Prevention of Oppression and Mismanagement

1. Introduction

To begin with, let us understand the basic concept hidden behind this chapter. Why would the company law even introduce such a thing, when all the provisions are super clear and explanatory? Because, the law evaders find a way to the loophole. Okay, let’s see this more clearly – imagine a situation of a company say, Rexagon Private Limited, which has 7 shareholder – Abhishek, Archit, Ankur, Anupam, Himanshu, Manas and Rajan. Out of these, Abhishek, Archit and Ankur hold around 94% of the shares of the company. Now, at the general meeting of the company, when any resolution is required to be passed – ordinary or special, the resolution shall be passed in the favour, if these three people vote in the favour of the resolution, since they form a majority. Therefore, the voice of the minority shareholders – Anupam, Himanshu, Manas and Rajan won’t be heard.

This is because the corporate law works on the principle of democracy and it becomes more vulnerable because it is reckoned with the number of shares and not with the number of individuals involved. This is known as the famous ‘Rule of Majority’ or which is also called the ‘Foss v. Harbottle’ Rule, which is a landmark judgment in the history of company law. It states that the ones who hold majority of shares “rule” the company (Foss v. Harbottle (1843) 2 Hare 461). The judgment held that if the majority shareholders have made a decision to take or not to take a certain action, it shall be respected. Also, the courts are not expected to ordinarily intervene to protect the minority interest affected by resolution.

What happened in Foss v. Harbottle? In the said case, two shareholders commenced legal action against the promoters and directors of the company alleging that they had misapplied the company assets and had improperly mortgaged the company property. The Court rejected the two shareholders’ plea and held that a breach of duty by the directors of the company was a wrong done to the company for which it (i.e. the company) alone could sue. In other words, the proper plaintiff in that case was the company and not the two individual shareholders. Thus, the Foss v. Harbottle derives two major rules or principles of the company law – first, a company is a legal entity separate from its shareholders; and second that the Court will not interfere with
the internal management of companies acting within their powers. Therefore, where an ordinary majority of members can ratify the act, the Court will not interfere.

However, the said rule has 4 exceptions, which are as follows –

- **Ultra-vires** or illegal acts;
- Transactions requiring special majorities;
- Personal Rights; and
- The “fraud on the minority” exception.

This Chapter focuses on the last exception as mentioned above.

**Oppression**

Let us understand the meaning of ‘oppression’ as used in the Act. The meaning of the term “oppression” as explained by Lord Cooper in the Scottish case of *Elder v. Elder & Watson Ltd.* was cited with approval by Wanchoo J. of the Supreme Court of India in *Shanti Prasad Jain v. Kalinga Tubes*. He said that the conduct of complained of, should at least involve a visible departure from the standards of their dealing, and violations of conditions of fair play on which every shareholder who entrusts his money to company, is entitled to rely.

The complaining member must show that he is suffering from oppression in his capacity as a member and not in any other capacity.

To constitute oppression, persons concerned with the management of the company’s affairs must, in connection thereof, be guilty of fraud, misfeasance or misconduct towards the members. It does not include mere domestic disputes between directors and members, or lack of confidence between one set of members and others.

It was observed in *Rao (V.M.) v. Rajeshwari Ramakrishnan* that the oppression complained of must affect a person in his capacity or character as a member of the company; harsh or unfair treatment in other capacity, e.g., as a director or a creditor is outside the purview of this chapter.

There must be a continuous acts constituting oppression up to the date of the petition.

The events have to be considered not in isolation but as a part of a continuous suffering.

The conduct complained of, can be said to be “oppression” only when it could be said that it is burdensome, harsh and wrongful; involves at least an element of lack of probity and fair dealing to a member in matters of his proprietary right as a shareholder.
How Act explained oppression and mismanagement: The Act defines that

(i) If affairs of a company have been or are been conducted prejudicial to public interest or in a manner prejudicial or oppressive to any member or prejudicial to the interest of company, there is a case of oppression or mismanagement.

(ii) Any material change that has taken place in management or control of a company and that by reason of such change it is likely that the affairs of a company will be conducted prejudicial to interest of its member or company, that would also be considered as oppression or mismanagement.

2. Application to Tribunal for Relief in Cases of Oppression, etc. [Section 241]

The section seeks to provide the circumstances in which an application may be made to the Tribunal by any member of a company or by the Central Government for relief in cases of oppression and mismanagement in the affairs of the company.

