8.0 “Majority Rule” as Applied in the Management of a Company

The Companies Act, 1956, together with the protection granted to minority under the Common Law, attempts to maintain a balance between the rights of majority and the minority shareholders by admitting in the rule of the majority but limiting it at the same time by a number of well-defined minority rights, and thus protecting the minority shareholders.

Minority shareholders are protected by:
1. the Common Law; and
2. the provisions of the Companies Act, 1956.

8.1 Protection at Common Law

It is a well-known principle, enunciated in Foss vs. Harbottle that the rule of majority shall prevail. But there are certain exceptions to this rule where the majority rule does not prevail. These are as under:

(a) Where the act complained of is illegal or ultra vires the company;
(b) Where the act done by the majority constitutes fraud on the minority;
(c) Where a resolution is passed by a simple majority for any act, which requires special resolution for it to be effective;
(d) Where the act infringes the personal rights of an individual member;
(e) Where any act amounts to oppression of minority or mismanagement of the affairs of the company.

In all these cases a minority shareholder is entitled to bring an action for a declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. All these principles have been followed in a few leading cases in India as well.

8.2 Oppression and Mismanagement

The management of companies is based on the principle of majority rule ordinarily; decision of the majority is the rule for the minority. This sound principle has, occasionally, been abused and the whip of the majority has often produced sullen effects, prejudicial to the best interests of the shareholders. Until the commencement of the Companies Act, 1956 the only remedy
available (under the Indian Companies Act, 1913) to an oppressed minority was to petition to the Court to wind up the company on the ground that it was "just and equitable" so to do. The winding up remedy is, however, not always advantageous to the petitioning shareholder, or shareholders because the very persons whose conduct is complained of, may be the only persons capable of buying up the shares of the dissentients. Nevertheless, the oppression or mis-management calls for some remedial action. Sections 397 to 409 of the Companies Act, 1956 are the specific provisions which empowers (i) the Company Law Board and (ii) the Central Government to deal with such situations preventing oppression and mis-management in the company.

Meaning of Oppression- As per section 397 of the Act, where the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members, may be termed as oppression. There the members complaining may apply to the Company Law Board for appropriate relief subject to section 399.

Meaning of Mis-management- As per section 398 of the Act, where the affairs of the company are being conducted in a manner prejudicial to the public interest or in a manner prejudicial to the interests of the company, or where any material change has taken place in the management or control of the company, by which it is likely that the affairs of the company will be conducted in the manner prejudicial to public interest or prejudicial to the interests of the company. This may be termed as mis-management in the company. The complaining members of a company may apply to the Company Law Board for the relief subject to Section 399. Section 399 provides, however, that a single member is not entitled to make an application under either of the sections, viz., Sections 397 and 398.

8.3 Who May Apply to the Company Law Board when Oppression or Mis-management is complained of?

The application can be made only by:

(a) In the case of a company having a share capital:
(i) not less than one hundred members or not less than one tenth of the total number of members whichever is less; or
(ii) a member or members holding not less than one-tenth of the issued share capital of company provided that the applicants have paid all calls and other sums due on their respective share [section 399(1)(a)]. It may be noted that joint members are counted as one member.

(b) In the case of a company not having a share capital: not less than one-fifth of the total number of members [section 399(1)(b)].

(c) The Central Government: The Central Government can also apply or authorise a member or members to make an application under section 397 or 398, though the requisite conditions mentioned in the [i] and [ii], given above, are not satisfied [section 399(4)].

An application under section 399(4) must contain the names and addresses of the applicants, the total numbers of applicants, etc., it must be verified by an affidavit. The Central
Government may require the applicant to produce documentary evidence in support of the complaint [Section 399(4)]. It may also require the members to give security for costs [section 399(5)].

### 8.4 Difference between Sections 397 and 398

Under section 397, the existence of conditions justifying the making of winding up order on the ground that it is just and equitable that the company should be wound up, is a condition precedent to the interference by the Company Law Board. On the other hand, under section 398, the C.L.B. would interfere on its being satisfied that by reason of any material changes in the management or control of the company, it is likely that the affairs of the company will be conducted in a manner prejudicial to the interest of the company. The two positions are distinct. Whereas in the first case, the C.L.B. acts to prevent injustice being done to a member or members in his or their individual capacity, in the second case the C.L.B. acts in order to prevent injury being inflicted to the interest of the company as a whole.

The material change in the management or control contemplated in the preceding paragraph will be deemed to have taken place in any of the following circumstances, viz.:

1. when there has been alteration in the Board of directors;
2. when a replacement of its manager has taken place;
3. when a change has occurred in the ownership of the shares of the company;
4. when there has been a change in the membership of a company having no share capital;
5. when a change has taken place in any other manner whatsoever.

