


Subject: **LAW**

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Paper : **CORPORATE LAW**
Shareholders and Creditors remedies of personal
Module : **actions derivative actions or class action suits**
including cases of oppression and mismanagement



ज्ञान-विज्ञान विमुक्तये

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Q1: E-TEXT

Module ID 21: Shareholders and creditors remedies of personal actions, derivatives action or class action suits including cases of oppression and mismanagement

Overview: Shareholders and creditors are the most vital organs of an artificial body called 'company'. A company can grow only if its shareholders and creditors are happy and satisfied from the working of the company. As soon, the company involve in any misfeasance like oppression or mismanagement, its future start seeing its nightfall. In this module, the concept of oppression and mismanagement will be discussed thoroughly. Moreover, what remedies the shareholders or the creditors can claim or what actions they can take in such a situation will also be discussed. Personal actions, derivative actions and class actions are the creamy actions. There is no statutory provision mentioned in the Indian Companies law with regard to the derivative actions. However, the Courts have recognised the doctrine of derivative actions. With regard to the 'class actions', the new Companies Act, 2013 introduced a new provision i.e. Section 245 which specifically deals with class actions.

Subject Name: Law

Paper Name: Corporate Law

Module ID: 21

Pre-requisites: Fundamental knowledge of Company Law, role and responsibilities shareholders and creditors of a company.

Key Words: Remedies, Shareholders, Creditors, Derivative Actions, Personal Actions, Class Action Suit, Oppression and mismanagement

Objectives:

To provide thorough details regarding the concept of Oppression and Mismanagement and

To discuss the various actions which the shareholder or the creditors can take.

I. **Introduction**

Shareholders and creditors are those two groups who has given or invested their money in corporate bodies. However, it is not necessary that all the shareholders have the controlling power in the company. The group of shareholders is divided into two parts i.e. Majority Shareholders and Minority Shareholders. Minority shareholders are those who have invested their money in the company but they are not holding so many shares that can give them controlling powers; and



because of this their interest in the company and its affairs sometimes get neglected.

“The protection of the minority shareholders within the domain of corporate activity constitutes one of the most difficult problems facing modern company law. The aim must be to strike a balance between the effective control of the company and the interest of the small individual shareholders”

- **N. A. Bastin,**

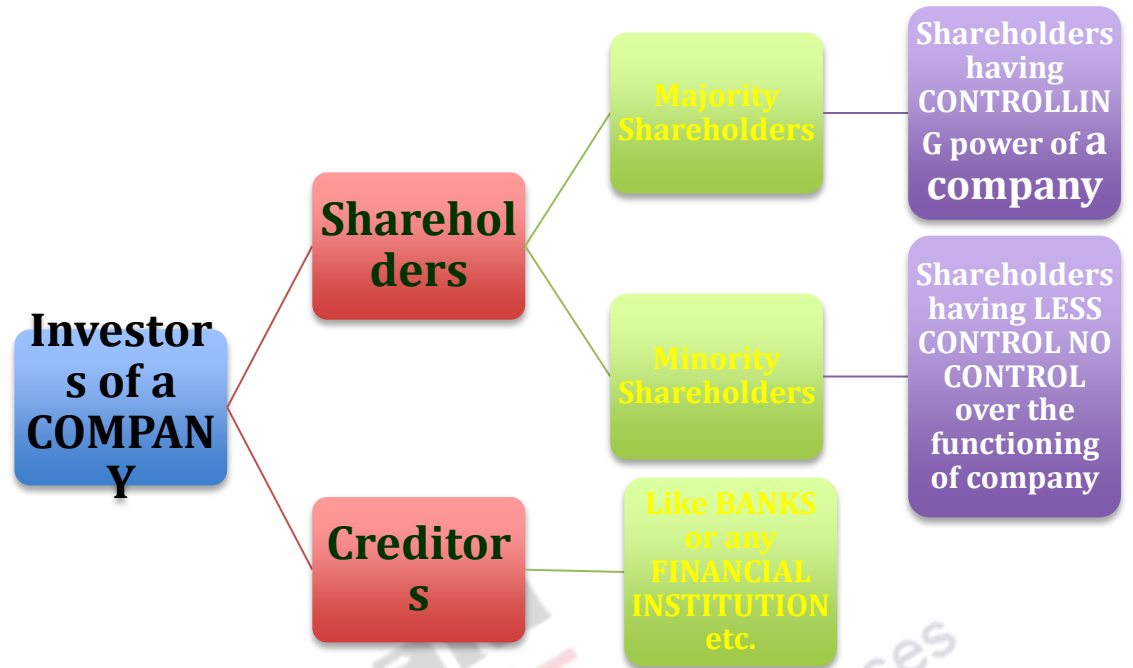
Minority Protection in Company law,

1968 JBL 320

Rule of *Foss v. Harbottle* [(1843) 67 ER 189]

The basic rule laid down in this case was that “the courts will not, in general, intervene at the instance of shareholders in matters of internal administration; and, will not interfere with the management of a company, by its directors so long as they are acting within the powers conferred on them under the articles of the company”.

