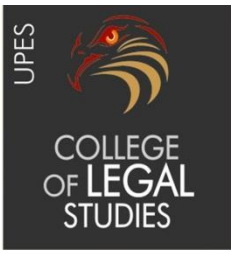
TITLE : SQUEEZING OUT MECHANISM IN INDIA UNDER COMPANIES ACT

SANSKRITI SINGH

Submitted under the guidance of: Prof. Sujith P Surendran

This dissertation is submitted in partial fulfillment of the degree of B.B.A., LL.B. (Hons)



College of Legal Studies

University of Petroleum and Energy Studies

Dehradun

2015

CERTIFICATE

This is to certify that the research work entitled **"Squeezing out mechanism in India under Companies Act"** is the work done by Miss Sanskriti Singh under my guidance and supervision for the partial fulfillment of the requirement of B.B.A., LL.B. (Hons) degree at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

Signature & Name of Supervisor

Designation

Date

DECLARATION

I declare that the dissertation entitled **"Squeezing out mechanism in India under Companies Act"** is the outcome of my own work conducted under the supervision of **Prof. Sujith P Surendran**, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

Miss Sanskriti Singh

(Signature)

Date :

LIST OF CASES-

P. Ltd. (1985) 58 Comp Cas (Cal)	
49. Rai Saheb Viswamitrav Amer Nath Mehrotra (1986) 59 Comp Cas 854	40
50. Stadmed Pvt. Ltd v Kshetra Mohan Saha (1969) 39 Comp Cas 741	41
51. N. Satyaprasad Rao v L.N. Sastry (1988) 64 Comp Cas 492, 496	41
52. Jagdish Chandra Mehra v New India Embroidery Mills (1964) 1 Comp U 2911	41
53. Sayedabad Tea Company Ltd. v Samarendra Nath Ghattak (1995) 83 Comp Cas 504	42
54. Makhanlal Jain v Amrit Banaspati Company Ltd. (1953) 23 Comp Cas 100	42
55. Shanker v South Indian Concerns Ltd. (1997) 1 Comp U	42
56. Re,,Sindri Iron Foundry Pvt. Ltd. (1964) 34 Comp Cas 510	43, 46
57. Bilasrai Joharmal v Akola Electric Supply Company Pvt. Ltd. AIR (1959) Born 176	43
58. Rajahmundri Electric Supply Corporation v Na_geshwara Rao AIR 1956 SC 213	36, 42, 44, 45
59. Worldwide Agencies Pvt. Ltd and another v Margaret T Desor and others	46
60. Dr. V. Sebastian v City Hospital Pvt Ltd. (1985) 57 Comp Cas 453	46
61. Bennet Coleman Co. Ltd v Union of India, (1977) 47 Comp Cas 92	48
62. Skipper Construction Co. P. Ltd. v Union of India, (1992) 3 Comp Li 160, 162	50
63. Secretary to Government of India v Leafin India Ltd. (2002) 38 SCL 121(CLB)	50
64. Peerless General Finance & Investment Co.	50

83. Re, Eric Holmes (Property) Ltd. (1965) 2 All ER 333	60
84. Re, Parkes Garage (Swadlincote) (1929) 1 Ch 1391	61
85. Official Liquidator v Parthasarathi Sinha (1983) 53 Comp Cas 163 (SC)].	61

LIST OF ABBREVATIONS

1. 1956 Act: Companies Act, 1956
2. 2013 Act: Companies Act, 2013
3. AGM: Annual General Meeting
4. AOA: Articles of Association
5. BOD: Board of Directors
6. CA: Chartered Accountant
7. CCI: Competition Commission of India
8. CEO: Chief Executive Officer
9. CFO: Chief Finance Officer
10. CG: Central Government
11. CMA: Cost and Management Accountant
12. CRA: Credit Rating Agency
13. CS: Company Secretary
14. CSR: Corporate Social Responsibility
15. DRR: Debenture Redemption Reserve
16. EGM: Extra-Ordinary General Meeting
17. FY: Financial Year
18. GOI: Government of India
19. HUF: Hindu Undivided Family
20. ID: Independent Director
21. IEPF: Investor Education and Protection Fund
22. KMP: Key Managerial Personnel
23. LLP: Limited Liability Partnership

24. MCA: Ministry of Corporate Affairs

25. MD: Managing Director

26. MOA: Memorandum of Association

27. NBFC: Non-Banking Finance Companies

28. NCLT: National Company Law Tribunal

29. NCLAT: National Company Law Appellate Tribunal

30. NED: Non-Executive Director

31. NFRA: National Financial Reporting Authority

32. OL: Official Liquidator

33. OPC: One Person Company

34. PAC: Persons Acting in Concert

35. RIF: Rehabilitation and Insolvency Fund

36. RBI: Reserve Bank of India

37. RSE: Recognised Stock Exchange

38. ROC: Registrar of Companies

39. SEBI: Securities and Exchange Board of India

40. RV: Registered Valuer

41. SRC: Stakeholders Relationship Committee

42. SFIO: Serious Fraud Investigation Office

43. VC: Video Conferencing

44. WTD: Whole Time Director

45. WOS: Wholly Owned Subsidiary

Contents

1. OVERVIEW-

Since a long time there has been constant talking about the control over the shareholders as they constitute to be the most important element in the company and over that controlling the minority, the controlling shareholder often looks for his interest way more then what he would bring to them. Laws and legislature in India works with the aim to culminate the evils of this biasness and thereafter uplift the minority's interest. When we refer to 'squeezing out mechanism", it means when the minorities are offered a way out to exit the company by withdrawing their shares to the majority and are offered various methods to pursue that.

Its often debated that this mechanism can bring with it immense monetary benefits to the company as it results in acquisition but that does not undermine the fact that often the minorities are suppressed at the discretion of the controlling shareholder.

Keeping our country, India's judicial system around this mechanism, its very recent i.e. since the last 10 years it has shown a rapid growth in our country and in lieu to such speed it will just multiply in the near future. Despite of this fact, there hasn't so far much work done in favor of its regulation and thus by my dissertation report I shall try to strike a balance between the current legislation, reforms made so far and thereafter my suggestions for its benefit and control.

1.1 MEANING OF THIS MECHANISM-

This is a situation where an arrangement is made between the two companies in which one get the control over the other, and the company under the control withdraws its shares at the prescribed exit price which is offered[1] by the one exercising this control. But how exactly does this operate, this procedure varies from situation to situation.

1. The company exercising the control can offer an exit price to the controlled minority giving no leverage to the company to exercise a straight interaction. Here the person having the control operates indivisually.

[1] Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003);

2. The company exercising the control could simply takeover and thereafter nullify there shares and result in the consolidation of his position as being the only equity handler. Here the person having the control cannot operates indivisually rather does not become a part of this entire scene at all.

3. They can at last come to an agreement to combine their shares and thus, work together in a newly developed arrangement.

Either of these methods could be adopted to bring this in operation but the fact still remains that the person having the control in a company over the other becomes very powerful and the only person to decide that how, when and where will this happen and this decision doesn't take the minorities collective choices instead they are directed the way they deem fit.

Now the result need to be understood here that it can lead to a very distressing situation where the minority will become reluctant to put their money in the company for they think that there interest may not be looked after as efficiently as it should or demand a lesser price then the original keeping in mind that they eventually now or then have to exit anyways. This would disturb the entire financial regulation in the company and thereafter of the entire financial markets. Thus, there is a strong need to look at this concern and resolve.

But not all the results are ill. It also results in betterment of the company at various times. Often when the company is not able to live up to the legal structure and statutory compliance needs, it can simply remove the minors and avoid the excessive operational costs .thus, both pros and cons are attached to this mechanism.[2]

1.2 PRESENT LEGAL SCENARIO ON THIS MECHANISM-

Companies Act, 1956 was operating in India so far on this mechanism until the newly enacted 2013 Act came in force. However not the entire Act has been notified so far, Thus both the Act are operational.

[2] Umakanth Varottil, *Squeezing Out Minority Shareholders: A Recent Judgment*, INDIACORPLAW BLOG (May 6, 2009), available at http://indiacorplaw.blogspot.sg/2009/05/squeezing-out-minority-shareholders.html

1.2.1 COMPROMISES, ARRANGEMENTS AND AMALGAMATION OF COMPANIES

(Chapter V of Part VI of the Companies Act, 1956 consisting of Sections 390 to 396A)[3]

1.1 MEANING -

The expression 'compromise' has not been defined by the Companies Act. It implies the existence of a dispute. There can be no compromise unless there is a dispute. The settlement of the dispute results in a compromise. In other words, 'compromise' denotes an agreement between two or more persons for the ascertainment of their rights when there is some question in controversy between them or some difficulty in the enforcement of their rights.[4]

Meaning of 'arrangement'

The term is wider in scope than the word 'compromise'. It includes any form of internal reorganisation of the company or its affairs, as well as scheme for amalgamation of two or more companies. A few examples of arrangement are as follows:

(a) Issue of fully paid up shares to pay off debentures.

