

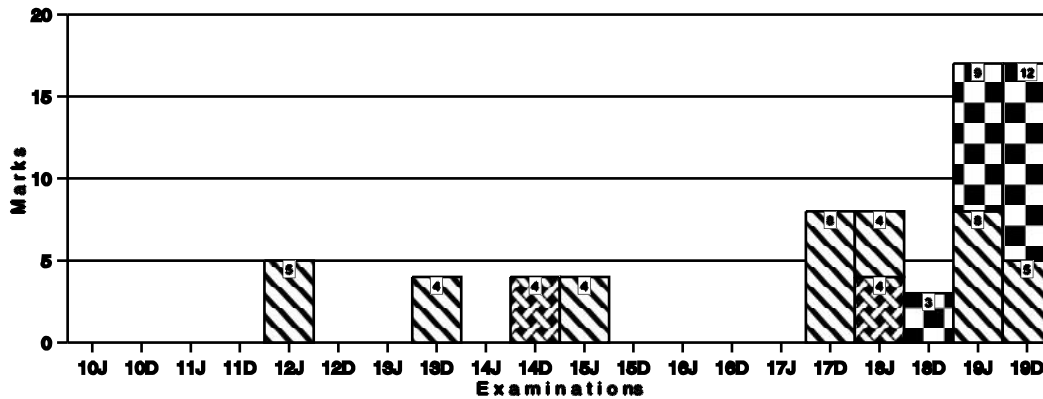
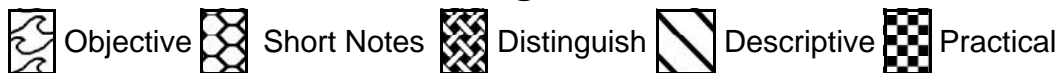
1 SHAREHOLDERS' DEMOCRACY AND CORPORATE DISPUTES

THIS CHAPTER INCLUDES

- Shareholders' Democracy
- Majority Powers and Minority Rights
- The Principle of Non-interference (Rule in *Foss v. Harbottle*)
- Exceptions to the Rule in *Foss v. Harbottle*
- Transfer and Transmission of Securities (Section 56)
- Punishment for personation of shareholder (Section 57)
- Refusal of Registration and Appeal Against Refusal (Section 58)
- Rectification of Register of Members (Section 59)
- Punishment for Wrongful withholding of Property (Section 452)
- Class Action Suits
- Impacts of Class Action Suits
- Compensation in case Security Fraud
- Who can file class action suits?

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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CHAPTER AT A GLANCE

Shareholders' Democracy

- The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives.
- The Government of India, has been endeavouring to disperse the shareholding as widely as possible to avoid concentration of ownership in few hands.
- Thus the shareholder' democracy can play an important role in stimulating the Board of directors, raising company performance, and ensuring that the community at large takes a greater interest in industrial progress.
- Democracy means the rule of people, by people and for people. In that context the shareholders democracy means the rule of shareholders, by the shareholders', and for the shareholders' in the corporate enterprise, to which the shareholders belong.
- Precisely it is a right to speak, congregate, communicate with co-shareholders and to learn about what is going on in the company.

Majority Powers and Minority Rights

- A company being an artificial person with no physical existence, functions through the instrumentality of the Board of directors who is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole.
- It is, therefore, a cardinal rule of company law that prima facie a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs. Member's right to vote is recognised as right of property and the shareholder may exercise it as he thinks fit according to his choice and interest.

- A special resolution, for instance, requires a majority of 3/4^{ths} of those voting at the meeting and therefore, where the Act or the articles require a special resolution for any purpose, a three-fourth majority is necessary and a simple majority is not enough.
- The resolution of a majority of shareholders, passed at a duly convened and held general meeting, upon any question with which the company is legally competent to deal, is binding upon the minority and consequently upon the company.

The Principle of Non-interference (Rule in *Foss v. Harbottle*)

- The general principle of company law is that every member holds equal rights with other members of the company in the same class.
- The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members the issue is decided by a vote of the majority.
- Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed.
- The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority.
- The basic principle of non-interference with the internal management of company by the Court is laid down in a celebrated case of *Foss v. Harbottle* 67 E.R. 189; (1843) 2 Hare 461 that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

Exceptions to the rule in *Foss v. Harbottle*

The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

- (a) the common law; and
- (b) the provisions of the Companies Act.

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases:

1. Ultra Vires Acts
2. Fraud on Minority
3. Wrongdoers in Control
4. Resolution requiring Special Majority but is passed by a simple majority
5. Personal Actions
6. Breach of Duty
7. Prevention of Oppression and Mismanagement

Meaning of Oppression

The words “oppression” and “mismanagement” are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.

Right to apply

The following members of a company shall have the right to apply u/s 241, namely:

- (a) In the case of a company having a share capital:** Not less than 100 members of the company or not less than one -tenth of the total number of 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 members.

However, the Tribunal may, on an application, waive all or any of the above requirements so as to enable the members to apply u/s 241.

