THE CONCEPT OF MAJORITY RULE AND THE NEED FOR PREVENTION OF OPPRESSION AND MISMANAGEMENT UNDER COMPANY LAW: A COMPARATIVE STUDY

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ABSTRACT

The adoption of the new economic policy which is based on the concept of Liberalisation, Privatisation and Globalisation has led to the emergence of many companies in India. In the modern economy, the companies play an important role in shaping the economy of the nation and thus proper laws are required to solve any kind of internal or external disputes that might arise as a result of conflict between the members of the company. This article describes how the judiciary through its decisions and legislature through its enactments has prevented the majority shareholders from abusing their authority and restrained the minority shareholders from becoming an obstacle to the smooth governance of a company and thus tried to establish a balance between the majority shareholders and minority shareholders of the company to ensure the welfare of the company and the society. The rule of majority has been adopted by almost all the democratic nations of the world which states the principle of non-interference of courts in the matters of the company as long as the actions of the members of the company are based on corporate democracy and are taken in accordance with the law. However, the adoption of majority rule creates a significant difficult for the company in protecting the interests of its minority shareholders against the majority shareholders which creates a negative effect on the operations and management of the company. In response to the oppression of minority shareholders as a result mismanagement of the company by the majority shareholders, the court of law evolved exceptions to the majority rule which consequently became known as the concept of Prevention of Oppression and Management. The judicial decisions of the court of law as well as the provisions of the Company Act, 2013 has tried to establish a balance between the interests of the majority shareholders and minority shareholders to ensure the smooth functioning of the companies.

Key words: Rule of Majority, Non-interference of court, Minority Shareholders, Majority shareholders, Corporate democracy, Oppression and Mismanagement, Company Act, 2013

1. INTRODUCTION

Under Company Law, the concept of Prevention of Oppression and Mismanagement is an exception to the concept of Majority Rule. It should be noted that the phrases "oppression" and "mismanagement" are not defined under the Companies Act. As a result, the general meaning of both phrases must be evaluated. The term "oppression"[1] refers to an apparent divergence from fair dealing norms and a violation of the fair play criteria on which every shareholder who entrusts his money to a corporation is allowed to rely.[2] Whereas mismanagement means that the company's affairs are being conducted in a manner detrimental to the public interest or detrimental to the company's interests.[3] The majority rule, on the other hand, provides that the rule of majority shall prevail if the decision of the majority members of the company is within the boundaries of the company legislations.

It is a well-established legal principle that the rule of majority shall apply if the decision of the majority members of the company is within the limits of the company legislations. Majority authority is extremely important in the operation of a corporation, and "Courts will no longer routinely intervene at the request of the shareholder in concerns of internal management." As a result, the general public of the participants has magnificent authority to exercise the powers of the organisation and generally to govern its activities and minority owners must surrender to most people's choice. This, however, raises the possibility that the individuals with the majority vote will be oppressive to the minority shareholders by abusing their dominant power. To address this issue, the Companies Act of 2013 created a solution in the form of several clauses to address the issues commonly encountered by minority shareholders.

2. ORIGIN

2.1. Origin of Majority Rule

The evolution of the majority rule principle in common law was developed in the case of *Foss v. Harbottle*[4], in which a suit was instituted by two shareholders of the company on behalf of all the other shareholders against the company's directors and solicitor, alleging that they had caused loss to the company's property through concerted and illegal transactions. The directors were accused of engaging in major fraudulent and illegal transactions, and the plaintiff

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[1] Volume 7, 4th Edition, Halsbury's Laws of England, 1011 (LexisNexis, 2015)
[2] Elder v Elder & Watson. Ltd., (1952) Scottish Cases 49.
[3] *In re Albert* David Ltd., [1964] 68 *CWN* 163.
[4] Foss v. Harbottle, [1843] 2 Hare 461.

requested that the defendant be ordered to make good on the losses.[5] The primary issue before the Hon'ble Court of Law was the suit's maintainability.

