
CASE LAW ANALYSIS: NEEDLE INDUSTRIES (INDIA) V. NEEDLE INDUSTRIES NEWHEY (INDIA) HOLDING LTD.

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ABSTRACT

The case of Needle Industries (India) v. Needle Industries Newhey (India) Holding Ltd.¹ is one of the landmark decisions on the issue of oppression and mismanagement pronounced by the Hon'ble Supreme Court of India and further more serves as precedent to similar cases. The judgement is unprecedented and has paved a unique path for the Indian company law cases by not relying on the rule of supremacy of majority shareholders. The case has also assured substantive justice even if the case petition fails. The judgement lays down the fact that not all illegal acts are oppressive and not all oppressive acts are illegal. The case analysis begins with an introduction to legislations dealing with cases of oppression and mismanagement, followed by the facts, background and issues of the case. It is followed by contentions presented by the Appellants and Respondents. It is further followed by the judgement and effects of the judgement. Finally, the case analysis concludes with a short note on grounds of revision for the judgement.

¹ 1981 Air 1298, 1981 Scr (3) 698

INTRODUCTION

The corporate world is a place where disputes are prevalent and abundant in nature, it is not uncommon to hear about quarrels between shareholders of a company. This phenomenon of feuds is not common to a specific country but to the entire world. The most common element of the quarrels is act of oppression of minority shareholders by the majority shareholders. The Indian laws does recognise the disadvantages faced by the minority shareholders and has provided solution by the way of provisions in the legislation regulating companies in India. The effectiveness of the is still a matter of debate. The Sections of erstwhile Companies Act, 1956 from Section 397 to Section 399² dealt with the matter of oppression and mismanagement of against member or members of a company incorporated in India and also provided the relief to be sanctioned if a situation of oppression and mismanagement is actually present. The Companies Act, 2013 deals with oppression and mismanagement under Chapter XVI from Section 241 to Section 246³. Previously, the relief for oppression and mismanagement was granted by the Company Law Board, but the Companies Act, 2013 transferred power and authority to grant relief to National Company Law Tribunal and National Company Law Appellate Tribunal. The 2013 Act also deals with past oppression by giving retrospective effect and provides an avenue for the victimised shareholders to seek justice.

The Act does not provide a proper and clear definitions of Oppression and Mismanagement. However, the Courts do have the liberty to interpret them on case-by-case basis as they deem fit to check whether there is an instance of oppression or mismanagement and to pass a judgement based on principles of justice, equity and good conscience and to protect the interest of the public.

FACTS OF THE CASE

In the present case, the holding company (Needle Industries Newey (India) Holding Ltd.) based in UK filed a suit against its subsidiary company (Needle Industries India Ltd.) under section 397 and section 398 of the Indian Companies Act, 1956 on the basis of oppression by the NIIL. The majority of the shares were held by the NIIL.

² The Indian Companies Act, 1956

³ The Indian Companies Act, 2013

In 1993, the FERA Act⁴ was passed, as a consequence NIIL was obligated by law to reduce the shares of non-resident from 60% to 40% within a period of twelve months. Mr. Devagnanam who was the managing director of NIIL, proposed a course of action to issue the excess shares to the existing Indian shareholders alone. This idea was vehemently rejected by the Holding company. A consensus couldn't be reached between the holding company and NIIL, even after multiple rounds of deliberations and negotiations with regards to the course of action in which Indianization could be realised.

The subsidiary company issued rights shares to its existing shareholders at a price much lower than the market price without properly consulting the holding company. This act of the subsidiary company made the holding company which was previously a majority shareholder in to minority shareholder. The subsidiary company also appointed Silverstone as an additional director.

The holding company filed a suit against NIIL stating the NIIL and Devagnanam purposefully held the Annual General meeting with the intention of issuing the excess shares to existing Indian shareholder with the ulterior motive of providing greater control over the company to Mr. Devagnanam. The suit was also filed to contest the appointment of Silverstone as an Additional Director and his post of independent director in the annual general meeting in which the issue of rights shares was deliberated and decided upon.

BACKGROUND OF THE CASE

The suit was first filed in the Hon'ble High Court of Madras, the Court held that the acts of NIIL were oppressive and ordered NIIL to compensate the loss borne by the Holding Company, because the rights shares were actually sold at a very low price which caused considerable loss to the holding company.

An appeal was filed by NIIL against the decision of the single bench of High Court of Madras. The division bench of High Court of Madras also stood by the decision of the lower bench and also removed Devagnanam as the Managing Director of NIIL, removed the existing board of directors and appointed an interim board. The division bench further issued additional instructions concerning the affairs of NIIL.

