company cannot dispose of it unencumbered by the charge without having obtained the consent of the holders of the charge. In the case of a debenture secured solely by a floating charge, the company may dispose of the property on which the charge exists unencumbered without consulting the holders of the charge until an event happens on which the floating charge, according to its terms, 'crystallises' i.e. becomes a fixed charge. Before crystallisation the company has a free hand to deal with and dispose of the property charged in the ordinary course of the business of the company."

Statutory Restrictions

Section 539 imposes an important condition for the validity of a floating charge. It provides that a floating charge created within twelve months immediately preceding the commencement of winding up shall be invalid, except in the following cases:

(*a*) if the company immediately after the creation of the charge was solvent;

(*b*) to the extent to which any cash was paid to the company under the charge.

Eric Holmes Property Ltd, Re,[28] is an illustration of the utility of this provision :

A company created a charge in favour of a creditor who advanced £400 in cash at the time. Winding up having followed within a year, the charge was held to be void as a fraudulent preference over other creditors save to the extent of £400.

Further, Section 123 provides that if the debenture-holders seek to get their payment by enforcing the charge, the preferential payments as detailed in Section 530 shall have priority over them. Thus, in *IRC* v *Goldblatt*[29] it was held that a receiver would be personally liable if he pays debenture-holders with knowledge that there are unpaid preferential creditors.

Apart from this, there is another category of persons, as established by common law, which is not affected by the floating charge. Such persons include a landlord who has levied for rent due his distress before the crystallisation of the charge;[30] a creditor who has obtained a decree and has got certain goods of the company sold in the execution of the decree[31] or whom the company has paid to avoid an execution sale[32] or who has obtained an absolute (as opposed to a temporary or *nisi*) garnishee order attaching the property of the company,[33]

28 [1965] 2 All ER 333: [1966] 1 Comp LJ 19: [1965] Ch 1052.
29 [1972] 2 WLR 333: [1972] 2 All ER 202.
30 *Roundwood Colliery Co, Re*, [1897] 1 Ch 373 CA.
31 *Standard Mfg Co, Re*. [1891] 1 Ch 627 (CA).
32 *Heaton & Dugard Ltd* v *Cutting Bros*. [1925] 1 KB 655.
33 *Evans* v *Rival Granite Quarries Ltd*, [1910] 2 KB 979 CA.

provided all these things take place before crystallisation of the charge: and, a person who has supplied goods to the company under a hire purchase agreement, the goods being still his property.[34]

Crystallisation of floating charge

Debentures generally contain an undertaking to pay the principal sum at a specified date with interest in the meantime. When the company makes a default or when it comes to be wound up, the debenture-holders should take steps to enforce their security by seizing the assets over which the charge was until then floating. When they do this the charge is said to crystallise. But even after the default the charge keeps floating until the debenture-holders intervene. This was laid down in *Government Stock and other Securities Investment Co Ltd* v *Manila Railway Co Ltd*.[35]

> A company issued debentures by which it undertook to pay the principal at a distant day and interest on fixed days half-yearly and charged by way of floating security all its property present and future. The company reserved the right in the course, and for the purpose of its business, to sell or otherwise deal with its property until the company made a default in payment of interest for three months after the same should have become due. After an instalment of interest had been due more than three months but before the debenture-holders had taken any steps to enforce their security, the company mortgaged its assets.

This mortgage was held to be valid because real crystallisation takes place not on default, but on intervention by debenture-holders after the default. Lord MACNAGHTEN observed: "It is of the essence of a floating charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes. As long as he does not intervene the business will be carried on, not as of right, but by the sufferance of the debenture-holders and at their mercy."[36] Thus a floating charge crystallises when the company ceases to be a going concern, or when it comes to be wound up or when the charge-holders intervene on the happening of default[37] by giving notice to that effect.[38]

In another case, where a demand and default took place in accordance with the terms and since this had happened before the appointment of the receiver, it was held that the charge had already become crystallised and was no longer floating at the time of the appointment and, therefore, the money in the company's banking account was to be handed over to the charge-holder.[39]

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34 *Morrison, Jones & Taylor Ltd, Re*, [1914] 1 Ch 50 CA.

35 1897 AC 81: 75 LT 553. *See* M. J. Robble and C. P. Gill, *Fixed and Floating Charges: A New Look at the Bank's Position*, 1981 JBL 95.

36 *Id.*, at 86-87.

37 *See* J Farrar, *World Economic Stagnation puts the Floating Charge on Trial*, 1 Co Law 83.

38 *Brightlife Ltd, Re*, [1986] 3 All ER 673 Ch D, the charge-holder gave notice before commencement of winding up, held, effective crystallisation for the purpose of defeating preferential payments except as provided in the Act.

39 *Permanent Houses (Holdings) Ltd, Re*, 1980 BCLC 563 Ch D. *See* also *Brightlife Ltd*, the Times, Aug 9, 1986, Financial Times, Aug 13, 1986, giving liberty to the charge-holder to

Debenture trust deed [Ss. 118-119]

Where the debenture-holders do not have the time to look after their interest in the properties mortgaged or charged to them, they may appoint some of themselves as trustees for the supervision of their common interest. A trust deed is made under which some of them are appointed as trustees. Properties of the company are mortgaged or charged to the trustee in favour of the debenture-holders. The deed also contains provisions defining the rights of the debenture-holders and the company. The advantage of this arrangement is that it becomes the function of the trustees to watch the interest of debenture-holders. They are bound to act with the same degree of honesty, care and diligence as is required of all trustees. Any clause in the trust deed which exempts them from liability for breach of their duty as trustees or which indemnifies them against liability is void.[40] Another advantage is that if and when the company makes a default, they can take action for enforcing the security on behalf of all the debenture-holders. Section 118 entitles every debenture-holder and member to demand from the company a copy of the debenture trust deed.[41]

The rights of a debenture-holder were examined by SUJATA MANOHAR J of the Bombay High Court in *Narotamdas T. Toprani* v *Bombay Dyeing & Mfg Co Ltd.*[42]

> A company proposed to issue a new series of debentures. Of the company's present debentures 96% were held by institutions, which permitted the new series; of the remaining 4% which were held by individuals, one questioned the validity of the proposal and wanted the Bombay High Court to stay it till he was able to examine the ratio between the assets and liabilities of the company. The company refused to permit him such access to its assets and stock registers.

The High Court agreed with the company in holding that he had no right to go beyond the declared accounts and allowed the company to go ahead with its debenture-issue subject only to this that if the aggrieved shareholder wanted payment, he should be paid out in cash. The court asserted that it can examine the motive of a petitioner like the present so as to see whether he is really

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convert by notice the floating charge into a fixed charge, and when that notice was given before winding up, the charge became a fixed mortgage. *See* note "*Automatic Crystallisation of Floating Charge*", 1986 JBL 350.

40 S. 119(1). *See* also sub-sections (2) and (3) which allow the trustees in certain circumstances to be released from liability. A debenture trust deed is not in itself a mortgage or a bond. It is only a document expressing the faith of the shareholders upon their chosen trustee and has, therefore, to be stamped as a deed only. *Chief Controlling Revenue Authority* v *State Bank of Mysore*, AIR 1988 Kant 1, 7-10; (1989) 65 Comp Cas 427 FB, following *Murugharajendra Co* v *Chief Controlling Revenue Authority*, AIR 1974 Kant 60 FB and *United Bank of India Ltd* v *Lekharam Sonaram & Co*, AIR 1965 SC 1591. A debenture trustee is not an officer of the company and, therefore, he is not entitled to relief under S. 633 against any apprehended proceedings for negligence, breach of trust etc. *Central Bank Executor & Trustee Co Ltd* v *Magna Hard Temp Ltd*, (1997) 89 Comp Cas 40 AP.

41 S. 118(1). The trust deed is also open to the members or debenture-holders in the like manner as the register of members, S. 118(4). Sub-section (2) makes denial of this right a punishable offence and sub-section (3) empowers the Court to direct copies to be given.

42 [1986] 3 Comp LJ 179 Bom.

concerned with the interests of the debenture-holders or has something up his sleeves. The court pointed out that the right of a debenture-holder of inspecting the company's records is extremely limited. Under Section 118 he can inspect the debenture-trust deed and obtain a copy of it. Under Section 163 he can inspect and obtain copies of the register of members and of debenture-holders, annual reports and copies of certificates and documents annexed thereto. He may also have the right to copies of annual accounts. But he does not have the right of detailed inspection of the record and registers and books of account and no adverse inference can be drawn if the company does not permit it.[43]

The Companies Amendment Act, 2000 has brought in a set of provisions about debenture trust deeds.

Section 117-A contains three provisions:

Form of trust deed.—The deed has to be in such form and executed within such time as may be prescribed.

Supply of copies and inspection.—A copy of the deed should be available for inspection to members and debenture-holders. They are also entitled to get copies on payment of prescribed fees.

Penalty.—If a copy of the trust deed is not made available for inspection or is not given to any member or debenture-holder, every officer of the company who is in default shall be punishable with fine extending up to Rs 500 for every day of default.

Appointment of debenture trustees and their duties [S. 117-B]

Appointment of debenture trustees has to be made before making a debenture issue and the fact of the appointment and their consent to act as such has to be mentioned on the face of the prospectus or letters of offer.

Persons not qualified.—Following persons cannot be appointed as debenture trustees:

1. a beneficial holder of shares in the company;
2. a person who is beneficially entitled to the money which is to be paid by the company to the debenture trustee;
3. a person who has entered into a guarantee in respect of principal debts secured by debentures or interest thereon.

Functions.—The functions of debenture trustees are generally to protect the interests of holders of debentures, to bring about the creation of securities within the stipulated time and to redress grievances of debenture-holders.

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43 The Supreme Court took opportunity in *Narendra Kumar Maheshwari* v *UOI*, [1989] 2 Comp LJ 95 to explain the value of guidelines issued by the Government of India from time to time on company matters including in this case on the ways in which debenture-holders are to be protected by maintaining among other things the debt-equity ratio. The court may overlook deviations from guidelines if the deviation is justifiable keeping in mind the public interest sought to be served by the State. This is because guidelines by their very nature, do not fall into the category of legislation, direct, subordinate or ancillary. They have only an advisory role to play and non-adherence to or deviation from them is necessarily and implicity permissible if the circumstances so warrant. *See* Section N of SEBI Guidelines for Disclosure and Investor "Protection on Protection of Interest of Debenture-holders".

Duties.—The particular duties are:

1. to ensure that the assets of the company issuing debentures and of the guarantors are sufficient to discharge the principal amount at all time;
2. to satisfy himself that the prospectus or the letter of offer does not contain anything inconsistent with the terms of the debentures or debenture trust deed;
3. to ensure that the company does not commit any breach of the covenants and provisions of the debenture trust deed;
4. to take reasonable steps against any breach of the covenants or terms of issue;
5. to take care to call meetings of debenture-holders as and when it is required to be held.[44]

Petition to Tribunal.—Where at any time the debenture trustee comes to the conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, he should file a petition before the Tribunal. The Tribunal may hear the company or any other interested person. It may then impose restrictions on the company in the matter of incurring further liabilities to safeguard the interests of debenture-holders.[45]

Responsibility of company to create security and debenture redemption reserve [S. 117-C]

The company issuing debentures has to create a debenture redemption reserve. Adequate amounts have to be transferred to the fund every year from the profits of the company till the debentures are redeemed.

The amounts so credited cannot be used for any other purpose. The company is under a duty to go on paying interest and to redeem debentures in accordance with the terms and condition of the issue.

On failure of the company to do so, the debenture-holders or any one of them can apply to the Tribunal. The Tribunal, after hearing the parties, may direct the company to pay off interest and principal amount and redeem the debentures. If the orders of the Tribunal are not carried out, the defaulting officers are liable to punishment by way of imprisonment extending to three years and a fine extending to Rs 500 for every day of default.

Remedies of debenture-holders

The remedies of debenture-holders depend upon the terms of their agreement with the company. A debenture-holder who wishes to realise his security and get back his money may exercise remedies given by the debenture

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44 A proviso introduced by the Second Amendment Act of 2002 says that in the case of revival and rehabilitation of a sick industrial company under Part VI-A, the provisions of this section shall have effect as if for the word Central Government the word Tribunal had been substituted.

45 *Indian Overseas Bank* v *Essar Machine Works Ltd*, (2002) 112 Comp Cas 557 CLB, the company denied creation of the charge in favour of the bank. The matter was being examined by the Debt Recovery Tribunal. The CLB refused to adjudicate.

trust deed or resort to legal proceedings to enforce his rights.[46] If money due on a debenture is payable on demand the debtor company is entitled, once demand is made, to reasonable time to implement the mechanics of payment, but it is not entitled to any time to raise the money if it was not at hand. A demand under a debenture need not specify the amount due.[47] It is not necessary to allow time to the borrowing company to enable it to engage in a commercial transaction for the purpose of raising funds for redemption of debentures.[48] But one of the remedies which is always open to them as mortgagees under the Transfer of Property Act is to bring the property charged to sale.[49]

Receiver

Secondly, they may appoint a receiver to take charge of the assets subjected to the charge. If they do not have this power under the terms of their debentures they may have a receiver appointed by the court. In either case the fact of appointment must be brought to the notice of the Registrar within thirty days, whose duty is to enter the same in the register of charges.[50] A similar notice has to be given by the receiver when he ceases to act.[51] When the receiver takes possession of the assets comprised in the charge, he has to maintain proper accounts of his receipts and payments and to submit an abstract with the Registrar once in every half year.[52] If he is appointed under a debenture as an agent of the company, he is under a duty to keep full accounts of the company's affairs, i.e., fuller than abstracts of receipts and payments and to produce them to the company when required to do so.[53] The fact of the receiver's appointment should also be mentioned on every invoice, order for goods, or business letter issued on behalf of the company.[54] Where a company which had gone into liquidation was facing an action and the receiver took over the responsibility of defending the company against the action, it was held that the Court could order that any costs awarded to the plaintiff should be paid by the receiver and that such costs should be treated as expenses of receivership.[55]

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46 *Lloyds Bank plc* v *Lampert*, [1999] BCC 507.

47 *Bank of Baroda* v *Panessar*, [1986] 3 All ER 751 Ch D.

48 *Lloyds Bank plc* v *Lampert*, [1999] BCC 507.

49 See *Narain Singh & Co* v *U.P. Oil Industries Ltd*, [1964] 1 Comp LJ 225 (All); following *Union of India* v *Official Liquidator*, AIR 1964 AP 555; *Govinda* v *Khan Saheb Abdul Kadir*, AIR 1923 Nag 150.

50 S. 137(1). This he does on payment of the prescribed fee. The notice has to be given by the person who appoints or obtains appointment.

51 S. 137(2). Sub-section (3) imposes penalty upto Rs 500 for every day of default.

52 S. 421.

53 *Smiths* v *Middleton*, [1979] 3 All ER 842. The court explained here the duty of the receiver to preserve the security in good faith for the benefit of his mortgagee as well as the company and other encumbrancers. Followed in *Downsview Nominees Ltd* v *First City Corpn Ltd*, (1993) 3 All ER 626 PC: [1994] 1 Comp LJ 31.

54 S. 422. *See* also S. 423 which contains penalty provisions. The section says that if default is made in complying with the requirements of S. 421 (Filing of accounts of receivers) and S. 422 (Invoices etc. to refer to receiver if there is one) the company and defaulting officer are punishable with fine extending up to Rs 2000. For the purposes of this section the receiver is deemed to be an officer of the company.

55 *Anderson* v *Hyde*, (1996) 2 BCLC 144 CA.

Manager

When the receiver has taken possession of the company's assets, obviously they cannot be used by the company for business. Yet sometimes it may be necessary to carry on business for beneficial winding up. In such a case the debenture-holders may appoint a manager also or have him appointed under an order of the court. The above provisions relating to a receiver also apply to a manager.[56]

It has been held that a receiver or manager is not an "officer" of the company for the purposes of the Companies Act, nor a "manager" of the company and consequently he cannot be subjected to public examination.[57] He functions as manager, not of the company, but of the assets subject to the charge, and not for the benefit of the company, but for the purpose of realising the security for the benefit of the charge-holders. He is an agent of the company for that purpose so that he may effectively deal with third parties. That is the whole purpose of his appointment and of powers which are conferred upon him.

Though misfeasance proceedings and public examination may not be available, he will definitely be liable for any breach of duty, for he is a trustee of the assets which he is appointed to realise.[58] Thus where he damaged the interest of a subsidiary of the company, the court ordered the Government to appoint an inspector to investigate the affairs of the company.[59] His contention that his conduct cannot be regarded as the affairs of the company was rejected. The court said:

> "What the receiver and manager does may in a narrow sense be his affair, but it is also the affair of the company in the broad and natural meaning of the phrase, 'its affairs'. He acts in the name of the company — what he does may ruin its shareholders or leave them with some prospect of future recovery. Under clause (2) of the debenture it is the undertaking of the company which is confided to him and it is its business that he is managing and he is its agent and it is made responsible for his acts or defaults.
>
> There is a clear authority for the proposition that where a receiver or manager is appointed by the court his function as manager confers a duty on him to preserve the goodwill and property of the company, both in the interests of the mortgagee and of the mortgagor."[60]

A receiver's duty to provide accounts or other information to a debtor company is not restricted to his statutory obligations. The extent of the receiver's obligation to provide additional information is to be deducted from the nature of

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56 S. 424.

57 *B. Johnson & Co, Re*, 1955 Ch 634 CA. A receiver was held to be not personally liable to the employees whose services he continued, *Leyland DAF Ltd*, (1994) 4 All ER 300 Ch D.

58 *Moss Steamship Co Ltd* v *Whinney*, 1912 AC 254 HL.

59 *R* v *Board of Trade*, [1965] 1 QB 603.

60 The same duty is cast upon a mortgagee of shares. *Bishop* v *Bonhama*, 1988 BCLC 656 CA; *Westminster Corpn* v *Haste*, 1950 Ch 442, dealing with company property in an unwarranted manner. *American Express International Bkg Corpn* v *Hurley*, [1985] 3 All ER 564, the bankers as debenture-holders controlling the actions of the receiver, held liable for the receiver's negligence.

the receivership and a company's right to such information depends on the showing that the information is needed to enable the board of directors to exercise its residual powers or to perform its duties. The right if any, which the company has to obtain information from the receiver is qualified by the receiver's primary responsibility to the debenture-holder so that he can withhold the information if he thinks that the disclosure would be contrary to the debenture-holder's interest.[61]

A receiver has a right to have the documents of the company produced from the custody of the company's solicitors and they cannot refuse on account of their lien because their lien is against the company and the receiver is a third person and not the company for this purpose.[62]

The same should hold good when a receiver and manager is appointed by the debenture-holders.

Kinds of debenture

1. *Redeemable Debentures*

Debentures are generally redeemable. This means that on expiry of the term of the loan the company has the right to pay back the debenture-holders and have its properties released from the mortgage or charge. This is called redemption of debentures. Redeemed debentures can be re-issued. This power is expressly given by Section 121. According to this section if there is no provision to the contrary in the articles, or in the conditions of the issue or if there is no resolution showing an intention to cancel the redeemed debentures, the company shall have the power to keep the debentures alive for the purpose of re-issue. The company may re-issue the same debentures or other debentures in their place. Upon such re-issue the person entitled to the debentures has the same rights and priorities as if the debentures had never been redeemed.[63]

2. *Perpetual Debentures*

A debenture which contains no clause as to payment or which contains a clause that it shall not be paid back is known as a *perpetual or irredeemable debenture*. Section 120 provides that a "condition contained in any debenture . . . shall not be invalid by reason only that thereby, the debentures are made irredeemable, or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long."

