

Minority being the victim need to be protected - Prevention of Oppression and Mismanagement

By



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Introduction

This Article mainly deals with the oppression and mismanagement. The Companies Act, 2013 under Chapter XVI covering Sections 241 to 246 deals with Oppression and mismanagement and Class Action. Further provisions for class action are provided under Section 245 and 246. We have a separate article on class action.

As we all know majority always wins and majority rule over minority. It is very ordinary that majority oppress the minority. Likewise, in politics and other area, in companies also a majority of members of a company exercise the powers of the company and generally control its affairs. During the course of business, oppression of small or minority shareholders could take place by the majority shareholders who are in control of the company. There are about 13 Lakhs companies in India and the company functions through the decisions of the Board of Directors.

In order to function the corporate affairs effectively and successfully and to increase the corporate governance, the interest of the minority need to be protected.

The Company law had given a protection to such minority shareholders by giving an option to go to Tribunal for relief and the tribunal on such application shall take to prevent such oppression and mismanagement.



What is Oppression?

In order to understand the law behind oppression and mismanagement, it is very important to first understand the meaning of the term. As I can say that we can't solve the problem unless we know about the problem. Here the problem is oppression and mismanagement and the solution are its prevention by legal statute.

Ordinary meaning of oppression- prolonged cruel or unjust treatment or exercise of authority. An act or instance of oppressing or subjecting to cruel or unjust impositions or restraints

The term '*Oppression*' has been explained by *Lord Cooper* as, "The essence of the matter seems to be that 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 the company is entitled to rely”

Oppression is very common practice in corporate sector. Company is an artificial person having separate legal entity. Different legal entity is having different opinions. There must be a conflict of interest between the parties. Majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs. Shareholders have a fiduciary duty to treat minority shareholders fairly.

The company law gives the minority shareholders a power to protect their interest and prevent oppression and mismanagement.

Mismanagement means to manage incompetently or dishonestly.

Examples of Oppression

Oppression in relation to minority shareholders may occur in the following ways:

1. improper diversion of a business to another entity;
2. payment of excessive remuneration to a controller or associate;
3. failure to prosecute an action;
4. improper share issue;
5. improper exclusion from participation in management;
6. denial of access to information;
7. misuse of company funds;
8. Oppressive conduct at board meetings.

Examples of Mismanagement

Some of these instances which can be termed as mismanagement are:

1. Preventing Directors from Functioning;
2. Absence of Company's Records Causing Prejudice to Company's Business;
3. Sale of assets at a low price and without compliance with the Act
4. Violation of Statutory Provisions;
5. Violation of Provisions of Memorandum and Articles of the Company;
6. Irregularities in conduct of affairs;
7. Misuse of Funds Etc.
8. Causing losses due to rash decision
9. Not maintaining proper records,
10. Not calling requisite meetings.
11. Drawing considerable expenses for personal purposes by directors/management of the company.



Majority and minority interest

A person or entity holds more than 50% of the company's total shares are the majority shareholders. At any time during the year any person acquires more than 50% of the total share capital, he attains the majority.

Minority shareholders are the person or entity who holds less than 50% of the company's total shares. By virtue of his or her below fifty percent ownership of the firm's equity capital, minority shareholder has no voting control of the firm. As a result, if a dispute arises over the sale or distribution of assets or another issue requiring shareholder votes, a minority shareholder doesn't have voting strength on his own.

Why this law was made?

The reason behind such law is to maintain peace in the company and to successfully run the affairs of the company. As the company is an artificial person having a separate legal entity, it cannot function on its own. It has appointed shareholders who manage the affairs of the company. In this case, there may arise some dispute between the shareholders. The shareholders who hold majority of shares of the company have the control of the company.

They sometimes misuse their power and treat the minority with cruelty. In order to safeguard the interest of such minority shareholders, this law has been enacted.

Background

The concept of oppression and mismanagement was first seen in the Companies Act, 1956 under Chapter VI covering Sections 397 to 409. Earlier 10 Sections were dealt with the oppression and mismanagement.