However, the Court has also given certain exceptions to this rule, among which one is “oppression and mismanagement”. It has been stated by SINHA J of the Calcutta High Court in *Kanika Mukherji v. Rameshwar Dayal Dubey [(1966) 1 Comp LJ 65 Cal.]* that the principle embodied in Sections 397 and 398 of the Indian Companies Act which provide for prevention of oppression and mismanagement is an exception to the rule in *Foss v. Harbottle* which lays down the sanctity of the majority rule.



II. Meaning of ‘Oppression’ and ‘Mismanagement’

The meaning of the term ‘oppression’ as explained by Lord COOPER in the Scottish case of *Elder v. Elder & Watson Ltd [(1952) SC 49 Scotland]* was cited with approval by WANCHOO J of the Supreme Court of India in *Shanti Prasad Jain v. Kalinga Tubes Ltd. [1965] 1 Comp LJ 193*, “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.”

‘Mismanagement’ again is an atrocious act of the majority shareholders. An illustration explaining the conduct of mismanagement is the case of *Rajahmundry Electric Supply Corpn v. Nageshwara Rao [AIR 1956 SC 213]*, in this, a petition was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the Vice Chairman grossly mismanaged the affairs of the company and had drawn considerable amounts for his personal purposes, that large amounts were owing to the Government for charges for supply of electricity, that machinery was in a state of disrepair, that the directorate had become greatly attenuated and “a powerful local



junta was rulling the roost” and that the shareholders outside the group of the Chairman were powerless to set matters right. This was held to be sufficient evidence of mismanagement.

Exceptions to the rule of Foss v. Harbottle:

1. • Act Ultra vires
2. • Fraud on minority
3. • Acts requiring Special Majority
4. • Wrongdoers in control
5. • Individual membership rights
6. • **Oppression and mismanagement**

III. Remedies

Sec. 241 of the Companies Act, 2013 provides that, any member of a company who complains regarding any oppression or mismanagement being occurred in a company, may apply to the Tribunal. Moreover, even the Central Government, if of the opinion that the affairs of the company are being conducted in a manner prejudicial to the public interest, then it may itself apply to the Tribunal for an order.

In this module we will discuss, three different actions which the shareholders can take, i.e. Personal action, Derivative action, or Class action.

Personal Action



In this, the shareholder claims their personal rights which arise from the constitution of the company i.e. Memorandum of Association and Articles of Association. However, in Indian Companies Law, personal actions of the shareholders aggrieved from the acts of oppression or management do not possess any statutory provision.

Derivative Action

An interesting area of law is the law governing derivative action mechanism which enables the shareholders of a company to bring an action on behalf of the company against a third party before a regular civil court. Again, there is no specific statutory provision for derivative action in the Indian companies' law. However, the doctrine of derivative action is recognised by the Indian courts. If a shareholder alleges that a wrong has been done to the company by persons in control thereof, he may bring a derivative action where he derives the authority from his corporate right to sue on behalf of the company. The premise on which the court entertains this extraordinary form of action is upon the complaining shareholder's assertion that the company cannot sue as the persons in control would not bring an action on its behalf or for its benefit.

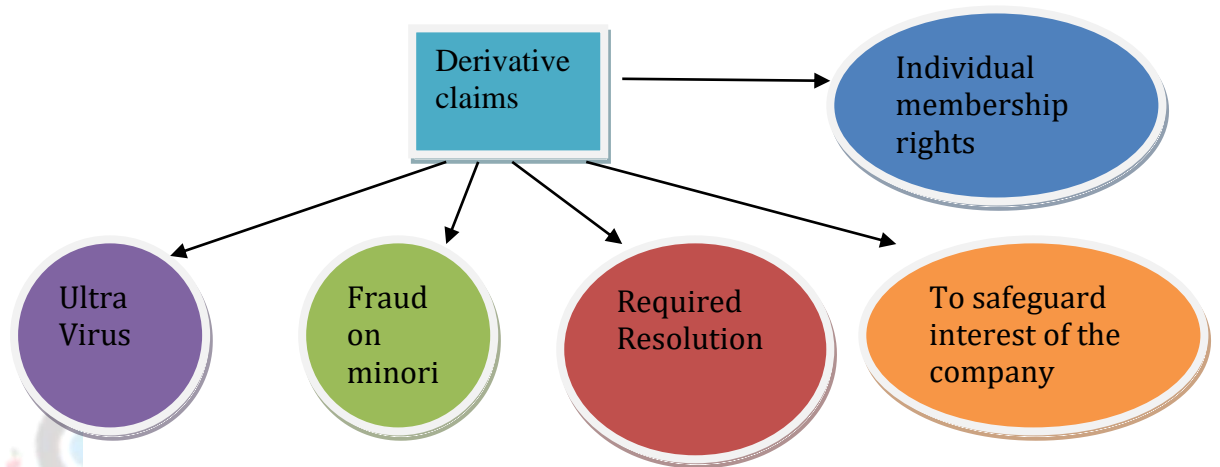
Derivative action is defined as an action by one or more shareholders of a company where the cause of action is vested in the company and relief is accordingly sought on its behalf. Since the company has a distinct legal personality with its own rights and liabilities which are different from those personal rights of individual shareholders, this action is brought by a shareholder not to enforce his or her own personal rights but, rather, the rights and liabilities of the company on its behalf and for the benefit of the company; which the company cannot itself do, as it is controlled by the 'wrong-doers'.