3. *Debentures to Registered Holder and Bearer Debentures*

A company which has issued debentures will obviously maintain a register of its debenture-holders, as Section 152 provides that every company shall keep a register of the holders of its debentures. The name of the holder is placed both on the debenture certificate and on the company's register. Such a

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61 *Gomba Holdings U K Ltd* v *Homan*, [1986] 3 All ER 94 Ch D; *Gomba Holdings U K Ltd* v *Minories Finance Ltd*, [1988] 1 All ER 261, receiver's duty to return documents.

62 *Aveling Barford Ltd, Re*, [1988] 3 All ER 1019 Ch D.

63 S. 121(2).

holder is known as the registered holder. He can transfer his debentures in the open market in just the same way as shares are transferred.[64] Transfer will have to be registered with the company. The transferee's title will be subject to all equities between the transferor and the company.[65] Registration of transfer can be avoided only by issuing debentures payable to bearer, as the company has not to maintain a register of such debenture-holders.[66] Such debentures are transferable, like negotiable instruments, by simple delivery and are called debentures payable to bearer. It has been held by the Calcutta High Court in *Calcutta Safe Deposit Co Ltd* v *Ranjit Mathuradas Sampat*,[67] that a person to whom a bearer debenture is transferred becomes its holder and is as such entitled to recover the principal and interest when due. If the same is not paid to him, he can also apply for winding up and, if the petition is otherwise competent, the company cannot ask him to explain how he came by the debenture or why he did not collect the interest for a long time. The court pointed out that Section 118 of the Negotiable Instruments Act applies and, therefore, every holder of a bearer debenture is presumed to be a holder in due course unless the contrary is shown.[68]

Register of debenture-holders [S. 152]

A company issuing debentures has to maintain a register of debenture-holders showing the following particulars:

1. the name, address and occupation of each debenture-holder;
2. the debentures held by each holder, showing numbers and the amount actually paid or deemed to be paid;
3. the date at which each person was entered as a debenture-holder; and
4. the date at which any person ceased to be a debenture-holder.

Index

Where the number of debenture-holders exceeds fifty, an index should be maintained which should enable the entries relating to a debenture-holder to be readily found. Any change in the particulars of the register should be reflected by the index within fourteen days.

Shareholder compared with debenture-holder

In many respects debentures are similar to shares. In the words of Gower: "The company's securities fall into two classes which legal theory tries to keep rigidly separated but which in economic reality merge into each other. The first of these classes is described as shares; the second as debentures."[69] Some of the resemblances between the two are that both the shareholder and the debenture-holder have invested their money in the company; both get some return on the

64 S. 108.
65 *Natal Investment Co, Re*, (1868) 3 Ch App 355; 18 LT 171.
66 S. 152(4).
67 (1971) 41 Comp Cas 1063 Cal.
68 *See* at 1070 of (1971) 41 Comp Cas 1063.
69 THE PRINCIPLES OF MODERN COMPANY LAW, 343 (3rd Edn, 1969).

investment, although one gets it by way of dividend and the other by way of interest; perpetual or irredeemable debentures, like shares, are not generally paid back; debentures, like shares, are transferable; and where debentures carry a charge, the lot of debenture-holders, like that of shareholders depends upon the assets of the company. Moreover, redeemable preference shares and debentures have many common features. The company can pay back both such securities.[70] The position of the shareholder is undergoing serious transformation. "Indeed, it may be questioned whether shareholders should remain in their present position as owners of the business or be converted into some form of creditors of the business."[71] There are suggestions to the effect that companies should issue participating debentures so as to provide the small saver with adequate return of interest plus a participation in the profits.[72]

The following points of difference are, however, also quite apparent.

In the first place, the basic difference is that while a shareholder is a member of the company and enjoys all the rights of membership, a debenture-holder is simply a creditor of the company. A shareholder, for example, has the right to vote, whereas Section 117 declares that "no company shall issue any debentures carrying voting rights at any meeting of the company, whether generally or in respect of particular classes of business".

Secondly, the debenture-holders are entitled to a fixed rate of interest which the company must pay whether there are profits or not. But they do not have any right to interfere with the business of the company unless, on the company's default, they step in to enforce their security. Shareholders, on the other hand, have the full right of control and the ultimate destiny of the company is in their hands. Of course, they are entitled to get dividends only out of profits, but the rate of dividend may be much higher than the rate of interest.

Thirdly, unless the debentures are perpetual, the company can pay back the debenture-holders but the shareholders cannot be paid back as long as the company is a going concern.[73]

Lastly, in the winding up, debenture-holders, being secured creditors, are paid in priority. Whereas shareholders are paid back only after all other claims have been satisfied.[74]

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70 *See* Lord SIMONS in *Scottish Insurance Corpn* v *Wilson & Clyde Coal Co*, 1949 AC 462: [1949] 1 All ER 1068.

71 R. S. Nock, *The Ford Foundation Workshop on Company Law, July 1969*, (1970) 11 Journal of the Society of Public Teachers of Law, at 10.

72 1976 JBL 2.

73 A company may, however, pay back redeemable preference shares, (S. 80), or generally under a scheme involving reduction of capital.

74 The provisions of the Act relating to transfer of shares, remedies against refusal to register a transfer, issue of certificates, etc., are also applicable to debentures. *See* Sections 108, 111 and 113.

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Majority Powers and Minority Rights

"The protection of the minority shareholders within the domain of corporate activity constitutes one of the most difficult problems facing modern company law. The aim must be to strike a balance between the effective control of the company and the interests of the small individual shareholders."[1] Similarly, in the words of Palmer: "A proper balance of the rights of majority and minority shareholders is essential for the smooth functioning of the company."[2] The modern Companies Acts, therefore, contain a large number of provisions for the protection of the interests of investors in companies. The aim of these provisions is to require those who control the affairs of a company to exercise their powers according to certain principles of natural justice and fair play.[3]

RULE IN FOSS v HARBOTTLE

The basic principle relating to the administration of the affairs of a company is that "the courts will not, in general, intervene at the instance of shareholders in matters of internal administration; and will not interfere with the management of a company by its directors so long as they are acting within the powers conferred on them under the articles of the company".[4] "Nothing connected with the internal disputes between the shareholders is to be made the subject of an action by a shareholder."[5] This rule was laid down as early as 1843 in the celebrated case of *Foss* v *Harbottle*:[6]

> In this case the action was by two shareholders in a company against the directors charging them with concerting and effecting various fraudulent and illegal transactions whereby the property of the company was misapplied and wasted, and praying that the defendants might be decreed to make good to the company the losses. The action was rejected in respect of those transactions which a majority of the shareholders had the power to confirm. Briefly, the opinion of the Court was this: "The conduct with which the defendants are charged is an injury not to the plaintiffs exclusively, it is an injury to the whole corporation. In such cases the rule is that the corporation should sue in its own name and in its corporate character. It is not a matter of course for any individual members of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law the corporation and the aggregate of members of the corporation are not the same thing for purposes like this."

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1 N. A. Bastin, *Minority Protection in Company Law*, 1968 JBL 320.

2 Palmer's COMPANY LAW, 492 (20th Edn, Ed. by Clive M Schmitthoff and Curry, 1959) on Majority and Minority Rights.

3 These principles are briefly summed up by K. W. Wedderburn, *Going the Whole Hogg* v *Cramphorn*, (1968) Mod LR 688. *See also* by the same writer, *Unreformed Company Law*, (1969) 32 Mod LR 563.

4 VENKATARAMA AYYER J in *Rajahmundry Electric Supply Corpn* v *A. Nageshwara Rao*, AIR 1956 SC 213, 217: (1956) 26 Comp Cas 91.

5 JAMES LJ in *MacDougall* v *Gardiner*, (1875) 1 Ch D 13: [1874-80] All ER Rep Ext 2248.

6 (1843) 67 ER 189: (1843) 2 Hare 461.

The rule was applied in *MacDougall* v *Gardiner*,[7] where MELLISH LJ stated it thus:

> In my opinion, if the thing complained is a thing which, in substance, the majority of the company are entitled to do, or something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes.

The rule was restated in the following terms by JENKINS LJ in *Edwards* v *Halliwell*:[8]

> The rule in *Foss* v *Harbottle* comes to no more than this. First, the proper plaintiff in respect of a wrong alleged to be done to a company is prima facie the company itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company by a simple majority of members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company is in favour of what has been done, then *cadet quaestio.*

An illustration of the working of the rule is to be found in *Bhajekar* v *Shinkar*:[9]

> The directors of a company resolved to appoint a company as its managing agents. Some of the shareholders objected but the appointment was confirmed at two general meetings of the company. An action was then commenced by certain shareholders to restrain the managing agents from acting on the ground that the managing agents' company was a dummy company and it was against the company's interest to appoint them. The Court ordered a general meeting to be held under the supervision of a chairman appointed by it. The chairman put a resolution to the meeting to the effect: "whether the company is willing to maintain the suit and proceed with it." He reported that the resolution was lost. "Under these circumstances", the court held, "it is difficult to see how a few shareholders who represent a minority are entitled to maintain the suit and ask the Court to interfere on the question as to who should be the managing agents of the company."[10]

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7 (1875) 1 Ch D 13: [1874-80] All ER Rep Ext 2248; *P.S. Offshore Inter Land Services (P) Ltd* v *Bombay Offshore Suppliers and Services Ltd*, (1992) 75 Comp Cas 583 Bom, the advocate appearing for the company must have the authority of the board of directors or principal officer of the company and not merely the backing of majority shareholders.

8 [1950] 2 All ER 1064, 1066.

9 AIR 1934 Bom 243.

10 *See* also *Jhajharia Bros Ltd* v *Sholapur Spg & Wvg Co Ltd*, AIR 1941 Cal 174: 195 IC 36 and *Heyting* v *Dupont*, [1964] 1 WLR 843: [1964] 2 All ER 273; *Normandy* v *Ind Coope & Co Ltd*, [1908] 1 Ch 84, where a shareholder was not allowed to maintain an action against directors' increasing their remuneration without the sanction of the general meeting. He must appeal to the general meeting.

The briefest possible statement of the rule occurs in the observation of Justice CARDOZO that for erring directors there may be absolution if all the shareholders are satisfied.[11] Two English cases *Hogg* v *Cramphorn Ltd*[12] and *Bomford* v *Bomford*[13] bear witness to this absolving power of the majority of shareholders. In either case there was the disposal by the directors of the unissued capital of the company as a tactical move in a battle for control of the company. The court conceded that the power to allot shares was exercised for an improper motive and the directors were guilty of a misfeasance,[14] but held that it is a common place in company law that the directors can by making a full and frank disclosure and calling together the general body of the shareholders, obtain absolution and forgiveness of their sins.[15]

A 50% shareholder brought an action against a director to hold him liable for misappropriation of the company's assets. The court did not allow it. Such loss is recoverable only by the company. It is not recoverable by a shareholder because he does not suffer any distinct loss from that suffered by all the shareholders.[16]

EXCEPTIONS

The majority supremacy, however, does not prevail in all situations. The operative field of the rule in *Foss* v *Harbottle* extends to cases in which the corporations are competent to ratify managerial sins. But there are certain acts which no majority of shareholders can approve or affirm. In such cases each and every shareholder may sue to enforce obligations owed to the company. He brings the actions as a representative of the corporate interest. In the American literature a representative action of this kind is called the "derivative action".[17] The relief goes to the company.[18] Similarly, a shareholder may sue to recover *ultra vires* spent money from the company's officers responsible for the transaction.

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11 *McCandless* v *Furland*, 296 US 140, 157.

12 (1968) 31 Mod LR 688.

13 [1969] 2 WLR 1107.

14 *See* RUSSEL LJ at 1114.

15 *See* HARMAN LJ at 1111. *See* C. J. H. Thomson, *Share Issues and the Rule in Foss* v *Harbottle*, (1975) Aust LJ 134; where a company accepted an order of the Court, a few shareholders were not permitted to file an appeal on behalf of the company. *Bennett, Coleman & Co* v *UOI*, (1977) 47 Comp Cas 92 (Bom); *Rajendra Nath Dutta* v *Shibendra Nath Mukherjee*, (1982) 52 Comp Cas 293 Cal, where the managing director was not permitted to challenge a transaction of the company in his personal capacity; *Vivek Goenka* v *Manoj Santhalia*, (1995) 83 Comp Cas 897 Mad, no interference in board managed company or in appointment of directors by directors or of executive directors; grievance, if any, should be sorted out under S. 397; *Bisch* v *Sullivan*, [1958] 1 All ER 841, where the directors appropriated the assets of the company, action was allowed but no action was allowed in *Paulides* v *Jenen*, (1956) Ch 565 where the allegation was that the company's assets were sold at an undervalue.

16 *Stein* v *Blake (No 2)*, [1998] 1 BCLC 573: [1998] 1 All ER 724 CA.

17 *See* A. J. Boyle, *The Derivative Action in Company Law*, 1969 JBL 120.

18 For the right of the petitioning shareholder for indemnity, A. J. Boyle, *Indemnifying the Minority Shareholder*, 1976 JBL 18.

1. Acts ultra vires

A shareholder is entitled to bring an action against the company and its officers in respect of matters which are *ultra vires* the company and which no majority of shareholders can sanction. The rule in *Foss* v *Harbottle* applies only as long as the company is acting within its powers. The facts of *Bharat Insurance Co Ltd* v *Kanhaiya Lal*[19] provide a suitable illustration:

> The plaintiff was a shareholder of the respondent company. One of the objects of the company was: "To advance money at interest on the security of land, houses, machinery and other property situated in India...." The plaintiff complained that "several investments have been made by the company without adequate security and contrary to the provisions of the memorandum and therefore prayed for a perpetual injunction to restrain it from making such investments".

The court observed as follows:

> The broad rule in such cases is no doubt that in all matters of internal management of a company, the company itself is the best judge of its affairs and the court should not interfere. But application of the assets of a company is not a matter of mere internal management. It is alleged that directors are acting ultra vires in their application of the funds of the company. Under these circumstances a single member can maintain a suit for a declaration as to the true construction of the article in question.

The plaintiff's own conduct in the circumstances must be proper. Since the minority shareholder's action in which the plaintiff shareholder sues on behalf of the company is a procedural device for the purpose of doing justice for the benefit of the company where it is controlled by miscreant directors or shareholders, the court is entitled to look at the conduct of the plaintiff to satisfy itself that the plaintiff is a proper person to bring the action. Thus, if the plaintiff's conduct was so tainted as to bar equitable relief or if there was an unacceptable delay in bringing the action, the plaintiff might well be held not to be a proper person to bring the action. In this case the action was by the wife, a minority shareholder, against the wrongdoings of her husband as a director. In a matrimonial proceeding between them she came to know of the improper profits made by the husband and such profits were even taken into consideration in preparing the award, it was held that she was not a proper plaintiff for a derivative action.[20]

Where it was proved that the funds of the company were diverted to extraneous purposes, it was held that the court had jurisdiction to pass an order

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19 AIR 1935 Lah 792: 160 IC 24. *See* also *Nagappa Chettiar* v *Madras Race Club*, [1949] 1 MLJ 662: ILR 1949 Mad 808. The action is for recovery of money in favour of the company where it has already been paid over. It must be shown that there was some reason why the company could not sue. Where the independent shareholders of a company in a majority resolved that no recovery should be made of over payment to directors, the court attached importance to this fact and dismissed the minority shareholder's action. *Smith* v *Croft* (No 2), [1987], 3 All ER 909 Ch D.

20 *Narcombe* v *Narcombe*, [1985] 1 All ER 65 CA.

for repayment to the company not only against the guilty members and directors but also against third persons who had knowingly received such money or improperly assisted the wrongful diversion.[21]

2. Fraud on minority

The conduct of a majority of shareholders can also be impeached if it constitutes a "fraud on the minority". The meaning of this phrase is not very clear. But, speaking very briefly, it means a discriminatory action. EVERSHED MR said in *Greenhalgh* v *Arderone Cinemas Ltd*[22], that "a special resolution would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and minority shareholders, so as to give to the former an advantage of which the latter were deprived".

The concept of "fraud on the minority" can best be understood with reference to the line of cases in which it has been developed and applied. The first important case seems to be *Menier* v *Hooper's Telegraph Works*:[23]

> Two companies *A* and *B* were in rivalry. The majority of the members of company *A* were also the members of company *B*. Company *A* had commenced an action against company *B*. At a meeting of company *A*, the majority passed a resolution to compromise the action in a manner favourable to company *B* and unfavourable to *A*. Thus they attempted to deprive the company of the benefits which could have been recovered from company *B*. Consequently, in an action by the minority, the resolution was held invalid. "It would be a shocking thing", the Court observed, "if that could be done, because the majority have put something into their pockets at the expense of the minority."

It follows that the court will interfere to protect the minority where the majority of a company propose to benefit themselves at the expense of the minority. The principle was again applied in *Cook* v *Deeks*:[24]

> Where the directors of a company holding three quarters of the capital obtained a contract in their own names to the exclusion of the company, Lord BUCKMASTER observed: "If, as their Lordships find on the facts, the contract in question was entered into under such circumstances that the directors could not retain the benefit of it for themselves, then it belonged in equity to the company and ought to have been dealt with as an asset of the company. Even supposing it to be not ultra vires of a company to make a present to its directors, it appears that directors holding majority of votes would not be permitted to make a present to themselves. This would be to allow a majority to oppress the minority".

Secondly, just as majority cannot appropriate to themselves the property of the company, similarly they are not allowed to expropriate the interest of

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21 *Lowe* v *Fahey*, (1996) 1 BCLC 262 Ch D.
22 [1951] Ch 286: [1950] 2 All ER 1120.
23 [1874] 9 Ch App 350.
24 [1916] 1 AC 554: [1916-17] All ER Rep 285.

minority shareholders. *Brown* v *British Abrasive Wheel Co*[25] is a case of this kind:

> A company was in great need of further capital. The majority representing 98% of the shares, were willing to provide this capital if they could buy up the 2% minority. Having failed to do this by agreement, they proposed to pass an article enabling them to purchase the minority shares compulsorily on certain terms. The plaintiff refused to surrender and brought an action to test the validity of the majority resolution. He succeeded. The question, in the view of the Court, was whether the proposed new article was "for the benefit of the company as a whole. As it was neither just nor equitable, nor for the benefit of the company as a whole to purchase the shares of a minority compulsorily", the resolution was held void.

The decision, therefore, means to suggest that majority powers must be exercised in good faith for the benefit of the company as a whole. If they have not been so exercised there is a "fraud on the minority". The phrase "benefit of the company as a whole" seems to have been borrowed from the judgment of LINDLEY MR in *Allen* v *Gold Reefs of West Africa*[26], where he said:

> The power of altering articles must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised ... bona fide for the benefit of the company as a whole....

Now, what is meant by the phrase "the company as a whole"? Does it mean the company as distinct from the members or as the whole body of corporators? This question was raised in *Sidebottom* v *Kershaw, Leese & Co*:[27]

> The plaintiffs who were in minority in the defendant company carried on a competing business. The majority of the shares were held by the directors, who passed a special resolution altering the company's articles and introducing a power for the directors to require any shareholder who competed with the company's business to transfer his shares at their full value to nominees of the directors. The validity of this resolution was challenged on the ground that it was not for the benefit of the company as a whole. "If the company as a whole means the whole body of corporators and every individual corporator, and if one of them has detriment occasioned to him by the alteration, it cannot be for the benefit of the company as a whole."
>
> The court rejected the suggestion and held that it was very much for the benefit of the company to get rid of the members who were in competing business, as such members have the unique opportunity of exploiting the company's business secrets against its very interest.

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25 [1919] 1 Ch 290.

26 [1900] 1 Ch 656, 671: [1900-03] All ER Rep 746. *See* further on this point, *Mutual Life Ins Co of New York* v *Rank Orgn*, (1995) BCLC 11.

27 [1920] 1 Ch 154.