⁴ Foreign Exchange Regulation (Amendment) Act, 1993

The subsidiary company further filed the final appeal in the Hon'ble Supreme Court of India.

ISSUES IN THE CASE

1. Will the Act of NIIL (issuing right shares to existing Indian shareholders at much lower price than the market price) constitute as a case of Oppression under Section 397 of the Indian Companies Act, 1956 against the Holding Company?
2. Is the appointment of Silverstone as Additional Director valid?
3. Was there an abuse of fiduciary powers by the Indian Stakeholders?
4. Whether the Courts have the jurisdiction to decide a case solely based on affidavits and nil oral evidence where there are allegations of mala fides and abuse of fiduciary powers?

CONTENTIONS OF APPELLANTS

The counsel for appellants was senior Advocate Shri Nariman, who argued that a case of oppression by Indian shareholders did not exist because of the fact that the company had to arrive at a decision without further ado as the time period provided by the RBI was about to come to an end. The decision was taken with regards to the best interests of the company. The holding company did not provide an alternative solution to the problem of how to reduce its share percentage after rejecting the issue of rights shares to the existing Indian shareholders. As a consequence, NIIL had no other alternative recourse but to proceed in a way which it deemed reasonable so as to save the company.

He also contested that if the decision which was made by the Indian directors keeping the best interests of the company in mind which incidentally affected the majority shareholders rights by reducing them into a minority shareholder will not imply that the decision arrived is unconstitutional and motive of the directors is to be questioned. The holding company was provided with two reasonable options which were to either disinvest or give consent to offer rights shares. The holding company lost right to deny the directors the right to issues rights shares to the Indian shareholders by the virtue of declining to disinvest.

With regards to the validity of appointment of Silverston, it was contended by Mr. Nariman just because he acted as a well-wisher and advisor to the Indian shareholders does not mean that he was biased as the act was done to fulfil his duty as a solicitor. The provision of section 299 of the companies Act explicitly lays down the fact when a director is an interested party, he must disclose the object of interest, in this case Silverston had no such interest and the fact that he was on friendly terms with the Indian directors would not mean he was biased towards them. For certain functions to be carried out, the directors are empowered to appoint additional directors as necessary by virtue of the provision of section 260 the Companies Act, 1956.

Shri Nariman further stated that Sanders was requested to attend the meeting held on 6th of April, Sanders was absent. Thus, Devagnanam had no other recourse but to appoint Silverston as an Independent Director to fulfil the required quorum so as to continue with the meeting.

He further contested that under the Company Court Rules framed by this Court, petitions, including petitions under section 397, are to be heard in the open Court (Rules 11 (12) and Rule 12 (1)). The practice and procedure of the Court and of the Civil Procedure Code are applicable to such petitions (Rule 6)⁵ and under the Order XIX Rule 2 of the Code of criminal procedure, it is open to a party to request the Court that the deponent of an affidavit should be asked to submit to cross-examination⁶. There was no request for cross examination of Devagnanam in the trial Court. When there is an extremely grave allegation made against a person which can completely jeopardise his position, such allegation needs oral evidence and not just be based in mere affidavits. Because only Devagnanam had through comprehension of all that has occurred and his intentions and actions must be questioned in cross examination in an open Court and cannot be based on mere declaration of a person who does not have sufficient and complete knowledge of important facts.

Shri Nariman referred to various cases like *Nanlal Zaver v. Bombay Life Assurance*⁷, *Plexcy v. Mills*⁸ to back his arguments.

CONTENTIONS OF RESPONDENTS

The counsel for respondents was senior advocate Shri Seervai who contended that the decision

⁵ Companies (Court) Rules, 1959

⁶ The Code Of Criminal Procedure, 1973

⁷ 1950 Air 172

⁸ (1920) 1 Ch 77

of NIIL to issue rights shares to Indian shareholders only in a much lower price compared to the market price was direct action of oppression against the holding company. He further stated that the MD of NIIL had taken this decision based on his own personal interest which was to further extend his own control of NIIL. The holding company never stated that it was not willing to give up 20% of the shares, it merely did not agree with the idea put forth by Devagnanam. As Devagnanam wanted more control over the company, he went ahead with his own idea instead of an alternative solution to the problem. The subsidiary company failed to send an application to the Control of Capital Issues which could fix the prices of the rights shares equalling to the market price, instead it sold the shares at a much lower price. The holding company was not provided with sufficient time to attend the General Body Meeting. Even if NIIL had not complied with the notification of the RBI, it would not have led to shutting down of the company, nor would it have attracted penalties or legalities of any kind to the Indian Directors. The Appellants could have provided an opportunity for the holding company to attend the meeting by filing a petition to RBI with regards as to extension of time.

