E-Notes (Compiled)

on

Company Law-II

(No. 1)

(LL.B. 3yrs - ivth Semester)

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Prevention of Oppression and Mismanagement

Synopsis

Elaborate Analysis

Relevant Sections

-241 to 246 of the Companies Act, 2013 (Hereinafter referred as the new Act).

Brief Historical Background

- Prior to 1956, there was no statutory provision to combat oppression and mismanagement in the companies. At that time only judicial remedy was available under '**just and equitable clause**'.

- **For the first time**, on the basis of recommendations of the '**Bhabha Committee**', Sections **397 & 398** was **inserted in the Companies Act, 1956** to provide remedies through application to Company Law Board in cases of oppression and mismanagement in the affairs of the company.

- Prior to the enactment of the Companies Act, 2013, provisions relating to oppression and mismanagement were incorporated **in different sections** *i.e.,* under section **397 oppression** & under section **398 mismanagement**.

- **But**, under the new Companies Act, 2013, instead of separate provisions for both independently, a mixed provision under sections 241 to 246 has been provided in Chapter xvi titled PREVENTION OF OPPRESSION AND MISMANAGEMENT.

With a view **to check the abuse of powers in** the form of **oppression and mismanagement**, the Companies Act contains special provisions for prevention of such activities. The **aim of** such provisions contained in **sections 241 to 246** of the Act of 2013 **is to safeguard** the **interest of investors/members** as well as **to protect the public interest.**

- In cases of oppression and mismanagement, **the primary statutory remedy** in the hands of the **oppressed /sufferers of mismanagement** (investors, depositors and minority shareholders) is **to approach the Tribunal**.

The cause of action to move to the Tribunal may arise:

(A)- Whenever the affairs of the company have been or being conducted in a manner prejudicial to public interest or **in a manner oppressive** to any

member/members, an application can be made to the Tribunal under **sub-section (a) of section 241 (1)** of the Companies Act, 2013.

(B) – Where the **material change has taken place in the management or control of the company** which is not in the interest of any creditors, debenture holders or class of shareholders of the company, an application can be made to the Tribunal under **sub-clause (b) of the same section** on the grounds that.

- The **change may be** due to **an alteration** in the **Board of Directors**, or **manager**, or in the **ownership of the company's shares**, or if it **has no share capital**, in **its members**, or in any **other manner** whatsoever.

But, the applicant has reason to believe that due to such change the affairs of the company are likely to be conducted in a manner prejudicial to the interest of the company or its members or class of members.

Thus, a shareholder **aggrieved** by oppression and mismanagement **has two alternative remedies** to:

- apply to the Tribunal **under section 241** for relief against oppression or mismanagement; or
- apply for winding up on the grounds mentioned **under clause (g) of section271**, suggesting that would be proper that company be wound up.

In this context, Sections **241** (cause of action) & **242** (powers of Tribunal) **are intended to avoid winding up** of a company **if possible**, and **keep it going** on while at the same time **relieving** the minority shareholders **from acts of oppression and mismanagement** or **preventing** its affairs **from being conducted** in a manner prejudicial to public interests.

In fact, the reliefs under sections 241 & 242 are perhaps, **a better alternative** to the winding up.

Determination of Oppression /Mismanagement

- **No hard** and **fast** rule **can be laid down** as to what will amount to oppression/mismanagement. It **cannot be defined** but the same **depends upon the facts and circumstances** of each case.

- It shall have **to be dealt** with **as a whole** and **it is the duty of the Tribunal** (under the Act of 2013) **to see** for itself **as to whether** any oppression or mismanagement has committed/or being committed/or may take place.

Dealing with the issue as to how to ascertain or construe 'oppression' in a proceeding, the Calcutta High Court in *Bagri Cereals Pvt. Ltd*., v. *State*, (1998) has observed that:

- Incidentally it is to be noted that in a petition under the Act, **it is left to the Court to decide on the facts of each case** as to whether there exists any oppression **which calls for action**. There is statutory definition of what oppression is, but the fact remains it must be shown that the conduct is oppressive and the events shall have to be shown in such a manner **so as to evince** a consecutive **set of facts which would render the Court to come to a conclusion** that the company is being conducted in a manner oppressive to some members of the company.

- The **conduct** shall have **to be burdensome, harsh and wrongful**. It is now well settled principle of law that isolated act by itself may not support the inference that there was a *mala fide* intention or that the act can be termed to be as such oppressive or burdensome.

