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Debunking the Threshold for waivers: Mismanagement under Indian Companies Act, 2013

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Corporate democracy, like its political counterpart, promotes the majority's will as a guiding principle in company decision-making. At the same time, corporate democracy ensures that minorities in a business are protected against unjustified bias that harms their interests. Section 241 of the Companies Act of 2013 recognizes the need of balancing the rights of majority and minority members in order to protect the company's common interests. Section 241 gives minority shareholders the right to petition the Tribunal for relief from acts of oppression and mismanagement perpetrated by the majority while running the firm. Minority shareholders' rights, on the other hand, are conditional on the members meeting the locus standi - a numerical criterion – set forth in Section 244. The Act does, however, give the Tribunal the power to issue a waiver of the locus requirement, allowing members who do not meet the numerical criteria to nonetheless file a complaint with the Tribunal for oppression and mismanagement. This article examines the reasons that lead to the Tribunals granting such a waiver, with a focus on Cyrus Investments v Tata Sons, a case that has become crucial in this doctrine.

Keywords: *corporate democracy, oppression, mismanagement, shareholder, locus standi.*

INTRODUCTION

'Corporate Democracy' is a concept, particularly by way of which all the decisions that are taken in a company within any aspect, are made on the basis of the 'majority rule', which essentially highlights that all matters that are deliberated upon in the meeting are carried forward laying reliance on the majority vote received. [1]In order to better understand, just as how India is a democratic country with a well-defined and structured set of laws and regulations, wherein every citizen of India has been guaranteed protection against any and all oppressive majoritarian actions by the virtue of the Indian Constitution, in a similar manner, when we discuss corporate democracy, the minority members are provided protection from oppressive actions against the majority shareholders by virtue of the provisions of Oppression and Mismanagement contained under Chapter XVI of the Companies Act, 2013[2]. The provisions relating to Oppression and Mismanagement under the Companies Act, 2013 were initially highlighted by way of Section 210[3] of the English Companies Act, 1948, which in particular, at a later stage became a driving force for plenty of other Common Law countries, including India, to adopt as well as inculcate such provisions in our land, for better working, management as well as protection of the minority members of any company. It was crucial to provide every member protection against the decisions taken by the majority of those decisions that were not in favor of the minorities. Nonetheless, alongside the enactment of such laws, the Indian Legislation additionally created a unique stance that emphasized that any application applied for by the minority shareholders is compulsorily required to be backed up by at least 10% of the issued share capital and 20% of the entire membership in the event of firms without share capital.[4] Initially, the original intention of creating such a threshold was to provide a shield to the majority shareholder members of the company from frivolous lawsuits, accordingly, this particular component of the Companies Act, 2013, has resulted in dominating the Indian corporate law panorama, owing to its distinctiveness and exceptions which has been generated by judicial decisions over the years.

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[1] P.S. Sangal, 'Abuse of Authority by a Majority of Shareholders in a Company' (1964) 6 (4) Journal of the Indian Law Institute, 380-381

[2] Companies Act, 2013, s 152

[3] English Companies Act, 1948, s 210

[4]Companies Act, 2013, s 244(a)

The notion of majority rule is what serves to be the essence of corporate democracy. The rule was laid down in the case of **Foss vs Harbottle**[5], which established the principle of majority, stating that individual shareholders would have no cause of action in law for any improper conduct by the corporation, and hence, any action that would be brought about with respect to such losses must be looked after by the corporation itself or by means of a derivative action. It is ironic to point out that while majority rule is considered to be the norm, it is a frequent practice that minority rights are overlooked more than often. The goal is to achieve a balance between individual shareholders' interests and align them with the company's effective control in order to create stability. In this regard, to serve this purpose, the Indian Company Law, 2013 enacted Sections 241-246 in order to protect minority rights. Sections 241-246 of the Companies Act, serve as remedies for those members who have grievances relating to the affairs of the company which is being conducted in a manner that is regarded as oppressive in nature. In such a situation, wherein the member feels that the act of the company does not serve the interests of its member, it has a right to approach and apply to the Tribunal and seek assistance in this regard. Such an application can also be applied by the Central Government to the Tribunal. After further conduct of study and research, if the Tribunal is of the opinion that the company's conducts are prejudicial to the interest of the public at large, members of the company inclusive, in such a circumstance the Tribunal has the authority to decide whether the company should still be in existence or be directed to wound up. In order to better understand the concept of Section 244 of the Companies Act[6], 2013, a detailed analysis has been conducted in the research paper along with judicial interpretations.