Exceptions to the Rule in *Foss v. Harbottle* or Protection of Minority Rights and share-holders remedies

- Ultra Vires Act
- Fraud on Minority
- Wrongdoers in Control
- Resolution requiring Special Majority but is passed by a simple majority
- Personal Actions
- Breach of Duty
- Prevention of Oppression and Mismanagement

Under the Provision of Companies Act, 2013:

The first remedy in the hands of an oppressed minority is to move the NCLT. **Section 241** provides 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(s) (including any one or more of themselves) may make an application to the NCLT by way of petition for relief. Following requirements must be satisfied for seeking a relief under **Section 241**:

- (i) That the affairs of the company are being conducted: (a) in a manner prejudicial to public interest; or (b) oppressive to any members.
- (ii) That the fact justified the compulsory winding up order on the ground that it is just and equitable that the company should be wound up.
- (iii) That to wind up the company would unfairly prejudice the petitioners
[Ramji Lal Baiswala v. Britain Cable Ltd., (1964) 14 Raj. 135].

On being satisfied about the above requirements, the NCLT may make the necessary orders for ending the matters complained of. The first requirement relates to public interest or oppression. First we analyse and discover the precise connotation of the word "oppression" with the help of judicial decisions.

Transfer and Transmission of Securities (Section 56)

- (1) A company shall not register a transfer of securities of the company, or the interest of a member in the company in the case of a company having no share capital, other than the transfer between persons both of whose names are entered as holders of beneficial interest in the records of a depository, unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation,
- (2) Nothing in **sub-section (1)** shall prejudice the power of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.
- (3) Where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.
- (5) The transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.

Punishment for Personation of Shareholder (Section 57)

If any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

Punishment for wrongful withholding of property (Section 452)

- (1) If any officer or employee of a company –
- (a) wrongfully obtains possession of any property, including cash of the company; or
 - (b) having any such property including cash in his possession, wrongfully withholds it or knowingly applies it for the purposes other than those expressed or directed in the articles and authorised by this Act, he shall, on the complaint of the company or of any member or creditor or contributory thereof, be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

What is a class action suit?

- A class action suit is a lawsuit where a group of people representing a common interest may approach the Tribunal to sue or be sued.
- It is a procedural instrument that enables one or more plaintiffs to file and prosecute litigation on behalf of a larger group or class having common rights and grievances.

Impacts of class action suits

- Class action suits is an invention of equity to enable it to proceed to a decree in suits where the number of those interested in the subject of the litigation is so great that their joinder as parties in conformity to the usual rules of procedure is impracticable.
- Thus, the said curative measures, viz. class action suit is evolved to overcome such drawbacks and allow a set of persons to represent all other members of said class who are scattered in different jurisdictions.

Clubbing of similar application and bar on future litigation

When the facts are similar in suits filed in different dominions by the members of the same class, standing against the same or similar defendants, it makes sense to combine them all and adjudicate it under one roof. Clubbing of similar claims/suits would also result in efficiency of judiciary, as the same would save precious time of judiciary from adjudicating the similar dispute numerous times.

Compensation in case security fraud

As stated earlier, representative suits are not naïve in India, instead there are three sets of remedies available. In case of civil court, it is settled position of law that in case of securities related fraud, no court of law hold jurisdiction and Securities and Exchange Board of India (SEBI) holds exclusive jurisdiction in such matter.

Who can file class action suits?

There are following set of classes recognized under the Act to file class action suits – (i) members (ii) depositors and (iii) any class of them. The Companies Act, 2013 just like its predecessor recognizes the following persons as members of a company :

- (i) The subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members;
- (ii) Every other person who agrees in writing to become a member of the company and whose name is entered in the register of members of the company;
- (iii) Every person holding shares of the company and whose name is entered as a beneficial owner in the records of a depository.

DISTINGUISH BETWEEN

2014 - Dec [2] Distinguish between the following:

(b) 'Oppression' and 'mismanagement'.

(4 marks)

Answer:

Points	Oppression	Mismanagement
Meaning	The term 'Oppression' is not defined in the Companies Act, 2013. Oppression, according to the dictionary meaning of	The term "Mismanagement" is also not defined in the Companies Act, 2013. Normally mismanagement means gross

	<p>the word, is any act exercised in a manner burdensome, harsh and wrongful. Oppression means violation of condition of fair play. The complaining member must be under a burden which is unjust, harsh or tyrannical. It involves lack of probity or fair dealing to a member in the matter of rights as a shareholders.</p>	<p>misconduct of affairs of the company or misuse of powers given to directors or members under the Companies Act, 2013.</p>
<p>Examples</p>	<p>Some of the acts held as oppressive are as follows:</p> <ul style="list-style-type: none"> • Continuous refusal to register shares to retain control over affairs of the company. • Illegal removal of director one group and appointing other director without notice to one group of directors. • Calling board meeting with 2 days notice so that NRI directors cannot attend and allotting shares to one group so that it comes into majority. • Issuing shares to wife of directors for wholly illusive consideration. 	<p>Some of the acts held as mismanagement are as follows:</p> <ul style="list-style-type: none"> • Not allowing director to function as director • Reckless sanction and disbursement of loans. • Serious violation of legal provisions • Acting beyond authority of memorandum and articles. • Directors do not take serious actions in case of corruption, embezzlement etc. • Diversion of funds • Operation of bank accounts by unauthorized persons.

6.10

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- Attempt to deprive members of his ordinary membership rights e.g. denial of voting right or denial to contest election as director.

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2018 - June [2] Distinguish between the following:

(a) Oppression and mismanagement application and Class action suits.

(4 marks)

Answer:

Oppression and Mismanagement Application:

Section 244 of the Companies Act, 2013 provides that the following members of a company have the right to apply in case of oppression and management referred to under **Section 241** to the tribunal:

- (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:

The Tribunal has the power that on an application made to it in this behalf, waive all or any of the above mentioned requirements so as to enable the members to apply under **Section 241**.