"Individual interest may be sacrificed to the economic exigencies of the enterprise and the judgment of directors as to this must prevail."[28]

But in doing so no more damage should be done to the individual shareholder than is absolutely necessary for protecting the company's interest. The limits were exceeded in *Dafen, Tinplate Co Ltd* v *Llanelly Steel Co Ltd*:[29]

> There was no power in the original articles of the defendant company for compulsory acquisition of a member's interest. A special resolution was passed altering articles and introducing a power enabling the majority of the shareholders to determine that the shares of any member may be offered for sale by the directors to such persons as they should think fit at the fair value to be fixed. The defendant company was formed with the object that all its shareholders were to take their tinplates from the company. The plaintiff company refused to do so and the defendant company resolved to acquire the plaintiff company's shares. But it was held that the resolutions in conferring an unrestricted and unlimited power on the majority to expropriate any shareholder they might think proper at their will or pleasure went much further than was necessary for the protection of the company.

Hence, "the question in each case is whether the alteration is genuinely for the benefit of the company, or was the alteration made for the benefit of some section of the company."[30] Now who shall be the ultimate judge of the fact whether a particular line of action adopted by the majority is genuinely for the benefit of the company. Obviously the shareholders are the best judge. The courts cannot manage the affairs of the company for the shareholders. The only restraint upon the majority powers. therefore, is that whatever the majority may decide, they must do so in good faith as reasonable businessmen. This approach was initiated by SCRUTTON LJ in *Shuttleworth* v *Cox Bros & Co*:[31]

> When persons, honestly endeavouring to decide what will be for the benefit of the company, decide upon a particular course then, provided, there are grounds on which reasonable businessmen would come to the same conclusion, it does not matter whether the Court would not come to the same decision. It is not the business of the courts to interfere or to manage the affairs of the company, this is for the shareholders and directors. The absence of any reasonable grounds for deciding that a certain course of action is conducive to the benefit of the company may be a ground. for finding that the shareholders with the best motives, have not considered the matters which they ought to have considered.

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28 Berle & Means, THE MODERN CORPORATION AND PRIVATE PROPERTY, 277 (1932).

29 [1920] 2 Ch 124.

30 See *Peters American Delicacy Co Ltd* v *Health*, (1939) 61 CLR 457, 481. The judgment in this case contains an elaborate discussion of cases on this subject. A decision of the High Court of Australia.

31 [1927] 2 KB 9.

Finally, in *Greenhalgh* v *Arderone Cinemas Ltd*,[32] EVERSHED MR, explained the concept in the following words:

> "In the first place, it is now plain that 'bona fide for the benefit of the company as a whole' means not two things but one thing. It means that the shareholder must proceed on what, in his honest opinion, is for the benefit of the company as a whole. Secondly, the phrase 'the company as a whole' does not... mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body. That is to say, you may take the case of an individual hypothetical member and ask whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit. I think the thing can, in practice, be more accurately and precisely stated by looking at the converse and by saying that a special resolution of this kind would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter were deprived. When the cases are examined where the resolution has been successfully attached, it is on that ground that it has fallen down."

Thus the phrase "corporators as a general body" means both the present and future members of the company.[33]

But all this is subject to the principle which still holds ground that the right to vote is the private property of a shareholder and, therefore, "a shareholder may vote as he pleases even when his interests are different from or opposed to those of the company. Shareholders are not trustees for the company or for one another and the relations between them cannot be identified with relations between partners."[34] Shareholders often vote in their own selfish interest. They cannot always be required to have only the benefit of the company in view. For example, in *Jhajharia Bros Ltd* v *Sholapur Spg & Wvg Co Ltd*:[35]

> The plaintiffs Jhajharias, were the managing and the sole selling agents of the defendant company. They also held minority interests in the company. The company dismissed them from both the offices. They owed certain sums to the company for which a good number of their shares were forfeited and allotted to the new managing agents. The new agents, with the help of these votes combined with those of directors and some shareholders managed to pass a resolution for further increase of capital which was underwritten by them. They thus placed themselves in a position of safe majority. The court could find no ground to interfere. "There is no inherent wrong in that. A majority can increase its own majority, generally speaking, unless there be an element of expropriation or coercion. Proof of party feeling or animosity by itself would not be enough."

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32 1951 Ch 286: [1950] 2 All ER 1120, 1126.

33 *Gaiman* v *National Assn of Mental Health*, (1971) 1 Ch 317, per MAGARRY J at 330. His Lordship also added that principles of natural justice are not applicable in this field.

34 See *North-West Transportation Co* v *Beatty*, (1887) 12 App Cas 589; *Public Trustee* v *Rajeshwar Tyagi*, (1973) 43 Comp Cas 371 Del.

35 AIR 1941 Cal 174: 195 SC 36.

Thus the fundamental question is as to who should control the company. From the administrative point of view the company is a collection of the members and, therefore, should be under their control. In the case of any conflict between the interest of the organisation and that of a member, the individual interest is sacrificed. But what often happens is that the majority tends to identify its own interest with that of the company and if the right to vote is their personal property they can use it to fortify their interests. In such cases the rule should be as suggested by Professor Aharan Barack:[36]

> "It should be recognised that the shareholder, particularly one with a controlling interest, is not a 'stranger' to the company, but owes it a fiduciary duty and a duty of care, requiring him to act in good faith for the good of the company as a whole. If this approach were to be recognised then the power to ratify would be given only to 'independent' shareholders, i.e., to those who had not colluded in a breach of duty by the directors, and who were not subject to their control."[37]

The present trend is towards a principle that any breach of duty which causes loss to the company should be regarded as a fraud on the minority. In an English case[38] the sale of a company's property below its natural market value was held to be a fraud. Welcoming this decision[39], it has been observed that "in view of the inactivity of the legislature in the area of minority protection, it is welcome that the courts have taken it upon themselves to extend that area and to enable minorities more frequently than before to have their grievances ventilated in court". It has been added in a subsequent case that an action should lie whenever directors are guilty of a breach of duty to the company (including their duty to exercise proper care) and as a result of that breach they obtain some benefit.[40] Opinions have been expressed that action should be allowed under this category whenever the justice of the case demands and that the whole doctrine should be adapted to prevent a wrongdoing without a redress.[41] For example, the test of benefit of the company as a whole will fail to apply where class rights are involved and, therefore, in such cases the only requirement could be that the minority should not be made the victim of fraud or oppression.[42]

3. Acts requiring special majority

There are certain acts which can only be done by passing a special resolution at a general meeting of shareholders. Accordingly, if the majority purport to do any such act by passing only an ordinary resolution or without passing special resolution in the manner required by law, any member or

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36 *A Comparative look at the Protection of Shareholders' Interests: Variations of the Derivative Suit*, (1971) 19 ICLQ 22.

37 *Id.* at 34.

38 *Daniels* v *Daniels*, The Times, July 26, 1977: (1977) New LJ 938.

39 1976 JBL 347.

40 *See* VINELOTT J in *Prudential Assurance Co Ltd* v *Newman Industries Ltd, (No 2)*, [1982] Ch 204: [1980] 2 All ER 841, 869: [1980] 3 WLR 543.

41 *Estmanco (Kilner House) Ltd* v *Greater London Council*, (1982) 1 WLR 2 at 11: [1982] 1 All ER 437.

42 *Peter's American Delicacy Co Ltd* v *Health*, (1939) 61 CLR 457 (High Court of Australia).

members can bring an action to restrain the majority. Such actions were allowed in *Dhakeswari Cotton Mills* v *Nil Kamal Chakravarty*[43] and *Nagappa Chettiar* v *Madras Race Club*.[44]

4. Wrongdoers in control

Sometimes an obvious wrong may have been done to the company, but the controlling shareholders would not permit an action to be brought against the wrongdoer. In such cases, to safeguard the interest of the company, any member or members may bring an action in the name of the company.[45] This was recognised in *Foss* v *Harbottle* itself:

> If a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters, and asking in such character the protection of these rights to which in their corporate character they were entitled, one cannot but think that the principle so forcefully laid down by Lord Cottenham in *Wallworth* v *Holt*[46], and other cases would apply, and the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue.

The principle has now found a suitable illustration in the facts of *Glass* v *Atkin*[47], a decision of the Ontario High Court:

> A company was controlled equally by the two defendants and the two plaintiffs. An action arose alleging that the two defendants had fraudulently converted the company's assets to their own use.
>
> Allowing the action the Court said:
>
> While the general principle was for the company itself to bring an action where it had an interest, it was appropriate for the two plaintiffs here to bring an action on behalf of the company since the two defendants controlled the company in the sense that they could prevent the company from taking action.

The word "control" for this purpose means majority control. But it has now been recognised that control can exist without majority power. It has been held that "control exists if it would be futile to call a general meeting because the wrongdoers would directly or indirectly exercise a decisive influence over the result. This exception to *Foss* v *Harbottle* applies whenever the defendants are shown to be able by means of any manipulation of their position in the company to ensure that the action is not brought by the company."[48]

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43 AIR 1937 Cal 645: 41 CWN 1137.

44 [1949] 1 MLJ 662: ILR 1949 Mad 808.

45 *V. P. Singh* v *Chairman, Metropolitan Council*, AIR 1969 Delhi 295.

46 4 Mycle & Cr 635. *See* also *Marshall's Valve Gear Co Ltd* v *Manning Wardley & Co Ltd*, [1909] 1 Ch 267: 100 LT 65, *supra* Chap. 9.

47 (1967) 65 DLR (2d) 501. *See* also *Satya Charan* v *Rameshwar Prasad Bajoria*, AIR 1950 FC 133: 20 Comp Cas 39: 1949 FCR 673: 1950 SCR 394 where FAZL ALI J restates all the cases in which a shareholder can take steps to redress a wrong done to the company.

48 *See* note on *Derivative Actions and Foss* v *Harbottle*, in (1981) 44 Mod LR 202 reviewing the decision of VINELOTT J in *Prudential Assurance Co Ltd* v *Newman Industries Ltd, (No 2)*, [1982] Ch 204: [1980] 2 All ER 841; [1980] 3 WLR 543.

It has been suggested that the principle should extend to this extent that "when a director is in breach of fiduciary duty, every shareholder may be regarded an authorised organ to bring the action".[49]

5. Individual membership rights

Lastly, every shareholder has, vested in him, certain personal rights against the company and his co-shareholders. A large number of such rights have been conferred upon shareholders by the Act itself, but they may also arise out of articles of association. Such rights are commonly known as "individual membership rights" and respecting them the rule of majority simply does not operate. In the words of Palmer, "if such a right is in question, a single shareholder can, on principle, defy a majority consisting of all the other shareholders".[50] For example in *Nagappa Chettiar* v *Madras Race Club*[51], the court observed: "A shareholder is entitled to enforce his individual rights against the company, such as his right to vote, the right to have his vote recorded, or his right to stand as a director of a company at an election." *Pender* v *Lushington*[52] is another authority.

> A shareholder who had the right to vote, but whose vote was rejected, brought an action to compel the directors to record his vote. JESSEL MR observed: "He is a member of the company and whether he votes with the majority or the minority he is entitled to have his vote recorded — an individual right in respect of which he has a right to sue. That has nothing to do with the question like that raised in *Foss* v *Harbottle* and that line of cases.[53] He has a right to say 'whether I vote in the majority or minority, you shall record my vote, as that is a right of property belonging to my interest in this company, and if you refuse to record my vote, I will institute legal proceedings against you to compel you'.[54]"

This principle was applied by the Kerala High Court in deciding *Joseph* v *Jos*.[55]

> At a meeting of a company it was proposed to elect some directors by separate elections. The plaintiff was a candidate and he contested the election, but was defeated. He was proposed as a candidate again to fill up the second vacancy. But the chairman, on account of his previous defeat, disqualified him.

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49 *Id.* at 30. For a statement of principles and indemnity as to costs see *Wallersteiner* v *Moir* (*No 2*), [1975] 1 All ER 849 CA.

50 Palmer on COMPANY LAW, 492 (20th Edn).

51 [1949] 1 MLJ 662, 667: ILR 1949 Mad 808.

52 [1877] 6 Ch D 70.

53 *Id.* at pp 80-81.

54 His Lordship also observed at 75-76 that "it is no ground for rejecting a shareholder's vote that he has voted against the interest of the company. There is no obligation on a shareholder of a company to give his vote merely with a view to what other persons may consider the interests of the company at large. He has a right, if he thinks fit, to give his votes from motives or promptings of what he considers his own individual interest." There is a useful list of such rights at 493-96 in Palmer's COMPANY LAW, 20th Edn (1959).

55 [1964] 1 Comp LJ 105. Also see *Srinivasan* v *Subramania*. AIR 1932 Mad 100: 136 IC 193.

In his action against this ruling, the court held that he was entitled to a declaration that the proceedings of the meeting as regards the election of directors were null and void. "An individual membership right implies that the individual shareholders can insist on strict observance of the legal rules, statutory provisions and the provisions in the memorandum and articles which cannot be waived by a bare majority of shareholder. Every shareholder can assert such a right in his own name."[56]

Similarly, in *Karus* v *Lloyd Property Ltd*:[57]

> A director refused to retire in accordance with the articles and invalidly continued in office. The plaintiff shareholder was held entitled to bring an action on the ground that "the individual rights of the plaintiff as a member have been invaded."[58]

The plaintiff, in still another case, was allowed to assert that new articles adopted by the company by a resolution were not binding because when the resolution was being considered, the chairman had wrongly rejected his right to propose an amendment.[59]

6. Oppression and mismanagement

Lastly, it has been stated by SINHA J of the Calcutta High Court in *Kanika Mukherji* v *Rameshwar Dayal Dubey*[60] that the principle embodied in Sections 397 and 398 of the Indian Companies Act which provide for prevention of oppression and mismanagement, is an exception to the rule in *Foss* v *Harbottle* which lays down the sanctity of the majority rule.[61]

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56 Following articles on the subject may be consulted: *Minority Shareholders' Action—Rule in Foss* v *Harbottle*, (1964) Camb LJ 39; A. J. Boyle, *Minority Shareholder in the Nineteenth Century*, 28 Mod LR 317 (1965); K. W. Wedderburn, *Shareholders' Right and the Rule in Foss* v *Harbottle*, (1957) Camb LJ 194 and (1958) Camb LJ 93; *Freezing out Minority Shareholders*, 74 Har LR 1630; *Acquisition of Minority Shares*, 1960 LQR 314; *A Liberal Approach to Foss* v *Harbottle*, 27 Mod LR 603 (1964); G. R. Bretten, *Alteration of Articles and Protection of Minorities*, 1970 JBL 185.

57 1965 VR 232(Aust.); noted 30 Mod LR 78. *See* also *Berar Trading Co* v *Gajanan Gopal Rao Dixit*, (1972) 42 Comp Cas 48 Bom.

58 HUDSON J at 236. *See* K. W. Wedderburn, *Shareholders' Control of Directors' Powers: A Judicial Innovation*, (1967) 30 Mod LR 77, 78.

59 *Henderson* v *Bank of Australasia*, (1890) 45 Ch D 330; [1886-90] All ER Rep Ext 1190.

60 [1966] 1 Comp LJ 65 Cal. A petition under these sections cannot be stayed under S. 10, CPC, *Rijush K. Guha* v *W.B. Pharmaceuticals Phyto Commercial Corpn Ltd*, [1982] 1 Comp LJ 199: AIR 1982 Cal 94.

61 This forms the subject-matter of the next chapter. The vulnerable position of the minority shareholder and how he can be protected by expanding the scope of the fiduciary responsibilities of majority shareholders has been explained in the recent American case, *Jones* v *H. F. Ahman Son & Co*, decision of the Supreme Court of California, Cal 3d 93: 81 Calf Report 592, and is commented upon in a note: *Jones* v *Ahman Son: The Fiduciary Obligations of Majority Shareholder*, (1970) 70 Col LR 1079.

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Prevention of Oppression and Mismanagement

In addition to the protection afforded to the minority by the exceptions to the rule of the supremacy of majority, the modern Companies Acts contain special provisions for prevention of oppression and mismanagement. The aim of such provisions, now contained in Chapter VI of Part VI of the Companies Act, 1956, is to safeguard the interest of investors in companies and also to protect the public interest. The rights conferred on shareholders by this chapter are also known as qualified minority rights.[1] The chapter provides for judicial as well as administrative remedies.

PREVENTION OF OPPRESSION

Who can apply (S. 399)

The first remedy in the hands of an oppressed minority is to move the National Company Law Tribunal. Whenever "the affairs of a company are being conducted in a manner oppressive to any member or members or prejudicial to public interest", an application can be made to the Company Law Board under Section 397. The requisite number of members who must sign the application is given in Section 399. Where the company is with a share capital, the application must be signed by at least 100 members of the company or by one-tenth of the total number of its members, whichever is less, or by any member or members holding one-tenth of the issued share capital of the company.[2] If the company is without share capital, the application has to be signed by one-fifth of the total number of its members.[3]

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1 *See* Palmer's COMPANY LAW, Chap. 51 at, 505 (1959) 20th Edn.

2 *T. N. K. Govindaraju Chetty & Co* v *Kadri Mills (CBE) Ltd*, (1998) 30 Corpt LA 49 CLB, the percentage is to be taken on the basis of the position before the increase of capital which has been questioned and which has reduced the percentage of the petitioner. *Mega Resources* v *Bombay Dyeing and Mfg Co Ltd*, (2003) 116 Comp Cas 205 (CLB), a portion of the holding was in violation of SEBI Takeover Code and without it, 10% shareholding was not there with the petitioner.

3 This being a statutory right, cannot be taken away by contrary provisions in the articles or by an arbitration clause. *Kare (P) Ltd, Re*, (1977) 47 Comp Cas 276 Del; *O. P. Gupta* v *Shiv General Finance (P) Ltd*, (1977) 47 Comp Cas 279 Delhi. All the consenting members together have to hold the requisite number and not every one of them individually. *Kuttanad Rubber Co Ltd* v *K.T. Ittiyavirah*, [1993] 3 Comp LJ 39 Ker. Consent through a general power of attorney is valid for this purpose. *P. Punniah* v *Jeypore Sugar Co Ltd*, (1994) 4 SCC 341: (1994) 81 Comp Cas 2 SC. A petition cannot be filed by a general power of attorney. He must be specifically authorised. *Shri Kiran M. Lulla* v *Vikron Fashions P Ltd*, (1994) 81 Comp Cas 566 CLB where a company was a member and aggrieved of oppression, an unauthorised director was not allowed to proceed. He needed a decision of the company or its board. Consent of members to a draft petition was not a good consent. There was nothing to show that the petition was based on the grounds noted in the draft. *K. N. Sankarnarayanan* v *Shree Consultations & Services (P) Ltd*, (1994) 80 Comp Cas 558 Mad.

However, the Central Government may, on application, allow any member or members to sue "if in its opinion circumstances exist which make it just and equitable to do so".[4]

Once the consent of the requisite number is obtained, the application may be made by one or more of them on behalf and for the benefit of all of them.[5] The term "consent" for this purpose means, as defined in Section 13 of the Contract Act, an agreement upon the same thing in the same sense. Accordingly, the Madras High Court[6] rejected a petition because the consenting members were only told that their signatures were needed for requisitioning a meeting. The signatories must be told of the specific facts which are alleged to be as constituting an oppression. "There cannot be a blanket consent."[7] It has been held by the Supreme Court in *Rajahmundry Electric Supply Corpn* v *A. Nageshwara Rao*[8] that if some of the consenting members have, subsequent to the presentation of the application, withdrawn their consent, it would not affect the right of the applicant to proceed with the application.[9] By holding that where a petition has been properly presented, it does not cease to be maintainable merely because three of the applicants have transferred their shares and ceased to be shareholders of the company. "The validity of the petition must be judged on the facts as they are at the time of its presentation. Neither the right of the applicant to proceed with the application, nor the jurisdiction of the court to dispose of it on its own merits, can be affected by events happening subsequent to the presentation."[10]

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4 S. 399(4). The Government may demand security for costs as a safeguard against vexatious litigation. *See* sub-section (4).