The act of directors by issuing rights shares was purely to convert the majority shareholder to a minority shareholder which is unconstitutional and void, also an abuse of fiduciary powers. The defence of the appellants that the actions were done with the best interest of the company is pointless and in vain because what is in the best interest of the company must be decided by the majority shareholders. In the meeting conducted, the majority of the were absent, they must have been compulsorily taken into account. Thus, the entire meeting was worthless. The result of the fruitless meeting was to issue rights shares to Indian shareholders only.

The appointment of Silverston as Additional Director was contested by stating that there was no need to appoint an additional director to conduct the meeting. Shri Seervai also contested the appointment of Silverston in a meeting which was to issue rights shares. Section 300 of Indian Companies Act, 1956 explicitly prohibits an interested director to take part in the proceedings, Silverston is an interested person as he had been an advisor to the Indian Shareholders earlier, such a person under no situation can be said to be an unbiased person with regards to any issues between the holding company and NIIL. As Silverston who as an Independent Director and also an interested person had taken part in the meeting on 6th April which issued the rights shares should be declared as an invalid meeting and thus bearing no consequence.

The learned counsel further argued that when the present case was in Trial and Appellate Courts, the parties had consented to move forward on only on basis of documents and affidavits. There was no request for cross examination by both the parties. The document and affidavits contained sufficient material which plainly displays the mala fide intentions of the Indian Directors. Shri Seervai also argues that certain similar cases were decreed on basis of oral evidence does not mean that all such cases must be decided on the basis of oral evidence. The documents submitted by the parties voluntarily proves the fact that appellants agreed for a convenient method of proceedings. Therefore, Shri Seervai humble requested the Court to dismiss the contention of appellant that mala fide intention cannot be proved by documents and affidavits only.

JUDGEMENT OF THE COURT

The acts which are “Burdensome, harsh and wrongful” indicates that is synonymous with the term Oppressive manner. A separate act may be against the law, but it cannot be said to be oppressive if it does not have mala fide intention cloaking it or if the act was harsh, burdensome and wrongful. However, if there are multiple illegal acts, it automatically means that all the acts were a part of one action with the motive to oppress the persons against whom the acts have been done.

The person claiming oppression against another party has the duty to prove in which way the act of oppression led him to compromise on his decision and submit to an act lacking integrity, an act which is prima facie unfair and further on how it has affected his proprietary rights.

Hence, the allegation of act of oppression by NIIL and Devagnanam against the Holding Company was rejected. It was held that Devagnanam and his colleagues acted in a reasonable manner in which a partner in a business is expected to do so. The already existing Indian shareholders were willing to pay for the shares at a premium rate, the act of NIIL of offering the rights shares at a much lower rate than the market price has undoubtably caused unjustifiable loss to the holding company. Hence, even though the case petition has failed, the Court has asked the existing Indian shareholders of NIIL to make good the loss suffered by the holding company and purchase the shares at a premium rate in order to attain substantial justice. This would erase even the slightest hint of oppression alleged in this case.

Providing a judgement solely based on the basis of affidavits and documents may prima facie be unsatisfactory but it cannot be stated to be illegitimate in matters involving grave consequences. If the matter in question involves bon fide or mala fide intentions, if the documents prima facie contains sufficient proof, then such document can be taken as sole evidence. In this case, both the parties consented to move forward with affidavits, as a consequence the High Court of Madras was justified with not permitting any party to argue that mere affidavits cannot prove a mala fide act.

There may be multiple reasons provided for the power to issue shares, one of the reasons may be to meet the adequate number of shareholders required for the efficient and proper functioning of the venture. Even if the directors are indirectly benefitted by the process of issuing shares, it cannot be invalidated. The directors cannot be presumed to have mala fide intention just because while deciding the best course of action for the business, the directors are incidentally benefitted. However, if the issuing is done for an inappropriate purpose of the directors, then the fact it was done for the good of the company will be irrelevant.

There is a wide gap between the private companies and public companies and in the present gap there are different types of companies like private companies that have become public companies and such kinds of companies are provided with a certain proviso of a private company while being deterred from enjoying certain rights and privileges of being a private company. In this present case, NIIL belongs to the above-mentioned category.