By reason of any of the aforesaid changes, the affairs of the company are likely to be conducted in manner prejudicial to public interest or to the interest of the company [section 398(1)(b)].

Thus on an application made in the foregoing circumstances, the Company Law Board will interfere only if it is of the opinion:

1. When it is made under section 397: (a) that the company's affairs are being conducted in a manner oppressive to any member or members [section 397(2)] or in a manner prejudicial to public interest; 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 “just and equitable” ground.

2. When it is made under section 398:

   (a) that affairs of the company are being conducted in a manner prejudicial to the public interests or in the manner prejudicial to the interests of the company [section 398(1)(a)];

   or

   (b) that a material change has taken place in the management or control of the company and as a consequence the affairs of the company may be conducted in a manner prejudicial to the public interest or in a manner prejudicial to the interests of the company [section 398(1)(b)].
The Company Law Board may make such order it thinks fit with a view to bringing to an end, or preventing the matters complained or apprehended, as the case may be.

(3) Under section 397, the Company Law Board can end the oppression complained of whereas, under section 398, it can prevent the matters complained of or apprehended. In other words, only section 398 is preventive; section 397 is not.

A complaint under section 399 can be made only by a member or members and not by officers or directors who might be oppressed in these capacities. [Elder vs. Elder & Weston Ltd. (1952) 102 Law J. 91; (1952) S.C. 49].

In the aforementioned case, the interpretation of section 210 of the English Companies Act, 1948, corresponding to section 397 of our Act, was considered. There it was alleged that the majority of the shareholders of a private company had removed two minority shareholders from their directorship and employment but there was no suggestion of mismanagement to the detriment of the share holders. The Court held that these allegations could not support an application under the Section, which required oppressive conduct to members in their character as members. Such conduct towards a member in any other capacity, e.g., as a director or creditor could not per se justify an application. 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 a company, is entitled to rely” (ibid) (per Lord Cooper).

8.5 Notice to Central Government of applications given under sections 397 & 398

As per section 400 of the Act, C.L.B. is required to give notice of every application made to it under section 397 and 398 to the Central Government before passing any order and to take into consideration the representations, if any, made to it by that Government.

8.6 Right of the Central Government to apply for an order under sections 397 & 398

The Central Government may itself apply to the C.L.B. for an order under sections 397 & 398, or cause an application to be made to the C.L.B. for such an order, by person authorized by him.

8.7 Powers of the Company Law Board on Application under Sections 397 or 398

Without prejudice to the generality of the powers of making any order as it thinks fit under section 397 or 398 the C.L.B. has, in particular under section 402, the following powers:

(a) to regulate by order the conduct of the company’s affairs in the future;
(b) to order the purchase of shares or interest of any member or members of the company by the other members thereof or by the company;
(c) in the case of a purchase of shares by the company as aforesaid, to order the consequent reduction of its share capital;
(d) to terminate, set aside or modify any agreement, howsoever, arrived at, between the company on the one hand and any of the following persons on the other, namely: (i) the managing director; (ii) any other director; (iii) the manager upon such terms and conditions as may, in the opinion of the Company Law Board be just and equitable in all the circumstances of the case;

(e) to terminate, set aside or modify any arrangement between the company and any person not referred to above, after giving due notice to, and obtaining the consent of the party concerned;

(f) to set aside any transfer, delivery of goods, payment, execution of other act, relating to property made or done by or against the company within 3 months before the date of the application under section 397 or 398 which would in the case of an individual be deemed in his insolvency to be fraudulent preference; and

(g) to deal with any other matter for which, in the opinion of the C.L.B., it is just and equitable that provision should be made.

The C.L.B. may make an interim order for regulating the conduct of the company’s affairs, pending the passing by it of a final order under section 397 or 398 (section 403).

8.8 Effect of alteration by order under section 397 and 398

Where an order made under section 397 or 398 involves an alteration of the Memorandum or Articles of Association of the company, the company shall not have the right to make any alteration therein, subsequently, in a manner which is inconsistent with the order passed by the C.L.B. without its leave (section 404). Certified copies of the alteration must be filed with the Registrar. Where, an order of the C.L.B. under the foregoing section involves the termination of any of the agreement mentioned herein before, such termination shall not give rise to any claim for damages against the company for loss of office or in any other respect either under the agreement or otherwise. Further, no managing or other directors or manager whose agreement has been terminated or set aside shall, without leave of the C.L.B. be appointed in any of the above capacity in respect of the company for a period of five years from the date of the order. Any contravention of this provision is punishable with imprisonment for a term, which may extend to one year, or with a fine up to `50,000 or with both. Before leave is granted, the Central Government must be notified and heard (section 407).