- It is further to be noted that a **mere lack of confidence would not** bring home the charge of harsh and wrongful act, **neither** can it **conclusively prove an oppression** of minority by the majority.

- There must be **an existing element of lack of probity or fair dealing** to a member in the matter of his rights as a shareholder.

Note – '**Prevention of Oppression'** has been **discussed in detail in class room lecture** before **Lockdown**.

PREVENTION OF MISMANAGEMENT

- Section 241 of the Act states the conditions under which an application to the Tribunal for relief in cases of mismanagement can be filed. Though, as per title of the section 241(Application to Tribunal for relief in cases of oppression, *etc*.,), the term 'mismanagement' has not been specifically mentioned. The drafting policy of the new Act does not clarify the legislative intent for omission /unknown reasons. It seems that the legislative enactment as consolidated under section 241 (1) (a) & (b) presumes that meaning of the term 'mismanagement' will be construed under relevant contexts.

Mismanagement

For conceptual clarity about the term mismanagement, we can take the help of some illustrative judicial pronouncements relating to mismanagement under the old Companies Act, 1956.

- A clear illustration of mismanagement can be found in the case of *Rajahmundry Electric Corporation* v. *A. Nageshwara Rao*, AIR 1956 SC 213.

- In this case, a petition was brought against the 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 this 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 **Board of Directors had become greatly attenuated** and a **powerful local public was ruling the 'roost'** and that the **shareholders** outside the group of Chairman **were powerless to set matters right.**

- **All these conditions/circumstances** were held to be sufficient evidence of **mismanagement** by the Supreme Court; and

- Accordingly, the Court appointed two administrators for the management of the company for a period of six months vesting in them all the powers of the Board of Directors.

- **Likewise**, in *Sindhri Iron Foundry (P.) Ltd., Re***,** (1964) 34 Comp. Cas. 510 (Cal.), the Calcutta High Court took the management of Company from the Board of Directors and ordered for the appointment of administrators.

- In the instant case, Mitra *J.*, further observed that **if the court finds that the company's interest is being seriously prejudiced by the activities of one or 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 into the hands of unauthorized persons who have taken wrongful possession and who claim to be shareholders and directors, that the bank accounts of the company have been practically frozen, **there is no reason why the court should not make appropriate orders to put an end to such matters.**

- **Similarly**, in *Richardson & Cruddas Ltd*., v. *Haridas Mundra*, AIR 1959 Cal. 695, where Directors preferred objects of their liking and made huge allotment of shares for a consideration other than cash, it was held to be a mismanagement of affairs.

- **As a relief**, the Calcutta High Court ordered for the composition of new Board of Directors consisting of the representatives of State Bank of India, Railway Board and representative of main creditors of the company replacing the Board of Directors appointed by the shareholders of the company.

- The another illustrative case of mismanagement is *Chander Krishan Gupta* v. *Pannalal Girdhari Lal (P.) Ltd*., (1984) 55 Comp. Cas. 702 (Delhi).

- The facts of this case were that for quite some time the company had been incurring losses. The directors of the company were carrying on other business. The disputes among the directors of the company had resulted in the records of the company not being available. The management of the company had miserably failed in protecting the company's records and this failure resulted in prejudice being caused to company.

- **Moreover**, the constant fight amongst the directors, who were also the shareholders of the company, had an adverse effect on the conduct of the company's business with the result that the company started incurring losses.

- It was held **as a fit case of mismanagement** and the court passed appropriate orders under section 398 of the Companies Act, 1956 (now can be passed under section 241 of the Companies Act, 2013).

Circumstances (which can be termed as Mismanagement) for obtaining relief of

Or

Circumstances under which an application for relief in cases of mismanagement can be made

- Section 241 of the Companies Act, 2013 provides for relief in cases of mismanagement.

- It can be invoked in either of the two circumstances; where -

(A) - the affairs of the company **have been** or **are being** conducted in a manner which is-

(i) prejudicial to **public interest**; or

(ii) prejudicial to the **interests of the company**.

Or

(B) - it is likely that the affairs of the company **will be conducted** in a manner-

(i) prejudicial to its **members** or **any class or members**; or

(ii) prejudicial to the **interests of the company**

Reason thereby that -

- due to a material change that has taken place in the **management or control** of the company.