(b) Creditors agreeing to waive a part of their dues.

(c) Preference shareholders surrendering their right of arrears of dividend.

(d) Exchange of company's assets for shares in a newly formed company.

The words 'compromise' and 'arrangement' imply that both the parties make concessions and give up something. A total surrender of the rights by one party would not amount to a compromise or arrangement. As such, where it was proposed that members should abandon all their rights without any compensating advantage, it was held not to be a compromise or arrangement and hence the Court had no jurisdiction to sanction it [Re, N.F.U. Development Trust Ltd.[5]].

Generally, the expressions 'reconstruction' and 'reorganisation' are used where one company is involved and the rights of its shareholders or creditors are varied. The term 'amalgamation' is

[3] Chapter XV of die Companies Ac. 2013 consisting of sections 230 to 240 has not been notified till 30.01.2015

[4] http://icmai.in/upload/Students/Syllabus2012/Study_Material_New/FinalPaper13.pdf

[5] Re, N.F.U. Development Trust Ltd (1972) I WLR 1 548

used where two or more companies are fused into one by merger[6] or by one taking over the other.

Meaning of 'reconstruction'

'Reconstruction' implies that substantially the same business shall be carried on by substantially the same persons. As such, the same company comes in a new form with the same members and creditors.

'Reconstruction' can be resorted to for the following purposes:

(i) To reorganise capital.

(ii) To compound with creditors.

(iii) To extend the objects of the company.

(v) To compel the members of a company to contribute further capital by taking new shares.

(vi) To revive a sick unit.

Modes of effecting reconstruction

Reconstruction may be carried out by any of the following methods:

I. Sale of the company under the powers

2. Sale undertaking

3. Acquire shares in another company (Takeover of a company) — Section 395.

5. Reconstruction of a company which is under members' voluntary wound up — Section 494.

6. Reconstruction of a company which is under creditors' voluntary wound up — Section 507.

7. Reconstruction by a scheme of arrangement with the creditors by a company in voluntary winding up —Section 517.

All these modes of reconstruction have been discussed in the succeeding paragraphs.

Meaning of 'amalgamation'

[6] Kamal Preet Kaur , E-Newsline PSA legal- "Merger Regime Under The Companies Act, 2013" Pg-2

The term amalgamation has not been defined by the Act. In amalgamation, two companies are joined to form a third entity or one is absorbed into or blended with another. Under an amalgamation, assets of the two companies become vested in one company which has as its shareholders all or substantially all the shareholders of the two companies.

Amalgamation can be effected by[7] —

(a) following the procedure as specified under sections 391 to 394.

(b) a takeover bid as specified under section 395.

Amalgamation can resort to for the following purposes:

(i) To effect economies.

(ii) To avail tax concessions and benefits.

(iii) To revive a sick unit.

(iv) To diversify or expand business.

(v) To eliminate competition.

(vi) To make full use of the unutilised capacity.

(vii) To mobilise resources or improve cash flow.

(viii) To acquire assets at discount.

1.2.2 PROCEDURE FOR COMPROMISE OR ARRANGEMENT (SECTIONS 391 TO 393)

The procedure for making a compromise or arrangement with the intervention of Court is explained as follows:

Stage 1. Application to the Court

application shall describe the scheme of the arrangement and the parties between whom it is proposed. Parties to compromise.

[7] http://meghpol.nic.in/acts/central/Companies_Act.pdf

When in liquidation, right of the creditor or member to make an application is not lost[8] [Rajendra Prasad Aggarwal v Official Liquidator (1978) 48 Comp Cas 476]. Not only him, but creditor and a member may also make an application for compromise or arrangement.

Stage II. Directions for holding the meeting

The Court will give the directions for holding the meeting only if it is satisfied that the scheme is reasonable and workable.

Stage III. Notice to the Central Government

The Court is not bound to accept the opinion expressed by the Central Government.

Stage IV. Information about compromise or arrangement

Notice to contain specified particulars.

such notice must mention that the explanations are available at the company's office and the explanations shall be furnished free of charge.

Stage V. Approval of the scheme

other words, scheme of arrangement between the company and members must be approved by more than 50% of the members who hold at least 75% of the value of shares. It is to be noted that members or creditors not present in the meeting or present in the meeting but remaining neutral are not to be counted. The scheme must be approved by both equity and preference shareholders. If separate meetings of preference shareholders and equity shareholders are ordered, then the scheme shall be approved by preference shareholders and equity shareholders in their separate meetings.

Stage VI. Satisfy the bona fideness to the Court

It is a well -accepted view that no scheme can be foolproof and it is possible to find faults in a particular scheme but that in itself is not sufficient to reject the scheme.[9] The Supreme Court has discussed at length the procedure to be followed in determining whether the scheme is bona fide and capable of being sanctioned [Miheer H. Malaita! V Malaita Industries Ltd. (1996) 87 Comp Cas 792].

[8] Rajendra Prasad Aggarwal v Official Liquidator (1978) 48 Comp Cas 476
[9] Miheer H. Malaita! V Malaita Industries Ltd. (1996) 87 Comp Cas 792

If the scheme is not bona fide but intends to cover the misdeeds of delinquent directors, then the Court shall not sanction the scheme [Pioneer Dyeing House Ltd. v Dr. Shanker Vishnu Marathe (1967) 2 Comp Li 16]. It might be possible to find faults in a scheme, but that would not be sufficient ground to reject it. No scheme can be foolproof and it is possible to find faults in a particular scheme but that by itself is not enough to warrant a dismissal of the scheme [Re, Sussex Brick Co. Ltd (1960) 30 Comp Case 536].

Stage VII. Sanction of the scheme

Where the Court is satisfied that the scheme is bona fide, it may sanction the scheme.

Stage VIII. Filing of order of the Court with the registrar

Until such filing, sanctioned scheme remains dormant and no creditor or member can enforce any right under the scheme.

Effect of scheme coining into operation. After the sanctioned scheme is filed with the registrar, it becomes binding on all the creditors, shareholders, contributories and liquidators. Such scheme cannot be varied or amended by any agreement between the parties.

Stage IX. Annexed to the memorandum shall be the copy of this order-

Post filing the company shall annex to every copy of memorandum, a copy of such scheme. This is to ensure that any person who deals with the company will have the notice of the scheme.

Stage X. Supervision and modification of the scheme

1.2.3 PRACTICAL PROBLEMS-

1. **Whether approval of scheme by 200 members holding 5,00,000 shares is valid if 70 members holding 4,00,000 shares voted against the scheme?**

The legal position

scheme of arrangement between the company and members must be approved by more than 50% of the members who hold at least 75% of the value of shares. It is to be noted that members or creditors not present in the meeting or present in the meeting but abstain from voting, are not to be counted.

The given case

Members who attended the meeting 200 members

Shares held by the members who attended the meeting 5,00,000 shares

Members who voted in favour of the scheme 70 members

Shares held by the members who voted in favour of the scheme 4,00,000

Members who voted against the scheme 130 members

Shares held by the members who voted against the scheme 1,00,000

Conclusion

The scheme has not been approved by the majority of members, present and voting, though it has been approved by the members holding three -fourth of the shares. It is evident that the requirements of approval by members in terms of 'majority in number of members' and 'three -fourths in value of shares' are cumulative, i.e., these are two separate compliances. Accordingly, the scheme has not been approved by the requisite majority, scheme thus rejected.

2. **Whether approval to scheme by 70 members holding 4,00,000 shares is valid if 120 members holding 90,000 shares voted against the scheme?**

The legal position

scheme of arrangement between the company and members must be approved by more than 50% of the members who hold at least 75% of the value of shares. It is to be noted that members or creditors not present in the meeting or present in the meeting but abstain from voting, are not to be counted.

The given case

Members who attended the meeting 200 members

Shares held by the members who at i ended the meeting 5,00,000 shares

Members who voted in favour of the scheme 70 members

Shares held by the members who voted in favour of the scheme 4,00,000

Members who voted against the scheme 120 members

Shares held by the members who votied against the scheme 90,000

Members who abstained from voting 10 members

Shares held by the members who abstained from voting 10,000

Conclusion

The scheme has not been approved by the majority of members, present and voting, though it has been approved by the members holding three -fourth of the shares. It is evident that the requirements of approval by members in terms of 'majority in number of members' and 'three - fourths in value of shares' are cumulative, ie., these are two separate compliances. Accordingly, the scheme has not been approved by the requisite majority, and scheme thus rejected.