Class Action Suits:

Section 245 of the Companies Act, 2013, deal with Class action suits. It is provided that members, depositors or any class of them, 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.

The requisite number of members is 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.

Further, the requisite number of depositors 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 is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

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DESCRIPTIVE QUESTIONS

2008 - Dec [7] (b) What reliefs are available to the minority shareholders against wrongful conduct of the majority? **(7 marks)**

Answer:

Protection is accorded to minority Shareholders under the Companies Act in the following circumstances:

1	The variation of class rights	The rights attached to the shares of any class can be varied as per Section 48(1) with the consent in writing of the holder of not less than 3/4 th of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class. But the holders of not less than 10% of the shares of that class who had not assented to the variation may apply to the Tribunal for the cancellation of the variation as per Section 48(2) .
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2	Schemes of reconstruction and amalgamation	The minority is accorded protection in cases where they dissent to the scheme of reconstruction or amalgamation.
3	Oppression and mis-management	The principle of majority rule does not apply to cases where Sections 241 to 246 are applicable for prevention of oppression and mis-management. A member, who complains that the affairs of the company are being conducted, in a manner oppressive to some of the members including himself, or against public interest, he may apply to the Tribunal.
4	Alternative remedy to winding up	Any member or members, who complain that the affairs of the company are being conducted in a manner oppressive to some of the members including themselves, may apply for winding up of company.
5	Investigation by the Government	As per Section 210 the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of any company and to report thereon in such manner as the Central Government may direct.

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2009 - Dec [1] {C} Attempt the following :

(iv) "Oppression need not be continuous." Discuss.

(5 marks)

Answer:

Oppression must be a continuous process	<ul style="list-style-type: none"> The Supreme Court has observed regarding the meaning of term 'oppression' as follows: It is not enough to show that there is just and equitable cause for winding up though that must be shown as preliminary to the application of Section 241 of Companies Act, 2013.
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	<ul style="list-style-type: none"> • It must further be shown that the conduct of the majority shareholders was oppressive to the minority as members and this requires that events have to be considered not in isolation but as part of a consecutive story. • There must be continuous acts on the part of the majority shareholders continuing up to the date of petition. [<i>Shanti Prashad vs. Kalinga Tubes (1965) 35 Comp. 351</i>].
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2012 - June [1] {C} Comment on the following:

- (iii) The NCLT or law will not interfere with the internal management of companies acting within their powers. **(5 marks)**

Answer:

1	The Principle of Majority Rule	<ul style="list-style-type: none"> • Majority must prevail is the principle of company management like any democratic set up, the majority has its way in a company though due provision must also be made for the protection of minority interest. • This principle that the will of the majority should prevail and bind the minority is known as the principle of majority rule. • The principle of majority rule was first given recognition in the case of <i>Foss. Vs. Harbottle</i>.
2	Fact of the Case	<ul style="list-style-type: none"> • Two members of an incorporated company took legal proceeding against the directors of the company, charging them guilty of fraudulent acts resulting in loss to the company. • The minority shareholders, therefore, decided to take an action for damages against the directors.

	<ul style="list-style-type: none"> • The shareholders in general meeting by majority resolved not to take any action against the directors alleging that they were not responsible for the loss which has been incurred. • The NCLT held that the actions were capable of confirmation by the majority.
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A. General Law:

1	Act illegal or ultra vires	<ul style="list-style-type: none"> • The Rule in <i>Foss Vs. Harbottle</i> applies only where the act complained of is within the powers of the company. If act is ultra vires the company, the rule does not apply, no majority can sanctioned or confirm such an act and every shareholder is entitled to bring on action against the company and its officers in respect of it. • Thus, every shareholder is entitled to sue for an injunction to restrain the <i>ultra vires</i> acts of the directors or the officers of the company.
2.	Fraud on the minority	Where the majority of a company members use their power to defraud or oppress the minority, their conduct is liable to be impeached even by a single shareholders.
3.	Wrongdoers in control of the company	<ul style="list-style-type: none"> • When the persons against whom the relief is sought themselves hold and control the majority of shares in the company and will not permit an action to be brought in the name of the company and shareholders may sue in their own names. • Its reason is that if the majority of shareholders will not be given such right their grievance can never reach the NCLT because the wrongdoers themselves, being in control of company would not allow the company to sue.

4	Acts requiring a special resolution	Sometimes the act or the articles of the company require acts to be done only by passing a special resolution at a general meeting of the company and therefore if the majority shareholders purport to do any act without passing a special resolution (i.e. by passing an ordinary resolution), anyone can bring an action to prevent the majority to do so.
5.	Individual membership rights	In case of infringement of the individual membership rights, every shareholder is entitled to bring an action in his own name. "If such a right is in question a single shareholder can, on principal, defy a majority consisting of all the other shareholders."

Space to write important points for revision

2013 - Dec [2A] (Or) Explain the following:

- (iv) Mere lack of confidence between the majority shareholders and minority shareholders would not be enough to order for relief under Section 241 . **(4 marks)**

Answer:

- The scope of **Section 241** was very succinctly enunciated by the Supreme Court in ***Shanti Prasad Jain v. Kalinga Tubes Ltd.*** where it observed that "It is not enough to show that there is just and equitable cause for winding up of the company though that must be shown as a preliminary to the application under **Section 241**."
- It must further be shown that the conduct of majority shareholders were oppressive to the minority as members and this requires that events have to be considered not in isolation but as a part of consecutive story.
- There must be continuous acts on the part of the majority shareholders continuing to the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some members. the conduct must be burdensome, harsh and wrongful.