(1) Right to apply by member: Any member of a company who complains that—

(a) the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company; or

(b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by 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 membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members, may apply to the Tribunal, provided such member has a right to apply under section 244, for an order under this Chapter.
Section 241(1) addresses complaints on the conduct of the company's affairs, which could be prejudicial to public interest and prejudicial or oppressive to the members or the company.

The provision gives the members, the right to move the Tribunal not only on complaints of oppression but also on complaints that the conduct of the affairs of the company have been or are prejudicial to them.

Thus, section 241(1)(a) also includes past acts of oppression.

This section also corresponds to the remedy for mismanagement in the affairs of the company. It states that a member can complain "that the affairs of a company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company".

So, a company can complain in case a material change in the management is likely to be prejudicial to the interests of the members.

(2) **Central Government suo moto to apply the Tribunal:** The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order under this Chapter.

**Examples**

1. A shareholder was reduced to a minority status since the company had increased the capital and allotted the additional shares in a manner that resulted in a new majority. As against a petition filed by this shareholder, the majority shareholders offered to restore his status back to the existing before the increase of capital, if the management of another company was handed over to them. Such a transfer of management of another company, does not come under the purview of this section.

2. In an application filed to the Tribunal, claiming oppression, a shareholder who is also the director of the company cannot claim compensation by way of salary paid to other directors. Shareholders can share the dividend of the company, if it is declared but cannot seek directions to be compensated. The payment of salary is a question that concerns the Board of Directors and not the Tribunal.

3. Failure to declare dividend does not amount to oppression. (Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd).

4. A shareholder died. A petition was filed by his legal heir who was in the position of a minority shareholder. Can the application filed by the legal heir to the Tribunal, be maintainable in court?

   The legal heir of the deceased shareholder with minority status is entitled to file the petition.

5. Where a person without being so appointed, was acting as a Managing Director and was discharging his functions as such, whether with or without the knowledge of the members, a member could not claim that it was an act of oppression, by filing an application with the Tribunal.

6. While obtaining relief from Tribunal, continuous losses cannot, by itself, be regarded as oppression (Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth).
3. **Right to apply under section 241 [Section 244]**

The section is linked to section 241 of the Act, and provides for the eligibility of members who hold the right to file the application under section 241 for oppression and mismanagement with the Tribunal. These qualifications as provided in section 244 ensure that only the persons with sufficient interest in the affairs of the company can file the petition under section 241 of the Act.

(1) **Members having right to apply:** The following members of a company shall have the right to apply under section 241, namely:

   a) in the case of a company having a share capital, not less than one hundred members of the company or not less than 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 issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

   b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members:

Provided that the Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified in clause (a) or clause (b) so as to enable the members to apply under section 241. (Thus, The section also enables the members not meeting the membership qualification in section 244(1) to file an application with the Tribunal for waiver of these requirements for filing the petition.)

**Explanation**—For the purposes of this sub-section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

(2) **Entitlement to members to make an application:** Where any members of a company are entitled to make an application under subsection (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.

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**Diagram: Right to apply u/s 241**

- **Company having share capital**
  - 'Which ever is less' of:
    - Atleast 100 members; OR
    - At least 1/10th of the total members (or any member holding 1/10th of issued share capital)

- **Company not having share capital**
  - At least 1/5th of the total number of members
Examples

1. In case, where the shareholding of the petitioner-member gets reduced to below 10 per cent because of fresh issue/allotment of shares, which is challenged as oppressive, the maintainability of the petition would be reduced after determining the validity of the issue of allotment. The petition shall be maintainable and the petitioner-member shall be entitled to relief.

2. The requirement of shareholding up to the prescribed percentage is mandatory. It must be shown with the help of documentary evidence. Possession of share certificates is a prima facie proof that the petitioner is a shareholder. There is a presumption that a share certificate is a valid title to shares.

3. Shareholding and membership is reckoned not on the basis of the subscribed or paid-up share capital, but on the basis of the 'issued' share capital. For instance, a company may have issued a capital of 50 lakh rupees divided into 50,000 shares of 100 rupees each, but only 45,000 shares may have been subscribed for. The remaining shares will then be left to be disposed of in such a manner as the Board of Directors think best in the interests of the company. ‘Issued’ share capital would include both equity and preference share capital.

4. The consent to be given by a shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by any shareholder during the course of proceedings shall not affect the maintainability of the petition [Rajamundhry Electric Corporation Vs. V. Nageswar Rao A.I.R. (1956) Sc. 2013.]