1.2.4 RECONSTRUCTION OR AMALGAMATION BY SALE OF UNDERTAKING (SECTION 394)

1. **Under section 391 apply at the Court**

To effect the reconstruction, a company shall u/s 391 at the Court.

Contents of application. The application shall state the following particulars:

(a) Purpose of compromise or arrangement.

(b) Transfer of undertaking etc.

2. Order by Court

If the order so directs, the properties shall be vested in the transferee company free from any charge.

However, the order of the Court cannot provide for automatic transfer of contracts of person service. Therefore, the workers of the transferor company can lawfully refuse to join the service in the transferee company. In such a case, the workers will secure damages for early terminating the services.

3. Filing of order of the Court

Time frame is of thirty days.

4. Duties of Court before making order

The principles adopted by the Court while approving amalgamation or reconstruction are same as those adopted at the time of approving a compromise or arrangement. The duties of the Court under section 394 are onerous and have to be carefully performed. The duties of the Court are as under:

(a) ***Compliance of statutory provisions.*** The reconstruction or amalgamation involves a compromise or arrangement. Thus, the Court shall sanction the reconstruction or amalgamation only when all provisions relating to compromise or arrangement (i.e., sections 391, 393 and 394A) and reconstruction or amalgamation (Section 394) are complied with.

(b) ***Meeting held properly.*** The holding of the extraordinary general meeting cannot. be dispensed with on the ground that the shareholders have unanimously approved the merger [10]at an ordinary meeting [Re, Southern Automotive Corpn. P. Ltd. (1960) 30 Comp Cas 119].

(c*) Notice to the Central Government*

(d) *Scheme should be bona fide.* Court will have to be satisfy itself that the scheme is reasonable and fair to all the parties [Shankaranarayanan Hotels P. Ltd. v Official Liquidator (1992) 74 Comp Cas 290].

Where the object of the scheme of amalgamation was to cover the misdeeds of directors and the implications of the proposed scheme was not clear to the creditors, the Court rejected to sanction the scheme [Pioneer Dying House Ltd. v Dr. Shanker Vishnu Marathe (1967) 37 Comp Cas 546].

Burden of proof on party opposing the scheme.

(e) *Amalgamation must be in public interest* The Court must be satisfied that the scheme is not contrary to public interest. The scheme should not result in impeding the promotion of the industry or obstructing the growth of the economy.

[10] Kamal Preet Kaur , E-Newsline PSA legal- "Merger Regime Under The Companies Act, 2013" Pg-2

(f) Valuation of shares. The material on the basis of which share valuation has been worked out should be placed on the records of the Court. The Court has to be satisfied that the price arrived at is reasonable and fair.

***(g) Satisfaction report of the registrar*.** This obligation cannot be dispensed with by the registrar. So long as such report is not submitted by the registrar, the Court cannot pass final order either by accepting the scheme of amalgamation or rejecting it [Shriniwas Fertilisers Ltd. v Khaitan Chemicals & Fertilisers Ltd.].

1.2.5 In SHRINIWAS FERTILISERS LTD. V KHAIIAN CHEMICALS & FERTILISERS LTD (2003) 2 Comp Li 25,

the Court sanctioned a proposed scheme of merger, by taking into consideration the following factors[11]:

- There was no kind of infirmity or objectionable feature or any kind of illegality or lacking bona fides in the proposed scheme.
- Almost all the persons directly or indirectly associated with these companies had given their no objection certificate for approval of the scheme.
- The only objections raised against the acceptance of the scheme was by three shareholders.
- The scheme was not prepared to defeat the creditors, shareholders or etc Government dues.
- The proposed merger would enable the companies to run more effectively and economically than what they are presently functioning.
- None of the liabilities of the companies would be adversely affected.
- The rights of shareholders of the companies will remain intact.

1. **Demerger requires compliance of section 394**

Where a company intends to demerge one or more of its undertakings, will be effective by r/w sections 391, 392 and 393

2. **No power in object clause required**

[11] Kamal Preet Kaur , E-Newsline PSA legal- "Merger Regime Under The Companies Act, 2013" Pg-2

The power to amalgamate is derived from the Act (i.e., the provisions of section 394 read with Sections 391, 392 and 393). Also, neither section 394 nor any other section requires specific inclusion of power to amalgamate in the memorandum of association. Moreover, 'to amalgamate' the companies making an application for amalgamation need not have any power to amalgamate in their object clause [Re, E1TA India Ltd. AIR 1997 Cal 208].

1.2.6 CAN THE SERVICES OF WORKERS BE TRANSFERRED TO TRANSFEREE COMPANY?

As per section 394, the order of the Court sanctioning the reconstruction or amalgamation of company without execution of any further document. However, the order shall not automatically transfer contracts of personal service. Therefore in the given case, workers of ABC Co. Ltd. / Sunrise Company Limited will succeed against XYZ Co. Ltd. / Moonlight Company Limited. The workers cannot be compelled to join XYZ Company Limited / Moonlight Company Limited, and therefore, they shall be entitled to receive compensation.

1.2.7 PROCEDURE FOR DEMERGER[12]

For effecting the reconstruction of a company, the provisions of section 394 need to be complied with. Since, demerger is also a kind of reconstruction.

1.2.8 RECONSTRUCTION BY SALE OF SHARES/TAKEOVER OF A COMPANY (SECTION 395)

An amalgamation of two companies may be carried out by following the procedure as prescribed under sections 391 to 394. However, the prescribed procedure is very cumbersome and time consuming. Instead of following the Court procedure, section 395 enables a company (i.e., the transferee company) to acquire the shares of another company (i.e.. the transferor company). This process is commonly called as a 'take-over'. It does not involve the intervention of the Court unless the dissenting shareholders approach the Court. The company taken over remains in existence. The takeover may be effected by agreement with the directors, by purchase in the open market or by a 'take-over bid'

[12] Kamal Preet Kaur , E-Newsline PSA legal- "Merger Regime Under The Companies Act, 2013" Pg-2

1.2.9 SECTION 396 WHEN IT IS DONE IN THE INTEREST OF PUBLIC

Usually, procedure prescribed in Act for amalgamation of companies leads to prolonged delays. Therefore, the power has been conferred on the Central Government to order amalgamation of two or more companies in public interest. This results in speeding up the procedure for amalgamation of companies. Following procedure shall be adopted for effecting amalgamation of companies under section 396:

I. Preparation of draft order of the scheme

The Central Government shall prepare a draft order of the scheme of amalgamation of two or more companies. It shall provide that every member, debenture holder and creditor practically the same rights and interests in the new company as he possessed before amalgamation.[13]

2. Determination of compensation

Where the rights and interests of a member in the new company are less than those he possessed before amalgamation. The amount compensation and the parties entitled to compensation (viz, the members, debentureholders and creditors) shall be published in the Official Gazette.

3, Appeal against award of compensation

On determination of compensation by the Company Law Board, the draft order of amalgamation, as modified by the order of Company Law Board giving the revised compensation, and objections and suggestions received from the companies, shall become the final order.

4. Preconditions for making an order of amalgamation

The Central Government may make a final order of amalgamation under section 396, if following conditions are satisfied:

(a) Amalgamation in public interest.

(b) Consideration of objections and modification in scheme. The Central Government shall fix the time within which the objections and suggestions may be made, which shall not be less than 2 months. It shall consider any objections and suggestions of the companies concerned or

[13] Yogesh Malhan (Singh & Associates)- "Merger and Acquisition- transformed rules of the game"

any class of shareholders or creditors thereof. It may make modifications in the draft scheme in the light of suggestions and modifications so made.

(c) No pending appeal against compensation. The draft order made by the Central Government specifies the compensation. The Central Government shall ensure that an appeal against the determination of compensation has not been filed or where it has been filed, the same has been finally disposed of.

5. Order of amalgamation

Where all the conditions for making the final order are satisfied, the Central Government may order the amalgamation of those companies. The order shall contain the following particulars:

(**a) Constitution etc**.

(b) Legal proceedings.

(c) Other measures.

1.2.10 RECONSTRUCTION WHERE ITS BEING WOUND UP (SECTION 494)

Section 494 confers powers on a company (transferor company) for reconstruction if the company's been wound up. Transferor company has the power to transfer the assets to another company (transferee company) in. The liquidator distributes such shares and securities among the shareholders of the transferor company.[14]

I. Applicability of section 494

(a) Company in liquidation. The transferor company must be in liquidation

(b) Must be wound up on board's will. advantage of this section cannot be availed of if its on the courts order.