INTERPRETATION OF SECTION 244 OF COMPANIES ACT, 2013, WITH SPECIAL REFERENCE TO THE TATA-MISTRY CASE

Section 241 of the Companies Act[7], 2013 gives each member of the company a right to file an application to the National Company Law Tribunal in order to seek relief if they are of the opinion that the company's interests are being pursued in a manner that is prejudicial to the

[5] *Foss v Harbottle* [1843] 67 ER 189
[6] Companies Act, 2013, s 244
[7] Companies Act, 2013, s 241

public interest, oppressive to any member of the company, or against the company's own interest, or when a material change in management occurs. In other words, Section 241 protects a corporation's stockholders from persecution and mismanagement.

Section 241 of the Companies Act, 2013 reads as follows:

"***241.*** *(1) Any member of a company who complains that-*

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

(b) the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members,

may apply to the Tribunal, provided such member has a right to apply under Section 244, for an order under this Chapter.

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

The members of the company have the right to apply to the Tribunal in order to seek relief in cases pertaining to oppression and mismanagement of the company, Section 241 of the Act lays down the 'eligibility criteria' and 'locus stands which must be satisfied by the minority members in order to seek relief from the Tribunal.[8] Section 244(1) [9]of the Act specifies three

[8] Sunjay R. Bach, 'Maintainability of Petition Seeking relief in cases of Oppression and Mismanagement vis a vis Tata Mistry Dispute' (*Law Street India,* 12 July 2017) <http://www.lawstreetindia.com/experts/column?sid=202> accessed 13 March 2022

categories of people who can apply to the Tribunal under Oppression and Management under Section 241 of the Companies Act:

"**244.** *(1) The following members of a company shall have the right to apply under section 241, namely: –*

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

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

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

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

Significantly, the Act provides the Tribunal the authority to "waive" the locus requirement by allowing an aggrieved member who does not meet the qualifying conditions mentioned under Section 244 of the Act to seek relief as per Section 241 of the Act. The Central Government had the authority to remove the threshold criterion for claims which relate to oppression and mismanagement of the company under the Companies Act of 1956. As per the proviso of 244, which came into force in the year 2016, this power was thereby transferred to the Tribunal, as a result of which, the Tribunal's use of the waiver authority is still in its infancy. In exercising its

[9] Companies Act, 2013, s 241(1)

jurisdiction to issue waivers in cases that come before it, the Tribunal has plenty of leeways.[10] It is indisputable that, however, judicial discretion can at no cost be capricious or arbitrary in nature, and must always be exerted well within the channels and prescribed legal norms. A basic reading of Section 244 highlights two major important problems for discussion, which the Tribunal has addressed in certain cases. The problems are first, whether a petitioner is bound to meet all the three conditions which are imposed in Section 244(1)(a)[11], or only one of them. Secondly, whether the term 'issued share capital in the Section is referred to as equity share capital solely or indicates both equities as well as preference share capital. In the case of **Rajeev Mishra v Jwala Engineering Pvt. Ltd**.,[12] the Tribunal has stated that every petitioner who has filed an application under Section 241[13] of the Act, must make note of the fact that only one of the requirements under 244(1)(a) is required to be fulfilled. The applicant, in this case, was qualified to lodge a case of oppression and mismanagement under Section 241 if any one of the criteria was met. Owing to the fact that the applicant was one of the company's three shareholders, he formed one-tenth of the total number of members, even if he did not compromise a hundred members or own one-tenth of the entire issued capital. The Tribunal denied the waiver request, stating that the petitioner did not require a waiver of qualifying requirements due to the fact that he fulfilled all requirements as mentioned under Section 241.