Such change may take place due to alteration in the

- company's Board of Directors, or
- Manager, or
- ownership of its shares; or
- membership; or
- in any the manner whatsoever.
- **But**, such change **not being a change** brought about or in the interests of any creditors including debenture holders or any class of shareholders of the company.
- The Delhi High Court while observing the **nature of relief under old section 398** (new section 241) in the case of *Suresh Kumar Sanghi* v. *Supreme Motors Ltd*., (1988) 54 Comp. Cas. 235 (Delhi), has observed that-

- It can be obtained only if -

(i) the affairs of the company are being conducted in a manner prejudicial to public interest;

(ii) the affairs of the company are being conducted in a manner prejudicial to the interests of the company; and

(iii) there is a material change which has taken place in the management or control of the company in the manner set out in the said section; and

- **that by reason of such change** it is likely that **the affairs of the company will be conducted** in a manner prejudicial to public interest, or in a manner prejudicial to the interests of the company.

- It was also observed that **section 398** (present section 241) **comes into play** only when there is **actual mismanagement**, or **apprehension of mismanagement** of the affairs of the company.

- **Likewise**, prior to the decision of *Suresh Kumar Saughi's* case, the Allahabad High Court in the case of *Raghunath Swaroop Mathur* v. *Har Swaroop Mathur*, (1970) 40 C. cases All., has held that to get remedy under section 398 (now section 241) there must be instances of present mismanagement.

Similarly, in *Seth Mohan Lal Ganpat Ram* v. *Shri Shayaji Jubilee Cotton & Jute Mills Company*, (1964) Guj. H.C., honourable Justice Bhagwati has said that the object of sections 397 & 398 (now section 241 & 242) is to provide **preventive remedy** against the continuous wrongs being conducted in the affairs of the company.

Right to apply under section 241

Or

Who can apply for remedy under section 241

- This section provides that the **requisite number of members** (as provided in **section 244** of the Act of 2013) of a company **may apply to the Tribunal** for appropriate relief **on the grounds of mismanagement** of the company.

Section 244

- It provides that who can make application to the Tribunal or who can apply.
- To apply under this section a **minimum number** of members (**requisite number** of members) is required. In other words, the application under this section **must be signed** by the requisite number of members.
- The requisite number of members **varies** with the fact **as to whether the company has a share capital or not.**
- As per **section 244**, the following members of a company shall have the right to apply, namely-

(a) In case of a company having a share capital-

The application must be signed by:

(i) at least **one hundred (100)** members; or

(ii) at least one-tenth (**1/10)** of the **total number of its members**, whichever **is less**.

As an alternative to this requirement, an application may also be made any member or members holding not less than **one-tenth (1/10) of the issued share capital** of the company;

- **subject to condition** that the applicant or applicants **has or have paid all calls** and other sums **due** on his or their shares.

(b) In case of a company not having a share capital-

The application under this clause will be valid only **if it is signed by at least one-fifth (1/5)** of the **total number of members** of the company.

In case of joint holding of the shares, the joint holders will be **counted as one** and a member after taking consent of the requisite number of members may make the application on behalf of all of them.

- **Apart from these**, the Tribunal has the right to waive all or any of the requirements as aforesaid to enable the members to make the application under section 241.

Who cannot apply for relief under section 241

- The following **cannot apply** for relief **u/s 241**:

(a) a member or members whose **calls are in arrear**;

(b) a **holder of a letter of allotment** of a **partly paid share**;

(c) a holder of a **share warrant**;

(d) a **holder of** a **share certificate** to bearer;

(e) a **transferee of shares who has not lodged** the shares for transfer to the company; and

(f) **shareholders of a holding company** cannot file petition against a subsidiary of the holding company.

For example, in *Arvind Parasramka* v. *Calcutta Investment Co. Ltd*., **(2016)**76 taxmann.com292(Kolkata), where the petitioners were not members of respondent company but were only transferee of shares and transferor of shares had not authorized petitioners to file petition on date of presentation of petition.

- It was held that as petitioners were not members, they had no right to file and bring a petition.

Likewise, in *Yerramaneni Rama Krishna* v. *Peddi Venkata Koteswara Rao*, **(2016)**70 taxmann.com384(Chennai), it was held that where the petitioner has transferred his shares and ceased to be a share holder, the has no *locus standi* to file petition under section 241/242 of the companies Act, 2013.

Relief by the Tribunal

- On an application made under **section 241**, the Tribunal shall **frame its opinion** and may give relief **if is of the opinion** that -

(a) **the affairs of the company** are being conducted in a manner **prejudicial to the public interest** of in a manner prejudicial **to the interests of the company;**

(b) **by reason of a material change in the management or control** of the company, the affairs of the company **are likely to be conducted** in a manner **prejudicial to the public interest** or in a manner prejudicial **to the interests of the company.**

- **On the basis of analysis of reliefs under this section**, we find that the applicant **must prove** that the affairs of the company are being conducted/ likely to be conducted in a manner prejudicial to public interest/interest of the company.