Oppression as per section 397(1) of Companies Act 1956 has been defined as when affairs of the company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to public interest or in a manner oppressive to any member or members.

Section 397 of the Companies Act, 1956 deals with oppression and mismanagement which says that any member of a company who complain that 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 (including any one or more of themselves) may apply to the Company Law Board for an order under this Section provided such members have a right so to apply in virtue of Section 399. On application, if the Company Law Board is of opinion that the company affairs are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members and 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 Company Law Board may, with a view to bringing an end to the matters complained of, make such order as it thinks fit.

Section 398 provides that any members of the company, who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company or that a material change (not being a change brought about by, or in the interests of, any creditors including debenture holders, or in any class of shareholders, of the company) has taken place in the management or control of the company whether by an alteration in its 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 public interest or in a manner prejudicial to the interests of the company, may apply to the Company Law Board for an order provided such members have a right so to apply in virtue of Section 399. If the Company Law Board is of the opinion that the affairs of the company are being conducted as aforesaid or that by reason of any material change as aforesaid in the management or control of the company, it is likely that the affairs of the company will be conducted as aforesaid, the Company Law Board may, with a view to bringing an end or preventing the matters complained of or apprehended, make such order as it thinks fit.

Under Section 398 the applicant has to prove that the affairs of the company are being conducted in a manner prejudicial to the public interest or prejudicial to the interest of the company itself, or that there has been material change effected in the management/ownership of the company which is against public interest or against the interest of the company.

Legal provisions

Chapter XVI-Sections 241 to 246 (6 sections) deals with oppression and management

241. Application to Tribunal for relief in cases of oppression, etc.

242. Powers of Tribunal.

243. Consequence of termination or modification of certain agreements.

244. Right to apply under section 241.

245. Class action.

246. Application of certain provisions to proceedings under section 241 or section 245.

Application to Tribunal for relief in cases of oppression, etc (effective from 1st June, 2016)

Section 241(a) defines Oppression as the affairs which are conducted in a manner prejudicial to public interest, members of the Company or in a manner to the interests of the Company.

Section 241(b) defines Mismanagement as any material change which is conducted in a manner prejudicial to public interest by altering the ownership of the Company.

An Application can be made to the National Company Law Tribunal under section 241(1) if the members of the Company believe that affairs of the Company are done in a manner which is detrimental towards the members of the Company and against public interest.

If the Central Government feels that the activities of a Company are conducted in a manner which is prejudicial to public interest it may itself apply to the tribunal.

Powers of Tribunal to prevent Oppression and Mismanagement under section 242

Section 242 of the Companies Act confers power upon the National Company Law Tribunal to take action if it is of the opinion that the conduct of the company is prejudicial and oppressive to the members of the Company. Apart from winding up of the Company, it can take:

- Regulation of affairs of the company in future.
- Other members purchase the shares or interests of any member of the company.
- Purchase of its shares by the company resulting in reduction of its share capital.
- Restrictions can be imposed on the transfer or allotment of the shares.
- The termination, setting aside or modification of any agreement, between the company and the managing director, any other director or manager which is deemed necessary by the Tribunal.
- The termination, setting aside or modification, of any agreement, between the company and any person other than those referred above which is deemed necessary by the Tribunal.
- 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 3 months before the date of 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.
- Removal of the managing director, manager or any other director of the company.

- Recovery of undue gains made by any managing director, manager or director and utilization of the recovery by transfer to Investor Education and Protection funds or repayment to identifiable victims.
- The procedure to appoint a new Managing Director or Manager after the removal of an existing Managing Director or manager.
- Appointment of persons as directors, who may be required to report the Tribunal.
- Pass an interim order as the Tribunal may deem fit for regulating the conduct of the Company.
- Pass an order to alter the Memorandum or Article of Association of the Company and it should be in accordance with the order of the Tribunal.
- Other Steps as it may deem necessary by the Tribunal.

Who can file petition for oppression and mismanagement? (Section 244)

Section 244 prescribes the right to apply for oppression and mismanagement.