In the case of **Cyrus Investments v Tata Sons**[14], the NCLAT was questioned as to whether the ten percent "issued share capital" requirement as per Section 244(1) was confined to equity share capital or compromised both equities as well as preferential share capital. Since the Legislature did not indicate that only equity shares would be considered as a part of the computation, and therefore, the Tribunal concluded that the Legislature's goal must be to include the whole share capital (equity and preference) under the phrase "issued share capital". As a consequence of this, the Tribunal determined that "Cyrus Investments' 18.37 percent equity shareholder-ship did not meet the section's requirement." Since the total issued share capital of "Cyrus Investments was 2.17 percent, it did not meet the ten percent

[10] *Photocon Infotech Pvt. Ltd. v Medici Holdings Ltd. (*2018)
[11] Companies Act, 2013, s 244(1)(a)
[12] *Rajeev Mishra v Jwala Engineering Pvt. Ltd.* (2019)
[13] Companies Act, 2013, s 241
[14] *Cyrus Investments Pvt. Ltd. v Tata Sons Ltd.* (2017)

requirement as mentioned under Section 244(1)."[15] Section 241(1)(a)[16] establishes the power of members to sue corporations backed by share capital for acts of tyranny and mismanagement under section 241. Similarly, 241(1)(b) [17]gives members the ability to apply under 241 for businesses that are not backed by share capital but are guaranteed by a guarantee. The right can be exercised under subclause (b) if not less than one-fifth of the total members of the firm apply. These criteria under 244(1) – subclauses (a) and (b) – may be avoided by submitting an application to the Tribunal under the section's proviso.

FACTORS FOR GRANT OF WAIVER UNDER SECTION 244

The case of Cyrus Investments is crucial to the interpretation of the Tribunal's jurisdiction to award exemptions under Section 244 proviso (1). The NCLAT has also decided on one of the initial waiver applications. The Tata Sons group's chairman, Cyrus Mistry, was ousted in 2016. This led the Mistry family, which had invested in Tata Sons, to file a complaint with the Tribunal under Section 241 of the Act, alleging continued persecution of minority shareholders as well as mismanagement of the company's business. They also requested a waiver of the 10% minimum criterion under Section 244's proviso (1).[18] The NCLT, on the other hand, dismissed both the waiver application and, as a result, the Section 241 application. In determining and understanding the application for grant of relief to the petitioners on appeal, the NCLAT established extensive conditions to be met for the award of waiver under the provision. The NCLAT established a list of considerations that the NCLT must consider when deciding on a waiver application. The following factors have been reproduced:

"*151. (i) Whether the applicants are a member(s) of the company in question? If the answer is negative i.e. the applicant(s) is not a member(s), the application is to be rejected outright. Otherwise, the Tribunal will look into the next factor. (ii) Whether (proposed) application under §241 pertains to 'oppression and*

[15] *Ibid*
[16] Companies Act, 2013, s 244 (1) (a)
[17] Companies Act, 2013, s 244 (1) (b)
[18] Megha Mandavia, 'Cyrus Mistry removal as Tata Industries director, no more Chairman' (*The Economic Times*, 13 December 2016) <https://economictimes.indiatimes.com/news/company/corporate-trends/cyrus-mistry-removed-as-tata-industries-director-no-more-chairman/articleshow/55936797.cms> accessed on 13 March 2022

mismanagement? If the Tribunal on perusal of the proposed application under §241 forms the opinion that the application does not relate to 'oppression and mismanagement of the company or its members and/or is frivolous, it will reject the application for 'waiver'. Otherwise, the Tribunal will proceed to notice the other factors. (iii) Whether a similar allegation of 'oppression and mismanagement, was earlier made by any other member and stand decided and concluded? (iv)Whether there is an exceptional circumstance made out to grant 'waiver', so as to enable members to file an application under §241 etc.?"[19]

In order to conduct a detailed analysis of NCLAT's approach toward the system of waiver applications, it is imperative to delve further into studying the factors that affect it. The following has been discussed to better understand the approach.

- ***Whether or not the applicant(s) is a member(s) of the company?***

When considering whether or not to grant a waiver, the Tribunal must first assess whether or not the petitioner is a business member. If you respond no, your waiver application will be rejected outright. Due to the serious implications of non-membership for the application, the Tribunal must determine whether the applicant could/should be regarded as a member. An examination of the company's register of members is always the first step in determining a person's membership. Every business is required under Section 88[20] of the Act to preserve and maintain a register of members, which details the type of shares they own. The NCLAT rejected the contention that the respondents could not be deemed members of the firm since they had "nearly zero percent ownership" in **Manoj Bathla v Vishwanah Bathla**[21]. Even a decreased "ownership of 0.3 percent of the firm would not disqualify a shareholder from becoming a member of the company, according to the tribunal." As a result, the size of a shareholder's holdings has no bearing on the evaluation of membership for the purpose of granting a waiver.