- Mere lack of confidence between the majority shareholders and the minority shareholders would not be enough unless lack of confidence springs from oppression of minority by the majority in the management of the company's affairs and such oppression must involve at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as a shareholder."

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2015 - June [3A] (Or) (iv) A petition signed by 100 members of a company has been moved to NCLT for prevention of mismanagement. Later on, half of the members (signatories) withdrew their consent after filing the petition. Examine whether the remaining applicants (petitioners/signatories) to the petition would be successful in their complaint to NCLT. **(4 marks)**

Answer:

1	Right to apply under section 241	The following members of a company shall have the right to apply u/s 241, namely: (a) In the case of a company having a share capital: Not less than 100 members of the company or not less than one -tenth of the total number of 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 members.
2	Rajahmundry Electric Supply Co. v. A. Nageshwara Rao, AIR 1956 SC 213	However, the Tribunal may, on an application, waive all or any of the above requirements so as to enable the members to apply u/s 241. Once the consent has been given by the requisite number of members by signing the

		<p>application, the application may be made by one or more of them on behalf and for the benefit of all of them. It has been held by the Supreme Court in <i>Rajahmundry Electric Supply Co. v. A. Nageshwara Rao</i>, AIR 1956 SC 213, that if some of the consenting members have, subsequent to the presentation of the application, withdrawn their consent, it would not affect the right of the applicant to proceed with the application.</p> <p>Obtaining of consent is a condition precedent to the making of the application and hence a consent obtained subsequent to the application is ineffective. <i>Makhan Lal Jain Vs. The Amrit Banaspati Co. Ltd., I. L. R. (1954) I All. 131.</i></p>
3	Chandramurthy V. K. L. Kapsi (2005) 48 SCL 294 CLB	<p>In <i>L. Chandramurthy V. K. L. Kapsi (2005) 48 SCL 294 CLB</i>, a person who had disposed off his shares was not allowed to apply. Therefore, in the above case, the withdrawal of consent by some of the members shall not affect the success of the remaining applicants.</p>

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2017 - Dec [6] (a) What do you mean by Class Action Suit? Discuss with reference to eligibility criteria for class action, nature of relief and effect of Tribunal's order. **(4 marks)**

Answer:

Section 245 of the Companies Act, 2013 makes provision for class action by investors. The term 'investors' include shareholders, deposit holders and any class of security holders of the company.

Section 245 permits a representative of any class of investors to file a suit before the National Company Law Tribunal for relief.

In terms of **Section 245 (1)**, 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)** of the section 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 relief specified.

Eligibility criteria for class action

Sub-section (3) (i) of Section 245 of the Companies Act, 2013 provides 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.

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 is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

Nature of Relief

The order by Tribunal may relate:

- (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 if the resolution was passed by suppression of material facts or obtained by mis-statement 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.

Effect

Any order passed by NCLT shall be binding on the company and all its members, depositors, auditors, consultants and advisors or any other person associated with the company. Non-compliance of the order by the company shall be punishable with fine which shall not be less than ₹ 5 Lakhs but which may extend to ₹ 25 Lakhs and every officer of the company who is in default shall be punishable with imprisonment for a term upto 3 years and with fine ranging from ₹ 25,000 to ₹ 1 lakh.

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2017 - Dec [6] (b) What do you understand by 'class action suit' as introduced by the Companies Act, 2013? Explain the objective behind introducing this provision in the Companies Act and the persons who can initiate such class action suit. **(4 marks)**

Answer:

A class action suit is a lawsuit where a group of people representing a common interest may approach the Tribunal to sue or be sued. It is a procedural instrument that enables one or more plaintiffs to file and prosecute litigation on behalf of a larger group or class having common rights and grievances.

The major objective behind the provision of class action suits is to safeguard the interests of the minority shareholders. So, class action suits are expected to play an important role to address numerous prejudicial and abusive acts committed by the Board of Directors and other managerial personnel.

Person to initiate Class Action Suit:**(A) Members:**

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.

(B) Depositors:

According to **Section 245(3)(ii)** the requisite number of depositors provided in **Section 245(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 is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.

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2018 - June [6] (d) In a scheme of amalgamation, it was proposed that name of the transferor company shall be deemed to be name of transferee company. The Regional Director (RD), Ministry of Company Affairs, objected to the same on the ground that proposed name is undesirable if it is identical with or too nearly resembling name of an existing company. Decide if the stand taken by the RD is valid under the Companies Act, 2013. Reference may be made of decided case laws. **(4 marks)**

Answer:

It has been held in earlier judgement PMP Auto Industries Ltd. that in case of amalgamation **Chapter XV of the Companies Act, 2013** is a complete code in the nature of a "single window clearance" system, the object of which is to eliminate frequent applications being made to the Court in order effectively to implement a scheme of amalgamation which the Court sanctions in exercise of its powers. Further in case, Michelin India Private Limited High Court held that a complete code by itself on the subject of arrangement/compromise and reconstruction comprehensive enough to include a change in the name consequent on the amalgamation or arrangement.

Thus, considering the above, in present case the objection of RD is invalid.

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2019 - June [6] (c) "Class action suit is a new mechanism in India to claim the loss caused to the specified stakeholders of the Company not only from the Company but also from other entities". Analyse the statement in brief.