In order to be classified as a derivative action, the following aspects must be satisfied:

- It must be brought in a representative form, even though it is the company, rather than the other shareholders, whom the person initiating the legal action / proceedings seeks to represent. Thus, by implication, all the other shareholders are bound by the result of the action.



- Although the action is brought on behalf of the company, the company appears as a defendant, so that the action takes the form of a representative action by the initiating shareholder on behalf of himself and all the other shareholders (other than the alleged 'wrong-doers'), against the alleged 'wrong-doers' (who are, in fact, in control of the company) and the company. Derivative claims may be brought by a shareholder or shareholders in the following instances, as described as follows:



(a) *Ultra Virus*

A shareholder may bring an action against the company and its Directors in respect of matters which are *ultra vires* the Memorandum or the Articles of the company and which no majority shareholders can sanction. For example, Directors of the company sanctioning an action that is contrary to the objects of the company.

(b) *Fraud on Minority*

Directors and the company would also be liable if the conduct of the majority of the shareholders constitutes a "fraud on minority", i.e., a discriminatory action. For example, where the shareholders have passed a special resolution with an effect of discriminating between the majority shareholders and minority shareholders, so as to give the former an advantage of which the latter were deprived.



(c) Required Resolution

Certain actions of the company can be approved only by passing a special resolution at a general meeting of shareholders. If the majority seek to circumvent this legal requirement and pass only an ordinary resolution, or do not pass such a special resolution in the manner required by law, any member or members can bring an action to restrain the majority.

(d) To safeguard Interests of the Company

For instance, an obvious wrong may have been done to the company by the Directors, but because of the control of such Directors on the majority shareholders, such shareholders may not permit an action to be brought against the 'wrong-doer' Directors. Therefore, to safeguard the interests of the company, any member or members may bring a derivative action.

(e) Individual Membership Rights

As a general rule, personal rights *per se* are not to be enforced through derivative actions; however, some exceptions have been recognized. These exceptions often arise in cases of rights that have been conferred upon the shareholders by the Companies Act itself or the respective Articles (commonly known as "individual membership rights"). For example, the right to vote, the right to have one's vote recorded, or the right to be nominated as a candidate for the post of a Director during the election of Directors at a general meeting of the shareholders. *Prevention of Oppression and Mis-management* A representative action may be brought for prevention of oppression and mismanagement, which are cases where the majority acts in a manner that oppresses the minority; or where the affairs of the company are being conducted in a manner prejudicial to public interests or oppressive to any member(s) or in a manner prejudicial to the interests of the company including an adverse material change in the management or control of the company. Since these proceedings are initiated for the benefit of the company, it can be considered a form of derivative action and find specific place in the scheme of the Indian company law under the Companies Act. In order to obtain relief, the Company Law Board can be approached by:



a. Not less than one hundred (100) shareholders, or not less than one-tenth of the total number of members; or

b. Members holding not less than one-tenth of the issued shares capital of the company, provided all the dues on the shares have been paid by the applicants.

Class Actions

The provision for class actions was recommended in the Companies Bill, 2012. The J J Irani committee recommended in its report as follows:

“In case of fraud on the minority by wrongdoers, who are in control and prevent the company itself bringing an action in its own name, derivative actions in respect of such wrong non-rectifiable decisions have been allowed by courts. Such derivative actions are brought out by shareholder(s) on behalf of the company, and not in their personal capacity, in respect of wrong done to the company. Similarly the principles of “Class/Representative Action” by one shareholder on behalf of one or more of the shareholders of the same kind have been allowed by courts on the grounds of persons having same locus standi.”

Class suit is not limited to corporate law but extends to the whole realm of civil procedures. In fact, class suits are not so much a provision of law as a procedure. For example, Order 1 Rule 8 of the Civil Procedure Code, 1908 provides that where there are numerous persons having the same interest in a suit, one or more persons may, with the permission of the court, either sue, or defend the suit, for the benefit of all interested. Sub-rule (2) provides for the power of the court to publicize a representative suit either by service, or depending on the number of persons involved, by public advertisement. The procedure has widely been used in India for what is commonly termed as public interest litigation.



The Companies Act, 2013 in its Sec. 245 contains the provision with regard to 'class actions'.

The concept of class actions and derivative actions are very close to each other. In fact, at the time of proposing the addition of this provision in Companies Law Bill, it was not clear that whether the Parliament was seeking to introduce the 'class action' provision or the 'derivative action' provision.

IV. Summary

Minority Shareholders, though, possess a very small space in the administration of a company; still, their absence affects the company alot. It's like the presence of salt in food is never noticed, but its absence make the food tasteless. So, protection of minority shareholder which often get affected by the bad decision of those members of the company which are having controlling power, is very much necessary. The chapter XVI, Sections 241 to 246 provides the various actions which the aggrieved shareholders can take to protect the right and interest of themselves collectively as well as of the company from those directors which are abusing their controlling power.