The Hon'ble Court refused to intervene in the company's internal management and ruled that minority shareholders may not bring an action against the wrongful act committed by the majority owners.

The majority rule was expanded upon in the case of case of *Edwards v. Halliwell*[6], the Hon'ble Court held that when a wrong is alleged to have been done against a company, the proper plaintiff in an action shall be the company itself; and when such alleged wrong is a transaction which might be binding on the company or all its shareholders by the special majority of the members, no individual shareholder of the company is allowed to maintain an action in respect of such matter. In general, the courts will not intervene at the request of shareholders in matters relating to internal administration and management of the company by the directors as long as they are working within the scope of the company's articles.[7]

Thus, it is clear that the rule of majority is based on two major legal presumptions: first, the court will not intervene in internal irregularities if they can be ratified or condoned by the company's internal process; and second, if the alleged wrong is done against the company, the plaintiff is usually the company itself.[8]

2.2. Origin of Concept of Prevention of Oppression and Management

The operation of any company of any size in terms of issued shares is based on the broad rule of corporate democracy, which states that the company makes decisions on its various affairs based on the rule of majority voting, in one form or another, with votes cast by its shareholders to approve or disapprove of a particular course of action. However, it is possible that the majority's decisions are harmful to the company or the public interest, or are harmful or oppressive to any of its members. The measures relating to oppression and mismanagement are inserted in company law as an exception to the majority rule in order to prevent the majority shareholders' voting power from being misused or abused.[9]

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[5] Ibid.
[6] [1950] 2 All ER 1064
[7] Rajahmundry Electric Supply Co. v. Nageshwara Rao, 1956 AIR SC 213
[8] 22nd Edition, Francis Beaufort Palmer, Palmer's Company Law 220 (Sweet & Maxwell, 1976).
[9] Mitali Kshatriya and Kumar Sudeep, India: Some Recent Trends In Oppression & Mismanagement Cases Under The Companies Act, 2013, Mondaq (June 22, 2022, 10:22 P.M.)

Due to the growing emphasis on corporate governance, the Ministry of Corporate Affairs has made a remarkable effort to defend the interests of minority shareholders by inserting comprehensive provisions in the Companies Act of 2013 as opposed to the Companies Act of 1956. The Companies Act of 2013 is more comprehensive and well-thought-out for the benefit of minority shareholders, and it aims to promote caution and openness in the overall operation of a company. Minorities frequently suspect that the business is not being handled properly, but they lack proof to back up their suspicions.[10] All claims must be supported by evidence. Controlling shareholders and directors frequently refuse to freely give information. Though there are significant discrepancies and gaps in this area, Indian corporate governance has come a long way in preserving the rights of minority shareholders. Having said that, it is the responsibility of management and shareholders to keep their end of the deal and avoid abusing the remedies or powers bestowed upon them.

Section 241 to Section 246 lays down the law relating to the concept of Prevention of Oppression and Mismanagement under the Companies Act, 2013

3. MAINTAINABILITY OF APPLICATION TO NATIONAL COMPANY LAW TRIBUNAL (NCLT)

3.1. WHO CAN APPLY TO TRIBUNAL?

Section 244[11] confers the right to apply for an action under Section 241 on the following persons:

a. in the case of a company with a share capital, not less than one hundred members or one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one-tenth of the company's issued share capital, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or her shares[12];

b. not less than one-fifth of the total number of members in the case of a firm without a share capital.[13]

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https://www.mondaq.com/india/shareholders/1077784/some-recent-trends-in-oppression-mismanagement-cases-under-the-companies-act-2013

[10] Sanjana Rao, Minority shareholder rights, iBlog Pleaders (June 24, 2022, 12:18 P.M.) https://blog.ipleaders.in/minority-shareholder-rights/

[11] The Companies Act, 2013, § 244, No. 18, Acts of Parliament, 2013 (India).