4. Powers of Tribunal [Section 242]

(1) **Order passed by the tribunal:** If, on any application made under section 241, the Tribunal is of the opinion—

(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; 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,

the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

(2) **Nature of orders that can be passed by the Tribunal:** Without prejudice to the generality of the powers under sub-section (1), an order under that sub-section may provide for—

(a) the regulation of conduct of affairs of the company in future;
(b) the purchase of shares or interests of any members of the company by other members thereof or by the company;

(c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

(d) restrictions on the transfer or allotment of the shares of the company;

(e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

(f) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e):

Provided that no such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;

(g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;

(h) removal of the managing director, manager or any of the directors of the company;

(i) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);

(k) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;

(l) imposition of costs as may be deemed fit by the Tribunal;

(m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

(3) **Filing of copy of order of tribunal:** A certified copy of the order of the Tribunal shall be filed by the company with the Registrar within 30 days of the order of the Tribunal.

(4) **Interim order:** The Tribunal may, on the application of any party to the proceeding, make any interim order which it thinks fit for regulating the conduct of the company’s affairs upon such terms and conditions as appear to it to be just and equitable.
(5) **Alteration through order of the tribunal:** Where an order of the Tribunal makes any alteration in the memorandum or articles of a company, then, notwithstanding any other provision of this Act, the company shall not have power, except to the extent, if any, permitted in the order, to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order, either in the memorandum or in the articles.

(6) **Punishment in case of contravention:** If a company contravenes the provisions of sub-section (5) [i.e. not amending the memorandum or articles of association of the company, in a manner consistent with orders passed for alteration of these documents], the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both.

(7) **Altered provision shall apply:** The alterations made by the order in the memorandum or articles of a company shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act and the said provisions shall apply accordingly to the memorandum or articles so altered.

(8) **Certified copy of altered order shall be filed with the Registrar:** A certified copy of every order altering, or giving leave to alter, a company's memorandum or articles, shall within 30 days after the making thereof, be filed by the company with the Registrar who shall register the same.

**Examples**

1. Mere lack of confidence among members themselves resulting in certain acts of irregularities or illegalities cannot be held to be oppressive *per se*. A case of oppression as well as mismanagement has to be made out by the petitioners substantiating that the acts complained of have caused prejudice to the interest of the company and its members and shareholders to have a cause of action to attract the provisions of the Act.

2. Directorial complaints cannot be entertained in such a petition unless it is a composite complaint and is in the case of a company in the nature of *quasi* – partnership (i.e. small partnerships of a limited number of individuals which, although operating as a limited company, run as if they are partnership between those individuals at the control.

3. The matter of selection and appointment of dealers of the company’s products is not within the ambit and scope of the proceedings under section 241 (erstwhile section of the Act). In a tripartite agreement with the government, a project was assigned to the company. In this case, the right to manage the affairs of the company is vested in the majority of the shareholders and not in the person who might have procured the project for the company.

4. The decisions relating to the operation of the company’s bank accounts are a part of the managerial power of the directors. The mere fact that a director is not being associated
with the operation of the company’s bank accounts, does not constitute oppression or
mismanagement. (Sudha M. Singh v. Eagle Cones Pvt. Ltd (2000) 36 CLA 189)\(^1\)

5. The decision of the Board of Directors to write-off bad debts is a commercial decision and
does not require any judicial interference.

6. The members of the company, Minions Private Limited have filed an application for
oppression in the company. To prove their facts, the members have requested for the
inspection of documents of the company, which the company denied to provide. Discuss,
whether this amount to oppression?

The right to inspection of documents and books of account of a company is not limited to
the Board of directors. In order to prove allegations made in a petition under section 241
(erstwhile section of the Act), the shareholders are entitled to be allowed inspection of the
books of account and other relevant papers of the company. However, mere denial of
inspection, whether during the pendency of the petition or before it, does not amount to an
act of oppression as held in the case of Lalita Rajya Lakshmi v. Indian Motor Co.
(Hazaribagh) Ltd. (1962) 32 Com Cases 207. If a petitioner cannot make out a case of
mismanagement and oppression, because he was unable to collect materials for the
purpose, it is not for the court to direct the directors of the company to offer inspection of
the company’s books and accounts so as to enable a petitioner to collect materials for the
petition under the Act.

7. In deciding an application under section 241 and 242 (erstwhile section of the Act), the
Tribunal has to bear in mind that the act of oppression must be a continuing one. A single
act of renting out the premises of the company without the knowledge of the members
cannot be termed as oppression or mismanagement.