5 The requirement as to minimum shareholding is applicable only at the time of filing. The petition can continue even if after filing some shareholders cease to be members. *S. Varadrajan* v *Venkateswara Solvent Extractions (P) Ltd*, (1994) 80 Comp Cas 693 Mad.

6 *M. C. Duraiswami* v *Sakthi Sugars Ltd*, (1980) 50 Comp Cas 154 Mad.

7 The court considered *Bengal Luxmi Cotton Mills, Re*, (1965) 35 Comp Cas 187 Cal, and *Makhan Lal Jain* v *Amrit Banaspati Co Ltd*, (1953) 23 Comp Cas 100. For another case of consent by misrepresentation see *Naranjan Singh* v *Edwardganj Pub Welfare Assn*, (1983) 54 Comp Cas 330 P&H. Consent to proceedings on the general ground of mismanagement or oppression will not do. *Omni India Ltd* v *Balbir Singh*, [1989] 2 Comp LJ 229; (1989) 66 Comp Cas 903 Del; *K. P. Chackochan* v *Federal Bank*, [1989] 2 Comp LJ 269; (1989) 66 Comp Cas 953 Ker. Consent taken without informing shareholders of the specific grounds so as to give them an opportunity for application of mind will render the petition invalid. See *P. S. Nanawati* v *Jaipur Metals and Electricals Ltd*, (1990) 69 Comp Cas 769 Raj. Preliminary issues relating to maintainability and procedural requirements under CPC and court rules should be decided in the context of the grounds raised. *Saurashtra Cement and Chemical Industries Ltd* v *Essma Industries (P) Ltd*, (1990) 69 Comp Cas 372.

8 AIR 1956 SC 213; (1956) 26 Comp Cas 91.

9 *Kilpest (P) Ltd* v *Shekhar Mehra*, (1987) 62 Comp Cas 717, the court also pointing out that the petition cannot be converted into one for winding up. The Punjab High Court has gone a little further in *Jagdish Chandra Mehra* v *New India Embroidery Mills*, [1964] 1 Comp LJ 291 by holding that even if the petitioning member disposes of his shares, the petition remains competent. *V. Shanker* v *South Indian Concerns Ltd*, (1997) 24 Corpt LA 54 CLB, the petitioner not competent himself in shareholding, consents filed by him did not inspire confidence, petition not entertained.

10 Where the transferee was an already registered shareholder and, therefore, his petition was entertained, the removal of his name by the company subsequently from the register on the ground that the transfer deeds carried uncancelled stamps was held to be not a material fact and

All the material facts should be set out in the petition itself. Allegations of fraud, *mala fide*, etc, must be supported with particulars. Supporting facts cannot be brought in subsequently.[11]

Similarly, in a petition against a transport company, the Madras High Court refused to take into account the subsequent conduct of the majority in disposing of all the buses of the company.[12] "The petitioner is not entitled to take advantage of a circumstance that happened after the presentation of the petition."

Where a person has obtained a decree for rectification of his company's register of members so as to have his name entered in it, he may apply for relief under the section although the decree has not yet been enforced and the register does not show his name.[13] Similarly, in *Bayswater Trading Co, Re*,[14] and again in *Jermyn Street Turkish Baths Ltd, Re*.[15] Section 210 of the (English) Companies Act, which provided for relief against oppression, was interpreted to include the representatives of a deceased shareholder.[16] But it seems probable that a purchaser of shares who is not yet registered may not be allowed relief under the section against the oppression caused by the company's refusal to register his name.[17] The Bombay High Court did not

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the petition remained competent. *Sayedabad Tea Co Ltd* v *Samarendra Nath Ghattak*, (1995) 83 Comp Cas 504 Cal.

11 *P. S. Offshore Inter Land Services (P) Ltd* v *Bombay Offshore Suppliers and Services Ltd*, (1992) 75 Comp Cas 583 Bom; *M. M. Dua* v *Indian Dairy and Allied Services (P) Ltd*, (1996) 86 Comp Cas 657 CLB; *Karedla Suryanarayanan* v *Sri Ram Das Motor Transport Co (P) Ltd*, (1998) 28 Corpt LA 233 CLB, matters of subsequent occurrence and amendment of pleadings. *Subhash Chand Agarwal* v *Associated Limestone Ltd*, (1998) 29 Corpt LA 190 CLB, an amendment cannot be allowed to set up a new case which was not set out in the original petition. *Srihari Rao* v *P. K. Majumdar*, (1998) 30 Corpt LA 373 CLB, burden of proof on the petitioner.

12 *C. P. Gnanasambandam* v *Tamilnadu Transports (P) Ltd*, (1971) 41 Comp Cas 26 Mad

13 *Stadmed (P) Ltd* v *Kshetra Mohan*, AIR 1968 Cal 572: [1968] 1 Comp LJ 321: 72 CWN 601. See RAY J (as he then was) at 579. Where a pledgee of shares was registered as shareholder and exercised membership rights, it was held that on the removal of his name from the register under an order of the Company Law Board, he ceased to be member for the purposes of a petition under the section. *Malleswara Finance and Investment Co* v *CLB*, (1994) 81 Comp Cas 66: AIR 1994 Mad 341.

14 [1970] 1 All ER 608: [1970] 1 WLR 343: (1970) 40 Comp Cas 1196.

15 [1970] 3 All ER 57.

16 A similar view has been adopted under the Companies Act so as to enable the legal representatives to apply. See *Worldwide Agencies (P) Ltd* v *Margaret*, (1990) 1 SCC 536: 1990 SCC (Tax) 171: (1990) 67 Comp Cas 607 SC: AIR 1990 SC 737: [1990] 1 Comp LJ 208, affirming *Margaret T. Desor* v *Worldwide Agencies (P) Ltd*, (1989) 66 Comp Cas 5 Del. In the event of the death of one of the respondents, it is not necessary to bring his legal heirs on the record. *Rajender Nath Bhaskar* v *Bhaskar Stoneware Pipes (P) Ltd*, [1990] 1 Comp LJ 351: (1990) 68 Comp Cas 256 Del. A person who has become entitled to be a member has a right to apply. *Shri Balaji Textile Mills (P) Ltd* v *Ashok Kavle*, (1989) 66 Comp Cas 654 Ker; *Srikanta Datta Narsimahraja Wadiyar* v *Venkateshwar Real Estates Enterprises (P) Ltd*, (1990) 68 Comp Cas 216: *N. Satyaprasad Rao* v *V. L. N. Sastry*, (1988) 64 Comp Cas 492 AP, share certificates issued.

17 This view is expressed in Gower's PRINCIPLES OF MODERN COMPANY LAW, 600, (3rd Edn 1969). A person whose name has been struck off the register also cannot apply unless he first gets the register rectified so as to include his name. *Gulabrai Kalidas Naik* v *Lakshmidas Lallubhai Patel*, (1977) 47 Comp Cas 151. *See* further *Killick Nixon Ltd* v *Bank of India*, (1985) 57 Comp Cas 831 Bom, where the court held that a shareholder, who has transferred his shares but the same has not been registered by the company, is entitled to petition and also that the right to petition can be delegated to an agent. A person whose name was there in the

allow a derivative action to be filed by a director of the company who was not its shareholder. Order 1, Rule 1 of CPC would not permit a person to join a proceeding in which he has the right to relief. A person whose name is not borne out by the company's register of members has no *locus standi* to say that a wrong has been done to his company. The court would not lift the veil of incorporation at his instance so as to enable him to show his beneficial interest in the company through a chain of inter-corporate investments.[18] Even when the original petitioning member withdraws from the foray and does not want to continue the petition, he cannot compel dismissal of the petition. A representative action of this kind can still be considered on its merits. Any willing member may be substituted as a petitioner even if he is holding less than the requisite number of shares. Share qualification is relevant only to the time of filing and not to the continuance of the petition.[19]

The Central Government also has the power to apply for relief under the section.[20] The Government also has the discretionary power to permit a lesser number of members to proceed under the section.[21]

The employees of a company, however much they may be treated like members, or are members also, cannot get any relief under this jurisdiction in their capacity as employees.[22]

Section 400 requires the Tribunal to give notice of every application made to it under Section 397 or 398 to the Central Government. The Board has to take into consideration any representation made by the Central Government in connection with a particular application.

Once entertained, a petition under the section can be compromised or withdrawn only with the sanction of the Tribunal. The compromise should be in the best interest of the company and its shareholders.[23]

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register and was unlawfully removed under unauthorised signatures was allowed to file petition, *Rashmi Seth* v *Tillsoil Farms (P) Ltd*, [1992] 3 Comp LJ 126 CLB: (1995) 82 Comp Cas 409 CLB.

18 *BSN (UK) Ltd* v *Janardan Mohandas Rajan Pillai*, (1996) 86 Comp Cases 371 Bom. *Radhey Shyam Gupta* v *Kamal Oil & Allied Industries Ltd*, (2001) 103 Comp Cas 337 Delhi, those persons whose names are borne by the register of members and annual returns as shareholders are *prima facie* entitled to file petition. *Shankar Sundaram* v *Amalgamations Ltd*, (2001) 104 Comp Cas 635 CLB, shareholders of holding company cannot apply in respect of oppression or mismanagement in a subsidiary. The subsidiary may be impleaded, if necessary.

19 *LRMK Narayan* v *Pudhuthotam Estates Ltd*, (1992) 74 Comp Cas 30 Mad. The CLB may be approached even where the matter is pending before a High Court. Proceedings before CLB are not liable to be stayed for that reason. A representative of the petitioning group of shareholders was appointed by the CLB on the company's board by way of interim relief and was authorised to function as an independent chairman. *Mrunalini Deve Puar of Dhar (Dr)* v *Gaekwar Investment Corpn (P) Ltd*, [1993] 1 Comp LJ 89 CLB: (1995) 82 Comp Cas 899; *Rashmi Seth* v *Chemon (India) (P) Ltd*, [1992] 3 Comp LJ 89 CLB: (1995) 82 Comp Cas 563.

20 S. 401. A secretary cannot present a petition by himself. He requires authority of the board of directors. *Mohan Lal Mittal* v *Universal Works Ltd*, (1983) 53 Comp Cas 36 Cal.

21 *Efficient Publicities (P) Ltd, Re*, [1989] 1 Comp LJ 208 CLB where the permission was refused because the alleged facts were not true. *Edwardganj Public Welfare Assn, Re*, (1990) 69 Comp Cas 787 P&H, a petition by a single member in a company without share capital rejected.

22 *Jaber* v *Science and Information Technology Ltd*, (1992) BCLC 764 Ch D; *Alchema Ltd, Re*, [1998] BCC 964 Ch D, *French* v *Mason*, [1998] CLY Feb, para 96.

23 *Kelly and Henderson (P) Ltd, Re*, (1980) 50 Comp Cas 646 Bom, where the court refused to

"This ingenious remedy has not only permitted redress of many abuses, but its mere availability has had a deterrent effect upon management."[24]

Company itself cannot apply

The company cannot by itself be an applicant for any relief under this jurisdiction.[25]

Conditions of relief [S. 397]

There are certain preliminary conditions which must be satisfied to entitle a shareholder to some relief under the section.[26] These conditions are inbuilt in the language of the section itself. The section comes into play when (1) the company's affairs are being conducted in a manner, (2) prejudicial to public interest or oppressive to any member or members, (3) which would make it just and equitable to wind up the company, but, (4) winding up would unfairly prejudice such member or members.

Oppression

If an oppression of this kind is established, the Tribunal will, "with a view to bringing to an end the matters complained of, make such an order as it thinks fit". Before this section was enacted the only effective remedy against oppression was a winding up order under the just and equitable clause of Section 433. But this remedy was often worse than the disease.[27] And now the Tribunal has been given the powers to impose upon the parties whatever solution the Tribunal considers just and equitable in the circumstances. Thus, instead of forcing a sound business concern to winding up, an effort is made to salvage it.[28]

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sanction a compromise which was tilted in favour of the person against whom the grievances were alleged. Following, *Syed Md Ali* v *R. Sundaramurthy*, (1958) 28 Comp Cas 554: AIR 1958 Mad 587; *Jacob Cherian* v *K. K. Cherian*, (1973) 43 Comp Cas 235 Mad. See *Kumar Exporters (P) Ltd* v *Naini Oxygen*, (1986) 60 Comp Cas 984, 990, where a decree was passed in terms of compromise. All the material facts affecting the matter must be disclosed in the petition itself. Allegations of fraud, mala fide etc, if any, must be supported by particulars. *P. S. Offshore Inter Land Services (P) Ltd* v *Bombay Offshore Suppliers and Services Ltd*, (1992) 75 Comp Cas 583 Bom. The CLB will not stand in the way of withdrawal if there is nothing against public or company's interests, *V. Sundarajan* v *R. R. Spinning Mills Ltd*, (1998) 30 Corpt LA 35 CLB. A compromise cannot be recalled or altered because the CLB has no power to review its own decisions. An order also cannot be modified unless all the parties agree or it is established that the parties did not understand the nature and purport of the compromise (lack of consensus-ad-idem) or it was not voluntary, *Michelle Jawad-Al-Fahoum* v *Indo Sandi (Travels) P Ltd*, (1998) CLA 42 CLB: (1991) 71 Comp Cas 300 Cal.

24 George H. Hornstein, *The Future of Corporate Control*, (1950) 63 Harv LR 476.

25 *Ultrafilter (India) P Ltd* v *Ultrafilter GmbH*, (2002) 112 Comp Cas 93 CLB.

26 For the meaning of the word "satisfaction" see *Peerless General Finance & Investment Co Ltd* v *UOI*, [1989] 1 Comp LJ 56 Cal: (1991) 71 Comp Cas 300 Cal.

27 The remedy was introduced in S. 210 of the English Companies Act, 1948, as a result of the recommendations of the Cohen Committee, 1945. The Committee had suggested that: "The remedy of winding up to eliminate oppression is worse than the disease because it generally means that the business of the company would pass into the hands of the majority who would ordinarily be the only available purchaser and the break up value of the assets may be small." *See* SINHA J in *Kanika Mukherji* v *Rameshwar Dayal Dubey*, [1966] 1 Comp LJ 65 at 77 Cal.

28 *See*, for example, *K. R. S. Narayana Iyengar* v *T. A. Mani*, AIR 1960 Mad 338, 339; Cohen Committee's Report, 30-95.

The meaning of the term "oppression" as explained by Lord COOPER in the Scottish case of *Elder* v *Elder & Watson Ltd*[29], was cited with approval by WANCHOO J (afterwards CJ) of the Supreme Court of India in *Shanti Prasad Jain* v *Kalinga Tubes Ltd*.[30] "The essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely." The complaining shareholder must be under a burden which is unjust or harsh or tyrannical.[31] "A persistent and persisting course of unjust conduct must be shown."[32] In the above-mentioned Scottish case the allegations were that the petitioners, who were two shareholders in a small family company, were removed by the majority from directorship and also from their employment as secretary and factory manager. The petition failed because they had not suffered as shareholders but in different capacities.

"The result of applications under Section 210[33] in different cases must depend on the particular facts of each case, the circumstances in which oppression may arise being so infinitely various that it is impossible to define them with precision."[34]

An attempt to force new and more risky objects upon an unwilling minority may in circumstances amount to oppression. This kind of situation developed in *Hindustan Coop Insurance Society Ltd, Re*:[35]

> The life insurance business of a company was acquired in 1956 by the Life Insurance Corporation of India on payment of compensation. The directors, who had the majority voting power, refused to distribute this amount among the shareholders. Rather they passed a special resolution changing the objects of the company and to utilise the compensation money for the new objects. This was held to be an "oppression". The Court observed: "The majority exercised their authority wrongfully, in a manner burdensome, harsh and wrongful. They attempted to force the minority shareholders to invest their money in a different kind of business against their will. The minority had invested their money in a life insurance business

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29 1952 SC 49 Scotland.

30 [1965] 1 Comp LJ 193, 204: AIR 1965 SC 1535: (1965) 35 Comp Cas 351.

31 *See* Lord SIMONDS in *Scottish Cooperative Wholesale Society* v *Meyer*, 1959 AC 324 at 342: [1958] 3 All ER 66: (1958) 3 WLR 404 HL. His Lordship said that the dictionary meaning of the term is "burdensome, harsh and wrongful." Referring to this Professor Gower says: "difficulty has been experienced in tracing the dictionary from which he took it . . . it appears to be an adaptation of the SOED's unjustly burdensome, harsh or merciless". PRINCIPLES OF MODERN COMPANY LAW, 602 (3rd Edn, 1969).

32 See *H. R. Harmer Ltd, Re*, [1959] 1 WLR 62: [1958] 3 All ER 689.

33 Of the English Companies Act, 1948, on which S. 397 of the Indian Companies Act has been based. This section of the English Act was replaced by S. 459 of the 1985 English Act substituting the words "unfair prejudice" for the word "oppression".

34 *H. R. Harmer Ltd, Re*, fn 27, *supra*, adopted by WANCHOO J (afterwards CJ) in *Shanti Prasad Jain* v *Kalinga Tubes Ltd*, fn 25, *supra*. The judicial definitions have been collected by D. Prentice, *Protection of Minority Shareholders*, (1952) Current Legal Problems 122 at 137.

35 AIR 1961 Cal 443: 65 CWN 68: (1961) 31 Comp Cas 193.

with all its safeguards and statutory protections. But they were being forced to invest where there would be no such protections or safeguards."

Similarly, an attempt to deprive a member of his ordinary membership rights is an "oppression". This is shown by *Mohan Lal Chandumall* v *Punjab Co Ltd*:[36]

> A public company doing forward contract business amended its articles of association under a statutory direction in such a manner as to deprive its non-trading members of their right to vote, to call meetings, to elect directors and to receive dividends. The Court held that "the company in doing so trampled upon the valuable rights of such members by unjust exercise of its authority and power and it amounted to oppression within Section 377". "I cannot conceive of a worse oppression", said MAHAJAN J "than the denial of a voting right to a shareholder.... To take away the right of partaking in dividends is not merely oppressive but even confiscatory."

But as the amendments were in accordance with the requirements of an Act which provided that such companies should consist of only trading members, the court directed the company to purchase the shares of the complaining members to enable them to walk out of the company with such capital as they had invested.

A similar relief was allowed by the House of Lords in *Scottish Coop Wholesale Society* v *Meyer*.[37]

> The society created a subsidiary company to enable it to enter the rayon industry. Subsequently, when the need for the subsidiary ceased to exist, the society adopted a policy of running down its business which depressed the value of its shares.

The two petitioners who were managing directors and minority shareholders in the subsidiary successfully pleaded "oppression". The court ordered the society to purchase the minority shares at the value at which they stood before the oppressive policy started.

Similarly, in *Harmer Ltd, Re*,[38] the Court of Appeal allowed relief in circumstances where a majority controller persistently flouted the decisions of the board, committed the company to new business without proper procedure and procured the appointment of dummy directors. Where the chairman of a company, who owed his allegiance to a corporation which had underwritten the shares of the company, tried to oust the managing director of the company at a time when, as a result of the managing director's efforts, the company had brought up its factory and was only waiting for further loans to enter into production, that was held to be an "oppressive policy", which was also against public interest.[39] "Public interest" in this connection means that the company should function for public good or for general welfare of the community and not in a manner detrimental to public good. There was sufficient evidence to show that if the company had gone into production, it would have earned foreign

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36 AIR 1961 Punj 485.
37 1959 AC 324: [1958] 3 All ER 66: (1958) 3 WLR 404 HL.
38 [1959] 1 WLR 62: [1958] 3 All ER 689.
39 *N. R. Murty* v *I. D. Corpn of Orissa Ltd*, (1977) 47 Comp Cas 389 Ori.

exchange for the country. Those who were causing delay must be held to be guilty of working against public as well as company's interests.