There are the **two major aspects** on which the **relief rests**.

(i) Public Interest

- The concept of public interest **was** specifically **brought in by the Companies (Amendment) Act, 1963.** At that time, the idea was to enable the Court (now Tribunal) to pass an order on 'just and equitable' ground even on the basis of an application by one or two members of the company, **not holding the requisite number and value of shares**.

- The expression 'public interest' **is not** capable of **precise description**. It has been held to an **elusive abstraction** meaning thereby general **social welfare** or regard for **social good** and predicating **interest of the general public** in matters where a regard for the **social good is of the first moment**.

- In the words of **Frankfurter *J*.**, of the **United States Supreme Court**, the **public interest is a vague, impalpable**, but **all controlling consideration**.

- In *N. R. Murty* v. *Industrial Development Corporation of Orissa Ltd*., (1977)47Comp.Cas.389 (Ori.), it was held that **a thing is said to be in public interest** where **it is** or **can be** made to be **contributive to the general welfare** rather **than to the special privilege of a class**, group or individual.

- Our Supreme Court in *State of Bihar* v. *Kameshwar Singh*, AIR 1952 SC 252, has observed that the **expression public interest is not capable of a precise definition** and **has no rigid meaning** and is **elastic** and **takes its colours from the statute** in which it occurs, the concept varying with the **time and state of society and it needs**.

- **Thus**, what is public interest **today may not be** so considered **a decade later.** It **cannot be** considered **in value** but must be **decided on the facts and circumstances of each case.**

- In the case of a company intended **to operate in a modern welfare state**, the **concept of public interest** takes the **company outside the conventional sphere** of being a concern in which the shareholders alone are interested.

- It emphasizes the idea of the company functioning for the public good or general welfare of the community, at any rate, **not in a manner detrimental to the public good.**

'**Public Interest**' should **not be confused** with **public opinion**. In *G. Kasturi* v. *N. Murali*, (1992)74 Comp.Cas.611(Mad.), where non-publication of a news item (regarding **Bofors Issue**) in the newspaper **was held not** to be an act prejudicial to the public interest.

In this case, the Madras High Court observed that a decision regarding publication of a news item would be in public interest or not, cannot be said to affect or prejudice public interest.

Further, where the interest of the public **is in prejudice or not will be known only after publication but not before**.

- The Court felt that the expression '**interest**' in this context **must receive a meaning different from the interest of a reader of a news item**, who as the member of the public may have one or other opinion.

(ii) Prejudicial to the interests of the Company

- Like 'prejudicial to the public interest' no statutory meaning of the term 'prejudicial to the interests of the company' has been given under the Companies Act.

But, following **acts have been held as mismanagement** under section 398 of the Companies Act, 1956 by the Board (and **may also amount to mismanagement under new Act** by the Tribunal).

For example,

- Where, there is **serious infighting** between resulting in serious prejudice being caused to the company. (*Suresh Kumar Sanghi* v. *Supreme Motors Ltd*.,).
- Where **Board of Directors is not legal** and the illegality is being continued, it will amount to mismanagement and prejudicial to public interest. (*Sishu Ranjan Dutta* v. *Bholanath Paper House Ltd*.,).
- Gross **neglect of interests of the company** by sale of its only assets and **total inattention** thereafter to the affairs of the company. (*M. Moorthy* v. *Drivers and Conductors Bus Service (P.) Ltd*.,).
- Diversion of **public money for unknown/unwanted purposes** affecting grossly financial state of the company has been held an act of gross mismanagement. (*KRS Mani* v. *Anugraha Jewellers Ltd*.,).
- Where **bank accounts was operated by unauthorized persons**, advance of loans without execution of a document which is not repaid and even interest is not realized and where Directors **take no serious action to recover amounts** embezzled. (*Col. Kuldip Singh Dhillon* v. *Paragaon Utility Financiers (P.)Ltd*.,).
- Where, there is an instance of **sale of assets at low price** and without compliance with the Act. (*Malayalam Plantation (India) Ltd., Re,*).
- Where, there is a **collusive sale of assets** by landing institution. (*Mittal Dal Mills Ltd., Re,*).
- Where, there is **violation of statutory provision**s and those of Articles (*Akbarali A. Kalvert* v. *Konkan Chemicals(P.)Ltd*.,).
- Where, there is **erosion of** company's **substratum**. (*AIR Asiatic Ltd., Re,*).
- Where, there is **violation of the conditions of the company's memorandum** by those who are in charged company's management. (*S. M. Ramakrishna Rao* v. *Bangalore Race Club Ltd*.,).