[12] Vinod Kumar v. Union of India, 1981 SCC OnLine Del 123

[13] Fiba Shipping Agency and Ors. v. Dreams the Mall Company Ltd. and Ors., 2021 SCC OnLine NCLT 238

The Tribunal, on the other hand, has the authority to do away with the aforementioned numerical criteria if it finds it appropriate. In the case of *Cyrus Investments Pvt. Ltd. & Anr. v. Tata Sons Ltd.& Ors.*[14], the National Company Law Appellate Tribunal ("NCLAT") created a four-step analysis to evaluate whether the numerical requirement of Section 244 should be relaxed or not. NCLAT's four steps are as follows:

i. Are the applicants employees of the company in question? If the answer is negative, indicating that the applicant(s) are not members, the application will be refused outright. Otherwise, the Tribunal will investigate the following element.
ii. Does the (planned) application under Section 241 involve 'oppression and mismanagement'? If, after reviewing the proposed application under Section 241, the Tribunal determines that it does not relate to 'oppression and mismanagement' of the company or its members and/or is frivolous, the application for 'waiver' will be denied. Otherwise, the Tribunal will consider the remaining factors.
iii. Whether a comparable accusation of 'oppression and mismanagement' been previously brought by another member and has been decided and concluded?
iv. Is an extraordinary circumstance made out to give a 'waiver,' allowing members to file an application under Section 241 and so on?
v. As a result of the four-step approach applied to the facts of the case, NCLAT granted waiver to the Appellant/Applicant, despite falling short of the 10% criterion.

Furthermore, under Section 241(2), the Central Government may file an application to the Tribunal if it believes that the company's affairs are being conducted in a manner that is detrimental to the public interest.

3.2. LOCUS STANDI TO APPLY TO TRIBUNAL

As per Section 241 of the Companies Act of 2013, members may approach the National Company Law Tribunal ("Tribunal") in two instances. First, if the company's affairs have been or are being conducted in a manner adverse to public interest, prejudicial or oppressive to them or any other member(s), or prejudicial to the company's interests. [15]

Second, if there is a material change in the company's management and control, such as a change in the board of directors, membership, or share capital, or in any other way, and the change is likely to cause the company's affairs to be conducted in a manner prejudicial to the

[14] 2017 SCC OnLine NCLAT 261
[15] Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd., (1981) 3 SCC 333

company's affairs, its members, or any class of members.[16] However, if the modification is made in the best interests of the company's creditors, debenture holders, or any class of shareholders, it will not be considered a major alteration.

4. POWERS OF THE NATIONAL COMPANY LAW TRIBUNAL

4.1. Powers under Section 242 of The Companies Act, 2013

The Tribunal's powers are defined in Section 242[17]. It states that upon receipt of an application, if the Tribunal believes that the company's affairs are being conducted in a way that is prejudicial or oppressive to any member(s), or prejudicial to the public interest or interest of the company, and that the Tribunal would be justified in winding up the company on just and equitable grounds, but that doing so would unfairly prejudice such members or members of the company, then it can pass any order it deems fit.

Section 242(2) further includes a non-exhaustive list of sanctions that the Tribunal can take against firms if their acts are determined to be oppressive. Section 242(2) includes authorities to govern the conduct of the company's activities in the future, to prohibit the allotment or transfer of the company's shares, to remove the company's managing director or directors, and so on. Furthermore, Section 242(4) empowers the Tribunal to issue an interim order followed by a final ruling.

4.2. POWERS UNDER CERTAIN CIRCUMSTANCES

The tribunal can exercise certain powers vested in it by law under the following circumstances:-

i. Power to pass interim order:

If a prima facie case is established, the Tribunal may issue interim orders under Section 242. It was observed that the Tribunal's issuance of an interim order under Section 242(4) presupposes that the company's affairs have not been or are not being conducted in conformity with the provisions of law and the Articles of Association. To establish a prima facie case, the member alleging tyranny and mismanagement must show that he voiced legitimate concerns in the Company Petition that need investigation.[18]

ii. Power to decide matter pending before civil court:

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[16] Alwyn Sebastian, International Contracts: Jurisdictional Issues and Global Commercial and Investment Governance : a Collection of Essays on Recent Trends, 66 (Gujarat National Law University 2014)

[17] The Companies Act, 2013, § 242, No. 18, Acts of Parliament, 2013 (India).