(d) "The minority shareholders are empowered under the Companies Act, 2013 to bring action with a view to prevent the majority from oppression and mismanagement". Justify the statement with rights available to minority shareholders under the Act. **(4 marks each)**

Answer:

(c) A class action suit is a new mechanism to claim the loss caused to the specified stakeholders of the company not only from the company but also from other entities. Various persons/ entities against whom such actions can be taken are:

- (i) A company or its directors for any fraudulent, unlawful or wrongful act or omission.
- (ii) An auditor including audit firm of a company for any improper or misleading statement of particulars made in the audit report or for any unlawful or fraudulent conduct.
- (iii) An expert or advisor or consultant for an incorrect or misleading statement made to the company.

It is pertinent to note that the definition of the expert is wide under the Companies Act, 2013 which includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force. However the advisors or consultants are not provided, thus the definitions of the same will be derived from judicial precedence and use of the same in common parlance.

(d) The various rights are available to the minority shareholders under the Companies Act, 2013 to bring action with a view to prevent oppression and mismanagement:

1. **Right to appoint Small Shareholders' Directors:** The small shareholders or minority shareholders as often construed, of a listed company have a right to appoint a shareholder of their choice on the board and such shareholder may be called as a 'Small Shareholders' Director' under **section 151 of the Companies Act, 2013**.
2. **Right to apply to NCLT for Oppression and Mismanagement:** The minority shareholders can approach the National Company Law Tribunal (NCLT) under the provisions of the Companies Act, 2013. **Section 241, 242 and 244 of the Companies Act, 2013** under Chapter XIV lays down the remedies that minority shareholders can resort to in cases of oppression and mismanagement.
3. **Right to file a Class Action Suit under section 245(1) of the Companies Act, 2013:** It is another type of protection given to minority shareholders. A class action suit usually means a legal suit wherein a group of persons sharing a common interest can go to NCLT if they are of the view that the affairs of the company are conducted in manner that is prejudicial to the interests of the company or members or depositors.

2019 - Dec [1] (a) "Shareholders democracy means the rule of shareholders, by the shareholders and for the shareholders in the corporate enterprise, to which the shareholders belong". Comment on the above and enumerate any five provisions of the Companies Act, 2013 which demonstrate the same.

(5 marks)

PRACTICAL QUESTIONS

2018 - Dec [2A] (Or) (iv) In a case pertaining to oppression and mismanagement, the respondents pleaded that the legal heirs of a deceased member whose name is still on the register of members are not entitled to apply before Tribunal, as only member of the company can complain about oppression and mismanagement. Thus, legal heirs have no *locus standi*. Examine this argument in the light of decided cases.

(3 marks)

Answer:

According to **Section 241 of Companies Act, 2013** any member of the company may make an application to the Tribunal for relief in cases of oppression or mismanagement under given circumstance. In *Worldwide Agencies (P) Ltd. v. Margaret T. Desor (1990)*, it was decided that the legal representatives of a deceased member whose name is still on the register of members are entitled to file a petition, for relief against oppression or mismanagement.

In the above case, the above mentioned case is applicable, where the member has died and his name still exists in the register of members, the legal heirs are entitled to maintain the petition.

— Space to write important points for revision —

2019 - June [1] (a) A is a minority shareholder who brought an action for damages against the Company and its directors on the ground that they have been negligent in selling a plant owned by the Company for ₹ 25 Lakh. A alleged that the real value of plant was about ₹ 70 Lakh. Evaluate based on decided case law(s), whether action taken by A will be maintainable in the Court.

(5 marks)

Answer:

No, the action taken by "A" will not be maintainable in court on the mentioned ground. The management of company is based on the majority rule. Almost every question relating to the affairs of the company is required to be decided upon either by an ordinary Resolution or by a Special Resolution of shareholders.

In *Pavlides v. Jensen (1956) Ch. 565*, a minority shareholder brought an action for damages against three directors and against the company itself on the ground that they have been negligent in selling a mine owned by the company for £ 82,000, whereas its real value was about £ 10,00,000. It was held that the action was not maintainable. The judge observed, " It was open to the company, on the resolution of a majority of the shareholders to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of majority to decide that if the directors by their negligence or error of judgement has sold the company's mine at an undervalue, proceedings should not be taken against the directors".

— Space to write important points for revision —

2019 - June [3A] (Or) (ii) A group of shareholders of ABC Developers Limited consisting of 24 members decided to file a petition before the Tribunal for relief against oppression and mismanagement by the Board of Directors. The company has a total of 250 members and the group of 24 members holds one-tenth of the total paid-up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is that due to mismanagement by the Board of Directors, the company is incurring losses and they company has not declared any dividends even when profits were available in the past years for declaration of dividend. In the light of the provisions of the Companies Act, 2013, advise the group of shareholders regarding the chances of success for:

- (i) getting the petition admitted
- (ii) obtaining relief from the Tribunal.

(4 marks)

Answer:

Section 244 of the Companies Act, 2013 provides the right to apply to the Tribunal for relief against oppression and mismanagement. This right is available only when the petitioners hold the prescribed limit of shares as indicated below:

- (i) In the case of company having a share capital, not less than 100 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, provided that the applicant(s) have paid all calls and other dues on the shares.
- (ii) In the case of company not having share capital, not less than one-fifth of the total number of its members.

Since the group of shareholders do not number to 100 or hold 1/10th of the issued share capital or constitute 1/10th of the total number of members, they have no right to approach the Tribunal for relief.

However, pursuant to Section 244 of the Act, the Tribunal may, on an application made to it waive all or any of the requirements specified in (i) or (ii) so as to enable the members to apply under section 241.