(c) No specific power in memorandum is required.

2. Procedure under section 494

(a) The liquidator of the transferor company shall enter into a tentative agreement

[14] Anup Koushik Karavadi- "Changing contours of mergers and acquisitions under Companies Act, 2013"

(b) The compensation may be in the form of shares, cash or other consideration.

(c) The liquidator of the transferor company is authorised to carry out the agreement by passing a special resolution.

(d) The liquidator shall receive the compensation from the transferee company which shall be distributed.

(g) consideration paid for shares will be agreed upon between the liquidator and the dissenting member. If they cannot arrive at an agreement, they will appoint an arbitrator with mutual consent.

3. Such power may be conferred generally or specifically for a particular agreement. The sale or transfer of property of the company can be made only in favour of another company and not any other person or trustee of a company intended to be incorporated or about to be formed [Irrigation Co. of France, Re, Fox (1871) 6 Ch App 1761.

1.3. SCENARIO FOR THE OPPRESSED AND CONTROL OF MANAGEMENT

(Chapter VI of Part VI of the Companies Act, 1956 consisting of Sections 397 to 409)[15]

1.3.1 THE 'MAJORITY RULE'

In case of differences among the members, the issue is resolved by a vote of majority. The Courts do not usually intervene in the matters of internal management of the company.

1.3.2 RULE IN FOSS v. HARBOTTLE — Supremacy of majority

Two shareholders brought an action against the directors charging them with 'concerting . They claimed damages from the defendants. The Court dismissed the action on the following two grounds (These two grounds constitute the very basis of Majority Rule):

(a) Proper plaintiff is the company

[15] Chapter XVI of the Companies Act, 2013 consisting of sections 241 to 246 has not been notified till 30.01.2015

Only the company is aggrieved. The Court held that the damage was caused to the company and thus only the company was the aggrieved party. As such, the suit could be brought only by the company and not by any individual shareholder.

Mere injury is not enough. Where a damage or injury is caused to the company, it also affects its members. Yet, they are not entitled to maintain a suit because mere injury is not enough. A person would be aggrieved only if he is able to further establish that injury was caused due to a breach of duty to them. Since the directors owe no duty to an individual member but to the company as a whole, an individual member cannot be a proper plaintiff

(b) Unproductive litigation

As such, the award of damages by the Court would have been futile as the majority had the powers to ratify the alleged breach of duty and it could decide not to recover the damages. Thus, litigation would have proved worthless.

The main advantages of Majority Rule are as follows:

(a) Proper plaintiff Where an injury is caused to the company and not to the individual members, the company alone is aggrieved. As such, action can be brought only by the company. Thus, the Majority Rule recognises and supports the concept of separate legal entity of the company, i.e., a company is an entity separate from its owners.

(b) Unproductive litigation. If the wrong done to the company can be ratified by the company, it would be futile to have litigation except with the consent of the majority.

(c) Multiplicity of suits avoided. If every individual member is allowed to institute a suit for a wrong done to the company, it would result in countless number of suits on the same subject resulting in chaos and wastage of money and time.

(d) Recognition of 'will of majority'. The well accepted rule that will of majority must prevail has been followed and reaffirmed by the principle laid down in Foss v Harboule.

Does not apply on-

company acts through the majority of members and the resolutions passed by a majority of members bind the company as well as the minority. Since, the majority of members is in an

advantageous position to run the company as per their wishes, they may cause serious damage or injury to the company.

Where the directors, who also control the majority shareholding, misuse their powers for their personal gains, the minority has no right to sue them as per the 'Majority Rule'. Thus, to protect the minority interest, certain exceptions to the 'Majority Rule' have been developed.

I. Exceptions under common law

(a) Ultra vires and illegal acts

The Majority Rule applies only where an act has been done irregularly and ratification is possible. However, illegal acts cannot be ratified even with the consent of all the members and thus no majority vote can be effective if the action is ultra vires the company. Where the company proposes to enter into an illegal transaction, any member can restrain the company by obtaining an injunction. An individual member has a right to restrain the company from making excessive payments to its employees [Parke v Daily News Ltd. (1962) Ch. 927].

(b) Fraud on minority

Where the majority misuses its powers to defraud or oppress the minority, an action can be brought by an individual member. Few illustrative cases are discussed hereunder:

• ***Majority diverting the profits of the company*** to another company in which they are majority shareholders. Majority of members of 'Company A', who were also members of 'Company B', passed a resolution compromising an action against 'Company B'. The facts showed that the compromise was detrimental to the interests of 'Company A' but was favourable to 'Company B'. Held, the majority tried to put something in their pockets at the cost of the minority and thus minority was empowered to take an action [Menier v Hooper's Telegraph Works Ltd. (1874) L.R. 9 Ch. 350].

• ***Compulsory acquisition of shares of a minority shareholder***. A large majority of 98% wished to buy the shares held by the minority shareholders. When minority shareholders refused to sell their shares, the majority shareholders passed a resolution altering the articles so as to enable 9/10th of the shareholders to buy the shares of any other shareholder. Held, the minority could not be compelled to sell its shares to the majority [Brown v British Abrasive Wheel Co. (1919) 1 Ch. 290].

(c) Wrongdoers in control

Where wrongdoers are in control, the minority will have a right of action since otherwise the grievance would never reach the Court, for the wrongdoers would never allow the company to institute a suit.

(d) Breach of fiduciary duties

The directors and promoters owe fiduciary duties to the company. If they make a secret profit, there is a breach of duty (although it may not amount to fraud) and they can be compelled to account for the profits made by them.

• ***Utilising a contract belonging to the company for personal gains.*** As it amounted to breach of duty towards the company, they called a general meeting in which a resolution was passed to the effect that the company had no interest in the contract. It was held that the company could claim profits realised by the directors [Cook v Deeks (1916) 1 AC 554].

• ***Sale at gross undervalue.*** A husband and wife were the only two directors in a company. They held majority was sold to one of the directors at gross undervalue. Held, the minority shareholders had a valid cause to bring an action against the directors [Daniels v Daniels (1978) Ch. 406].

(e) Requirement of special resolution

As per the Majority Rule by the majority of members. However, where an act requires a special majority, i.e., where the business can be transacted only by passing a special resolution, simple majority is not sufficient.

(h) Infringement of rights of a member

Nagappa Chettiar v Madras Race Club (1949) VK.1.

In Foss v Harbottle (1843) 2 Hare 461] the wrongdoers to the company were its directors. But, it is immaterial as to who are the wrongdoers. Even where a wrong is done by a third party, the 'Majority Rule' shall apply and the company alone can bring an action against the third party

1.3.3 MISUSE OF CORPORATE OPPORTUNITY BY THE DIRECTORS - CAN MINORITY SUE THE DIRECTORS?

The Majority Rule governs the internal management of the company. As such if any wrong is done to the company, the proper plaintiff to institute of suit is the company itself and the Court would not interfere at the instance of the individual shareholders [Foss v Harbottle (1843) 2 Hare 461]. However, if the majority misuses its powers to defraud or oppress the minority, an action can be brought by an individual member_

Three directors holding 75% ,directors and obtained a contract in their own names. As it amounted to breach of duty towards the company, they called a general meeting in which a resolution was passed to the effect that the company had no interest in the contract. It was held that directors utilised the contract belonging to the company for their personal gain and it amounted to a fraud on the minority. The company could claim profits realised by the directors [Cook v Decks (1916) 1 AC 554].

1.3.4 CLAIMING RELIEF FROM OPPRESSION (SECTION 397)

The Majority Rule governs the internal management of the company. As such if any wrong is done to the company, the proper plaintiff to institute a suit is the company itself and the Court would not interfere at the instance of the individual shareholders [Foss v harbottle (1843) 2 Hare 461]. However, majority should not enrich itself at the expense of the minority in which case the Majority Rule is watered down. Section 397 recognises the right of the minority shareholders to seek remedy against the oppression section 397 are discussed as under:

'OPPRESSION'.

The term 'oppression' has not been defined by the Act. Mere cornering shares, non -declaration of dividend and building up reserves do not amount to oppression.

(a) **Exercise of statutory power cannot result in oppression**.

(b) Oppression in the capacity of a 'member'. Oppression in any other capacity, e.g., as a director or a creditor is outside the purview of this section. Thus, where the majority of directors override the minority directors, relief under section 397 is not available. The oppressed member(s) must prove oppression in his/their capacity of 'member'. A director removed under

section 284 cannot claim relief under section 397, since no wrong has been done to him in the capacity of a member. can alone be agitated and not in relation to any commercial relation that a member has with the company [Anil Gupta v Alirai Auto Industries Pvt. Ltd (2003) 113 Comp Cas 63 (CLB).