Suppressing notices of meetings to some of the members is an act of oppression towards them. Casual omissions may not be, but systematic elimination of notices to some of the members is a serious deprivation of their most important right.[40]

Minor acts of mismanagement, however, are not to be regarded as oppression. As far as possible shareholders should try to resolve their differences by mutual readjustment. Moreover, the courts will not allow these special remedies to become a vexatious source of litigation. For example, in *Lalita Rajya Lakshmi* v *Indian Motor Co*:[41]

> The petitioner alleged that the board of directors were guilty of certain acts detrimental to the minority of the shareholders. The allegations were that the income of the company was deliberately shown less by excessive expenditure; that passengers travelling without ticket on the company's buses were not checked; that petrol consumption was not properly checked; that second hand buses of the company have been disposed of at low cost, that dividends were being declared at too low a figure. It was held that even if each of these allegations were proved to the satisfaction of the court, there would have been no oppression.

The court further observed that "to attempt to get a majority by lawful means is not a fact or circumstance which justifies winding up of the company. If any authority is needed for that proposition, one need only refer to the Privy Council decision in *Ripon Press & Sugar Mills Co Ltd* v *Gopal Chetty*[42], where LORD BLANESBURGH made this significant observation: "The fact that Venkata Rao had a preponderating voice in the company by reason of his owning or controlling a large number of shares was of itself no reason for winding up of the company."[43] An unreasonable refusal to accept a transfer or transmission of shares has been held sufficient to warrant an order under the section.[44] Refusal

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40 *Shantidevi Pratap Singh Gaekwad* v *Sangram Singh P. Gaekwad*, [1996] 1 Comp LJ 72 Guj; *Farhat Sheikh* v *Esemen Metalo Chemicals (P) Ltd*, (1996) 87 Comp Cas 290 CLB; (1995) 16 Corpt LA 147 CLB; *Farhat Sheikh* v *Detinners P Ltd*, (1996) 87 Comp Cas 290 CLB.

41 AIR 1962 Cal 127; (1962) 32 Comp Cas 207.

42 58 IA 416; AIR 1932 PC 1.

43 *See* also, for example, *Bellador Silk Ltd, Re*, [1965] 1 All ER 667; [1965] 2 Comp LJ 30 where it was held that the petitioner was not entitled to relief under S. 210 of the English Companies Act, 1948 (corresponding to S. 397 of the Indian Act), because the presentation of the petition in order to bring pressure to bear to achieve a collateral purpose was an abuse of the process of the court and on the facts the contributories had no tangible interest in a liquidation, with the consequence that a contributory would not be entitled to a winding up order on the just and equitable ground, and, thus S. 210(2)*(b)* [Ss. 459-461 of the Act of 1985] was inapplicable.

44 *Gajarabai* v *Patni Transport (P) Ltd*, [1965] 2 Comp LJ 234. *See* also the decision of the Calcutta High Court in *Satish Chandra* v *Bengal Laxmi Cotton Mills Ltd*, [1965] 1 Comp LJ 45, where MITRA J observed: "The fact that the directors are accused of an offence or that investigation is being made or even if there was a conviction on a criminal complaint would be no ground for taking action under Ss. 397 and 398. Those matters are entirely foreign to company law and administration and beyond the ambit of the jurisdiction the Company Court exercises.... In the instant case there is no deadlock, the application is not one for winding up,

to allot shares under a rights issue to a particular shareholder in order to prevent him from becoming qualified to file a petition was held to be oppressive.[45] The removal of a director who had been there in the company for 20 years and denying him access to the company's premises just only to prevent him from having access to the company's records was held to be an oppressive conduct.[46] Shareholders' resolutions cannot be the subject of judicial review but their timings and the conduct of the majority in passing them can be taken into account for deciding whether the conduct of affairs is in an oppressive manner.[47]

"There must be an unfair abuse of the powers and impairment of confidence in the probity with which the company's affairs are being conducted as distinguished from mere resentment on the part of a minority at being outvoted on some issue of domestic policy." "It is not lack of confidence between the shareholders *per se* that brings the section into play... oppression involves at least an element of lack of probity or fair dealing to member in the matter of his proprietary right as a shareholder. Persons concerned with the management of the company's affairs must in connection therewith be guilty of fraud, misfeasance or misconduct towards the members. It does not include mere domestic disputes between directors and members or lack of confidence between one section of members and another section in the matter of policy or administration. Much less it covers mere private animosity between members and directors."[48] This statement has been cited with approval in *Kalinga Tubes*

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nor is the company a private company. It is a public company in which outsiders hold a substantial block of shares and so the principle, that lack of confidence among the directors in a private company resulting in a deadlock is a ground for a winding up order on the just and equitable ground, cannot be applied herein where the special discretionary jurisdiction of the Court (now CLB) under Ss. 397 and 398 has been invoked."

Another important decision is *Rights and Issues Investment Trust Ltd* v *Stylo Shoes Ltd*, [1964] 3 All ER 628: [1965] 1 Comp LJ 234, where PENNYCUICK J observed: "... as there was no principle of law that prevented the members of a company from altering the voting rights attached to shares provided that the alteration was sanctioned by the members in accordance with the constitution of the company, in good faith and for the benefit of the company as a whole, the Court would not grant interlocutory injunction sought." This was a petition under S. 210 of the [English] Companies Act, 1948 (now Ss. 459-461 of the Act of 1985).

See also *New Standard Coal Co (P) Ltd, Re*, [1964] 2 Comp LJ 184, Cal; *Lundie Bros, Re*, [1966] 1 Comp LJ 30: [1965] 2 All ER 692; *Mehta Bros (P) Ltd* v *Calcutta Landing & Shipping Co*, (1970) 40 Comp Cas 119 Cal, a catalogue of vague charges. The shifting of the registered office of a company from Calcutta to Hyderabad at the instance of A. P. State Financial Corpn was not an oppression. The company had its factory in A. P. *Pramod Kumar Mittal* v *Southern Steel Ltd*, (1980) 50 Comp Cas 555 Cal. *K.G. Raghavan* v *Foreword Advertising and Marketing P Ltd*, (2002) 111 Comp Cas 784 CLB, default in holding meetings and filing accounts, not acts of oppression, relief available under other sections.

45 *Shri Ramdas Motor Transport Ltd* v *Karedla Suryanarayana*, (2002) 110 Comp Cas 193 AP.

46 *Ibid.* Majority approval of such conduct is not a justification. Those in control can be directed to furnish information to which the shareholders have a legitimate right.

47 *Ibid.* Fabricated resolutions would be oppressive and contrary to public interest. *Pushpa Katoch* v *Manu Maharani Hotels Ltd*, (2002) 110 Comp Cas 584 CLB, preferential allotment without general body approval of the public company, oppression.

48 See *Kalinga Tubes Ltd* v *Shanti Prasad Jain*, [1964] 1 Comp LJ 117, where this statement of law has been cited by MISRA J of the Orissa High Court, at 146-147 from *Scottish Coop Wholesale Society* v *Meyer*, 1959 AC 324: [1958] 3 All ER 66 and *H. R. Harmer Ltd, Re*, [1958] 3 All ER 689: [1959] 1 WLR 62; *Devaraj Dhanram* v *Firebricks and Potteries P Ltd*, (1991) 4 Kant LJ 148, allegations bald, not proved: mere lack of confidence. *Desein P Ltd* v

Ltd v *Shanti Prasad Jain*,[49] where MISRA J of the Orissa High Court dismissed a petition under the section and his decision was affirmed by the Supreme Court in *Shanti Prasad Jain* v *Kalinga Tubes Ltd*.[50]

> A private company consisted of three groups of shareholders, the petitioner and the two respondents holding shares in equal proportion and with equal representation on the board. They had agreed in writing to maintain this equilibrium. But no such agreement was incorporated in the articles of the company. Subsequently, in order to obtain certain loan facilities, the company was converted into a public company and it was proposed to issue 39,000 more shares. Ordinarily, according to Section 81 such new shares should have been offered to the existing shareholders. But the majority of the shareholders consisting of the two respondents' groups passed a resolution to offer these shares to outsiders, which was accordingly done. The petitioner contended that the allottees were friends of the majority group and the allotment had been made purposely to them with the mala fide intention to increase their voting strength and to squeeze out the petitioner.

This, he contended, was oppression within the meaning of Section 397. He relied upon an observation in *Piercy* v *S. Mills and Co Ltd*,[51] to the effect that "if shares were issued to the public with the immediate object of controlling the greater number of shares in the company and of obtaining the necessary statutory majority for passing a special resolution, then it will not be a valid *bona fide* exercise of the powers."[52] The question, therefore, was whether the resolution offering the shares to the outsiders was passed in good faith for the benefit of the company or merely to capture an absolute majority and to squeeze out the petitioner.

BARMAN J held that this conduct of the majority amounted to an act of oppression of the minority. But, on appeal, his judgment was reversed. MISRA J of the Orissa High Court who delivered the leading judgment, was of the opinion that "the private agreement between the parties to maintain the equilibrium was not binding on the company". "The fact that the affairs of the company were managed with holding of shares in equal proportion amongst the

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Elecktrim India Ltd, (2003) 116 Comp Cas 341 (CLB), no proof was there of diversion of funds, not even when a new company was formed.

49 [1964] 1 Comp LJ 117.

50 [1965] 1 Comp LJ 193; AIR 1965 SC 1535; (1965) 35 Comp Cas 351. *See* also *V. M. Rao* v *Rajeshwari Balkrishan*, [1986] 1 Comp LJ 1 Mad.

51 [1920] 1 Ch 77.

52 *See* also *Hogg* v *Cramphorn Ltd*, [1966] 3 All ER 420; [1967] Ch 254; noted (1967) 30 Mod LR 77 and *Bamford* v *Bamford*, [1969] 2 WLR 1107; [1969] 1 All ER 969; [1970] Ch 212 and further still *Clemens* v *Clemens Bros Ltd*, [1976] 2 All ER 268 Ch D. Increasing majority to 95% by changing articles was held to be oppression in the circumstances, *Akbarali* v *Konkan Chemicals (P) Ltd*, (1977) 88 Comp Cas 245 CLB. The act and policy of materially reducing the voting strength of the petitioners by making a new issue and allotting it to the controlling family was held to be an oppressive conduct; the company was in no need of further capital, *Farhat Sheikh* v *Esemen Metalo Chemicals (P) Ltd*, (1996) 87 Comp Cas 290 CLB; (1995) 16 Corpt LA 147 CLB; *Farhat Sheikh* v *Detinners (P) Ltd*, (1996) 87 Comp Cas 290 CLB.

three groups for a period of four years by itself cannot create a right in favour of the petitioner that it must continue in the same manner even when the company becomes public. To compel the majority shareholders, in these circumstances, to offer the new shares only to the existing shareholders would, far from being an oppression of the minority, amount to depriving the majority of a right conferred upon them by Section 81 entitling them to direct free issue of shares. It would also not be compatible with dynamic concept of industrial expansion. For instance, the expansion scheme would require large capital in crores and any one of the groups may not be in a position to subscribe its proportionate shares as any one or both or residual groups can do. The balance is bound to be disturbed and equilibrium lost even if the affairs of the company would be conducted wholly *bona fide*."[53] The issue of rights shares has become a well known technique for manipulating internal positions. When rights shares are issued simply for manipulative purposes, they can rightly be described, as has been done by a commentator, as "Wrongful Issues."[54] The courts have not been able to come to the rescue of the affected shareholder because they are often not able to isolate the manipulative intention from the ostensibly declared purpose of the "*bona fide* interest of the company". It has, therefore, been suggested that:

> The question which arises is sometimes not a question of the interests of the company at all, but a question of what is fair as between different classes of shareholders. Where such a case arises some other test than that of interests of the company must be applied.[55]

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53 At 134. S. 81 was amended in 1960. Now to exclude the right of pre-emption of the existing shareholders, a special resolution is necessary and if only an ordinary resolution has been passed, prior approval of the Central Government must be obtained.

For a criticism of this decision *see* P. S. Sangal, *Abuse of Authority by a Majority of Shareholders in a Company*, Journal of the Indian Law Institute, Vol 10, (1964) 381 at 394-409. Also *see*, B. H. Macpherson, *Oppression of Minority Shareholders, Part I: Common Law Relief*, 36 Australian Law Journal 404, *Part II: Statuory Relief*, at 427; K.S.N. Murthy, *Minority Protection under Company Law*, [1964] 1 Comp LJ 113 (Journal Section); series of three lectures by Professor Louis Loss on "*The Protection of Investors*", delivered at the University of Witwaterstand, Johannesburg and published in (1963) LXXX South African Law Journal. They are entitled: *The Role of the Government*, 53; *The Role of the Accountant and The Role of the Courts*, 372; M. B. Rao: *Oppression of Minorities and Mismanagement*, [1965] 2 Comp LJ 43 (Journal Section); S. R. Chowdhary: *Freezeout Problems in Corporation Law*, CURRENT PROBLEMS OF CORPORATE LAW, MANAGEMENT AND PRACTICE, Indian Law Institute, (1964) 273.

54 Susan J Burridge, *Wrongful Rights Issues*, (1981) 44 Mod LR 40. Where the capital of a private company was increased without any explanation whatsoever and also in violation of articles, the court agreed with the petitioner that the purpose was to increase numerical strength and to reduce the petitioner to minority and the court ordered the most appropriate relief of requiring the new issue to be offered to existing shareholders. *Rashmi Seth* v *Chemon (India) (P) Ltd*, [1992] 3 Comp LJ 89 CLB; (1995) 82 Comp Cas 563. *Ashok V. Doshi* v *Doshi Time Industries P Ltd*, (2001) 104 Comp Cas 306 CLB. Non-allotment of agreed shares to the petitioner in the joint venture company in the nature of a quasi-partnership in which the petitioner had made an equal contribution, amounted to oppression.

55 See *ibid*, citing LATHAM CJ in *Mills* v *Mills*, 60 Com LR 150, 164. Asking members to buy more shares is not oppression in itself, unless there was some oblique motive, *Jacques Taru Lalvani* v *JBA Printing Inks Ltd*, (1997) 88 Comp Cas 759 Bom and then offering new shares to others on the members' failure to take them is also not oppression in itself. *Shantidevi Pratap Singh Gaekwad* v *Sangram Singh P. Gaekwad*, [1996] 1 Comp LJ 72 Guj. Offering new allotment to promoters at less premium and charging more premium from other members

The Supreme Court has suggested a way out by providing compensation to the injured shareholder. The case before the court was *Needle Industries Ltd* v *Needle Industries Newey (India) Holding Ltd.*[56]

> The articles of a private company contained a clause that when the directors decided to increase the capital of the company by the issue of new shares the same should be offered to the shareholders proportionately and, if they failed to take, they may be offered to others in such manner as may be most beneficial to the company. The company was a wholly owned subsidiary of an English company. Government of India adopted a policy of diluting foreign holdings. The company accordingly issued new shares to its employees and relatives reducing the foreign holding to sixty per cent. When Section 43-A came into operation, the company became a deemed public company because more than 25% of its share capital was held by a body corporate. The company, however, chose to remain a private company for all other purposes. The leader of the Indian 40% holding was the chief executive and the managing director of the company. The company was further required to reduce its foreign holding to 40%. At this stage the English and Indian blocks developed a difference. The English block wanted that the 20% reduction of their holding should be allotted to one of the Indian companies in which they had substantial interest. A meeting of the company's board of directors, on the contrary, adopted the policy of issuing new rights shares to the existing members, which the English company would not be able to subscribe and thereby its holding would be reduced to 40%. Under the resolution 16 days' time had to be given to the members to take their proportion. The letter offering its proportion to the holding company was sent only 4 days before the last date and it received the letter after the date for exercising the option had already expired. Similarly, the notice of the meeting of directors for completing the allotment was sent to them with so short a gap of time that they received it in England only on the day on which the meeting was being held in India. Neither was it able to exercise the option of buying its block of rights shares nor was it able to attend the crucial meeting of the board. Its block of shares was allotted to Indian shareholders.

The holding company complained of oppression on these facts. But the court was not convinced that there was any such thing as a continuous policy of oppression. The ultimate purpose of the scheme was Indianisation to the extent of 60%. This could be achieved either by buying the excess holding of the English company or by increasing the Indian shareholding. The latter course

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was not allowed to be questioned by those who participated in the process and took their proportion, *N. Jagan* v *Investment Trust of India Ltd*, (1996) 85 Comp Cas 75 Mad. All issues must be attended to, validity of rights issue and if certain investments were involved here, *Kaushiklal Parikh* v *Mafatlal Industries Ltd*, (1995) 17 Corpt LA 102 Guj; *Shrihari Rao* v *Gopal Automotive Ltd*, (1998) 30 Corpt LA 373 CLB, directors to decide on corporate needs of more capital and also matters of dividend distribution.

56 (1981) 3 SCC 333: (1981) 51 Comp Cas 743: AIR 1981 SC 1298: *Vijay M. Shah* v *Flex Industries Ltd*, (1996) 61 Delhi LT 378, matters of mismanagement in rights issue should be questioned under Ss. 397, 398.

was adopted in the interests of the company as it would make available to the company extra capital. The fact that proper notice was not given, no doubt, deprived the English company of its opportunity of participating in the rights issue. But the facts were such that even if proper notice was given, the English company could neither have subscribed for its proportion nor renounced it to anyone else. There was no right in the company's articles in favour of any member enabling him to renounce his rights shares in favour of others. In the case of a private company there simply cannot be the right of renouncing rights shares in favour of nominees because that would make it impossible for the company to restrict the number of members. The real loss suffered by the holding company was the loss in terms of the market value of the shares which fell to its share. The market value of the shares was much higher than their nominal value. The allotment was at nominal value. The loss of the holding company was the "unjust enrichment" of those whom the block of rights shares was allotted which, but for the policy restriction, belonged to that company. The Supreme Court accordingly held that the Indian allottees of those shares must compensate the holding company to the extent to which the market value was in excess of the nominal value.[57]

Dealing with the argument that the illegal nature of the board meeting should itself be an indication of the repressive policy, CHANDRACHUD CJ said:[58]

> The question sometimes arises as to whether an action in contravention of law is *per se* oppressive. It is said, as was done by one of us, BHAGWATI J in a decision of the Gujarat High Court[59] that "a resolution passed by the

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57 Increasing capital without any need may amount to an oppressive technique. Where this was so, the Company Law Board ordered the appointment of an interim administration in supersession of the board of directors. *R. N. Jalan* v *Deccan Enterprises (P) Ltd*, (1992) 75 Comp Cas 417 AP; *Rashmi Seth* v *Chemon (India) (P) Ltd*, [1992] 3 Comp LJ 89 CLB: (1995) 82 Comp Cas 563, rights issue allotted in violation of the company's articles, set aside. *Rashmi Seth* v *Tillsoil Farms (P) Ltd*, [1992] 3 Comp LJ 126 CLB: (1995) 82 Comp Cas 409 CLB, increasing majority by fabrication, set aside. Where the company was in genuine need of more capital and the requirements of S. 81 for excluding present shareholders were also satisfied, a complaint by the petitioning shareholder that his holding was thereby diminished was held to be not sustainable. *Standard Industries Ltd* v *Mafatlal Services Ltd*, [1992] 2 Comp LJ 113 CLB. Three warring members of a company were brothers, nobody was prepared to sell out, one of them made further issue of capital allotting the whole to himself thus increasing his majority, the CLB said that such an act is oppressive but because all of them were interlocked in a civil suit where the same issues were involved, it would not intervene. *Binod Kumar Agarwal* v *Ringtong Tea Co Ltd*, (1995) 16 Corpt LA 128 CLB. *Shankar Sundaram* v *Amalgamated Ltd*, (2002) 111 Comp Cas 252 (Mad), orders can be passed against a subsidiary company though the petition was only against the holding company.