[19] Cyrus Investments Pvt. Ltd. (n 14)
[20] Companies Act, 2013, s 88
[21] *Manoj Bathla v Vishwanah Bathla* (2018)

- ***Whether application filed under Section 241 of the Act is a case involving oppression and mismanagement of the company?***

The proposed application under Section 241 must be related to oppression and mismanagement in order to be granted a waiver. While the Tribunal is unable to consider the merits of the application under Section 241, it must ensure that the proposed claim is prima facie related to oppression and mismanagement of the firm or its member(s) while deciding on the waiver petition. [22]Unlike the Code of Civil Procedure, the Tribunal does not have to guarantee that the petitioner has a prima facie case. A simple reading of the proposed application under Section 241 should show that the accusations are about oppression and mismanagement. The scope of this article does not allow for a consideration of what constitutes tyranny and mismanagement. Although the Tribunal cannot evaluate the merits of the oppression and mismanagement case, it must guarantee that the application submitted under Section 241 is about oppression and mismanagement if locus standi under Section 244 is to be waived. The preliminary examination might be based on well-established definitions of despotism and mismanagement under the Act. If the assessment reveals that the Section 241 application is irrational and unworthy of consideration, the waiver application is denied.

- ***Whether a similar allegation of oppression and mismanagement was previously made by another member of the company has been decided upon.***

The Tribunal must make certain that no additional applications alleging persecution and mismanagement by other members are heard. [23]If the matter in question has already been resolved, the following issuance of a waiver would be pointless, and the waiver, if granted, would be a waste of the Tribunal's discretionary jurisdiction. While this is not the same as res-judicata, it appears that after an application is decided, there is a bar on the subject matter of the application. Inability to do so by the Tribunal, as well as any future judgment by the Tribunal on the application, would upset the earlier recorded conclusions of the courts and have an impact on the ongoing proceedings. It is also in the interests of justice that businesses

[22] Cyrus Investments Pvt. Ltd. (n 14)
[23] *Ibid*

are safeguarded from multiple legal processes, particularly when it comes to problems that have already been resolved. Furthermore, considering that waiver of the eligibility criterion under Section 244(1) is a departure from the substantive rule, this need may derive from the unusual character of the waiver. If such an accusation has already been determined and dealt with, granting the applicant such an exemption would constitute an abuse of the waiver.

- ***Whether the present case can be considered an exceptional case to allow a grant of waiver?***

A waiver is unmistakably an exception to the substantive prohibition of Section 244. In order for the Tribunal to use the proviso, the Tribunal must establish extraordinary circumstances that justify the waiver. Because the Tribunal's decision to grant a waiver constitutes a judicial act, it is required that the Tribunal issue a reasoned ruling stating why the case warranted a waiver. The following sections examine the jurisprudence in extraordinary circumstances that have developed from NCLAT and NCLT bench rulings. The Tribunals have generally granted waivers for three reasons: (1) considerable interest in the firm, (2) fragmented ownership, and (3) oppression resulting in member dilution below the ten percent minimum. It is important to note, however, that this is not a complete list of conditions that might be considered unusual and strong enough to warrant a waiver.

FRAGMENTED SHAREHOLDING

Multiple minority shareholders of a business must band together and create the required 10% issued share capital, according to Section 241(b)[24]. The NCLAT, however, granted a waiver in Cyrus Investments, citing a compelling and unusual case. The Tribunal determined that 49 minority shareholders could not constitute the requisite ten percent unless they approached in groups of six or more since their individual shareholdings were less than 2 percent. Minority shareholders' rights would be reliant on the actions of other members in such a situation.[25] The Tribunal issued a dispensation, recognizing the absurdity of the situation and noting that members cannot always be expected to approach in groupings where minority shareholding is

[24] Companies Act, 2013, s 244 (1) (b)
[25] *Thomas George v Malayalam Industries Ltd.* (2018)

split to the point that numerous shareholders are at the mercy of others to fulfill the ten percent threshold. The NCLAT decision was later reversed by the Supreme Court. However, the Supreme Court's judgment ignores the merits of the pre-decided waiver case. It's worth mentioning that the ownership structure of Indian businesses isn't dispersed.