(c) Continuity of oppression. The acts complained of must be continued acts of oppression. Further, acts constituting oppression must continue till the date of making the application.

(d) Justification of winding up. The application must make out a prima facie case that the degree of oppression is so severe.

(e) Winding up prejudicial to applicants. The applicants must satisfy the Company Law Board that though it is justified applicants.

2. Eligibility to make an application

An application under section 397 can be made only by the members of the company. Further, such members must meet the eligibility requirements, as prescribed under section 399, to make an application.

3. Orders by the Company Law Board

It may make necessary orders for ending the matters complained of. The Company Law Board has been vested with wide powers as listed under sections 402, 403, 404 and 407

4. What amounts to oppression? — Legal decisions

(a) Oppression must be continuous; A private company had three groups of shareholders. The two groups of shareholders passed a special resolution under section 81 for making further issue of capital to the public. The other group contended that this was an act of oppression by the majority group.

(b) Breach of standard dealing.

(c) A persistent and persisting course of unjust conduct must be shown. One of the shareholders and conducted the business of the company as if it were his own business. Held, it amounted to oppression [Re, Harmer (H.R.) Lid. (1959) 1 WLR 62].

(d) Forcing risky objects amounts to oppression. Where, after the life insurance business of a company was nationalised, the majority attempted to force new and more risky objects upon an unwilling minority, it was held that this amounted to oppression on the minority [Re, Hindustan Co-op. Insurance Society Ltd. AIR (1961) Cal 443].

(e) Isolated acts do not amount to oppression. An isolated act, which is contrary to law, may not necessarily and by itself support the inference that the law was violated with a malafide intention or that such violation was burdensome, harsh and wrongful .

(f) Only members can complain oppression. In Re, Bellador Silk Ltd. (1956) 1 All ER 667, the petition failed on the following grounds:

(i) The petition was brought for the collateral purpose of forcing the repayment of loans to other companies in which the petitioner was interested and was therefore an abuse of power.

(ii) The complainant filed the petition in the capacity of a director and not that of a member.

(iii) The circumstances were not such as to justify the winding up.

(g) Unwise acts do not imply oppression. Where the managing director was unwise, inefficient and careless and although the majority shareholders had failed to exercise their control to restrain the activities of the managing director, it was held that there was no oppression as the managing director did not act unscrupulously, unfairly or with any lack of probity and such acts or omissions of the majority shareholders were not designed to achieve some unfair advantage [Re, Five Minutes Car Wash Services Ltd. (1966) I All ER 242].

(h) family incorporated company showing Oppression. A company which is incorporated with mutual trust and confidence with a view to run it in the form of quasi partnership is generally termed as a family company.

- Although members have full right to remove a director, yet such right is not unrestricted in a family company, and an aggrieved member may always complain of oppression, amounts to oppression if the company was formed with a view to run it as a quasi partnership [Naresh Trehan v Hymatic Agro Equipments].
- Appointing additional directors in a family concern to marginalise the authority of the other group amounts to oppression [S James Fredrick v Mrs. Minnie R Fredrick].

- Increasing the number of directors and upsetting balance in the Board, when two groups were equally represented in the Board, will amount to oppression if one group is reduced to minority in Board [Ravi Shankar Taneja v Alotherson Triplex]
- In a family company, any change in shareholding without mutual agreement is an act of oppression. Issue of shares to one group is oppression [Pushpa Prabhudas Vora v Voras Exclusive Tools Pvt. Ltd.]
- Increase in capital to secure increase in voting strength by increasing the holding of one group, when there was no need of any funds, amounts to oppression.

1. Applicability of section 397

Section 397 applies to all companies, whether public or private.

2. Articles restricting the rights of members to be void

Proceedings under section 397 cannot be barred or defeated.

3. Relief against oppression — A remedy alternate to winding up

1.3.5 DEADLOCK IN MANAGEMENT - WHETHER AMOUNTS TO OPPRESSION?

An application seeking relief from the Company Law Board must make out a prima facie case that the degree of oppression is severe .

(1) Both Indian group and foreign groups are equally strong, and one is unable to oppress the other. As such, there may be a deadlock, but not oppression. [Gnanasambandam (CP) v Tamilna' Transports (Coimbatore) Pvt. Ltd. (1971) 41 Comp Cas 26]. Thus, the contention of the Indian group that the foreign group is acting in a manner oppressive to the Indian group is not tenable.

(ii) section 397 CLB powers are discretionary in character. Company Law Board may order the foreign group to buy out the minority group shareholding at the fair price with necessary permission as was held in Yashovardhan Saboo v Broz Beckert Saboo Ltd (1993) 1 Comp LJ 20. However, where there was deadlock in the management of private limited company and both the parties failed to buy the other group, the company was wound up under just and equitable clause [Kishan Lal Ahuja v Suresh Kumar Ahufa].

1.3.6 REMOVAL OF DIRECTORS OF A FAMILY GROUP - WHETHER OPPRESSION?

the removal of two directors cannot, ipso facto, amount to an act of mismanagement or an act prejudicial to public interest. Also, it does not amount to oppression because-

- The election and removal of directors is the prerogative of the members and such an act cannot ipso facto be treated as oppression on minority, unless the conduct. of the majority is based on malafide consideration's.
- The conduct eon be said to be oppression only when it is burdensome, harsh and wrongful. Mere removal of two directors does not amount to oppression.
- In the given case, it has been made clear that there is no other material on record in support of oppression on the minority. Since the conditions specified in section 397 have not been fulfilled, there is no oppression on the second family group and therefore relief from Company Law Board cannot be claimed.

1.3.7 WHETHER BONAFIDE CHANGE IN MANAGEMENT AMOUNTS TO OPPRESSION?

The person claiming relief on the ground of oppression has to prove on the part of majority:

- lack of probity:
- unfair conduct:
- prejudice to him in the exercise of legal and proprietary rights as a shareholder [Shanti Prasad Jain v Kalingo Tubes Ltd. (1965) 35 Comp Cos 351]. Seeking change of management does nor, prima facie, tantamount to oppression. In terms of the provisions of section 81(1A) of the Act, it is permissible for a company to offer the further issue of shares to any person other than the existing shareholders by passing a special resolution.

1.3.8 CLAIMING RELIEF FROM MISMANAGEMENT (SECTION 398)

The term 'mismanagement' has not been defined by the Act. It means some unfair abuse of power by the persons in charge of the management of the company. An unwise and inefficient management does not amount to oppression, though it may amount to mismanagement under section 398. Where the company is run overriding the wishes and interest of the majority of shareholders involving the company into costly litigations, the management can be said to be prejudicial to interest of the company. The provisions of section 398 are discussed as under:

1. Conditions for claiming relief from mismanagement

(a) Mismanagement or prejudice to public interest. Section 398 may be invoked in either of the

following two circumstances:

(i) That the affairs of the company are being conducted in a manner which is —

- prejudicial to public interest; or
- prejudicial to the interests of the company.

(ii) That due to a 'material change' that has taken place in the management or control of the company, it is likely that the affairs of the company will be conducted in a manner —

- prejudicial to public interest; or
- prejudicial to the interests of the company.

Meaning of 'material change'. For the purpose of section 398, material change in the management or control will be deemed to have taken place if there is an alteration in —

- the company's Board of directors; or
- manager; or
- the ownership of the company's shares; or
- the membership of the company, if the company has no share capital; or
- any other manner whatsoever (but not including a change brought about by, or in the interests of, any creditors, debenture holders or any class of shareholders).

(b) Continuity of mismanagement required. Where the wrongs contemplated were against a past director, the application was not maintainable under section 398. Charges of mismanagement even if proved in the past are not enough to establish an existing injury to the company or public interest. The mismanagement should be present and continuous [R.S. Mathur v H.S. Mathur (1970) 1 Comp Li 35].

If a director responsible for mismanagement is removed, mismanagement ends, and therefore application under section 398 is not maintainable.

2. Eligibility to make an application

An application under section 398 can be made only by the members of the company. Further, such members must meet the eligibility requirements, as prescribed under section 399, to make an application (Explained in Question 4).

3. Orders by the Company Law Board

Where an application is made to the Company Law Board complaining mismanagement, if the Company Law Board is satisfied that the conditions prescribed in section 398 are satisfied, it may make necessary orders for ending the matters complained of. The Company Law Board has been vested with wide powers as listed under sections 402, 403, 404 and 407 (Explained in Question 5).

4. What amounts to mismanagement? — Legal decisions

(a) Where the vice-chairman grossly mismanaged affairs of the company and had drawn considerable amounts for his personal purposes, that large amounts were owing to the Government towards charges for supply of electricity, that the machinery was in a state of disrepair, these are sufficient evidences of mismanagement [Rajahmundri Electric Supply Corporation v Nageshwara Rao AIR 1956 SC 213].