58 (1981) 3 SCC 333 at 367. The mere illegality of an act is not by itself an act of oppression. *Allianz Securities Ltd* v *Regal Industries Ltd*, (2000) 25 SCL 349 CLB. A conduct in breach of the principles of company law is not itself causative of unfair prejudice, *Anderson* v *Hogg*, [2000] SLT 634 Scotland.

59 *Sheth Mohan Lal Ganpatram* v *Sayaji Jubilee Cotton & Jute Mills Ltd*, (1964) 34 Comp Cas 777: AIR 1965 Guj 96: (1964) 5 Guj LR 804. Followed in *Kaushiklal Parikh* v *Mafatlal Industries Ltd*, (1995) 17 Corpt LA 102 Guj where a civil suit was allowed to test the validity of a board resolution though it was oppressive to shareholders for which special jurisdiction of CLB is prescribed. *Jayanthi R. Padukone* v *ICDS Ltd*, AIR 1994 Kant 354, right of

directors may be perfectly legal and yet oppressive, and conversely a resolution which is in contravention of the law may be in the interests of the shareholders and the company."

Two English cases, namely, *Five Minute Car Wash Service Ltd, Re*,[60] and *Jermyn Street Turkish Baths Ltd, Re*,[61] have further narrowed down the scope of relief under the section. *Five Minute Car Wash, Re*, the catalogue of charges was: (1) valid debts had not been paid, highly questionable debts had been paid; (2) the company failed to carry out its undertakings with petrol suppliers forcing them to refuse supplies to the company; (3) inefficient staff was being maintained; and (4) car washing machinery was ordered without testing. The court conceded that these charges showed that the majority shareholder was "unwise, inefficient and careless in the performance of his duties",[62] but these things did not establish that he was oppressive towards any particular members. In the *Turkish Baths* case the story was like this:

> A private company consisted of only two shareholders holding equal shares. One of them transferred his shares to one Mrs *P* and the other died. The condition of the company was precarious. But Mrs *P* brought back the company on its feet through further investments for which some shares and a debenture were allotted to her. The personal representatives of the deceased shareholder alleged oppression on the following grounds: (1) allotment of shares was a breach of duty; (2) directors' remuneration was fixed by the board and not by the shareholders as provided in the company's article; (3) notice of meetings was not given to the representatives; (4) excessive remuneration was paid to Mrs *P*; and (5) no dividends were ever declared.

Theoretically these charges showed serious irregularities, but the court could not have ignored the practical side of Mrs *P*'s successes. Commenting on the case D. Prentice observes:

> Mrs *P* had nursed the company from bankruptcy to comfortable profitability, she had devoted all her time to its affairs, and she had loaned capital to it at a time when the estate of *L* (the deceased shareholder) refused to do so. *L*'s representatives also enjoyed the benefits of her efforts as the market value of their shares was thereby increased.[63]

Where in the case of a private company the understanding was that parity of shareholding was to be maintained, it was held that the attempt of one group to take over the company by increasing its shares would entitle the affected

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shareholders to approach a civil court for the purpose of removing the chairman of the company cannot be taken away by the fact that the matter also involves things in the nature of oppression and mismanagement for which there is special jurisdiction.

60 [1966] 1 WLR 745: [1966] 1 All ER 242.

61 [1971] 3 All ER 184 CA.

62 *See* BUCKLEY J's judgment at 752. For criticism *see* H. Rajak, *Oppression of Minority Shareholders*, (1972) 35 Mod LR 156.

63 D. Prentice, *Protection of Minority Shareholders: S. 210 of the Companies Act, 1948*, (1952) CURRENT LEGAL PROBLEMS, 124 at 143.

members to proceed under the section as also under Section 433 for a winding up order.[64]

Existence of alternative relief

Where there were allegations of violation of foreign exchange regulations and improper accounting, the alternative relief of appointing inspectors under Section 209-A was provided.[65] In this case there was the further allegation that auditors were not appointed at the general meeting. No relief was allowed under these sections because this was a matter to be brought to the notice of the Central Government which alone could take care of it. The complaining shareholders-directors had not raised any objection at the meeting itself and the same auditors were reappointed at a subsequent meeting.[66] It was further held in this case that the orders of investigation are not generally passed under these sections particularly when it is the matter of a closely held company.[67] Another matter which was directed to be referred to the Central Government was that of appointment of managing director in another company which had to be passed at a meeting of the Board was dealt with by a resolution passed by circulation.[68] An objection of over-drawing of remuneration by the managing director which should have been raised at the meeting itself was not so raised. No relief was allowed on this point under this jurisdiction.[69]

Oppression of Majority

It should not, however, be supposed that these special remedies against oppression or mismanagement are available only to minorities. "In an appropriate case, if the court is satisfied about the acts of oppression or mismanagement, relief can be granted even if the application is made by a majority, who have been rendered completely ineffective by the wrongful acts of a minority group." A petition is not liable to be struck out as showing no

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64 *Bhaskar Stoneware Pipes (P) Ltd* v *R. N. Bhaskar*, (1988) 63 Comp Cas 184 Del; *Rajender Nath Bhaskar* v *Bhaskar Stoneware Pipes (P) Ltd*, [1990] 1 Comp LJ 351: (1990) 68 Comp Cas 256 Del; followed in *Margaret T. Desor* v *World Wide Agencies (P) Ltd*, (1989) 66 Comp Cas 5 Del, on appeal to Supreme Court *World Wide Agencies (P) Ltd* v *Margaret*, (1990) 1 SCC 536: 1990 SCC (Tax) 171: (1990) 67 Comp Cas 807 SC: AIR 1990 SC 737: [1990] 1 Comp LJ 208. An attempt to appoint one more director in the case of a private company without fulfilling the requirements of the company's articles which prescribed a special resolution was held to be oppressive of the minority shareholder, *V. B. Balasundaram* v *New Theatre Carnatic Talkies (P) Ltd*, (1993) 77 Comp Cas 324 Mad; *Farhat Sheikh* v *Esemen Metalo Chemicals (P) Ltd*, (1996) 87 Comp Cas 290 CLB, inadequate notice of shareholders' meeting; *Allianz Securities Ltd* v *Regal Industries Ltd*, (2000) 37 CLA 250, importune notice of Board meeting when a director was abroad. *Dipak G. Mehta* v *Anupar Chemicals (India) Ltd*, (1999) 98 Comp Cas 575 CLB, further issue and allotment of shares for the benefit of a group of shareholders, held oppression. *Praful M. Patel* v *Wonderworld Electrodes P Ltd*, (2003) 115 Comp Cas 377 CLB, issues of further capital exclusively to the minority, oppressive, filing of winding up petition not a bar to a petition under S. 397. *Kshounish Chowdhury* v *Kero Rajendra Monolithics Ltd*, (2002) 110 Comp Cas 441 CLB, another case of manipulated increase of shareholding to the disadvantage of the minority group.

65. *Desein P Ltd* v *Electrim India Ltd*, (2003) 116 Comp Cas 341 (CLB).
66. *Ibid.*
67. *Ibid.*
68. *Ibid.*
69. *Ibid.*

reasonable cause of action just only because it is filed by a majority shareholder.[70] Accordingly, a relief under the section was allowed to a majority group by MITRA J of the Calcutta High Court in *Sindri Iron Foundry (P) Ltd, Re.*[71] The learned judge observed that "if the court finds that the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, that two 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 to the hands of unauthorised persons who have taken wrongful possession and who claim to be the shareholders and directors, there is no reason why the court should not make appropriate orders to put an end to such matters."

The same fact-situation was presented before a bench of the Calcutta High Court in *Ramashankar Prasad* v *Sindri Iron Foundry (P) Ltd.*[72] Referring to the argument that the right to apply under Section 397 or 398 must be confined to cases where the complaint is by a minority against the majority and not *vice versa*, MITTER J said:

> "Section 399 is a code by itself as to the qualification necessary for application under Sections 399 and 398. I see no reason for holding that Section 399 was only aimed at finding the lower limit of qualification of any shareholder or group of shareholders complaining of oppression and mismanagement. If the Legislature has fixed a lower limit but no upper limit and if the object of the section be to prevent mischief, I see no reason why an upper limit should be implied so as to bring the section in line with the English section.[73] If the section is of a remedial nature, its proper construction should be to give the words their widest amplitude."

Referring to the argument that the majority could always call a meeting and put things in order by passing resolutions, the learned Judge said:

> "The facts in this case show very clearly, that there is no chance of redress in the domestic forum of the company. If a board meeting was to be called, one group would contend that there were five directors, whereas the other group would urge that there were seven. If a meeting of the

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70 *Baltic Real Estate Ltd (No 1), Re*, (1993) BCLC 498 Ch D; *Baltic Real Estate Ltd (No 2), Re*, (1993) BCLC 503 Ch D, the court adding that things like removing a director from office, which can be set right by using majority power, should better be accomplished at that level.

71 (1963) 69 CWN 118. *See* further, *Sebastian* v *City Hospital (P) Ltd*, (1985) 57 Comp Cas 453 Ker; *Laxmi Film Lab & Studio (P) Ltd*, (1984) 56 Comp Cas 110 Guj.

72 [1966] 1 Comp LJ 310.

73 S. 210 of the (English) Companies Act, 1948, appears under the heading *Minorities*, but the word "minority" is nowhere mentioned in the text of the section. Professor Gower's opinion, as expressly adopted in some cases, is that "the draftsman has rightly recognised that oppression may be exercised by those in control even though they lack in majority holding and that the section affords protection in such cases". PRINCIPLES OF MODERN COMPANY LAW, 599 (3rd Edn 1969). The relevant fn cites the following authorities: *Associated Tool Industries Ltd, Re*, [1964] ALR 73 at 82 (Australia); *Benjamin* v *Elysium Investments (P) Ltd*, [1960] 3 SA 467 (South Africa); *H. R. Harmer Ltd, Re*, [1959] 1 WLR 62: [1958] 3 All ER 689. It was, therefore, futile to have argued on the basis of the heading of the English section that relief was intended to be confined to minorities. Now Ss. 459-461 of the (English) Act of 1985 use the expression "unfair prejudice".

shareholders was to be convened, according to one group there would be only sixteen shareholders, while according to the other the number would exceed twenty-five.... There would be complete chaos and confusion....[74]"

Even where the whole number of members is suffering, relief may be allowed to the complaining member because some members may suffer more than others may do. Where the complaint was on the basis of an unfairly low dividend and though all members may suffer alike, the court said that the word "interests" is a wider term than "rights" and that the members of a company may have varying interests though their right might be the same. A course of conduct may affect all the members equally and all may be prejudiced, yet some of them only may be prejudiced unfairly. Low dividends may cause extraordinary prejudice to some members only.[75]

In exceptional cases legitimate expectations might arise on the part of the petitioner outside the terms of formal agreements entered into between the parties.[76] An agreement to conduct the affairs of the company in a particular manner may be outside the articles. It will support a petition if the agreement is broken by those conducting the affairs of the company.[77]

Even where majority shareholders are suffering at the hands of the minority, the Courts are usually very reluctant in ordering the majority to sell out to the minority. Such an order may be passed only exceptionally.[78] Generally, the minority shareholders will be required to sell to the majority.[79]

"Oppression qua Members"

The complaining member must show that he is suffering from oppression in his capacity as member and not in any other capacity. For example, in *Lundie Bros, Re*,[80] a minority shareholder of a private company was removed from his

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74 *See* also *Albert David Ltd, Re*, (1964) 68 CWN 163 where it was observed that "it is against the principles of company law that the minority should carry on the management without any election as provided in the Act and the majority of the shareholders should be kept out of the management". *Combust Technic (P) Ltd, Re*, [1993] 1 Comp LJ 61 Cal, though it is unusual to ask the majority to sell itself to the minority, a petition by the majority is maintainable. *See* the contrary observation of the Delhi High Court in *Suresh Kumar Sanghi* v *Supreme Motors Ltd*, (1983) 54 Comp Cas 235 Del.

75 *Abbey Leisure Ltd, Re*, 1989 BCLC 619 Ch D, not following *A Company, Re, (No 00370 of 1987* [1988] 1 WLR 1068, where an amendment was not allowed to add the fact of low dividends to the petition. *Ashoka Betelnut Co (P) Ltd* v *Chandrakanth (MK)*, (1997) 88 Comp Cas 274 Mad: (1997) 25 Corpt LA 146 Mad, continuous losses and therefore no dividends, minority's dissatisfaction, unsubstantiated allegations of financial propriety, further issue of shares for business needs and no ulterior motive, no relief under S. 397.

76 *A Company, (002015 of 1996), Re*, (1997) 2 BCLC 61.

77 *Anderson* v *Hogg*, [2000] SLT 634 (Scotland).

78 *Deepak Lohia* v *Kamrup Developers P Ltd*, (2003) 116 Comp Cas 188 (CLB), a private memorandum of agreement not enshrined in the company's articles not taken to be binding but could provide some help in moulding relief, manipulations had become irretrievably deep to be cured and, therefore, directions were issued for purchase of shares of majority group by minority group.

79 *Mahabir Pd Jalan* v *Bajrang Pd Jalan*, [1999] 2 Comp LJ 71 Cal.

80 [1966] 1 Comp LJ 30: [1965] 2 All ER 692. *Jaladhar Chakraborty* v *Power Tools & Appliances Co Ltd*, (1994) 79 Comp Cas 505, low dividend which did not affect the value of the petitioner's shares, neither oppression nor mismanagement.

position as a working director. As an ordinary shareholder he would have gained nothing as the company had never paid any dividend, directors' remuneration being the only return on investment. Yet he could not complain of it because he had suffered as a director and not as a member. This result has been criticised as being unrealistic.[81] Directorship is one of the privileges of membership. Any deprivation of this privilege is a kind of oppression as member.[82]

Removing a member from directorship is often a symbol of breakdown of relation of which the only possible solution is that one faction should move out of the company and the other should pay it out. It will then be a question not so much of deprivation from directorship or from any other place of profit as of which faction should move out and what shall be the procedure of valuation.[83] A member, however, will not be permitted to take advantage of his own misconduct first in inducing breakdown and then of forcing the other to buy him out.[84] The member who has lost directorship and, therefore, control to the extent that he has to seek the help of law, the legal choice would be to ask him to take his satisfaction and move out. A minority member cannot be given the privilege of driving out the majority shareholder.[85] The only question will be that of regulating the valuation of shares.

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81 *See* D. Prentice, *Protection of Minority Shareholders, S. 210 of the Companies Act*, 1948, (1972) CURRENT LEGAL PROBLEMS 124, 131-132. *A Company Re; ex p Schwarcz (No 2)*, 1989 BCLC 427 Ch D, where the total strength of the minority (father and son) shareholders was only 5.5%, refusal of directorship was held to be not unfairly prejudicial because they had no vested right to be directors.

82 *Quinlan* v *Essex Hinge Co Ltd*, (1996) 2 BCLC 47 Ch D, a shareholder-cum-director was summarily dismissed from production directorship without any justification. The majority shareholder was ordered to purchase his shares without any discount because of the minority shareholding. In the context of a small private company, the expectations of shareholders are not necessarily confined to the constitution of the company. *Kilpest (P) Ltd* v *Shekhar Mehra*, (1996) 10 SCC 696; (1996) 87 Comp Cas 615 and *Vijay Krishna Jaidka* v *Jaidka Motor Co Ltd*, (1996) 23 Corpt LA 289 CLB, partnership principles become applicable, breakdown of confidence and deadlock may make out a case for relief. See further, *Karedla Suryanarayana* v *R. M. Transport Ltd*, (1999) 98 Comp Cas 518 CLB, selection of dealers for the company's products cannot be a cause of complaint in itself unless favouritism could be shown due to other factors, which were not proved here.

83 An apprehension on the part of a director that his distributorship of the company's products was likely to be terminated was held to be not a matter coming within the special jurisdiction for prevention of oppression. Even otherwise the court cannot interfere in the matter of appointment and termination of distributorship. *M. L. Thukral* v *Krone Communications Ltd*, (1996) 86 Comp Cas 648 Kant.

84 *A Company, Re, (No 004475 of 1982)*, 1983 Ch 178; *A Company, Re, (No 007623 of 1984)*, 1986 BCLC 362; *A Company, Re, (No 004377 of 1986)*, [1987] 1 WLR 102. For a view of recent trends on the subject, *see* D. W. Fox, *Compulsory Purchase of Shares in a Private Company Some Recent Developments*, 1987 JBL 276.

85 *A Company, Re, (No 006834 of 1988)*, (1988) 5 BCLC 218. *Synchron Machine Tools (P) Ltd* v *U. M. Suresh Rao*, (1994) 79 Comp Cas 868, outster from directorship, the court directed majority to buy out minority. *Farhat Sheikh* v *Esemen Metalo Chemicals (P) Ltd*, (1996) 87 Comp Cas 290 CLB; (1995) 16 Corpt LA 147 CLB, direction to buy out minority shareholders at a price to be determined by accountant.

The questions of rights and interests of members as members can be made the subject-matter of a proceeding under the section and not matters arising out of commercial relations of a member with the company.[86]

Oppression in conduct of affairs

The legitimate expectations with which a person joins a company as a member and denial of which may amount to oppression must relate to the affairs of the company. The expectation that shares would be allowed to be transferred in breach of agreement or articles has not been held to be a legitimate expectation. The compulsion that shares must be transferred within the framework of the articles is not an oppression.[87] Where the objects of the company were defeated by a highhanded majority by shifting from construction and hoteling to film making the court said that it was an act straight against the expectations of the shareholders in joining the company. It amounted to oppression. The court ordered the majority group to buy out the minority at a value which was fixed by the court by reference to the cost inflation index issued by the Central Government for computation of capital gains.[88]

Facts must justify winding up

The facts alleged in the petition must justify a winding up order under the "just and equitable" clause of Section 433.[89] The petitioner cannot seek the relief of an order of winding up in the same petition.[90] A need for an order of winding up can arise when there is a deadlock on account of more or less equal share-holding or when there is lack of probity or no hope or possibility of smooth and efficient running. Where there is not so, no remedy under Section

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86 *Anil Gupta* v *Mirai Auto Industries P Ltd*, (2003) 113 Comp Cas 63 CLB, the subject-matter of the dispute was the termination of the petitioners sole selling agency.

87 *Leeds United Holdings Plc, Re*, (1996) 2 BCLC 545 Ch D.

88 *C. N. Shetty* v *Hillock Hotel (P) Ltd*, (1996) 87 Comp Cas 1 AP. *D.K. Chatterji* v *Rapti Supertonics P Ltd*, (2003) 114 Comp Cas 265 CLB, payment shown in the account books to a proprietary concern whose business was taken over by the company was held to be not a siphoning of funds. In this case, the lenders were not able to prove that they had asked the company for converting their loans into equity. There could be no finding of oppression on that ground. *C.N. Shetty* v *Hillock Hotels Ltd*, (2001) 104 Comp Cas 722 (AP), raising capital through allotment of shares excluding an equal shareholder and that too for an *ultra vires* purpose, oppressive.

89 *Hanuman Prasad Bagri* v *Bagress Cereals P Ltd*, AIR 2001 SC 1416, the petitioner must make out a case of winding up on just and equitable ground. The High Court's view that the termination of directorship of the petitioner was not such a ground was upheld. Misappropriation of funds by directors may not permit the extreme remedy of winding up and so no relief under the category of oppression or mismanagement. *Palghat Exports P Ltd* v *T. V. Chandran*, (1994) 79 Comp Cas 213 Ker. The Supreme Court has emphasised that normally the winding up of the concerned company should not be ordered in the exercise of these powers. *Kilpest P Ltd* v *Shekhar Mehra*, (1996) 10 SCC 696: (1996) 87 Comp Cas 615. *Senthil Kumar* v *Sudha Mills P Ltd*, (1996) AIHC 5230 Mad, consideration of a winding up petition should be deferred till petition under Ss. 397-398 pending before CLB; but it is not a bar to winding up proceedings. *A. K. Puri* v *Devi Dass, Gopal Kishan Ltd*, (1995) 17 Corpt LA 1 J&K.