8.9 Powers of the Central Government

Section 408 has vested some powers in the Central Government to prevent oppression or mismanagement. It can exercise these powers on an order of the Company Law Board which in turn will so order on the application of at least 100 members of the company or of members holding at least one tenth of the total voting power therein. But before exercising such powers, it must make such enquiry as it deems fit and be satisfied that it is necessary to exercise its powers in order to prevent the affairs of the company being conducted either in a manner oppressive to any members of the company or in a manner prejudicial to the interests of the company or to public interest.

(i) Appointment of the persons to safeguard the interest of company/
shareholders/public interest: Central Government may appoint such number of persons as the Company Law Board may, by order in writing, specify as being necessary to effectively safeguard the interest of the company, or its shareholders or the public interest, as directors thereof for such period not exceeding three years at one time as it may think fit [Section 408(1)].

(ii) Persons appointed by the Central Government shall hold office as additional directors: If the Company Law Board has not passed an order in the above manner, it may direct the company to provide for the proportional representation as per section 265 of the Act for the appointment of directors and make fresh appointment of directors with in the specified time [Proviso to section 408(1)]. Till new directors are appointed pursuant to the aforesaid order, such number of persons as the Company Law Board may, by order in writing, specify as being necessary to effectively safeguard the interest of the company, or its shareholders or the public interest will hold office as additional directors. The Central Government shall appoint such Additional Directors. [section 408(2)].

(iii) Director/ Directors not liable to retire by rotation: The director or directors appointed under sub-section (1) or (2) of section 408 are not liable to retire by rotation as contemplated by section 255 [section 408(3)].

(iv) Directors so appointed by Central Government not to hold qualification shares nor retirement by rotation: These directors are not required to hold any qualification shares; nor are their tenure of office liable to termination by retirement of directors by rotation. These directors may, however, be replaced by some others by the Central Government [section 408(4)].

(v) No change in Board of directors after appointment unless confirmed by the C.L.B.: No change in the Board of directors, after a person has been appointed or directed to hold office of a director or additional director under section 408 shall so long as such director or additional director holds office, be effective unless confirmed by the Company Law Board [section 408(5)].

On appointing directors or additional directors referred to in the first two sub-sections above, the Central Government may issue such directions to the company as it may consider necessary or appropriate in regard to its affairs. Such directions can be issued notwithstanding anything contained in this Act or in any other law for the time being in force [section 408(6)]. The Central Government may require these directors or additional directors to report to it from time to time with regard to the affairs of the company [section 408(5)].

On a complaint being lodged by the managing or any other director or the manager, the Company Law Board is empowered under section 409 to prevent any change in the Board of Directors, which is likely to affect the company prejudicially. The power conferred by this Section, however, cannot be exercised in relation to a private company, unless it is a subsidiary of a public company.
8.10 Powers of Central Government to Remove Managerial Personnel on the Recommendation of CLB

The powers of the Company Law Board to remove a director of a company are contained in Sections 388B to 388E of Companies Act, 1956.

(1) Reference of cases to the C.L.B.: The Central Government may state a case against any of the managerial personnel of a company and refer the case to the Company Law Board with a request that the Company Law Board may inquire into the case and record a finding whether or not he is fit and proper person to hold the office of director or any other office connected with the conduct and management of the company. The Central Government may exercise this power where in its opinion there are circumstances suggesting:

(i) that any person concerned in the conduct and management of the affairs of a company is or has been in connection there with guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or

(ii) that the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices; or

(iii) that a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or

(iv) that the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest [Section 388B(1)].

Every case under sub-section (1) shall be stated in the form of an application which shall be presented to the Company Law Board or such officer thereof as it may appoint in this behalf [Section 388B(2)].

The person against whom a case is referred to the Company Law Board under this section shall be joined as a respondent to the application [Section 388B(3)]. The application made to the C.L.B. must contain a concise statement of the circumstances and material as the Central Government may consider necessary for the purpose of the enquiry, and be signed and verified in the manner laid down in the Civil Procedure Code, 1908 for the signature and verification of a plaint in a suit by the Central Government [Section 388B(4)].

(2) Interim order by C.L.B.: The Company Law Board may, on the application of the Central Government, or on its own motion, by an interim order direct that the respondent shall not discharge any of the duties of his office until further orders of the Company Law Board; and appoint a suitable person in place of the respondent [Section 388C(1)]. Such appointee shall be deemed to be a public servant within the meaning of Section 21 of the Indian Penal Code [Section 388C(2)].

(3) Decision of the C.L.B.: At the conclusion of the hearing of the case the Company Law Board must record its findings (Section 388D). If the finding of the Company Law Board is against the respondent the Central Government, by order, shall remove him from office.
8.8 [Section 388E(1)]. The person against whom order of removal from office is made must not hold the office of a director or any other office connected with the conduct and management of affairs of the company for a period of 5 years from the date of the order of removal. The Central Government may, with the previous concurrence of the Company Law Board, remit or relax this period of 5 years [Section 388E(3)]. On the removal of a person from office in the above manner, no compensation in any circumstance whatever is payable to him for the loss or termination of office [Section 388E(4)]. The company may, with the previous approval of the Government, appoint another person to the office in place of the person removed [Section 388E(5)].