(b) Where the assets of the company are sold without complying with the requirements of section 293of the Companies Act, 1956 (corresponding to section 180 of the Companies Act, 2013) at low prices, it was held to be a case of mismanagement [Re, Malyalam Plantations (India) Ltd (1991) 5 Corp LA 361].

(c) Violation of the conditions of the memorandum by the person -in -charge of the management of affairs of the company would amount to this management [S. M. Ramakrishnarao v Bangalore Race Club Ltd. (1970) 40 Comp Cas 674].

(d) Serious disputes among the directors resulting in serious prejudice to the interest of the company amounts to mismanagement [Suresh Kumar Sangi v Supreme Motors Ltd. (1983) 54 Comp Cas 235]. No justification of winding up required

In case of mismanagement, there is no requirement of satisfying the Company Law Board that the acts of mismanagement justify the winding up of the company. Proof of prejudice to public interest or the interest of the company is enough.

1.3.9 ILLEGAL AND INVALID TRANSACTIONS - WHETHER RELIEF AVAILABLE?

Section 399 specifies the eligibility criterion to make an application to the Company Law Board for claiming relief from oppression or mismanagement. Accordingly, the members holding not less than 1/10th of the issued share capital of the company are eligible to make an application under section 399. In the present case, the shareholders holding 15% of the paid up capital have filed an application before the Company Law Board. The application fulfills the requirement of section 399 and is therefore valid. The following points are worth noting:

- Where the managing director was unwise, inefficient and careless, it was held that there was no oppression as the managing director did not Oct unscrupulously, unfairly or with any lack of probity [Re, Five Minutes Car Wash Services Ltd (1966)1 All ER 2423].
- An isolated act, which is contrary to law, may rot necessarily and by itself support the inference that the law was violated with a Wide intention or that such violation was burdensome, harsh and wrongful. But, a series of illegal acts following upon one another may lead justifiably to the conclusion that the members are being oppressed [Needle Industries (India) Ltd v Needle Industries Newey (India) Holdings Ltd (1981) 51 Comp Cos 7433]. An unwise, inefficient or careless conduct of a director cannot give rise to a claim for relief under section 397.
- Charges of mismanagement even if proved in the past are not enough to establish an existing injury to the company or public interest. The mismanagement should be present and continuous [R.S. Mathur v H5. Mathur (1970) 1 Comp LJ 35).

As is clear from the above noted decisions, the acts constituting oppression or mismanagement must indicate a continuous wrong. Further, such acts must continue till the date of making the application. In the present case, the shareholders have alleged that the company has entered into various illegal, invalid and irregular transactions. This in itself would not constitute a ground for invoking the provisions of sections 397 and 398 unless it is proved that these acts are oppressive to the shareholders or prejudicial to the interest of the company or public interest [Sheth Mohanlal Ganpatramv Shri Sayaji Jubilee Cotton and Jute Mills Co. Ltd (1964) 34 Comp Cas 777]. Therefore, the petition of the shareholders will fail unless they prove to the satisfaction of the Company Law Board that the acts complained of constitute oppression or are prejudicial to the interest of the company or public interest.

1.3.10 FRAUD AND MISMANAGEMENT IN PAST - WHETHER RELIEF AVAILABLE?

Sections 397 and 398 may be invoked only when the acts constituting oppression or mismanagement are continuous. Further, the acts constituting oppression or mismanagement must continue till the date of making the application. There are only two cases in which, on the application made under section 397 or 398 of the Companies Act, 1956 the Company Law Board is empowered to !jive relief in respect of past and concluded transactions which are no longer continuing wrongs; they are really in the nature of exceptions to the general principles as stated above. Firstly, section 402(f) enables the Company Law Board to set at naught transactions amounting to fraudulent preference, effected within 3 months before the date of the application under section 397 or 398 even though they are no longer continuing wrongs. Secondly, section 406 of the Companies Act, 1956, read with section 543 of the Act set forth in Schedule XI enables Company Law Board to book delinquent directors, manager and other office bearers of the company and to enforce the company's claim against them if they have misapplied or retained company's money or have committed any misfeasance or breach of trust in relation to the company [Sheth Mohanlal Ganpatramv Shri Satyaji Jubilee Cotton and Jute Mills Co. Ltd and others (1964) 34 Comp Cas 777].

1.3.11 INSTANCES NOT AMOUNTING TO OPPRESSION AND MISMANAGEMENT?

Following instances have been held as not amounting to oppression:

1. Violation of a personal contract among the members does not amount to oppression [Akbari A. Kalvert v Konkan Chemicals P. Ltd (1997)88 Comp Cas 245].
2. Where a company incurs a loss continuously, it cannot be regarded as an act of oppression [Ashoka Betelnut Co. P. Ltd. v M.K Chandrakantha (1997) 88 Comp Cas 274].
3. Increasing company's capital cannot be regarded as an act of oppression unless the motive of such increase is to reduce the complaining rival group to minority [Jaladhar Chakravorhy v Power Tools 4 Appliances Co. Ltd (1994) 79 Comp Cas 505].
4. Non -declaration of dividend is not an act of oppression [Chancier Krishna Gupta v Patina/al Girdharilal P.Ltd. (1984) 55 Comp Cas 702].
5. Filing of a suit against a shareholder for recovery of unpaid call money cannot be termed as oppression [Chennapassappa Kothambari v Multiplast Industries (Karnataka) P. Ltd (1985) 57 Comp Cas 5411

Following instances have been held as not amounting to mismanagement:

1. A bona fide decision of the Board not to recommend dividend and to accumulate profits [Thomas Vettom(VJ)v Kuttanad Rubber Co. Ltd (1984) 56 Comp Cas 284].
2. Mere allegation that the assets of the company have not been applied properly [Jaladhar Chakraborty V Chartugun Ram Maurya v U. P. Buildwares P. Ltd 1985 Tax LR 2030]. Similarly, allegation without any evidence of misappropriation of funds [Picksonk Electronks P. Ltd v Mrs. Ino'iara Singh (1998) 1 Comp LJ 136].
3. Where the directors of the company mode an arrangement with the company's creditors, during financially difficult period, so that they became shareholders of the company, it could not be regarded as mismanagement [Suresh Chand Marwahav Louis (P.) Ltd (1978) 48 Comp Cas 110].
4. Removal of works manager, holding nominal shares in the company is itself not a case of mismanagement [Re, Modern Furnishers (Interior Designers) P. Ltd. (1985) 58 Comp Cas (Cal)].

5. Appointment of new directors after removal of the directors cannot be challenged through an application under section 398 [Rai Saheb Viswamitrav Amer Nath Mehrotra (1986) 59 Comp Cas 854].

1.3.12 RIGHT TO APPLY UNDER SECTIONS 397 AND 398 (SECTION 399)

The provisions of section 399 have been enacted so as to discourage the presentation of frivolous applications by one or more disgruntled shareholders.

1. Eligibility to make an application

An application under section 397 or 398 may be made as follows:

(a) Members. Members eligible to make the application are as follows:

I. **Company having a share capital**. Members eligible to apply shall be the lowest of the following:
- 100 members; or
- 1/10th of the total number of members; or
- Members holding not less than 1/10th of the issued share capital of the company.

II. Company having no share capital. Application shall be made by at least 1/5th of total number of members. Application by lesser number of members. The Central Government has a discretionary power to permit a lesser number of members to file an application. However, before authorising any member as such, the Central Government may require the member to furnish such security, as the Central Government may deem reasonable.

(b) The Central Government. The Central Government may itself make an application (Section 401).

2. Validity of an application — Conditions to be fulfilled

a. The applicants must have paid all the calls and other sums due on their shares.
b. The applicants must hold the requisite number of shares at the time of filing the application.
c. Joint holders of shares are counted as one member only.

d. Section 399 requires that the application should be made by requisite number of members. It does not require that the member must be a holder of equity shares only. Thus, a preference shareholder, being a member, is also entitled to make an application to the Company Law Board.

3. Application by members — Certain issues

Following points need to be noted:

(a) Definition of member (Section 2(55) of the Companies Act, 2013). A person shall be a member of the company if —

(a) he agrees in writing to become a member; and
(b) his name is entered in its register of members.