90 *D.K. Chatterji* v *Rapti Supertonics P Ltd*, (2003) 114 Comp Cas 265 CLB.

397 would be available. Events subsequent to the petition cannot be taken into account for this purpose.[91]

This link with desirability of winding up may prevent relief in some deserving cases. This is so because winding up on the "just and equitable" ground itself is beset with many technical requirements. For example, in *Bellador Silk Ltd, Re*,[92] the petition failed because the petitioner could not prove that there would be sufficient assets left with the company for distribution among shareholders after paying off the creditors.[93] The difficulty of obtaining a winding up order is shown by cases like *Westbourne Galleries Ltd, Re*,[94] where a director of a private company which was very much like an incorporated partnership, was deprived by the majority of his directorship, thus making his existence in the company quite useless for him and even so the court finding it to be not just and equitable to wind up the company. The decision was, however, reversed by the House of Lords.

Unfair prejudice

The requirement that facts must justify winding up on the just and equitable ground had made the remedy "virtually useless in practice".[95] Accordingly, the requirement was dropped in 1980 and the amendment has been maintained through the Act of 1985. "The key concept is now 'unfair prejudice'. This expression has never caused practitioners or the courts any difficulty. 'Prejudice' denotes detriment of some kind, but because it must qualify as 'unfair' it must be a form of detriment which would strike a man of business as unjust and inequitable. The role of the non-controlling shareholder is that of an investor. No doubt the 'prejudice' will usually take the form of a diminution in the value of the petitioner's shareholding. A scenario which is clearly actionable under Section 459 [of the English Companies Act] though no devaluation of the petitioner's shareholding occurs is a history of unjustifiably low dividends without commercial reason.[96]

Deprivation of shareholders' legitimate expectations was regarded as unfair prejudice in *Saul D Harrison & Sons plc Re*.[97] The Court said that it would usually be considered unjust, inequitable or unfair for a majority to use their voting power to exclude a member from participation in the management without giving him an opportunity to remove his capital upon reasonable terms. The House of Lords in *O'Neill* v *Philips*[98] have laid this restriction upon the scope of the words "legitimate expectation" that this expression cannot be given

91 *Ashoka Betelnut Co P Ltd* v *Chandrakanth (M K)*. (1997) 88 Comp Cas 274 Mad.

92 [1965] 1 All ER 667: [1965] 2 Comp LJ 30.

93 A situation of this kind is not likely to arise in India as S. 439(3) has dispensed with this requirement. The English Companies Act, 1985, has also dropped the requirement of desirability of winding up.

94 [1971] 1 All ER 56 CA

95 *See* Ralph Instone, *Unfair Prejudice: An Interim Report*, 1988 JBL 20.

96 *Ibid* at 21-22 citing *R. A. Noble (Clothing) Ltd*, 1983 BCLC 273, 290-291 and *Bovey Hotel Ventures Ltd, Re*, 1981, cited *ibid.*

97 (1995) 1 BCLC 14 at 19.

98 [1999] 2 All ER 961: (1999) 97 Comp Cas 807: [1999] 1 WLR 1092.

the status of an independent rule. Such expectations must be founded somewhere. An unfounded expectation cannot support the plea of unfair prejudice. The only foundation which is possible is that there should be something in the articles or promises outside the articles to support the expectation. In this case the allegations were that the majority shareholder terminated the agreement for equal profit-sharing with the minority shareholder and also the agreement for allotment of more shares to the latter. The petition was not allowed because the majority shareholder had not given any such commitments. Their Lordships attached considerable importance to the fact that he had offered to purchase shares at a fair value.

It was held in the case of a quasi-partnership company that the summary removal of a director and his removal as an employee without any cause and with no offer to purchase his shares was an unfair prejudice to his position. The court ordered the purchase of his shares at a price to be calculated on the basis of the company as a going concern and multiple of earnings.[1] The removal of a director in the exercise of majority power and also passing of a resolution authorising excess remuneration and rights issue were held to be unfairly prejudicial to the minority shareholder because he was being virtually forced to leave the company. The majority shareholder was ordered to buy him out at a fair value.[2]

Oppression of continuing nature

The facts alleged must reveal an oppression of a continuing nature. Isolated acts of oppression will not do. This is apparent from the words of the section itself which says that the affairs of the company must be conducted in an oppressive "manner". This requirement would also prevent cognizance of past oppressive behaviour. For example, in *Raghunath Swarup Mathur* v *Har Swarup Mathur*,[3] M.H. BEG J observed that "whatever may have been the position in the past, the company was carrying on a profitable business, and, even if some bungling had taken place in the keeping of accounts in the past, it may not justify a winding up order where the company is a sound profit-making concern". Past acts are relevant if they constitute a continuing whole with the present facts or if the single past act complained of is capable of unleashing a continuing oppression.[4] Events subsequent to the date of the

1 *Pakinson* v. *Eurofinance Group Ltd.* [2000] All ER (D) 826.

2 *Regional Airports Ltd, Re*, (1999) 2 BCLC 30 Ch D. *S. Ranganathan* v *Shyamala Pictures & Hotels P Ltd*, (2002) 108 Comp Cas 880 (CLB), where shareholding was never equal between members, a complaint was not entertained because of unequal shareholding. *Neelu Kohli* v *Nikhil Rubber P Ltd*, (2002) 108 Comp Cas 422 (CLB), converting a majority shareholder into a minority in a manner which is not necessary for mobilisation of funds for the company was held to be oppressive.

3 (1970) 40 Comp Cas 282 All; *Palghat Exports (P) Ltd* v *T. V. Chandaran*, (1994) 79 Comp Cas 213 Ker, past acts which had ceased to exist, petition rejected.

4 *Surinder Singh Bindra* v *Hindustan Fastners Ltd*, [1989] 2 Comp LJ 216: AIR 1990 Del 32: (1990) 69 Comp Cas 718 Del.

petition are also not to be taken into account.[5] The mere fact of business losses does not by itself show either oppression or mismanagement.[6] The fact of low rate of dividend even when were high profits can be taken into account even if it is a subsequent event and has been brought on record by an amendment of the pleadings.[7]

A single act of issuing additional capital can have a continuing effect and was held to be capable of constituting oppression. There can be no time bar for seeking relief in such cases. The issue had the effect of converting in the family company the majority into minority. Though the petitioning group had a knowledge of the fact, directions were issued to the effect that control be handed over to them.[8]

Fairness of petitioner's conduct

There should be fairness in the conduct of the petitioner. There can be factors which would disentitle him though the others might be in the wrong. Accordingly where a reasonable offer is made to him before the petition is heard, the court will restrain further proceedings so as to maintain the status quo between the parties.[9] The majority had offered a fair price for purchasing the complaining members' shares. Similarly, where the articles of the company prescribe a fair procedure of valuation to enable the aggrieved minority to move out, the court may not entertain a petition unless a fair trial is given to that procedure.[10]

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5 *Ashoka Betelnut Co (P) Ltd* v *Chandrakanth (MK)*, (1997) 80 Comp Cas 274 Mad: (1997) 25 Corpt LA 146 Mad.

6 *Ibid*,

7 *Jer Rulton Ravasmaneck* v *Gharda Chemicals Ltd*, [2000] 2 Bom LR 56 Bom.

8 *Ashok Kumar Oswal* v *Panchsheel Textile Mfg & Trading Co P Ltd*, (2002) 110 Comp Cas 800 CLB. In a subsequent litigation between the same parties, *Ashok Kumar Oswal* v *Panchsheel Textile Mfg & Trading Co P Ltd*, (2002) 110 Comp Cas 825 CLB, order issued earlier was not modified because the party seeking modification had knowledge of the fact but suppressed it.

9 *Abbey Leisure Ltd, Re*, (1989) BCLC 619 Ch D. Where the minority shareholders who were complaining were given the offer to purchase shares of the majority and it was on their failure only that the shares were sold to outsiders which was not a violation of articles and hence there was no occasion for complaint. *Devaraj Dhanram* v *Firebricks & Potteries (P) Ltd*, (1994) 79 Comp Cas 722 Kant. Where an 85 year old minority shareholder, who had not taken any interest in the company for the last four years, was offered fair price by the majority to be worked out by an accountant and a solicitor, his conduct in continuing the petition with the prayer that he should be permitted to buy out the majority was held to be unfair, *A Company (No 00836 of 1995) Re*, (1996) 2 BCLC 192 Ch D. *See* also on this point *Yashovardhan Saboo* v *Groz Beekeri Saboo Ltd*, (1995) 83 Comp Cas 371 CLB and *Brenfield Squash Racquets Club Ltd, Re*, (1996) 2 BCLC 184 Ch D, where the majority controllers mixed up the affairs of two group companies and became indebted to one of them. They being not able to pay their debt had to sell their shares under the articles to other members. Thus the minority group became entitled to buy their shares. As a general rule the court would be ready to strike out a petition where it amounted to a serious abuse such as where there is some improper purpose behind it. The same applies where the respondent suffers prejudice by reason of the abuse. *A Company (No 002015 of 1996), Re*, (1997) 2 BCLC 1 Ch D.

10 *A Company, Re, ex p Kremer*, 1989 BCLC 365 Ch D. A motivated petition to pressurise payment is liable to be rejected. *Palghat Exports (P) Ltd* v *T. V. Chandran*, (1994) 79 Comp Cas 213 Ker.

The following observation on the facts of case is worthy of being noted:

> In this case, we have the spectacle of two distinguished directors who had themselves been participants in various acts of mismanagement alleged figuring with injured innocence as complainants before the court. This circumstance itself to a large extent demolishes the bona fides of the allegations put forward.[11]

An 85 year old minority shareholder who had not taken any interest in the company for the last four years, was not allowed to claim that he should be permitted to buy out the majority, which majority had offered him a fair price. It was held that it was an abuse of the process of the court for him to continue with the petition. There was no effective way available to him to prevent unfair treatment except that he should take a fair value of the shares and that whatever risk factor was there in working out a fair value was minimised because an independent accountant with the assistance of a solicitor was arranged for the purpose of valuation.[12]

Where the minority group had control over the Board of directors, and using that power, started promoting the interests of a rival company, it was held that this showed lack of *bona fides* and, therefore, in a petition by the majority group, the latter were directed to buy out the minority group.[13]

Effect of arbitration clause

Where a dispute arose amongst members concerning the breach of an agreement between them and the agreement contained an *arbitration clause*, the CLB (now Tribunal) said that such disputes were to be referred to arbitration under S. 8 of he Arbitration and Conciliation Act.[14]

A party was not allowed to seek reference to arbitration where it had already filed a full-fledged reply to the petition.[15]

PREVENTION OF MISMANAGEMENT [S. 398]

Section 398 provides for relief in cases of mismanagement. For a petition under this section to succeed, it must be established that the affairs of the company are being conducted in a manner prejudicial to the interest of the company or public interest, or that, by reason of any change in the management or control of the company, it is likely that the affairs of the company will be conducted in that manner. If the Tribunal is so convinced, it may, with a view to bringing to an end

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11 *Joseph (KM)* v *Kuttanad Rubber Co Ltd*, (1984) 56 Comp Cas 284 Ker. Another case where the conduct of the petitioner being not fair disentitled him to relief is *Srikanta Datta* v *Sri Venkateswara Real Estates*, (1991) 72 Comp Cas 211 Kant. *Anugraha Jewellers Ltd* v *K.R.S. Mani*, (2002) 111 Comp Cas 501 Mad, the petitioner was himself a party to siphoning of funds, not allowed to claim relief. *Amalgamations Ltd* v *Shankar Sundaram*, (2002) 111 Comp Cas 280 Mad, the petitioner had acquiesced in decisions of which he was complaining, his motive was to exert pressure on company to give him a place of profit.

12 *A Company* (*No 00836 of 1995*), *Re*, (1996) 2 BCLC 192 Ch D. *K.N. Bhargava* v *Trackparts of India Ltd*, (2001) 104 Comp Cas 611 (CLB), both factions in management, both guilty of acts of oppression against each other, the company was ordered to be divided between them.

13 *Ultrafilter (India) P Ltd* v *Ultrafilter GmbH*, (2002) 112 Comp Cas 93 CLB.

14 *Pinaki Das Gupta* v *Madhyam Advertising P Ltd*, (2003) 114 Comp Cas 346 CLB.

15 *V L S Finance Ltd* v *Sumair Hotels Ltd*, (2002) 111 Comp Cas 403 CLB.

or preventing the matter complained of or apprehended, make such order as it thinks fit. A very clear illustration of mismanagement contemplated by the section is *Rajahmundry Electric Supply Corpn* v *A. Nageshwara Rao.*[16]

> A petition was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the Vice-Chairman grossly mismanaged the affairs of the company and had drawn considerable amounts for his personal purposes, that large amounts were owing to the Government for charges for supply of electricity, that machinery was in a state of disrepair, that the directorate had become greatly attenuated and "a powerful local junta was ruling the roost" and that the shareholders outside the group of the Chairman were powerless to set matters right. This was held to be sufficient evidence of mismanagement. The court accordingly appointed two administrators for the management of the company for a period of six months vesting in them all the powers of the directorate.

A similar management was provided to a company by the Calcutta High Court in *Richardson & Cruddas Ltd* v *Haridas Mundra.*[17]

There should be present and continuing mismanagement. The charges of mismanagement in the past, even if proved, are not enough to establish an existing injury to the interest of the company or public interest.[18] Where directors preferred objects of their liking and made a huge allotment of shares for a consideration other than cash, this was held to be a mismanagement of affairs.[19] Misuse and misapplication of the company's finances by three brothers out of four who were operating the company was held sufficient to invite an order of CLB for readjustment of accounts so as to prevent extraneous use of funds outside the company's business and the shareholders' agreement.[20]

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16 AIR 1956 SC 213: (1956) 26 Comp Cas 91

17 (1959) 29 Comp Cas 549 Cal. Where the group in power was conspiring to defraud members, mismanagement was held to be established. *Hemant D. Vakil* v *RDI Print and Publishing (P) Ltd*, [1993] 2 Comp LJ 113 CLB Del. Where there were only two directors in a private company and one was keeping the other totally in the dark about the affairs of the company, mismanagement was held to have been established. *V.G. Balasundram* v *New Theatre Carnatic Talkies (P) Ltd*, (1993) 77 Comp Cas 324 Mad. A State Government cannot take over the undertaking of a company on the ground that the company has been the victim of mismanagement. The provisions of the Companies Act are sufficient in themselves to remedy situations like that whether at the instance of the affected persons or State agencies, *K. R. Lakshmanan* v *State of TN*, (1996) 2 SCC 226: (1996) 86 Comp Cas 66 SC.

18 *R. S. Mathur* v *H. S. Mathur*, [1970] 1 Comp LJ 35 All. Losses by themselves cannot support a plea of mismanagement, or that the directors are still drawing their salary or that they have called upon the petitioner to pay Rs 80,000 being the amount unpaid on his shares. *Chennabasappa* v *Multiplast Industries*, (1985) 57 Comp Cas 541 Kant. Where a company had no records, registers etc. whatsoever, it was held to be a fit case for the appointment of an administrator. *Bhajirao* v *Bom Docking*, (1984) 56 Comp Cas 428 Bom; where the newly appointed directors had not even taken charge, the petition was dismissed because it was too early to say as to how they would conduct themselves. *Rai Saheb Vishwamitra* v *Amar Nath Mehrotra*, (1986) 59 Comp Cas 854 All.

19 *Akbarali* v *Konkan Chemicals Ltd*, (1997) 88 Comp Cas 245 CLB.

20 *Narain Das* v *Bristol Grill (P) Ltd*, (1997) 90 Comp Cas 79: [1997] 3 Comp LJ 32 CLB. The advances out of the company's funds made by the controller to his sister concerns were not regarded as mismanagement because of satisfactory explanation and no detriment to the

A probe into the affairs of a company for finding out the fact of mismanagement may include an inquiry into the company's subsidiaries.[21] Where a set of properly appointed directors were not permitted to join and function as directors, their complaint was taken to be indicative of a symptom of mismanagement and was accordingly entertained.[22]

"Relief against mismanagement runs in favour of the company and not to any particular member or members."[23] Secondly: "It is not necessary for the court to find cause for winding up in cases of mismanagement in order to grant relief." Proof of prejudice to the public interest or to the interests of the company is enough. Thirdly, the section enables the court to take into consideration outside interests affected by corporate operations. Thus, the Calcutta High Court refused to order the winding up of a grossly mismanaged company and appointed special officers to manage it because the company was engaged in special industries necessary for the implementation of the country's plans.[24] Under S. 397 the power is of discretionary nature which enables the Company Law Board to make an order as it thinks fit with a view to bringing to an end the matters complained of, as distinct from the power granted under S. 398 which enables the Company Law Board to pass an order with a view to bringing to an end or preventing the matter complained of or apprehended.[25]

Powers of National Company Law Tribunal [S. 402]

Powers of the Tribunal under Sections 397 and 398 are fairly wide.[26] "In fact, the Board may make any order for the regulation of the conduct of the company's affairs upon such terms and conditions as may, in the opinion of the Board, be just and equitable in all the circumstances of the case."[27] Apparently the only limitation seems to be the overall objective of the sections and, therefore, the order must be directed to bringing to an end the matters complained

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lending company. *Boiron* v *SBL Ltd*, (1998) 30 Corpt LA 21 CLB. Where the complaint was based on misappropriation of funds and property of the company and it could be taken care of under S. 543 by way of misfeasance proceedings, a separate petition under S. 398 was considered to be not necessary, *Sanjeev Kumar Bhardwaj* v *Ghanshyam Dass*, (1999) 34 CLA 370: (2001) 103 Comp Cas 447 Delhi.

21 *Life Insurance Corpn of India* v *Haridas Mundra*, (1966) 36 Comp Cases 371 All; *Bajrang Pd Jalan* v *Mahabir Pd Jalan*, AIR 1999 Cal 156.

22 *Ador Samia Ltd* v *Indocan Engg Systems Ltd*, (1999) 35 CLA 224 CLB.

23 *See* Mathew J. Kust, FOREIGN ENTERPRISE IN INDIA, 293 (1964).

24 *Richardson & Cruddas Ltd* v *Haridas Mundra*, (1959) 29 Comp Cas 549 Cal.

25 *Palghat Exports (P) Ltd* v *T. V. Chandran*, (1994) 79 Comp Cas 213 Ker. Where the warring group would not come to terms, the court may hand over management to workers under some arrangement for competent guidance, *Kripal Ispat Ltd* v *Dalip Singh Majithia*, (1992) 20 All LR 34 (Summary of Cases). *Thakur Savadekar & Co* v *S. S. Thakur*, (1996) 22 Corpt LA 170 Bom, proceedings before CLB are not to be stopped because of an appeal against dismissal of winding up petition.

26 The Company Law Board has to be satisfied that the conditions of relief exists presently and not in reference to some possible conduct in the future. *Peerless General Finance & Investment Co Ltd* v *Union of India*, [1989] 1 Comp LJ 56 Cal: (1991) 71 Comp Cas 300 Cal.