According to a recent OECD analysis, the percentage of firms in which promoters own more than 50% has grown from 56 percent in 2001 to 66 percent in 2018.[26] However, with the growing participation of institutional investors and other new players in the Indian capital market, this may not be the case in the near future. The **Delhi Gymkhana Club** case[27] presents an intriguing scenario from this perspective. DGC is a limited-by-guarantee corporation with equal rights, obligations, and voting rights for all Permanent Members. Given that the membership structure resembles a corporation with a splintered shareholding, one question that arises is "whether the court may give a similar waiver from Section 244 (b), which requires that not less than 1/5th (one-fifth) of the total members join together. If the above-mentioned logic of Section 244 were applied to DGC, any aggrieved party would need at least 1120 of the 5600 Permanent Members to file a collective application with the Tribunal." This circumstance would produce an absurd situation akin to the Cyrus-Tata feud, in which members would be reliant on one another. However, as was the case in the Cyrus – Tata disagreement, the question as to whether to grant or not, in order to give is a setback from a lack of clarity in the law.

OPPRESSIVE ACTS WHICH WOULD PREDATE THE PETITIONER'S MEMBERSHIP IN THE COMPANY

A crucial point for the reader to examine is whether a petitioner can sue for acts of oppression that occurred before he joined the firm. In the DGC case, for example, some of the actions of tyranny and mismanagement may have occurred before the applicant became a member of the DGC. As a result, it is necessary to evaluate if the absence of company membership on the day that oppressive activities were performed constitutes a legal barrier for applicants. While the

[26] Sunjay R. Bach (n 8)
[27] *Commissioner of Income Tax v Delhi Gymkhana Club* (2010) 21 LL 1209

Indian legal debate on this topic is murky, a look into common law jurisprudence shows some intriguing tendencies.

In **Lim Seng Wah v Han Meng Siew**[28], the Singapore High Court was asked to decide whether "an applicant may sue the firm for oppressive conduct that occurred before he joined. The Court decided that an applicant's right to seek redress for previous conduct was not impaired."[29] The court's rationale was based on the wording of Section 216(1)(b) of the Singaporean Companies Act[30], which states that an applicant can seek remedy for "acts that have been done" and "resolutions that have been passed." The terms "the company's affairs are being or have been managed in an unjustly detrimental way" were used by the court under Section 459[31], the Court reasoned. A New Zealand court, in Tyrion Holdings Ltd v Claydon[32], reaffirmed the legal position. Section 241(1)(a) of the Indian Companies Act, 2013 reveals that the Indian legal framework takes a similar approach in this regard, allowing petitioners to complain of oppressive activities that "have been or are being conducted in a manner prejudicial to the public interest or members of the company." Indian petitioners should be allowed to seek remedy for oppressive behavior that occurred before they joined the firm if the Lim Seng Wah decision [33]is implemented.

CONCLUSION

The purpose of anti-oppression and anti-mismanagement measures is to safeguard the interests of minority shareholders in a corporation. The concept of screening out vexatious petitions, however, cannot be dismissed given the amount of business litigation. The goal of these filters should be to create a balance between legal protection and legal abuse. While the concept of a filter is not inherently flawed, the way it is classified must alter. In each of the aforementioned characteristics, India's unique situation differs from that of most other

[28] *Lim Seng Wah v Han Mang Siew* [2001] 12 WLUK 711
[29] *Ibid*
[30] Companies Act, 2013, s 216(1)(b)
[31] Companies Act, 2013, s 459
[32] *Tyrion Holdings Ltd. v Claydon* [2015] NZAR 698
[33] Lim Seng Wah (n 28)

jurisdictions. While there has been significant judicial action in the areas of oppression and mismanagement, there is a pressing need for a clear legislative stance or a Supreme Court opinion that may bind all other Courts and Tribunals to a common norm. Furthermore, as previously said, the current regime's 10% threshold has to be rethought urgently. If taken into consideration, the aforementioned recommendation would go a long way toward making India a more investor-friendly environment and filling up the gaps. Furthermore, rather than focusing on the numerical barrier, Courts and Tribunals should consider whether the minority shareholders can prima facie substantiate the allegations in the complaint. Otherwise, it would be contradictory to penalise a minority shareholder for initiating a lawsuit just because they are minorities inside the corporate structure, especially when the purpose of such rules was to safeguard minorities' interests and roles in the first place.