As regards obtaining relief from Tribunal, continuous losses cannot, by itself, be regarded as oppression (*Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth*).

Similarly, failure to declare dividends or payment of low dividends also does not amount to oppression. (*Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd*). Thus, the shareholders may not succeed in getting any relief from Tribunal.

_____ Space to write important points for revision _____

2019 - Dec [2] (d) Mrs. P who holds 500 equity shares of Zeta Limited made an application through instrument of transfer to the Company for transfer of 300 equity shares in favour of Mrs. H. Zeta Limited refused to register the transfer of shares in favour of Mrs. H, stating that she has been declared as a wilful defaulter by the banks. What are the rights available to Mrs. H, under the Companies Act, 2013 for such refusal? **(4 marks)**

6.26

Scanner CSPP —II Paper 6 (2017 Syllabus)

2019 - Dec [5] (a) HDF Limited, a listed entity was into real-estate business. Over a period in an attempt to diversify its operations it borrowed heavily from banks and financial institutions. The Company appointed a Merchant Banking firm, to provide strategic inputs for its business operations. On the recommendation of the firm, the Company created complex group structures and business models. Due to financial mismanagement and lack of strategic operations, the Company started making losses and over a period was not able to repay the loans it had taken. The Company also failed to repay the deposits it had raised from public. Gradually, the market capitalization of the Company eroded and now it has been reduced to a penny stock. The shareholders are evaluating the option of filing a case against the Company, the Merchant Banking firm and also the Rating Agency which were involved with the Company during such period.

Evaluate whether the shareholders and depositors be successful in filing a suit in these circumstances. **(8 marks)**

TOPIC NOT YET ASKED BUT EQUALLY IMPORTANT FOR EXAMINATION

SHORT NOTES

Q1. Write short notes on Class Action Suits.

Answer:

A class action suit is a lawsuit where a group of people representing a common interest may approach the Tribunal to sue or be sued. It is a procedural instrument that enables one or more plaintiffs to file and prosecute litigation on behalf of a larger group or class having common rights and grievances.

Application of Class Action and Reliefs [Section 245(1)]

Sub - section (1) of Section 245 states that such number of members, depositor or any class of them, as the case may be, may, file an application before the Tribunal 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 if the resolution was passed by suppression of material facts or obtained by mis-statement 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.

— Space to write important points for revision —

Q2. Write short notes on Effect of Order.

Answer:

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. **[Section 245(6)]**

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. **[Section 245(7)]**

— Space to write important points for revision —

Q3. Write short note on Transfer and Transmission of securities.

Answer:

Transfer and Transmission of Securities (Section 56)

- (1) A company shall not register a transfer of securities of the company, or the interest of a member in the company in the case of a company having no share capital, other than the transfer between persons both of whose names are entered as holders of beneficial interest in the records of a depository, unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or the transferee within a period of sixty days from the date of execution, along with the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities: Provided that where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to indemnity as the Board may think fit.

- (2) Nothing in **sub-section (1)** shall prejudice the power of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.
- (3) Where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice.
- (4) Every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted –
 - (a) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;
 - (b) within a period of two months from the date of allotment, in the case of any allotment of any of its shares;
 - (c) within a period of one month from the date of receipt by the company of the instrument of transfer under **sub-section (1)** or, as the case may be, of the intimation of transmission under **sub-section (2)**, in the case of a transfer or transmission of securities;
 - (d) within a period of six months from the date of allotment in the case of any allotment of debenture:
Provided that where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.
- (5) The transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer.

- (6) Where any default is made in complying with the provisions of **sub-sections (1) to (5)**, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.
- (7) Without prejudice to any liability under the **Depositories Act, 1996** where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under **Section 447**.

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DESCRIPTIVE QUESTIONS

Q4. Who can file class action suits?

Answer:

There are following set of classes recognized under the Act to file class action suits – (i) members (ii) depositors and (iii) any class of them. The Companies Act, 2013 just like its predecessor recognizes the following persons as members of a company:

- (i) The subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company, and on its registration, shall be entered as member in its register of members;
- (ii) Every other person who agrees in writing to become a member of the company and whose name is entered in the register of members of the company;
- (iii) Every person holding shares of the company and whose name is entered as a beneficial owner in the records of a depository.

In simple words:

- (i) subscriber to the memorandum of the company;
- (ii) persons who give consent to become shareholder of the company, in form of allotment letter or request for transfer, as the case may be and his name appears in the register of members;
- (iii) in listed entity a person whose name appears in the records of the depository as beneficial owner.

The other class which is allowed to file class action suit is depositors, which is defined under the **Companies (Acceptance of Deposits) Rules, 2014** (in short "Deposit Rules") as under:

- (i) any member of the company who has made a deposit with the company in accordance with the provisions of **sub-section (2) of Section 73** of the Act, or
- (ii) any person who has made a deposit with a public company in accordance with the provisions of **Section 76** of the Act.

— Space to write important points for revision —

Q5. What reliefs can be sought from tribunal?

Answer:

Any member or depositor who files the Class Action Suits can seek all or any of the following reliefs from NCLT:

- (a) 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;
 - Taking action contrary to any resolution passed by the members;
 - Committing an act which is ultra vires the articles or memorandum of the company;
 - Committing breach of any provision of the company's memorandum or articles;
- (b) To declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by misstatement to the members or depositors;
 - To restrain the company and its directors from acting on such resolution;

- (c) 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.