8. The power to issue shares should be exercised bona-fide in the interest of the company
and not for benefitting the directors or any other group. The directors are in a fiduciary
position with the company and must exercise their power to issue the shares for the benefit
of the company. If the power is exercised solely for their personal benefit, the Tribunal may
interfere and prevent the directors from doing so. The act of issue of further shares by the
directors of a company for the purpose of converting a majority into minority is a grave act
of oppression.

5. Consequences of termination or modification of certain
agreements [Section 243]

(1) Consequence of termination or modifications of certain agreements by an order
passed by the Tribunal: Where an order made under section 242 terminates, sets aside
or modifies an agreement such as is referred to in sub-section (2) of that section,—

(a) such order shall not give rise to any claims whatever against the company by any

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person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;

(b) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company:

Provided that the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

(2) **Penalty:** Any person who knowingly acts as a managing director or other director or manager of a company in contravention of clause (b) of sub-section (1), and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both.

6. **Class action [Section 245]**

This section introduces the concept of class action by shareholders and depositors of a company with substantive remedies. Under section 245 of the act, members and depositors, or an individual member or depositor, can file a petition for reliefs, if they are of the opinion that the affairs of the company are being managed or conducted in a manner prejudicial to the interests of the company, its members or depositors.

According to section 245:

(1) **Filing of application before the Tribunal on behalf of the members or depositors:** Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders, namely:—

(a) to restrain the company from committing an act which is ultra vires the articles or memorandum of the company;

(b) to restrain the company from committing breach of any provision of the company’s memorandum or articles;

(c) to declare a resolution altering the memorandum or articles of the company as void.
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if the resolution was passed by suppression of material facts or obtained by misstatement to the members or depositors;

(d) to restrain the company and its directors from acting on such resolution;

(e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;

(f) to restrain the company from taking action contrary to any resolution passed by the members;

(g) to claim damages or compensation or demand any other suitable action from or against—

(i) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;

(ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or

(iii) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;

(h) to seek any other remedy as the Tribunal may deem fit.

(2) Required number of members to apply:

(i) The requisite number of members provided in sub-section (1) shall be as under:—

(a) in the case of a company having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.

(ii) The requisite number of depositors provided in sub-section (1) shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever less is, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.
(3) **Requirement for consideration of application:** In considering an application under sub-section (1), the Tribunal shall take into account, in particular—

(a) whether the member or depositor is acting in good faith in making the application for seeking an order;

(b) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of subsection (1);

(c) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;

(d) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;

(e) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—

(i) authorised by the company before it occurs; or

(ii) ratified by the company after it occurs;

(f) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

(4) **In case of admission of application:** If an application filed under sub-section (1) is admitted, then the Tribunal shall have regard to the following, namely:—

(a) public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed;

(b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant’s side;

(c) two class action applications for the same cause of action shall not be allowed;

(d) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

(5) **Remedy:** Where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading
statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

(6) **Order shall be binding:** Any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.

(7) **Punishment for non-compliance:** Any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

In addition to this punishment, penalties given under sections 337 to 341 (both inclusive) shall also apply.

(8) **Application filed is frivolous/vexatious:** Where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost, not exceeding one lakh rupees, as may be specified in the order.

(9) **Exemption from application of section:** Nothing contained in this section shall apply to a banking company.

(10) **Application may be filed on behalf of affected persons:** Subject to the compliance of this section, an application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1).

7. **Application of certain provisions to proceedings under section 241 or section 245 [Section 246]**

The provisions of sections 337, 338, 339, 340 and 341 (both inclusive) related to winding up, shall apply *mutatis mutandis*, in relation to an application made to the Tribunal under section 241 or section 245.

Penalty for Frauds by Officers [Section 337]

Liability Where Proper Accounts not Kept [Section 338]

Liability for Fraudulent Conduct of Business[Section 339]

Power of Tribunal to Assess Damages Against Delinquent Directors, etc.[Section 340]

Liability Under Sections 339 and 340 to Extend to Partners or Directors in Firms or Companies [Section 341]
[All these sections are covered under chapter i.e. Winding Up]

In other words:

- The section seeks to provide that the provisions of the section 337 to 341 relating to power to punish for contempt of Tribunal shall apply in relation to a fraudulent application made to the Tribunal for oppression and mismanagement.

- The provisions of section 337 – 341 deal with offences by officers, contributories and promoters of a company after its winding up and provide for penalties and recompense for falsification of books, frauds committed by officers, failure to keep proper accounts, fraudulent conduct of business, and the power to access damages against such delinquent officers, including partners and directors when a firm or a body is involved.