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Scope of Term "Unfairly Prejudice" in the Oppression and Mismanagement

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ABSTRACT

The recent controversy of the infamous Cyrus Mistry case has created buzz over corporate governance. Corporate governance is bulwark of transparency and this transparency necessitates proper execution of rights against Oppression and Mismanagement in the Company. Initially the scope of remedy against prejudice was confined to only oppressive act, later on the basis of recommendations issued under Bhabha Committee report in 1952 the scope was widened to include mismanagement as well with the ambit of Indian Company Law. To protect the interest of shareholders the law relating to "Oppression and Mismanagement" Chapter XVI has been incorporated in Companies Act 2013. However, neither the term "Oppression" nor "Mismanagement" have been clearly defined under the act and therefore the scope rests entirely on judicial interpretation. This makes it quintessential to understand in depth the delineating features of the various terms finding mention under Companies Act and this article endeavours do so by analysing the term "Unfairly prejudiced". The term "unfairly prejudice" with regards to oppression and mismanagement has originated in UK and the same has not exactly found a place under Indian Law. Section 241 of Companies Act uses the term "Prejudice", therefore it becomes immensely important to understand the scope of the term to correctly prevent oppression and Mismanagement.

I. INTRODUCTION

There are two styles in which a company can be run: Monarch Model and Trusteeship Model. Under Monarch Model interest of promoters, board and management is given preference over others even if it is at the cost loss of interest of other stakeholders. The Uday Kotak Committee therefore termed the promoters as "Raja"(Monarch) under this model. On the other hand the trusteeship model implies holding of power by promoters as a "trustee" of the shareholders. Hence the interest of the stakeholders is kept above to that of the Company. The Uday Kotak Committee termed it as Custodian Model as here the promoters are acting as the custodians of the stakeholders. However unfortunately in Indian scenario one can clearly see Monarch Model

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applied rather than the Custodian Model.[2]

In UK "Unfairly Prejudice" has an standalone value as a remedy apart from oppression and mismanagement. But Indian Legal framework deems it feet to read it is conjunction with oppression and mismanagement and not in disjunction.

II. HISTORICAL BACKGROUND

On the basis of the recommendations issued by Cohen Committee Sec 210 was introduced in UK Companies Act, 1948. The same was incorporated in India under Companies Act 1913 through an amendment introduced in 1951.

Prior to this the only remedy available was "just and equitable" clause of §168 of the UK Companies Act, 1929. But with introduction of Section 210 winding order could be issued by tribunal on being satisfied that the act or omission of majority Shareholder was oppressive and hence justified winding up on "just and equitable" grounds.

III. LEGISLATIVE INTENT

The concept of "unfair prejudice" can be traced back to Companies Bill 2008 but it was not explained or analysed. Even the J.J Irani Committee on the basis of which 2013 Act was moulded was satisfied that the 2013 Act is equipped enough to deal with oppression and mismanagement.[3] The recommendations implied that there are two kinds of remedies in which the "prejudice" remedy was not emphasised upon.

Though Companies Bill 2009[4] and Companies Bill 2011[5] recommended introduction of words "or in a manner prejudicial to the interests of the company" but the same was not analysed. Further to add to it the Ministry of Corporate Affairs, the Government of India in it's Report of the Companies Law Committee recommended that no changes should take place in the existing provisions dealing with oppression and mismanagement and that they are sufficient.

Since legislative intent behind the "prejudice" remedy cannot be clearly drawn from the historical background under Indian scenario it becomes quite imperative to have a look at the legislative intent behind this remedy under English law.

In UK The Jenkins Committee[6] was the first one to categorically state that there are certain

[2]The Securities and Exchange Board of India "The Corporate Governance Committee Report" ('UdayKotak Committee Report'), (October 7, 2017)
[3] Rohit Dubey, Exploring constitutes of Words 'Oppression' & 'Mismanagement'(19 December, 2020, 12:12 am) available at: https://taxguru.in/company-law/exploring-constitutes-words-oppression-mismanagement.html
[4] LokSabha, Standing Committee on Finance, "21st report on Companies Bill 2009, (August, 2010)
[5]Fifteenth LokSabha, Standing Committee on Finance "57th report on Companies Bill 2011 (June, 2012).
[6] Board of Trade, Jenkins Committee report of the Company Law Committee (June, 1962).

inefficiencies pertaining to the prevention of oppressive act and recommended that a separate remedy of "unfairly prejudice" mist be added thereto. According to the report put forth by the committee the oppressive remedy has not produced the expected result[7] and the word "oppressive" cannot be applied for every act which is against the interest of the shareholders[8].

The committee highlighted following defects in the "Oppressive" remedy:

- The applicant needed to establish the just and equitable requirement before granting the winding up order in his favour.
- It was ambiguous as to whether the applicant is required to prove illegality of the act or whether proving reprehensibility of the act devoid of illegality sufficient.
- The remedy applies to only continuing acts and not a single oppressive act.