Following provisions are important in this regard;

- Where shares are held in depository system, the beneficial owner is treated as a member. So, application under section 399 can be made by the beneficial owner, and not by the depository.
- A person entitled to shares but whose name has not been entered in the register of members cannot apply.
- Where a person has obtained a decree for rectification of register of members of the company to have his name entered in it, he may make an application although his name is not entered in the register of members [Stadmed Pvt. Ltd v Kshetra Mohan Saha (1969) 39 Comp Cas 741].
- A person in whose favour share certificates have been issued can exercise the rights as a member notwithstanding the omission of his name from the register of members [N. Satyaprasad Rao v L.N. Sastry (1988) 64 Comp Cas 492, 496]. 1g
- A holder of share warrant is not a member of the company. Therefore, he is not eligible to make an application.

(b) Members ceasing to be members —

Consequences. The requirement as to minimum shareholding is to be satisfied only at the time of filing of the application. If some of the members who consented to the application ceased to be members by selling their shares, the application is still maintainable [Jagdish Chandra Mehra v

New India Embroidery Mills (1964) 1 Comp U 2911. Where after making of the application, the applicant's name was struck off from the register of members on the ground that the transfer was unstamped etc., the application continued to remain valid [Sayedabad Tea Company Ltd. v Samarendra Nath Ghattak (1995) 83 Comp Cas 504].

(c) Consent to make an application.

Any one member may make an application to the Company Law Board on behalf of all the members by obtaining the prior consent of other members in writing. All the consenting members need not join in the application. Consent must be prior to making of application. The consent to make the application must be obtained before making the application. As such, consent obtained subsequent to the making of the application is ineffective [Makhanlal Jain v Amrit Banaspati Company Ltd. (1953) 23 Comp Cas 100].

Members must consent to subject matter of application. Consenting members have to apply their mind both to the allegations and relief sought. Mere consenting to an application is not enough if the style of consent shows non -application of mind. Consent letter must show that the members exercised an intelligent mind [Shanker v South Indian Concerns Ltd. (1997) 1 Comp U].

(d) Withdrawal of consent — Consequences.

The consent to be given by shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by a shareholder during the course of proceedings does not affect the maintainability of the application [Rajahmundri Electric Supply Corporation v Nageshwara Rao AIR 1956 SC 213].

(e) Can majority claim relief under section 399?

Section 399 nowhere requires that application for claiming relief from oppression or mismanagement shall be made only by the minority shareholders. In other words, section 399 neither disentitles a majority of members to make an application, nor requires that application shall be made by minority members only.

Since section 399 is of remedial nature (i.e., object of section 399 is to prevent a mischief), its proper construction should be to give the words used their widest amplitude. 'Therefore, no upper limit should be implied in section 399. An application made by majority shareholders alleging oppression or mismanagement is not prima facie invalid. The facts and circumstances

may justify intervention of Company Law Board on an application made by majority of members. Company Law Board intervenes if the majority proves that there are sufficient grounds to constitute oppression on the majority [Re,,Sindri Iron Foundry Pvt. Ltd. (1964) 34 Comp Cas 510].

Some examples of oppression on majority are given below:

i. Where the minority, by physical force or other wrongful act, oust the majority, so as to prevent the lawful exercise of their rights as shareholders.
ii. (ii) Where there are serious disputes between two group of shareholders, and consequently two registered offices are set up, two separate Boards are elected, separate Board meetings are held and separate general meetings are held, company's business, property and assets are passed to unauthorised persons.
iii. (iii) Where the minority shareholders take advantage of absence of members holding majority share capital, and pass a resolution wrongly depriving a member of his shares in order to achieve a majority.

4. Notice to the Central Government

The Company Law Board shall give notice to the Central Government of every application made to it under section 397 or 398. The Central Government has the right to make a representation in respect of the application and the Company Law Board shall take into consideration such representation before passing a final order (Section 400). The Company Law Board is not bound by the representation made by the Central Government.

The notice need not be given if the application is dismissed summarily. But, if the application is admitted for hearing, both the Central Government and the company must be informed [Bilasrai Joharmal v Akola Electric Supply Company Pvt. Ltd. AIR (1959) Born 176].

Right to apply; conditions for proving oppression

As per section 399, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

(a) 100 members; or

(b) 1/10th of the total number of members; or

(c) Members holding not less than 1/10th of the issued share capital of the company.

1.3.12 ELIGIBILITY TO MAKE APPLICATION; SUBSEQUENT WITHDRAWAL OF CONSENT – WHETHER INVALIDATES THE APPLICATION?

The issued, subscribed and paid -up share capital of ABC Company Limited is Rs. 10 lakhs consisting of 90,000 equity shares of Rs. 10 each fully paid up and 10,000 preference shares of Rs. 10 each fully paid up. Out of members of company, 400 members holding one preference share each and 50 members holding 500 equity shares applied for relief under Sections 397 and 398 of the Companies Act, 1956. As on the 'date of petition', the company had 600 equity shareholders and 5,000 preference shareholders. Examine whether the above petition under Sections 397 and 398 is maintainable. Will your answer be different, if preference shareholders have subsequently withdrawn their consent?

As per section 399, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

(a) 100 members; or

(b) 1/10th of the total number of members; or

(c) Members holding not less than 1/10th of the issued share capital of the company.

It must be noted that the term 'member' includes an equity shareholder as well as preference shareholder. The consent to be given by shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by shareholder during the course of proceedings does not affect the maintainability of the application [Rajahmundri Electric Supply Corporation v Nageshwara Rao AIR 1956 SC 213). In the present case, the shareholding pattern of the company is as follows:

• Rs. 9,00,000 equity share capital held by 600 members.

• Rs. 1,00,000 preference share capital held by 5,000 members.

• Rs. 10,00,000 total share capital held by 5,600 members.

The application alleging oppression and mismanagement has been made by the members as follows:

(a) Number of members making the application:

• Preference shareholders 400

• Equity shareholders 50

• Total members 450

(b) Amount of share capital held by the members making the application:

• Preference share capital 4,000 (400 preference shares of Rs. 10 each)

• Equity share capital 5,000 (500 equity shares of Rs. 10 each)

• Total capitol 9,000

The application shall be valid if it has been made by the lowest of the following:

(a) 100 members

(b) 560 members (being 1/10th of 5,600)

(c) Members holding Rs. 1,00,000 share capital (being 1/10th of Rs. 10,00,000)

As is evident, the application made by 450 members meets the eligibility criteria specified under sect 399, and therefore the application is maintainable. Such application shall remain valid despite the fact that some of the applicants have subsequently withdraw their consents [Rajahmundri Electric Supply Corporation v Nageshwara Rao AIR 1956 SC 213].Comment It has been assumed that the members making the application have paid all the calls due on the shares.

1.3.13 CAN MAJORITY MEMBERS INVOKE SECTION 397?

The right to make an application is given under section 399. Section 399 specifies the minimum numb of members who are eligible to make an application. It nowhere prohibits a majority of members from making the application.

Where the application is made by a majority of members, relief may be granted if the Company Law Board satisfied that the majority is oppressed arid has been rendered completely ineffective by the wrongful acts of a minority group.

There may be oppression where a minority by physical force or other wrongful act oust the majority, so as to prevent the lawful exercise of their rights as shareholders. As such, where two different registered offices at two different addresses had been set up, that two rival Boards were holding meetings, that the company's business, property and assets had passed on to the unauthorized persons, that unauthorized persons claimed to be the shareholders and directors, the Court held that majority was oppressed [Re, Sind", Iron Foundry Pvt. Ltd (1964) 34 Comp

1.3.14 CAN A LEGAL REPRESENTATIVE OF A DECEASED MEMBER APPLY FOR RELIEF?

The legal representative of a deceased member is entitled to file a petition under sections 397 and 398 of the Act for relief against oppression and mismanagement, even though the name of the deceased member is still recorded in the register of members [Worldwide Agencies Pvt. Ltd and another v Margaret T Desor and others]. It would be wrong to insist that the name of the legal representative be first put on the register before he can move an application under sections 397 and 398. Therefore, the Company Law Board may entertain the complaint

1.3.15 POWERS OF COMPANY LAW BOARD TO PREVENT OPPRESSION AND MISMANAGEMENT (SECTIONS 402, 403, 404 AND 407)

As per sections 397 and 398, requisite number of members (as specified under section 399) may apply to the Company Law Board for claiming relief from oppression and mismanagement. After due inquiry the Company Law Board may make such orders as are necessary to bring an end to the matters complained of. The Company Law Board has been vested with powers of wide amplitude to grant relief from oppression and mismanagement. These powers are explained as follows:

1. Specific powers (Section 402)

Section 402 confers the power on the Company Law Board to make the following orders:

a) **Regulation of company's affairs**. An order regulating the conduct of the company's affairs in future.

b) **Purchase of shares of a member.** An order for purchase of shares or interests of any member by other members or by the company.

c) **Purchase of shares of a member and reduction of share capital.** An order for purchase of shares or interests of any member by the company and consequent reduction of share capital of the company. No sanction of the Court under section 100 of the Companies Act, 1956 is required in such a case.

d) **Termination or modification of agreement with director/manager.** An order directing that any agreement with the managing director or director or a manager shall be terminated or set aside, or modified on such terms and conditions as it may think just and equitable. Consequences of termination of certain agreements (Section 407). Where any such agreement is terminated, set aside or is modified, the following consequences shall follow:

i. *Vacation of office.* Such managing director or director or manager shall vacate his office as from the date of the order of the Company Law Board. The Company Law Board is not bound to follow the procedure prescribed under section 284 for making such an order. As such, the Company Law Board has unlimited powers to remove the existing managerial personnel.

ii. *No compensation for loss of office.* No person shall be entitled to claim any damages for compensation for loss of office or in any other respect.

iii. *No similar appointment for 5 years in the company.* No manager, managing director or director whose agreement is so terminated or set aside, shall act as the manager, managing director or director of such company for a period of 5 years except with the permission of the Company Law Board. The Company Law Board may grant such permission only after giving an opportunity of being heard to the Central Government.