— Space to write important points for revision —

Q6. Discuss the penalty for non-compliance of order passed by Tribunal.

Answer:

Any company which fails to comply with an order passed by the Tribunal under **Section 245** of the Act, shall be punishable with fine which shall not be less than ₹ 5 Lakh but which may extend to ₹ 25 Lakh and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to 3 years and with fine which shall not be less than ₹ 25,000/- but which may extend to ₹ 1, 00,000/-.

Under **Section 425** of the **Companies Act, 2013** the Tribunal has also been conferred the same jurisdiction, powers and authority in respect of contempt of its orders as conferred on High Court under the **Contempt of Courts Act, 1971**.

— Space to write important points for revision —

Q7. Discuss the impacts of Class Action Suits.

Answer:

Class action suits is an invention of equity to enable it to proceed to a decree in suits where the number of those interested in the subject of the litigation is so great that their joinder as parties in conformity to the usual rules of procedure is impracticable. Thus the said curative measures, viz. class

action suit is evolved to overcome such drawbacks and allow a set of persons to represent all other members of said class who are scattered in different jurisdictions.

Class action suits would allow individuals to hold some of the world's most powerful companies and organizations accountable for their actions. These lawsuits will cover a wide range of issues including the mismanagement of monies invested with a company, securities law related fraud, malfunctioning of accounts, restraining company to act ultra vires or in breach of the articles of association of the Company, etc. The new mechanism will not only protect the interest of investors but will also deter the promoters to enrich themselves at the cost of small shareholders. Class action suits will be taken as a lesson to wrong doers which will deter them as well as others to take such actions. Same has been witnessed in the counterparts, specifically in USA where behavior of doctors changed and they were encouraged to report suspected child abuses after a landmark case. Otherwise they would have faced the threat of civil action for damages in tort proximately if owing from the failure to report the suspected injuries.

_____ Space to write important points for revision _____

Q8. Discuss the Punishment for wrongful withholding of Property.

Answer:

Punishment for wrongful withholding of property (Section 452)

1. If any officer or employee of a company –
 - (a) wrongfully obtains possession of any property, including cash of the company; or
 - (b) having any such property including cash in his possession, wrongfully withholds it or knowingly applies it for the purposes other than those expressed or directed in the articles and authorised by this Act, he shall, on the complaint of the company or of any member or creditor or contributory thereof, be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

2. The Court trying an offence under **sub-section (1)** may also order such officer or employee to deliver up or refund, within a time to be fixed by it, any such property or cash wrongfully obtained or wrongfully withheld or knowingly misapplied, the benefits that have been derived from such property or cash or in default, to undergo imprisonment for a term which may extend to two years.

_____ Space to write important points for revision _____

Q9. Discuss the grounds of refusal of registration and appeal against refusal.

Answer:

Refusal of registration and appeal against refusal (Section 58)

1. If a private company limited by shares refuses, whether in pursuance of any power of the company under its articles or otherwise, to register the transfer of, or the transmission by operation of law of the right to, any securities or interest of a member in the company, it shall within a period of thirty days from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferor and the transferee or to the person giving intimation of such transmission, as the case may be, giving reasons for such refusal.
2. Without prejudice to **sub-section (1)**, the securities or other interest of any member in a public company shall be freely transferable: Provided that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract.
3. The transferee may appeal to the Tribunal against the refusal within a period of thirty days from the date of receipt of the notice or in case no notice has been sent by the company, within a period of sixty days from the date on which the instrument of transfer or the intimation of transmission, as the case may be, was delivered to the company.
4. If a public company without sufficient cause refuses to register the transfer of securities within a period of thirty days from the date on which the instrument of transfer or the intimation of transmission, as the case may be, is delivered to the company, the transferee may, within a period

of sixty days of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal.

5. The Tribunal, while dealing with an appeal made under **sub-section (3)** or **sub-section (4)**, may, after hearing the parties, either dismiss the appeal, or by order –
 - (a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of the order; or
 - (b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved.
6. If a person contravenes the order of the Tribunal under this section, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend five lakh rupees.

— Space to write important points for revision —

Q10. What are the consequences of termination or modification of agreements?

Answer:

Consequence of termination or modification of certain agreements **Section 243(1)** states that 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 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.

Further, **Section 243(2)** provides that 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.

— Space to write important points for revision —

Q11. Discuss the Justification and advantages of the Rule in *Foss v. Harbottle*.

Answer:

Justification and Advantages of the Rule in *Foss v. Harbottle*

The justification for the rule laid down in *Foss v. Harbottle* is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Moreover, a company is a person at law, the action is vested in it and cannot be brought by a single shareholder. Where there is a corporate body capable of filing a suit for itself to recover property either from its directors or officers or from any other person then that corporate body is the proper plaintiff and the only proper plaintiff [*Gray v. Lewis, (1873) 8 Ch. Appl. 1035*].

The main advantages that flow from the Rule in *Foss v. Harbottle* are of a purely practical nature and are as follows:

- 1. Recognition of the separate legal personality of company:** If a company has suffered some injury, and not the individual members, it is the company itself that should seek to redress.