Therefore to tackle such situations English Companies Act must be amended and it must be expressly include that any act which is prejudicial unfairly to the rights of shareholders must also be prevented and not merely an "oppressive act". This recommendation was incorporated under Section 459 of the English Companies Act of 1985, which can now be found under Section 994 of English Companies Act of 2006.

IV. DIFFERENCE BETWEEN INDIAN AND ENGLISH LAW

1. While English Law obliterated the "oppressive act" remedy by substituting it totally with the "unfairly prejudice" remedy whereas under Indian law the remedies of "oppressive act" and "unfairly prejudice" coexist. Indian legislature sought it appropriate to supplement the remedy of "oppressive act" with "prejudice" rather than striking it down completely.
2. English law seeks to highlight "unfair" aswell as "prejudice" whereas if we refer sec 241 of Companies Act, 2013 we merely find word "prejudice" being used. Thereby reducing the burden of the applicant to invoke the remedy.

V. INTERPRETING PREJUDICE REMEDY UNDER INDIAN SCENARIO

There can be three methods of interpreting the same[9]

(A) Literal interpretation

[7]Id at para 200
[8]Id at para 202
[9] Shreyas Jayasimha and Rohan Tigadi, "Arbitrability of Oppression, Mismanagement and Prejudice Claims in India: Need for Re-Think", NUJS Law Review, Vol. 11, Issue 4 (October-December 2018), pp. 547-584

This method of interpretation may narrow down the scope of the remedy and strictly strict to the statue. However one can counter this argument by contending that sec 241 of Companies Act 2013 is quite broad in itself and includes all kinds of prejudices and not only those which are unfair.

(B) Liberal-effect oriented approach

This implies considering the corporate conduct only and not its effect on the shareholder who complained against it. This might not be a good idea as this will open flood gate of frivolous complaints lodged against the company even on minor discrepancies. Which will also in-turn disrupt the working of business enterprise and huge amount of capital being wasted on defending such litigations.

(C) Considering both conduct and effect of the act/ omission

This will mean walking on the lines of English Law of incorporating components of 'fairness' and 'equitable consideration'. This will increase the burden of the applicant but at the same time act as a check against trifle and frivolous complaints.

(D) Rule of Construction of *noscitur a sociis*

According to this if a word is unclear or ambiguous and the interpretation of same is difficult then the meaning can be understood through the words surrounding the same.

In ***Subramanian Swamy*** **v.** ***Union of India***[10] it was stated the rule is most useful "when the intention of the legislature in associating wider words with words of narrowest significance is doubtful or otherwise not clear".

By applying this rule of construction in Indian scenario it can seen that the concept of oppression was narrower to the concept of prejudice and since Indian legislature has yet not focused on the latter, it would be safe to conclude that the intention of the legislature was to keep the narrower sense intact.

Irrespective of whichever method one uses it would ultimately depend on facts and mind-set of judges deciding that particular bench as to whether liberal or literal interpretation to be adopted.

VI. OPPRESSION AND "UNFAIRLY PREJUDICED"

The question which arises is whether the remedy of prejudice have a separate footing from

[10] *Subramanian Swamy v. Union of India* (2016) 7 SCC 221, at para 74.

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oppression or whether these two remedies are conjunctive. By interpretation of Section 241(1)(a) one can conclude that the remedy of "unfair prejudice" standalone because the provision uses the expression "prejudicial ***or*** oppressive" disjunctively and in open-ended manner.[11] Therefore it can be inferred that 2013 Act empowers a shareholder to not only bring action for oppressive act but also if it is unfairly prejudice or both.

Now another question which arises is whether the Indian courts should solely focus on the effect of the prejudice or should go by conduct along with effect i.e whether the conduct was itself unfair and not that just the effect was prejudicial to interest of shareholders.

In England both effect as well as the conduct are factors of consideration. However Indian law is yet not clear on the same.

Another question which one needs to ponder upon is whether the prejudice is public prejudice or Commercial prejudice. Former relates to prejudice against public interest in general. Whereas "Commercial prejudice" relates to the legitimate expectation of the shareholders, whether they had a right to obtain more than what they have received.[12]

This question has been clearly answered under Sec 241 as the provision specifically mentions the prejudice can be against public interest, against shareholder or even against company.

VII. MISMANAGEMENT AND "UNFAIRLY PREJUDICE"

With the introduction of amendment under Sec 241 now even for mismanagement one needs to prove whether the order of winding up would be prejudicial to members or whether it can be ordered on "just and equitable" grounds.

(A) When can the order of winding up be unfair prejudice for members?