When a director is alleged to be an interested person, then the direct concern or interest must be disclosed, and such concern or interest must be more than mere emotional or friendly interest in nature and if such friendly relations with the directors that are directly connected to the issues or agreement, will not make that person an interested person, even the relationship of attorney-client between the person and an interested director, will not make him an interested person.

EFFECTS OF THE JUDGEMENT

1. Interpretation of terms Oppression and Mismanagement

The present case has become a landmark judgement for the interpretation of terms oppression and mismanagement and also the rights of minority and majority shareholders. The Court by

deciding in the favour of minority shareholders has opened a new line of recourse and also provided the majority shareholders substantial justice by decreeing that the losses suffered by the holding company be sufficiently compensated. The hon'ble supreme Court has relied on number of cases and authorities to arrive at a conclusion on a different aspect. The extremely important parts of the judgement were the interpretation of the term Oppression contained in Section 397 of Indians Companies Act, 1956.

The case of *Seth Mohanlal Ganpatram v. Sayaji Jubilee Cotton & Jute Mills Co Ltd.*⁹ stated that a resolution passed may not be against the law but still be oppressive, alternatively a resolution may be against the law but still be for the best interest of the company. The hon'ble Court relied on the case of the *Shanti Prasad Jain v. Kalinga Tubes*¹⁰ which said that when the allegation is an act of oppression against the members of the company, it is not sufficient to show only one act or separate acts which will be constituted as oppression when considered separately but a series of events which forms a part of that act and as a consequence led to oppression. Definition of the term Oppression was procured from Halsbury's laws of England¹¹.

2. Justice

The Court in order to achieve substantial justice requested the Indian shareholders to purchase the shares at a premium rate even though the shares were issued at a price much lower than the market price. This was done in order to make good the loss suffered by the holding company due to the wanton actions of the subsidiary company. This judgement by the Court has set a precedent that even if oppression is not proved in the case, the Court may in order to provide justice to the party claiming oppression, so as to make sure they have been restored to place they would have been in if the alleged oppressive act had not taken place.

3. Intentions of director

The directors cannot be said to have mala fide intention even if they are incidentally benefitted while deciding on a course of business, if they keep the best interest of the company in mind

⁹ (1964) 34 Comp Cas 777

¹⁰ Air 1965 Sc 1535

¹¹ Halsbury's Laws Of England, Vol.7, 4th Ed., P.218

while doing so. For this aspect, the judges relied on the case of *Hogg v. Cramphorn*¹², which has affirmed the above said point.

4. *Proprietary rights*

This case has set another precedent when it declared the results of meeting to be still valid, even when the meeting was said to be illegal. An important factor was the fact the proprietary rights of the shareholders were not affected. Also, this was done due to the fact the decision taken in a wrong way was in the best interests of the company.

5. *Majority rule*

The rule of Supremacy of majority shareholders which was the pillar of company laws earlier was laid down in the case of *Foss v. Harbottle*¹³. The Majority Rule was overlooked in this judgement. The basic feature of democracy is majority rule and also prevalent in corporate sector. This rule was actually applied in cases with similar facts i.e., the resolution of the majority shareholders prevails over the preferences of the minority shareholders. The majority shareholders seem to of the opinion that they will never face any challenge in their management, even till the extent of the minority shareholders exiting the business. This aspect highlights the fact that majority shareholders will purchase the shares of the minority shareholders. The judgement of the *Needles* case has in fact weakened the importance of the rule of supremacy of the majority shareholders. This has led to the non-reliance of the rule in majority of the Indian corporate cases.

6. *FERA Act*

Meanwhile, in this case if the holding company i.e., the majority shareholder had been allowed to sell the excess shares to an Indian company of its choosing in which it was interested in, it would have contravened the spirit and letter of the FERA Act. If it was done so, the excess 20% of the shares would have been placed in the control of the holding company indirectly. Thus, the action of NILL with regards to proceeding ahead with the issue of rights shares does not amount to oppression in any sense and it was for the compliance with the FERA Act. Furthermore, it was in the best interests of the company.

¹² (1967) 1 Chancery 254, 260

¹³ (1843) 67 Er 189

REVISION OF JUDGEMENT

The judgement in the present case could be reversed if absolute reliance is placed on the Rule of Supremacy of Majority Shareholders, ignoring the fact the actions of the Indian directors were for the best interests of the company and were done in order to comply with the Indian legislation.