- Where **false information to statutory authorities is provided**, anti-dating of notice for general meeting and related documents and manipulating the process of conversion of a public company into a private company, amounts to mismanagement. (*Suresh Kumar Rungta* v. *Roadco (I) Pvt., Ltd.,*).

These are **some illustrative instances of mismanagement** for conceptual clarity about mismanagement.

General Powers of the Tribunal in Cases of Mismanagement

- **Section 242 (1) (a) & (b)** of the Act **confers general powers** on the Tribunal to pass necessary orders to bring an end to the matters concerning mismanagement. If an application is made to the Tribunal in this regard, it **shall frame** its **opinion on two points**:

(a) that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company (**section 242 (1) (a)**); and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up (**section 242 (1) (b)**.

- If the Tribunal is of the opinion that the circumstances mentioned under **sub-clause (a) or (b) of section 242 (1) is satisfied**, the Tribunal may, **with a view to bringing an end** the matters complained of, **make such order** as **it thinks fit**.

Specific Powers of the Tribunal

Or

What type of orders can be passed by the Tribunal

- Section 242 (2) empowers the Tribunal to grant certain specific reliefs under clause (a) to (m). It says that without prejudice to the generality of the powers under sub-section (1) of section 242, an order under that sub-section may provide for:
- the regulation of the conduct of the company affairs in future under section 242 (2) (a);
- the purchase of shares or interests of any members of the company by other members thereof or by the company under section 242 (2) (b);
- reduction of share capital under section 242 (2) (c);
- restriction on transfer or allotment of shares under section 242 (2) (d);
- termination, setting aside or modification of any agreement between the company and the managing director/director/manager under section 242 (2) (e);
- termination, setting aside or modification of any agreement between the company and any third party under section 242 (2) (f);
- setting aside of any transfer, delivery of goods, payment, execution or other act relating to property under section 242 (2) (g);
- removal of managing director, manager or any of the directors of the company under section 242 (2) (h);
- recovery of undue gains made by any managing director, manager or director under section 242 (2) (i);
- manner of appointment of managing director or manager of the company under section 242 (2) (j);
- appointment of directors in the Board under section 242 (2) (k);
- imposition of costs as may be deemed fit by the Tribunal under section 242 (2) (l); and

- any other matter for which, in the opinion of Tribunal, it is just and equitable to grant relief under section 242 (2) (m).

Scope of Powers/Limitations under Section 241

- The powers under section 241 **are not subject to any limitation**. It means that the Tribunal may pass **necessary orders** to end mismanagement and in exercise of its discretionary powers may pass any order **which it thinks fit** to do.

- In this context, the Madras High Court in a significant judgement in the case of *Harikumar Rajah* v. *Sovereign Dairy Industries Ltd*., has held that where a company committed large number of irregularities including allotment of shares against illusory consideration, accounts not audited, AGM not convened, annual returns not filed and cases being registered against persons concerned in the company for failure to comply with provisions of Companies Act, it appears to be a straight forward case under sections 397/398 (now section 241).

- It was held that **not only the company was mismanaged**; certain actions of the company were prejudicial to the interests of the company and of the other shareholders.

- **Regarding the scope of powers**, it was further held that the scope of powers under this section is **not subject to any limitation** and **relief seeking members need not be sent elsewhere for getting the reliefs**.

- All pervasive power in these matters includes the **power to alter articles without following required procedure**.

- The Court, *inter alia*, ordered supersession of the Board of Directors, declared allotment of shares to two of the respondents illegal and appointed a 'Receiver' to convene and hold AGM without audited accounts. It also ordered composition of a new Board of Directors.

Similarly, in *KRS Mani* v. *Anugraha Jewellers Ltd*., **in likewise circumstances**, instead of passing an order of winding up of the company, the CLB (now Tribunal) held that on the basis of facts and circumstances, it is not justified to wind up the company **but revamping of the management is necessary** and accordingly it **ordered supersession of the Board** and appointment of 'Administrator'.

- **Apart from this**, in the case of *Muthusamy* v. S. Balasubramanian, (2012), it was also held that the powers under this section are **administrative in nature** and it can exercise that powers *suo motu*.

- It was also held that **strict rules of pleading and proof as required in Civil Courts are not applicable** to proceedings before CLB (now Tribunal).

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