[18] Smt. Smruti Shreyans Shah v. The Lok Prakashan Ltd. & Ors., Company Appeal (AT) No. 25 of 2018 (decided on 5th September, 2019).

It would not be possible for a shareholder whose title to the shares had been disputed and who was ineligible to maintain a petition under Section 244 to pursue issues relating to the disputed shares through a petition for oppression and mismanagement, including by seeking a waiver of the petition's filing fee, because questions regarding right, title, and interest in shares as a result of nomination were pending before a civil court that had ordered status quo in relation to the SC matter.[19]

iii. Power to decide matters in presence of arbitration clause:

Although it cannot be disputed as a general proposition that the dispute arising out of breach of contractual obligations referable to the MOUs or otherwise would be arbitrable, acts of non-service of notice of meetings, financial discrepancies, and non-appointment of directors being matters specifically dealt with under Companies Act and falling within the domain of the Tribunal to consider grant of relief under Section 242 of Companies Act render the dispute non-arbitrable.[20]

iv. Power to implead auditors of the company under investigation:

In *Deloitte Haskins & Sells LLP v. Union of India*[21], the NCLAT permitted the government to accuse an organization's auditors of fraud and managerial error. In this matter, the Central Government filed a petition under Section 241(2) alleging fraud, mismanagement, and conduct of affairs detrimental to the public interest against Infrastructure Leasing & Financial Services ("IL&FS") and IL&FS Financial Services (IFIN), among others. The Central Government also attempted to implicate the partners of the firm that conducted the audit as well as the statutory auditing companies for IL&FS and IFIN (those who were still working with the firm or who had resigned). The auditors challenged this on the grounds that they were not required parties to the proceedings and that they had resigned from their position as auditors before the Central Government instituted the proceedings. Rejecting the argument, the NCLAT stated that the Tribunal's Section 242 powers are extremely broad and that it would be permissible for the Tribunal to hear from any party, including the former auditors, before making a decision in order to protect the interests of the company or the public interest.

5. CONSEQUENCES OF ORDER MADE BY TRIBUNAL ON CERTAIN AGREEMENTS

[19] Aruna Oswal v Pankaj Oswal & Ors., 2019 SCC OnLine NCLAT 505
[20] Dhananjay Mishra v Dynatron Services Private Limited & Ors., [2019]156 SC L824.
[21] Deloitte Haskins & Sells LLP v. Union of India, 2020 SCC OnLine NCLAT 381

Section 243 of the Companies Act, 2013 deals with the provision relating to "Consequences of termination or modification of certain agreements". It states that where an agreement mentioned under sub-section 2 of section 242 is terminated, set aside or modified by an order made by the tribunal under section 242, the following consequences ensue[22] –

(a) Such order shall not give rise to any claims against the Company for damages, compensation for loss of employment, or in any other manner by any individual.

(b) For a period of five years following the date of the order terminating or setting aside the agreement, no managing director or other director or manager whose agreement is thus terminated or set aside shall be appointed or act in such a capacity without the Tribunal's permission[23]

Proviso to sub-section (b) of Section 243(1) states that the Tribunal shall not grant leave unless the central government has been served with a notice of the intention to apply for leave and that Government has been given a reasonable opportunity of being heard in the matter and a violation of this law attracts imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both under Section 243(2) of the Companies Act, 2013.