2. **Need to preserve right of majority to decide:** The principle in *Foss v. Harbottle* preserves the right of majority to decide how the affairs of the company shall be conducted. It is fair that the wishes of the majority should prevail.
3. **Multiplicity of futile suits avoided:** Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are shareholders. Legal proceedings would never cease, and there would be enormous wastage of time and money.
4. **Litigation at suit of a minority futile if majority does not wish it:** If the irregularity complained of is one which can be subsequently ratified by the majority it is futile to have litigation about it except with the consent of the majority in a general meeting. In *Mac Dougall v. Gardiner*, (1875) 1 Ch. 13 (C.A.), the articles empowered the chairman, with the consent of the meeting, to adjourn a meeting and also provided for taking a poll if demanded by the shareholders. The adjournment was moved, and declared by the chairman to be carried; a poll was then demanded and refused by the chairman. A shareholder brought an action for a declaration that the chairman's conduct was illegal. Held, the action could not be brought by the shareholder; if the chairman was wrong, the company alone could sue.

Application of *Foss v. Harbottle* Rule in Indian context – The Delhi High Court in *ICICI v. Parasrampuriah Synthetic Ltd. SSL*, July 5, 1998 has held that an automatic application of *Foss v. Harbottle* Rule to the Indian corporate realities would be improper. Here the Indian corporate sector does not involve a large number of small individual investors but predominantly financial institutions funding atleast 80% of the finance. It is these financial institutions which provide entire funds for the continuous existence and corporate activities. Though they hold only a small percentage of shares, it is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of *Foss v. Harbottle* Rule would be unjust and unfair.

— Space to write important points for revision —

Q12. Explain the exception to the rule in *Foss v. Harbottle*.

Answer:

Exceptions to the Rule in *Foss v. Harbottle*

The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

- (a) the common law; and
- (b) the provisions of the Companies Act.

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases:

1. Ultra Vires Acts

Where the directors representing the majority of shareholders perform an illegal or ultra vires act for the company, an individual shareholder has right to bring an action. The majority of shareholders have no right to confirm an illegal or ultra vires transaction of the company. In such case a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an ultra vires act.

In *Bharat Insurance Ltd. v. Kanhya Lal, A.I.R. 1935 Lah. 792*, the plaintiff was a shareholder of the Bharat Insurance Company. One of the objects of the company was : "To advance money at interest on the security of land, houses, machinery and other property situated in India..." The plaintiff complained that "several investments had been made by the company without adequate security and contrary to the provisions of the memorandum and therefore, prayed for perpetual injunction to restrain it from making such investments".

2. Fraud on Minority

Where an act done by the majority amounts to a fraud on the minority; an action can be brought by an individual shareholder. This principle was laid down as an exception to the rule in *Foss v. Harbottle* in a number of cases. In *Menier v. Hooper's Telegraph Works, (1874) L.R. 9 Ch. App. 350*, it was observed that it would be a shocking thing if the majority of shareholders are allowed to put something into their pockets at the expenses of the minority. In this case, the majority of members of company 'A' were also members of company 'B', and at a meeting of company 'A' they passed a resolution to compromise an action against company 'B', in a manner alleged to be favourable to company 'B', but unfavourable to company 'A'. Held, the minority shareholders of company 'A' could bring an action to have the compromise set aside.

3. Wrongdoers in Control

If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court [Cf. **Birch v. Sullivan, (1957) 1 W.L.R. 1274**]. The reason for it is that if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue [Par *Jenkins L.J. in Edwards v. Halliwell, (1950) 2 All E.R. 1064, 1067*].

In *Glass v. Atkin (1967) 65 D.L.R. (2d) 501*, a company was controlled equally by the two defendants and the two plaintiff. The plaintiff brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use. The Court allowed the action and observed: "While the general principle was for the company itself to bring an action, where it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action."

4. Resolution requiring Special Majority but is passed by a simple majority

A shareholder can sue if an act requires a special majority but is passed by a simple majority. Simple or rigid, formalities are to be observed if the majority wants to give validity to an act which purports to impede the interest of minority. An individual shareholder has the right of action to restrain the company from acting on a special resolution to which the insufficient notice is served [*Baillie v. Oriental Telephone and Electric Co. Ltd.*, (1915) 1 Ch. 503 (C.A.); refer also *Nagappa Chettiar v. Madras Race Club*, 1 M.L.J. 662].

5. Personal Actions

Individual membership rights cannot be invaded by the majority of shareholders. He is entitled to all the rights and privileges appertaining to his status as a member. An individual shareholder can insist on the strict compliance with the legal rules, statutory provisions. Provisions in the memorandum and the articles are mandatory in nature and cannot be waived by a bare majority of shareholders [*Salmon v. Quin and Axtens*, (1909) A.C. 442]. In *Nagappa Chettiar v. Madras Race Club*, (1949) 1 M.L.J. 662 at 667, it was observed by the Court that “An individual shareholder is entitled to enforce his individual rights against the company, such as, his right to vote, the right to have his vote recorded, or his right to stand as a director of a company at an election.

6. Breach of Duty

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company. In *Daniels v. Daniels*, (1978) 2 W.L.R. 73, the plaintiff, who were minority shareholders of a company, brought an action against the two directors of the company and the company itself. In their statement of the claim they alleged that the company, on the instruction of the two directors who were majority shareholders, sold the company’s land to one of the

directors (who was the wife of the other) for £ 4,250 and the directors knew or ought to have known that the sale was at an under value. Four years after the sale, she sold the same land for £ 1,20,000. The directors applied for the statement of claim to be disclosed on reasonable cause of action or otherwise as an abuse of the process of the Court.

7. Prevention of Oppression and Mismanagement

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement. These are the statutory rights of the minority shareholders and find detailed discussion later in the study.

— Space to write important points for revision —