27 *See*, for example, *Lord Krishna Sugar Mills Ltd* v *Abnash Kaur*, (1974) 44 Comp Cas 210 Del, where the court, having constituted an interim board of management for a company, held that it had power under S. 402 to give directions and instructions from time to time so as to resolve the problems of the interim board. *See* also *Gokul Chand Morarka* v *Company Law Board*, (1974) 44 Comp Cas 173 Del.

of. The Tribunal can grant relief against a respondent who is no longer a member and such relief can possibly extend to requiring him to purchase the company's shares.[28] However, an attempt is made under Section 402 to define the powers of the Tribunal. This section provides that, without prejudice to the generality of the powers of the Tribunal, any order under Section 397 or 398 may provide for:

1. The regulation of the conduct of the company's affairs in future. Thus, for example, in *LIC* v *Haridas Mundra*,[29] the court appointed a special officer with an advisory board to the total exclusion of the shareholders of a company to function subject to the terms and conditions laid down in the order. In *Bennett, Coleman & Co* v *UOI*,[30] the Bombay High Court ordered a new article into the articles of association providing that all the shareholders' directors will retire every year and held that the clause was valid even if it was against the provisions of Section 255.[31]
2. The purchase of the shares or interest of any members of the company by other members or by the company. This kind of relief was provided in *Mohanlal* v *Punjab Co Ltd*,[32] and *H. R. Harmer Ltd. Re*,[33] and also in *Suresh Kumar Sanghi* v *Supreme Motors Ltd*,[34] where the group in

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28 *A Company, Re*, [1986] 2 All ER 253 Ch D.

29 63 CWN 439: AIR 1959 Cal 695: (1959) 29 Comp Cas 549.

30 (1977) 47 Comp Cas 92 Bom.

31 *See* also *Debi Jhora Tea Co Ltd* v *Barendra Krishna Bhowmick*, (1980) 50 Comp Cas 771, where the Calcutta High Court appointed a chairman to preside over the company's shareholders' as well as directors' meetings. *Combust Technic (P) Ltd, Re*, (1986) 60 Comp Cas 872 Cal where a special officer was appointed pending the constitution of a new board. The court may take over the management into its own hands or appoint a receiver or special officer to do so even if the directors who are in office enjoy majority support. *Pradip Kumar Sarkar* v *Luxmi Tea Co Ltd*, (1990) 67 Comp Cas 491 Cal. The power of removing a director can be exercised only when it is established that he acted in a fraudulent manner or used his fiduciary position to the detriment of the company or its shareholders or in a manner prejudicial to public interest. In this case the only alleged irregularity was letting out of the company's premises in a manner not permitted by the articles. But that had been going on for 20 years to the full knowledge of the shareholders and also to the advantage of the company. The CLB directed the matter to be referred to a meeting of the shareholders, *Arjun S. Kalra* v *Shree Madhu Industrial Estates Ltd*, [1997] 1 Comp LJ 318 CLB. In a situation of relentless oppression, the CLB reconstituted the Board of directors and directed it to hold meetings and allot shares to members from whom share money had been taken for further issue. *Shri Anupam Chemical India (P) Ltd* v *Dipak G. Mehta*, [1999] 4 Comp LJ 474 Bom.

32 AIR 1961 Punj 485. *P.K. Prathapan* v *Dale & Carrington Investments P Ltd*, (2003) 111 Comp Cas 425 Ker, setting aside of all capital issues made after the initial allotment and consequential rectification of the register of members.

33 [1959] 1 WLR 62: [1958] 3 All ER 689.

34 (1983) 54 Comp Cas 235 Del. *See* also *Surinder Singh Bindra* v *Hindustan Fastners (P) Ltd*, [1989] 2 Comp LJ 216: AIR 1990 Del 32: (1990) 69 Comp Cas 718 Del, where one group of shareholders was installed in power and directions were issued for taking over the shares of the other block. It is unusual to ask the majority to sell itself to the minority. Ordinarily, it would be the other way round. *Yashovardhan Saboo* v *Groz-Beckert Saboo Ltd*, [1993] 1 Comp LJ 20 CLB. Direction to one faction to buy out the other and on their failure to do so, order of winding up, *Nalam Satya Prasada Rao* v *V. L. N. Sastry*, (1991) 70 Comp Cas 303 AP.

actual control was given the opportunity to buy out the other at a value to be fixed by a judge.

3. In the case of a purchase by the company, of its shares the consequent reduction of its share capital.[35]
4. The termination, setting aside or modification of an agreement between the company and managing director, or any other director, the managing agent, the secretaries and treasurers and the manager.
5. The termination, setting aside or modification of any agreement with any person, provided due notice has been given to him and his consent obtained.
6. Setting aside of any fraudulent preferences made within three months before the date of the application.[36]
7. Any other matter for which, in the opinion of the court, it is just and equitable that provision should be made.[37]

In situations of irreconciliable disputes, the usual approach of the CLB has been to order the rival groups to part ways in the interests of the company and those of the public financial institutions having large stakes in it. The CLB can direct the partition of the assets of even a listed company and reducing the capital of the company to that extent.[38]

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35 *Vijay Krishna Jaidka* v *Jaidka Motor Co Ltd*, (1996) 23 Corpt LA 289 CLB, equitable in case of family funds gripping company.

36 Setting aside a transfer under this clause in *Roshan Lal Agarwal* v *Sheoram Bubna*, (1980) 50 Comp Cas 243 Pat, the Patna High Court held that there should be a net period of three months between the date of transfer and that of application. The court excluded the date of transfer in computing the period of three months.

37 *See* as an illustration, *Gajarabai* v *Patni Transport (P) Ltd*, [1965] 2 Comp LJ 234, a decision of the Andhra Pradesh High Court. The facts were that one of the directors died leaving behind a will bequeathing the shares in the company to his second wife and sons who were already the shareholders of the company and the petitioners. The directors on account of their private dispute with the petitioners, acted in a high-handed manner and unreasonably refused to transfer a part of the shares bequeathed under the will, while transferring some shares in favour of them as provided under the will. They made certain improper transfers also. The petitioners applied under Ss. 397 and 398 of the Companies Act for removal of one of the directors from the Board, and for the appointment of a committee of shareholders to manage the affairs of the company. But the court held that "proper order to make, in the circumstances, is to direct the directors to transfer the shares to the petitioners in accordance with the terms of the will". *See* also *Jhambu Kumar Raniwala* v *Edward Mill Co*, [1970] 2 Comp LJ 43, where directions were issued regulating the conduct of directors. *Shoe Specialities Ltd* v *Standard Distilleries and Breweries Ltd*, (1997) 90 Comp Cas 1 Mad, majority was reduced to minority, relief allowed. The CLB has power to exercise control over the implementation of its order. In *All India Shaw Wallace Employees Federation* v *Shaw Wallace & Co Ltd*, [1997] 1 Comp LJ 304 at 306, the directors of a company unanimously resolved to sell the company's undertaking because of financial crisis. Workers opposed it because of the seizure of the premises by Government agencies to investigate serious financial irregularities. The Company Law Board was approached for sanctioning sale. The CLB appointed two nominee directors to sit with others at a meeting for reviewing the proposal and to formulate specific recommendations. *M.M. Subramanyam* v *Gulf Olfines P Ltd*, (2003) 116 Comp Cas 115 (CLB), meeting not held, shares allotted discriminately, CLB (now Tribunal) ordered proportional allotment to aggrieved members and their induction back into the Board of directors. *Shri Ramdas Motor Transport Ltd* v *Karedla Suryanarayana*, (2002) 110 Camp Cas 193 AP, the power is wide enough to allow relief even when the fact of oppression is not made out.

38 *K. N. Bhargava* v *Trackparts of India Ltd*, (2000) 36 CLA 291 CLB.

If the Tribunal orders any alteration of the memorandum or articles of the company, the company shall not be at liberty to introduce any provision inconsistent with the order.[39] If the order sets aside or modifies any agreement with any managerial personnel, it will not give rise to any claim for damages or compensation for loss of office.[40] Further any managerial personnel whose appointment is so set aside shall not be capable of serving the company in any managerial capacity for a period of five years except with the leave of the Board.[41]

Under Section 406 misfeasance proceedings can also be commenced against guilty officers even though the company is not being wound up. The Gujarat High Court in *Colaba Land & Mills Co* v *J. Pilani*,[42] gave retrospective effect to the provision and allowed proceedings in respect of offences committed before these remedies were introduced by the Companies Act, 1956.

The powers under these provisions are not affected by the existence of an *arbitration clause*. The court may, however, in its discretion refer the matter to arbitration in terms of the parties' agreement and exercise any powers only thereafter.[43] The court cannot make any such direction in respect of matters which are outside the scope of the arbitration clause.[44] There are authorities to the effect that the Tribunal, being a judicial authority, is bound under Section 8 of the Arbitration and Conciliation Act, 1996 to direct the parties to go in for arbitration within the framework of the arbitration agreement.[45]

Where the shares of a private company were transferred and the method of valuation was under question, the court said that for the purpose of valuing the shares of a private company as a going concern when the company has high returns and little or no assets, the value of the company is the capitalised sum representing the future profits after making an allowance for risks.[46] The point emphasised was that the worth of the company as a whole must be calculated on the basis of the company as a going concern.[47] The "maintainable level of profits" plays a dominant role as a method of evaluation of the company's net worth. The asset base is another method of valuation. The methodology would vary with the features and nature of the company's business. Where two groups worked together for decades and then fell apart, it was held that each group was entitled to have the proportionate worth of the business.[48]

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39 S. 404(1). *See* also sub-sections. (2), (3) and (4).

40 S. 407(1)(*a*).

41 S. 407(1)(*b*). The prohibition applies to any person who becomes his associate [sub-section (1)]. *See* also sub-s. (3). S. 403 empowers the Board to make any interim order and S. 405 to implead persons who should have been impleaded.

42 (1971) 41 Comp Cas 1078 Guj.

43 *Gurvir Singh Gill* v *Saz International (P) Ltd*, (1987) 62 Comp Cas 197 Del.

44 *Khandwala Securities Ltd* v *Kuwa Spg Ltd*, (1999) 97 Comp Cas 632 CLB.

45 *Twentieth Century Finance Corpn Ltd* v *R. F. B. Latex Ltd*, (1999) 97 Comp Cas 636 CLB.

46 *Buckingham* v *Francis*, [1986] 2 All ER 738 QBD.

47 Again emphasised in *Bird Precision Bellows Ltd, Re*, (1984) 3 All ER 444 Ch D; [1985] 3 All ER 523 CA.

48 *Rakhra Sports (P) Ltd* v *Khraitilal Rakhra*, (1993) 76 Comp Cas 545 Kar.

The Company Law Board (now Tribunal) can itself do the valuation. In one such case the CLB took into account the financial position of the company and the petitioner's stake in it and fixed the value at which one should pay out the other and, if they failed to do so, the matter should be referred to the statutory auditors for appropriate valuation.[49]

The CLB (now Tribunal) can provide relief by prescribing a better method of a valuation where the articles of the company provide for an arbitrary or artificial method of valuation.[50] Where some stratagem has been attempted, for example, by delaying tactics for suppressing the value of shares, relief may be provided against it by taking valuation at a time before the suppressing tactics began.[51] Relief may also be provided where the valuer is a person who is not likely to be wholly independent.[52] Where the 40% holding of the complaining member was reduced by oppressing tactics to 4%, the court directed that valuation should be on the basis of 40% strength.[53]

The powers of Tribunal continue even after passing of an order till at least such time that its orders are implemented so as to put an end to the matters complained of. Regulation 44 of the CLB Regulations, 1991 is akin to Section 151 of CPC (now Regulations of Tribunal). It confers inherent powers on the CLB. The Board does not become *functus officio* after the passing of an order. Where a CLB order setting aside an allotment of shares by which an undeserved majority shareholding was created was stayed by the High Court and the stay order was subsequently vacated. Further necessary orders were passed for implementation of the original order.[54]

Compromise

The parties can enter into a compromise and consent orders can be passed on that basis. The compromise was held to be binding on the parties. When they picked up a dispute again over valuation of shares, they were not permitted to question the validity of the compromise by saying that the petition was not maintainable at its initial stage.[55]

Date of valuation

The court has discretion to fix the date of valuation which may not necessarily correspond with the date of the court order. It may correspond with the date of the petition.[56]

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49 *Solitaire Hotels (P) Ltd, Re*, [1992] 3 Comp LJ 119 CLB.

50 *A Company, Re, (No 004377 of 1986)*, [1987] 1 WLR 102. A similar approach was adopted in *Lloyd's Bank plc* v *Duker*, [1987] 1 WLR 1324. Here out of a total of 999 shares, 574 fell to the share of the executor of the deceased shareholder. The court ordered all the shares to be sold in the open market giving the executor the right to purchase any or all because that way the real value of the shares which carried the controlling power would be better ascertained.

51 *A Company, Re, (No 006834 of 1988)*, (1988) 5 BCC 218; *A Company, Re, (No 003843 of 1986)*, 1987 BCLC 562; *McGuiness* v *Bremner plc*, 1988 BCLC 673.

52 *Boxwell & Co (Steels) Ltd, Re*, (1988) 5 BCC 145.

53 *A Company, Harris, Re, ex p*, 1989 BCLC 383 Ch D.

54 *Shoe Specialities Ltd* v *Standard Distilleries and Breweries Ltd*, (1997) 90 Comp Cas 1 Mad.

55 *K. K. Framji* v *Consulting Engineering Services (India) Ltd*, (2002) 110 Comp Cas 482 CLB.

56 *Profinance Trust Ltd SA* v *Gladstone*, [2000] 2 BCLC 516 Ch D. The date of petition was

Central Government's power to appoint directors on Tribunal's order [S. 408]

The Central Government has the power to appoint such number of persons, known as Government directors, on the Board of directors of a company as the National Company Law Tribunal may direct. The National Company Law Tribunal can take up the matter for such direction on a reference by the Central Government[57], or on an application by not less than 100 members of the company or of those holding not less than 10% of the total voting power. The Board makes such inquiry as it deems fit in order to find out whether such appointment is necessary to prevent the affairs of the company being conducted in a manner which is oppressive to any members of the company or which is prejudicial to the company's or public interest. The Board has to indicate the period for which such an appointment may be made, but the same should not exceed three years on any one occasion.[58] Where the members of a housing company out of sheer frustration abandoned their company to its own fate, the Central Government approached the Tribunal. The latter ordered appointment by the Central Government of five directors whom two should be from among plot holders, who would carry further the business of the company.[59]

In lieu of such appointment, the Tribunal may order the company to amend its articles, by including Section 265 and to appoint fresh directors by proportional representation within such time as the Tribunal may specify. In the meantime the Board may ask the Central Government to put certain additional directors on the company's Board of directors. Any director so appointed shall not have to hold qualification shares, if any. Nor shall he be liable to retire by rotation. The Government may, however, remove or replace him. After such appointment any change in the Board of directors can only be made with the consent of the Tribunal.

The term of appointment may be extended after the expiry of the first term. It would be necessary for an extension to be valid that the original circumstances of oppression or mismanagement must subsist. For this purpose the company would have to be given an opportunity to explain its present position. If the

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ordered to be the date of valuation in this case.

57 It is not necessary for the exercise of this power that the Central Government should inform the company beforehand by a show-cause notice as to why a reference should not made. The Government should, however, have some cogent material before it at the time of the reference. *Skipper Construction Co (P) Ltd* v *Union of India*, [1992] 3 Comp LJ 160 Del following *Colgate Palmolive (India) Ltd* v *Union of India*, (1980) 50 Comp Cas 456 Del; *Urban Improvement Co (P) Ltd, Re*, (1995) 18 Corpt LA 10 CLB, directions to Government that in appointing directors due representation to be given to those members who were not able to make houses due to managerial non-functioning.

58 The Board has to be satisfied that the prejudicial circumstances are there presently and not in reference to some possible future conduct. *Peerless General Finance & Investment Co Ltd* v *Union of India*, [1989] 1 Comp LJ 56 Cal; (1991) 71 Comp Cas 300 Cal. The court also added that the power under the section is not available for regulating the financial schemes of the company and that the provisions of the section must be construed strictly. The powers under the section cannot be used to regulate the financial scheme of the company because that is the domain of the RBI.

59 *Urban Housing Development Co (P) Ltd, Re*, (1996) 85 Comp Cas 758 CLB; *Urban Improvement Co (P) Ltd*, (1996) 85 Comp Cas 758 CLB.

original circumstances have ceased to exist, the term of appointment should not be extended unless there is a clear possibility of recurrence if the appointment is not renewed.[60]

If this power is exercised in reference to any company, the Government will get the right to issue such directions to the company as it may consider necessary or appropriate in regard to its affairs.[61] The Government can also require the person appointed to report to the Government from time to time with regard to the affairs of the company.[62] Such directions may include an order to remove an auditor already appointed and to appoint another auditor in his place or to alter the articles of the company. Such removal, appointment or alteration shall have effect as if the relevant requirements of the Act have been complied with.

The Central Government can make an application under this section even when shareholders have petitioned for relief against oppression. The jurisdiction under one section does not become barred by an application under another section. The petitions can be heard analogously.[63]

Power to prevent change in Board of directors [Section 409]

Further, under Section 409, the Central Government has the power to prevent any proposed change in the board of directors or membership of the company, if it is likely to affect the company prejudicially. This power can be exercised on a complaint by the managing director, or any other director or manager of the company. The Tribunal can intervene only if the alleged prejudicial change in the composition of the Board of directors is an actual or likely result of a change in the character of the company's shareholding. This power cannot be used for preventing majority of shareholders from a management of their choice. Normal changes in the composition of the board of directors by a realignment among membership cannot constitute a ground for exercise of this power.[64] The Tribunal can restrain any resolution from taking effect whether passed or likely to be passed for a change in the Board of directors unless it is confirmed by the Tribunal. Interim orders can also be passed.

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60 *Vinod Kumar* v *Union of India*, (1982) 52 Comp Cas 211: (1981) Tax LR 2517 Delhi. Followed in *Shakti Trading Co Ltd* v *Union of India*, (1985) 57 Comp Cas 789 Del. Where 5 out of 9 directors were appointed to make sure that proceedings commenced against directors' malpractices were not frustrated.

61 S. 408(6).

62 S. 408(7). If the circumstances are made out, the choice of directors is with the Government. *Sakthi Trading Co (P) Ltd* v *Union of India*, (1985) 57 Comp Cas 789 Del. Such directors have the usual powers. Sale of a unit of the company, being not a sale of the undertaking, procedure of S. 293 was not necessary, *Pramod Kumar Mittal* v *Andhra Steel Corpn Ltd*, (1985) 58 Comp Cas 772 Cal. They do not automatically cease to function as such by efflux of time, *Union of India* v *S. C. Sugar Mills*, (1984) 55 Comp Cas 42 Bom.

63 *Manohar Rajaram Chhabria* v *Union of India*, (2002) 110 Comp Cas 162 Cal.

64 *B. Baba Chandersekhar* v *V.R. Textiles Ltd*, [1992] 2 Comp LJ 103 CLB. *P.H. Rao* v *Skycell Communication Ltd*, (2002) 110 Comp Cas 734 (CLB), 40.5 acquisition of shares which was not likely to affect the existing management. *Ashok Kumar Oswal* v *S.P. Oswal*, (2002) 110 Comp Cas 747 CLB, change of ownership in shares not in favour of an outsider but within the group in power. No interference necessary.

The section does not apply to a private company which is not the subsidiary of a public company.

Transfer of powers to Company Law Board

- By virtue of the amendment of 1988, the power of the court under Sections 397 and 398 for prevention of oppression and mismanagement; the powers of the court under Section 402 and that under Section 403 to pass interim orders, the power of approval of an alteration in articles or memorandum under Section 404 and that of the Central Government under Section 409 to prevent prejudicial changes in the composition of the board of directors, had been transferred to the Company Law Board.

Transfer of powers to Tribunal

The Company Law Board has been abolished by the Companies (Second Amendment) Act, 2002. A new Tribunal, called National Company Law Tribunal (Tribunal) has been constituted in its place. The jurisdiction for prevention of oppression and mismanagement has been vested in the Tribunal.