6. THE TUSSLE BETWEEN MAJORITY RULE AND CONCEPT OF PREVENTION OF OPPRESSION AND MISMANAGEMENT

The majority rule states that an action brought by a single shareholder cannot be considered since it does not have the approval of the majority of shareholders, and the majority of shareholders have the option to forgo their right to sue.[24] The business is a legitimate person. A business that has been legally formed, according to Section 9 of the Act[25], is considered a separate legal entity and has the "power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by its name." The court has repeatedly ruled in several cases that because a company is a person in the sense of

[22] 19th Edition, A Ramaiya, Guide to the Companies Act 278 (LexisNexis, 2013).
[23] Ananya K, Scope of Section 213 of Companies Act, Jus Corpus Law Journal (June 23, 2022, 08:11 P.M.) https://www.juscorpus.com/scope-of-section-213-of-companies-act/#:~:text=Section%20213(b)(i,having%20an%20interest%20in%20the
[24] 11th Edition, Sarah Worthington, Text, Cases, and Materials in Company Law (Oxford University Press, 2016).
[25] The Companies Act, 2013, § 9, No. 18, Acts of Parliament, 2013 (India).

the law, the right to take action belongs to the entire entity and cannot be exercised by any one individual member.

In *Foss v. Harbottle*[26], which established how corporation law operates, the notion of non-interference or majority rule first appeared. The rule, which for a very long time was followed, prioritised the will of the majority over the interests of the minority. But over time, we noticed a shift in the court's perspective. The court's recognition of some exceptions served as a consolation.[27] When it was necessary in the interest of justice, the court occasionally took matters into its own hands and intervened in the company's business activities. Such judicial rulings gave rise to the majority rule exceptions, and in one of these legal decisions, the concept of oppression and mismanagement developed as an exception to the majority rule.

There are certain exceptions to the general rule outlined in *Foss v. Harbottle*[28]. In other words, the majority rule is subject to several exceptions, and as a result, minority shareholders are not left defenceless but rather are safeguarded by the provisions of the 2013 Companies Act and judicial rulings. The minority has access to the cases in which the majority rule is overruled, which are known as exceptions to the rule in *Foss v. Harbottle*[29]. In any of these situations, a single member may file a lawsuit to have the resolution in question declared invalid or to obtain an injunction preventing the corporation from passing it.

7. CONCLUSION

Rule of majority shall apply if the decision of the majority of the members of the company is within the ambit of the terms of the company legislations, as is a well-established presumption in law. However, it is possible that occasionally the majority's actions be oppressive or harmful to any of the group's members as well as the enterprise or the public interest. In order to prevent the exploitation or abuse of the voting power of the majority shareholders, the measures relating to oppression and mismanagement are inserted in company law as an exception to the majority rule.

Although Section 242 grants the Tribunal broad authority to issue any order it deems fit to resolve the complaints, this authority is constrained by Sections 241, 242, and 244 of the

[26] Foss v. Harbottle, [1843] 2 Hare 461.
[27] Dr. Sukhvinder Singh Dari, Majority Rule and Minority Protection under Companies Act 1956 with special reference to Foss vs. Harbottle, Vol-1, Issue-9, International Journal of Research (IJR), 1399, 1405-1410 (2014)
[28] Ibid.
[29] Foss v. Harbottle, [1843] 2 Hare 461.

Companies Act, 2013. The applicant must first satisfy the numerical criteria under Section 244 in order to seek orders under Section 242, and they must then convince the Tribunal that there has been oppressive or detrimental behavior and that there is a just and equitable cause for winding up the company. Since the numerical requirement may only be waived in rare circumstances and a simple lack of confidence between members and directors does not constitute just and equitable grounds for winding up, these requirements have somewhat high thresholds. Thus, it can be said that the prohibitions against tyranny and poor management, along with court precedents, strike a balance between the interests of majority and minority shareholders in a company.

It is important to note that the procedure is time consuming, and at times, it takes years to obtain the reliefs. The provisions of prevention of oppression and mismanagement have played a vital role in checking the powers and actions of the majority members in a corporate to ensure fair and good governance in a company. Therefore, it is vital that the necessary adjustments may be adopted to make the proceedings under section 241 of the Companies Act, 2013 time-bound in order to stop the bad practices of a few parties who plan to postpone the process on one pretext or another and seek longer dates.