A STUDY ON THE MANAGEMENT OF A COMPANY VIS-A-VIS LAW RELATED TO OPPRESSION OF MINORITY SHAREHOLDERS BY MAJORITY SHAREHOLDERS

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Abstract

The management of a company is always done by two groups of shareholders namely majority and minority shareholders. But as the name suggests, these two groups are reported to be always in conflict with each other. Majority shareholders are the members who have a higher number of shares entitling them of control of the company. This conflict had been a heated topic for debate in the law related to corporations. The legal position had been adamant on the position of majority rule in the management of the company as propounded by the English case of *Foss v. Harbottle*. In the majority of cases, the minority shareholders are oppressed by the majority shareholder having control over the management of the company which eventually leads to the violation of the rights of the minority shareholders. Prevalence is always given to the decision reached by the majority shareholding group. However, the legislature has introduced some statutory safeguards in order to protect the rights of the minority shareholders and to prevent their suppression by the majority shareholding group having control over the affairs of the company. This article also discusses in detail the decision of the honorable Supreme Court in the case of *SP Jain v. Kalinga Tubes Ltd.* which throws light on the position of law related to the management of a company vis-a-vis the provisions related to the oppression and mismanagement of the company affairs by the majority shareholders. In conclusion, the article sets out the need to bring reforms to protect the rights of the minority shareholders and the existing safeguards and their effective implementation.

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1. Introduction

The concept of democracy has found its relevance in each and every field of administration and management. The affairs of a company are often managed by two forms of shareholders namely majority shareholders and minority shareholders. This characteristic of shareholders is determined by the number of shares held by the members of a company. The members holding the maximum shares which in turn entitles them to have control over the management of the company are known as majority shareholders, whereas, on the other hand, members holding less number of shares which divest them from the power to have control over the management of a corporation.

This division among the shareholders results in the oppression of minority shareholders and the violation of their rights by the majority shareholders. The majority rule has been recognized as a fundamental rule in the management of a company. The decision of the majority shareholding group is considered binding on the minority shareholders to which the chances of contradicting the majority decision are very less, eventually resulting in the overpowering of the minorities by the majority group.

Realizing the sufferings of the minority shareholders in a corporation and a dire need to bridge the gap between the two groups, the law has been amended providing some provisions for the protection and igniting the development of minority shareholders in the Companies Act, 2013 unlike the Act of 1956. Though the meaning of the term "minority shareholders" does not find its existence in the present act, but they have been somehow defined with the help of sections 395 and 399 of the Companies Act, 1956 which provides for Application to Company Law Board in cases of oppression and mismanagement respectively, minority shareholders have been set out as ten percent (10%) of shares or minimum hundred (100) shareholders, whichever is less, in companies with share capital; and one-fifth (1/5) of the total number of its members, in case of companies without share capital. The interference of law and management regarding the management of a company w.r.t. the majority and minority shareholder was discussed at length by the honorable Supreme Court in its landmark judgment in the case of *Shanti Prasad Jain v. Kalinga Tubes Ltd.*[2]., 1965.

2. Case Study of Shanti Prasad Jain v. Kalinga Tubes Ltd., AIR 1965 SC 1535

2.1 Facts-

The present disputes relate to the quarrel between two parties for the management of the company, namely M/s Kalinga Tubes. The bone contention of the appellant is the oppression of minority shareholders and mismanagement in the affairs of the company by the majority of shareholders.

The brief facts of the case were as follows:

1950- The company was managed by two groups of shareholders, namely Patnaik and Loganathan.

1954- The appellant, Patnaik, and Loganathan entered into an agreement by virtue of which equal shares as of the existing shareholders were given to the appellant, thereby vesting him with equal power and say in the matter of finance and management of the company. This agreement was entered into in the personal capacity of the shareholders, excluding the company as a party to the agreement. But, there was no change in the AOA to incorporate the subsequent changes.

1957- The three groups of shareholders converted the company into a public listed company.

1958- There was a general meeting in which the appellant was outvoted by the rest of the two shareholders resulting in a resolution leading to allotment of 39,000 new shares to outsiders and not to the existing shareholders.

1960- For the purpose of raising the capital and allotting additional equity shares to outsiders and not to existing shareholders, a notice of the general meeting was issued. Thereafter an application was filed by the appellant against the oppression of minority shareholders by the majority shareholders under ss. 397, 398, 402, 403 of the Companies Act, 1956. Exclusion of minority group by the majority shareholders group from the management of the company by acquiring

[2] AIR 1965 SC 1535

75% voting right against the terms of the agreement of 1954 was also alleged in the application. Lack of fair play, fair deal, lack of probity, mismanagement in the company, lack of confidence and trust was also alleged by the appellant.

2.2 Issue-

What can be termed as the oppression of minority shareholding group by the majority shareholding group?

Whether mismanagement, misconduct, and allocation of new shares to outsiders a just and equitable cause for winding up of a company?

A Single Judge bench of learned Justice Barman adjudicated the application and declared the manner in which new shares were allotted to outsiders oppressive against the appellant lead minority shareholders. He also held that the mismanagement due to the continuing oppression of minority shareholders is adverse to the interest of the company. He also held that the circumstances demanded winding up of the company, but in order to protect the interest of the company, the petition was allowed by him and subsequently relief was also granted u/s 397 and 398 restoring equal shareholding and control according to the terms of the 1954 agreement. This order of the Single Judge Bench was challenged by the company and various other shareholders by way of 14 appeals to the Division Bench[3] of Orissa HC.