When Company is a going concern When the shareholders has already invested a large amount in purchasing the shares of which they can merely retrieve break up value in the event of winding up.[13]

Whenever court is faced with such a dilemma it must first try to weigh the interest of applicant shareholders with that of the remaining shareholder. Therefore when the unfair prejudice

[11] *LIC v. D.J. Bahadur,* (1981) 1 SCC 315 at para 144

[12] Umakanth Varotti, "Unpacking the scope of oppression, prejudice and mismanagement under the Companies Act, 2013", SCC Online (December 26, 2020, 9:49 pm), https://www.scconline.com/blog/post/2020/09/12/unpacking-the-scope-of-oppression-prejudice-and-mismanagement-under-the-companies-act-2013/

[13] *VikramBakshi* v. *Cannaught Plaza Restaurants Ltd, (2016) 4 CLJ 349*

caused to the non-applicant shareholders outweighs the just and equitable defence taken up by the applicant shareholders, the Tribunal must refrain from passing an order of Winding up.

"The interest of the applicant alone is not of predominant consideration. The interests of the shareholders of the company as a whole apart from those of other interests have to be kept in mind at the time of consideration as to whether the application should be admitted".[14]

VIII. JUDICIAL ANALYSIS

Hoffmann, LJ in ***O'Neill* v. *Phillips***,[15]with reference to unfairly prejudiced observed:

"concept of fairness must be applied judicially and the context which it is given by the courts must be based upon rational principles and that the court has a very wide discretion, but it does not sit under a palm tree."

In **Re *Saul D. Harrison & Sons Plc*[16]**, Neill, LJ expounded "The conduct must be both prejudicial (in the sense of causing prejudice or harm to the relevant interest) and also unfairly so; conduct may be unfair without being prejudicial or prejudicial without being unfair, and it is not sufficient if the conduct satisfies only one of these tests …"

In the recent ***Cyrus Investments (P) Ltd.* v. *Tata Sons Ltd.***[17] outlined two important questions:

1. Whether the act to be made subject to inquiry must be conducted in a manner "prejudicial" or oppressive to any member or against public interest?
2. And if a winding up order is passed for same would it "unfairly prejudice" to member/(s) but it would otherwise be just and equitable to pass such an order.

IX. COMPANIES ACT 2013 LIMITS AS WELL AS EXPANDS THE REMEDY AT THE SAME TIME

It expands the remedy in the sense that now all acts either prejudicial to member company or public interest is included, which was not the case in 156 Act. The act limits the scope in the sense that now the applicant needs to prove either of the following and not all, thereby limiting the burden of proof.[18] One major striking difference is that previously the act relating to mismanagement was not weighed under point (ii) but now it needs it to satisfied as well thereby narrowing down the scope of the remedy available with the shareholders.

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[14]*Hind Overseas (P) Ltd.* v. *Raghunath Prasad Jhunjhunwalla*, (1976) 3 SCC 259, 271 at para 35
[15]*O'Neill v. Phillips*, (1999) 1 WLR 1092, at p. 1098 (HL)
[16] Re *Saul D. Harrison & Sons Plc*, [1995] 1 BCLC 14
[17]*Cyrus Investments (P) Ltd. v. Tata Sons Ltd.*, (2020) 154 CLA 47 at para 105
[18] CS Suman Gupta, OppressionAnd Mismanagement under Companies Act, 2013, TaxGuru (December 22, 2020 at 7:45 pm) available at:taxguru.in

X. CONCLUSION

Companies Act 2013 has made express provisions under Section 241-246 to prevent Oppression and Mismanagement. It acts as a check against arbitrary against arbitrary actions undertaken in the name of majority rule. However the claim against oppression can be made only if the minimum number of shareholders brings the claim together as per the provisions of the Act. If the tribunal deems fit, it may order winding up of the company, however before doing so the court must give due regards to the fact that whether the order to be unfair and prejudicial to the shareholders not supporting the claim.

Hence it can be said that Companies Act 2013 contains provisions meticulously so as to ensure that the rights of the minority shareholders are duly protected in every manner possible. Just because the shares held by them are lesser in number to those held by the majority shareholders the rights of the minority shareholders cannot be suppressed are made subservient to those of the majority shareholders. Furthermore due to their minority status there is need for special protection so that the interests of rights of those whole interests are not asserted firmly.

A harmonious balance between the rights of majority and minority shareholders is required to prevent oppression and mismanagement while ensuring that shareholders are not unfairly prejudiced. But with regards to scope of unfairly prejudice one cannot pinpoint the extent of application. Since sec 241 deals with only term ‘Prejudice’ and left out the term ‘Unfairly’, there exists grey area whether the application can be made same as to that of legal framework in UK.

Hence it can be concluded that since there is no clear guidance provided by the legislature with regards to the remedy of “prejudice” it opens gate for courts for interpretations.

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