In case of Company having share capital:

- (a) Not less than one hundred members of the Company, or
- (b) Not less than one-tenth of the total number of its members,

Whichever is less shall have the right to apply under Section 241.

In case of a company not having share capital, not less than one-fifth of the total number of its members shall have the right to apply under section 241.

Tribunal may, on an application made to it in this behalf, waive all or any of the requirements specified, so as to enable the members to apply under section 241.

Where any members of a company are entitled to make an application, 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.

Can a single member make an application?

A single member may make a complain to the Ministry of Corporate affairs through the regional director or registrar of companies. Then the ministry will make an application to the tribunal for such oppression and mismanagement.

Conditions to be satisfied for oppression

- Continuous Nature: the process of oppression must be of a continuing one.
- Prejudicial to Public Interest: It is another condition required to be fulfilled that the affairs of the company are being conducted in a way prejudicial to public interest. It means that it must not oppose to public welfare or the welfare of the society. It must act in the public interest.
- Winding up Order under Just and Equitable Clause: The principle behind this is that if there is persistent violation of the regulations and statutes and an appeal to general body is not likely to put an end to the matters complained of by reason of the fact that those responsible for the violations control the affairs of the company, then it will be just and equitable to wind up the company.

Powers of Tribunal (Section 242)

On an application, if the Tribunal is of 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 an end to the matters complained of, make such order as it thinks fit.

A certified copy of the order of the Tribunal under sub-section (1) shall be filed by the company with the Registrar within 30 days of the order of the Tribunal.

This means that Tribunal has unlimited power under this section. However, this section asks the Tribunal to give particular details in its order.

Details in order passed by Tribunal- Section 242 (2)

The order shall 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 utilization 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.

Interim Order -Section 242 (4):

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.

Consequence of termination or modification of certain agreements

Where an order was made by the tribunal to terminates, sets aside or modifies an agreement -

(a) such order shall not give rise to any claims whatever against the company by any 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 consent of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company.

Punishment

Any person who knowingly acts as a managing director or other director or manager of a company in contravention and every other director of the company who is knowingly a party to such contravention, shall be punishable with fine which may extend to five lakh rupees.

The National Company Law Tribunal Rules, 2016 -dated-21.07.2016

Rule 81, 82 and 83 of the National Company Law Tribunal Rules, 2016. There are 3 Rules which deal with the oppression and mismanagement.

Rule 81 deals with the application under section 241. NCLT-1 is the prescribed form for application made under section 241. Where an application is made by any one or more of

members, the letter of consent is to be signed by the rest of the members so entitled authorizing the applicant or the applicants to present the petition on their behalf.

Also, the names and addresses of all the members on whose behalf the application is presented must be given in a schedule to the application, and where the company has share capital, the application shall state whether the applicants have paid all calls and other sums due on their respective shares.

A copy of such application shall be served on the company, other respondents and all such persons as the Tribunal may direct.

Withdrawal of Application filed under section 241

An application shall not be withdrawn without the consent of the Tribunal. It means that in order to withdraw the application, the permission of NCLT should be taken.

Application under section 243

Rule 83 prescribes that the application for leave to any of the persons to be appointed or to act as the managing director or other director or manager of the company where the termination or modification of certain agreements has been made, shall be filed in Form NCLT-1.


Opportunities for Chartered Accountant under Oppression and Mismanagement

It is a wonderful opportunity for a Chartered Accountant to provide services under Oppression and Mismanagement


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- ✓ Drafting a petition
- ✓ Representation before Tribunal
- ✓ Carry out an investigative audit of the accounts of the company

- ✓ Report on the financial transactions of the company
- ✓ To carry on the management of affairs of the company
- ✓ scrutinize the books of account and vouchers and other concerned records of the company
- ✓ Appeal to the appellate tribunal
- ✓ Practicing advocacy

**PROFESSIONAL SERVICES
UNDER
CHAPTER XVI OF THE
COMPANIES ACT 2013-
PREVENTION OF OPPRESSION
AND MISMANAGEMENT**



Companies Act, 2013



**WITH CA (DR.) RAJKUMAR
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