The Division Bench held that the agreement of 1954 does not have any binding effect on the company irrespective of its nature in 1957 when it was converted into a public company from a private company.

The Division Bench set aside the order of Justice Barman and held that the application of the appellant does not carve out any case of oppression u/s 397 or mismanagement u/s 398. The ratio of the order of Division Bench was:

"It can be undoubtedly said that lack of confidence and animosity between the majority and minority shareholder groups has arisen due to the non-distribution of shares to the petitioner in proportion to the existing shareholdings. But due to this, the directors of the company cannot be

[3] AIR 1963 Ori. 189.

imposed with the charges of misconduct, fraud, and misfeasance. Therefore, it cannot be said that the Directors of the company have acted maliciously in order to oppress the minority shareholding group."[4]

2.3 Rule

The term "Oppression" has been defined u/s 210 of the new English Companies Act. It was widely discussed in the landmark English cases of Elder v. Elder and Watson, 1 (1952) SC 49, George Meyer v. Scottish Cooperative Wholesale Society Ltd., 2 (1954) SC 181, Scottish Cooperative Wholesale Society Ltd. v. Meyer, 3 (1958) 3 All ER 66, Re H.R. Harmer Limited, 4 (1958) 3 All ER 689.

A vast definition of the term "Oppression" was given in these aforementioned cases. Following essential elements must be proved by the applicant in order to succeed a claim for oppression:

It must continue until the date of the presentation of the petition.

It must be against a particular member of against some members of a company.

It must be related to the management of the company.

The oppressive behavior and violation of principles of fair play, a fair deal must be sufficient in nature to become just and equitable cause for winding up of the company.

Lack of confidence cannot be lead to the conclusion of being oppressed. Unfair treatment must be shown to prove oppression.

2.4 Application

Eventually, the matter went to the honorable Supreme Court which also upheld the decision of the Division Bench of the HC. The SC dismissed the appeal and held that the material placed before it is insufficient to show that there was a cause for winding up of the company. The court further stated that oppression must be a continuing fact and it should be proven in continuity and not in isolation with other transactions. The appellant in order to succeed must prove that the

[4] Ibid.

oppression by the majority shareholders continued till the date of the presentation of the petition. He must also prove that the management process of the company was against the principle of fair play, fair deal, probity, and detriment to the interests of a particular class of members of the company. The violation of proprietary rights as a shareholder must be there in order to bring a successful claim.

The SC further held that since the company was not a party to the agreement of 1954, therefore the company was not bound by the terms and conditions of the agreement and to a much lesser extent when it was converted into a public company in 1957. The court also held that the appellant failed to make out any case of mismanagement u/s 398 of the Companies Act, 1956. The SC ultimately held that the allotment of new shares to outsiders is in no way oppressive to the minority shareholding group. The reason given by SC for the above conclusion is:

"The allotment of new shares to outsiders by the majority shareholder group cannot be said to be oppressive towards the appellant minority group as such allotment was done to prevent the situation of taking over of the entire control of the company by the appellant when he was given shares in the company as at that time the other two shareholders i.e. Patnaik and Loganath had no money."

3. Conclusion

The above decision of SC was recognized and appreciated worldwide for taking a very realistic approach of section 397 of the Companies Act, 1956. The English legislators used the Indian statute as well as the decision in the form of section 210 of Companies Act, 1948 and in the case of Re Five Minute Car Wash Service[5] and Re Jermyn Street Turkish Baths Ltd.[6].

The ratio of the English cases of Elder v. Elder and Watson[7], Scottish Cooperative Wholesale Ltd. v. Myer[8] and Re H.R. Harmer Ltd.[9] was being used by the SC to reach the decision it stated in the case of Kalinga Tubes.

5 (1966) I All E.R. 242.
6 (1971) 3 All E.R. 184 (C.A.).
7 (1952) SC 49.
8 (1959) AC 324 (H.L.).
9 (1958) 3 All E.R. 689 (C.A.).

There have been many reported instances of a complaint by the minority shareholders regarding their oppression and mismanagement of affairs of the company by the majority shareholders. It is very surprising to note that the lawmakers of the country neglected to define the term "minority shareholders" in neither the Companies Act, 1956 nor the recent amended Companies Act, 2013. However, there have been some steps taken to resolve issues regarding oppression and violation of rights of minority shareholders in the Companies Act, 2013 which is clearly reflective of the intention of the lawmakers to provide safeguard mechanism for the protection of the rights of minority shareholders and also to prevent their exploitation and oppression by the majority shareholders.

The majority of shareholders are obliged to disclose all the decisions made by them to the minority shareholders. They are also under a legal duty to take into consideration the opinion of the minority shareholding group. The fiduciary relationship among the two groups of shareholders must be respected by the majority group and a transparent mechanism must be followed by the board so that the minority shareholders are not ignored and they are also entitled to equal participation in the management of the company. Engagement must be there between both the shareholding groups in the process of decision making to render a wise and widely acceptable decision.

Effective implementation of the statutory safeguards for the protection of minority shareholders can only be ensured with the realization of the majority shareholders regarding their legal obligations towards the minority shareholders. Endeavors must be made to adopt a collective approach in the management of a company that mandates for the participation of all the members of the company rather than overshadowing the minority shareholders by the majority shareholders. Serving the interests of the majority shareholders must not be the intention and role of the board. Institutional mechanisms should be put in place to redress the grievances of minority shareholders. Also, there is a parallel need to awaken the minority shareholders regarding their rights against the majority shareholders and the duties of the majority group for the enforcement of their rights.