8.11 Concept of Public Interest and Its Impingement on Company Law

The expression “public interest” is an elusive abstraction; it means general welfare of the society or “regard for social good” and pervades interest of the general public in matters where regard for the social good is of the first moment.

A thing is said to be in public interest where it is or can be made to appear to be contributive to the general welfare rather than to the special privileges of a class, group or individual. In common parlance, it is assumed to denote the interest to the community or nation as a whole as well as the State Government, which represents it. “The expression is not capable of precise definition and has not a 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 its needs. Thus, what is ‘public interest’ today may not be so considered a decade later. In any case, the expression cannot be considered in vacuum but must be decided on the facts and circumstance”. [Per Chief Justice Mahajan in State of Bihar vs. Kameshwar, A.I.R. 1952 SC 252].

Since the concept of public interest is bound to undergo frequent changes with a change in our social, political and economic values, no hard and fast definition can be and actually has been, laid down by the Act. Whatever furthers the general interests of the community as opposed to the particular interest of the individual (a company formed and registered under the Act is a legal person) is to be considered as “public interest”, i.e., an interest in which the community is directly and vitally concerned. A survey of the provisions of the Act would reveal the truth of the statement that the concept of public interest has been making rapid in-roads into the Indian Company Law, e.g., Sections 396, 397, 398, 408 etc. A survey of the provisions of the Act would reveal the truth of the statement that concept of “public interest” has been making rapid in roads into the Indian Company Law:

(i) Section 396, as you have seen earlier, empowers the Central Government to provide for compulsory amalgamation of companies (notwithstanding anything contained in sections 394 and 395) into a single company in the public interest. It may be noted that the expression “national interest” was used in 1956. The Amendment Act of 1960 brought the substitution of ‘public interest’ for ‘national interest’ into effect. The Indian Companies Act, 1913 contained no provisions similar to those of section 396. Therefore, the Companies Act, 1956, made such provision in the Company Law for the first time.
(ii) There may be a case where a transfer of shares in a company has taken place or is likely to take place and, as a result thereof a change in the composition of the Board of directors is likely to take place; and further such a situation (in the CLB's opinion) may be prejudicial to the public interest. In such a case, the CLB is empowered, under sections 250(3) and (4) to impose restrictions on such transfers e.g. the voting rights in respect of such shares shall not be exercisable for the period specified not exceeding three years or the resolution approving the transfer of such shares should not have effect unless confirmed by the CLB. Thus, the Amendment Act of 1960 has extended the provisions of section 250 in public interest also.

(iii) Under section 397, the member of a company has given the right to file an application to the Company Law Board for appropriate relief where the affairs of the company are being conducted, inter alia, in a manner prejudicial to public interest provided the requirements of section 399 are fulfilled.

(iv) Under section 398, the shareholder company can file an application to the Company Law Board for relief in cases (a) where the affairs of the company are being conducted in a manner prejudicial to public interest.

(v) Under section 408, the Central Government is empowered to appoint such number of persons as the Company Law Board may, by order in writing specify being necessary to hold office as directors in the company to effectively safeguard public interest (besides the interest of the company or its shareholders). Such an order may be made on a reference made to it by the Central Government or on an application of not less than 100 members of the company or of the members holding 1/10th of the total voting power therein.

(vi) Under section 394(1) of the Companies Act, 1956, the Court has been empowered: (a) to refuse its sanction to any compromise or arrangement in connection with a scheme for the amalgamation of a company which is being wound up, with another company where it receives a report from the Registrar that the affairs of the company have been conducted inter alia in a manner prejudicial to public interest; and (b) to refuse the dissolution of any transferor company under clause (iv) of section 394(1) where it receives a report from the Official Liquidator (on security of the books and papers of the company) that the affairs of the company have been conducted, inter alia in a manner prejudicial to public interest.

(vii) The office of public trustee has been set up so as to enable him to take over the voting rights of shares and debentures held in trust from their trustees to be exercised in such manner as he may determine (sections 153A and 153B). The object of this was to ensure that voting powers attaching to funds held in trust for the company or the public were exercised to promote the public interest and not to further those of private individuals who had formed tax-free trusts ostensibly for 'public motives'.

The Central Government is empowered to state a case against managerial personnel to the Company Law Board under section 388B where the circumstances suggest the company is or has been conducted and managed by such person in a manner which is likely to cause or has caused serious injury or damage to the interests of trade, industry or business to which such company pertains (vide) Amendment Act of 1988.

Note: In this chapter, wherever the word ‘Act’ is used, it refers to the Companies Act, 1956.