(e) Termination or modification of an agreement with third parties. The Company Law Board may make an order directing that —

i. any agreement with a third party shall be terminated or set aside after giving due notice to the party concerned; or

ii. any agreement with a third party shall be modified if the third party gives its consent to such modification. No compensation to third party. The third

party shall not be eligible to claim any damages for compensation for loss arising because of termination or modification of such agreement.

(f) Setting aside fraudulent preference. An order setting aside any transfer, delivery of goods, payment, execution or other act relating to property, made or done within 3 months before the date of the application. Such an order shall be made only lithe circumstances suggest that the transaction would have been deemed to be a fraudulent preference in an insolvency proceedings against an individual.

(g) General relief An order in respect of any other matter for which it is just and equitable that a provision should be made, i.e., in addition to the above powers, the Company Law Board may make such orders as it thinks fit for giving relief in respect of the matters complained of.

1.3.16 POWERS OF COMPANY LAW BOARD ARE ILLUSTRATIVE ONLY

1. Power to make an interim order (Section 403)

The Company Law Board may, on the application of any party to the proceedings, make an interim order for regulating the company's affairs pending the making of a final order. The order can stipulate such terms and conditions as may appear to the Company Law Board to be just and equitable.

2. Power to alter memorandum or articles (Section 404)

a) **Alteration by Company Law Board to be effective.** The Company Law Board is empowered to make any alteration in the memorandum or articles of a company, and such alteration shall have the same effect as if duly made by a resolution of the company. Where a particular regulation in the articles of the company was capable of being misused to prevent the members from exercising their ordinary right to demand a poll, the Company Law Board ordered the amendment of such article [Dr. V. Sebastian v City Hospital Pvt Ltd. (1985) 57 Comp Cas 453].

The Company Law Board is empowered to reframe or insert a new article, which may be against the company's memorandum or other articles and even against the Companies Act, provided that such an order is necessary to put an end to the matters complained off [Bennet Coleman Co. Ltd v Union of India, (1977) 47 Comp Cas 92].

b) **Further alterations to require permission of Company Law Board.** Any further alteration by the company would have to be consistent with the alterations already made by the Company Law Board and can be effective only if permission of the Company Law Board is obtained. Thus, once the Company Law Board has altered an article contained in the articles of the company, the company cannot make an alteration which is calculated to reduce the effect of the alteration made by the Company Law Board.

c) **Filing of copy of order of Company Law Board.** The company shall file with the registrar a certified copy of every order of the Company Law Board, which has the effect of altering the company's memorandum or articles, or which grants a permission to the company to alter its memorandum or articles in future. The certified copy shall be filed with the registrar within 30 days of order of the Company Law Board.

1.3.17 APPOINTMENT OF DIRECTORS BY THE CENTRAL GOVERNMENT (SEC 408)

Section 408 empowers the Central Government to appoint nominee directors on the Board of directors of a company if such an order is made by the Company Law Board. The procedure in this regard is as follows:

1. Reference or application to the Company Law Board

The Company Law Board has no suo mom u power to make an inquiry and pass orders for the appointment of nominee director(s). It can do so only if —

(a) a reference is made by the Central Government; or

(b) an application is made by not less than 100 members of the company; or

(c) an application is made by members holding not less than 1/10th of total voting power of the company.

Power of Central Government to make a reference. The power of the Central Government for making a reference under this section is of administrative nature. The only requirement at this stage of making a reference is that there should be some cogent material before the Central

Government for making a reference. Possession of sufficient evidence as to gross mismanagement or oppression is not a precondition for making a reference [Skipper Construction Co. P. Ltd. v Union of India, (1992) 3 Comp Li 160, 162]. No opportunity of being heard need be given to the company. The company, against whom an application or reference is made, is not entitled to any hearing at this stage.

2. Inquiry by the Company Law Board

On receipt of the reference or application, the Company Law Board shall make such inquiry as it deems fit.

3. Essential conditions for making orders

The Company Law Board may pass an order under this section only if it is satisfied that the following two conditions are fulfilled:

(a) The affairs of the company are being conducted in a manner which is prejudicial to any member of the company or interest of the company or public interest.

(b) It is necessary to make the appointment of one or more persons as directors of the company so as to

- prevent the current state of affairs of the company; and
- effectively safeguard the interest of members or the company or public interest.

'Satisfaction of Company Law Board' — Connotation thereof The word 'satisfied' means that there must be sufficient evidence and proof which ordinarily satisfies an unprejudiced mind beyond reasonable doubt, objectively and not subjectively, that the requisite conditions are present. Mere formation of an opinion cannot be equated with satisfaction [Peerless General Finance & Investment Co. Ltd. v Union of India, (1991) 71 Comp Cas 300 (Cal)]. In Secretary to Government of India v Leafin India Ltd. (2002) 38 SCL 121(CLB), it was held that the Central Government was empowered to appoint sufficient number of directors on the Board of a company in order to safeguard the public interest, keeping in view the following considerations:

- The company had collected over Rs. 15 crores from over 6,000 depositors which it failed to repay in time.
- There had been systematic diversion of funds by the directors through various front companies and subsidiaries.

- The company had disposed of certain valuable assets at throwaway prices.
- The managing director was absconding and his whereabouts were not known and five of the company's directors had resigned and therefore there was no effective Board in position to carry on the affairs of the company.

4. Nature of orders of Company Law Board and appointment of nominee directors by the Central Government

On completion of the inquiry, the Company Law Board may make any of the following alternative orders:

a) **Appointment of directors by Central Government** The Company Law Board may order the appointment of certain number of directors on the Board of the company. On such an order being made, the Central Government may appoint the directors as specified in the order of the Company Law Board. The directors appointed by the Central Government shall hold office for such period, not exceeding 3 years, as may be specified by the Company Law Board. However, the appointment can be extended for another period of 3 years if the same conditions are still persisting [Re, Urban Improvement Co. Pvt. Ltd. (1992) 73 Comp Cas 107].

b) **Adoption of proportional representation and appointment of additional directors**. The Company Law Board may direct the company to make the appointments of directors on the basis of 'proportional representation' as contained in section 163 of the Companies Act, 2013. On such a direction being given, the company shall be bound to make necessary amendment in the articles and make fresh appointments as per 'proportional representation' within the time specified by Company Law Board. Further, the Company Law Board may order the appointment of certain number of

c) **additional directors.** On such an order being made, the Central Government shall appoint the additional directors as specified in the order of the Company Law Board. The additional directors shall hold office until new directors are appointed on the basis of proportional representation.

5. Provisions applicable to nominee directors

A director appointed by the Central Government is in the same position as any other director. He is entitled to participate in the management of the business and affairs of the company. However, his position differs in respect of the following matters:

a) Ignored in reckoning two -third. In reckoning two -third or any proportion thereof, any director appointed by the Central Government shall not be taken into account.
b) Qualification shares not necessary. No director appointed by the Central Government shall be required to hold the qualification shares.
c) No retirement by rotation. No director appointed by the Central Government shall be required to retire by rotation. As such, provisions of sections 255 and 256 shall not apply to these directors.
d) Removal by the Central Government only. These directors can be removed by Central Government only, i.e., section 284 shall not apply. Any vacancy in the office of these directors can only be filled by the Central Government.
e) Monitoring by the Central Government The Central Government may require these directors to report to the Central Government with regard to the affairs of the company.

6. Change in the Board of directors to require approval of Company Law Board

Where the Central Government appoints directors or additional directors under section 408, no change in the Board of directors shall have any effect so long as the directors or additional directors appointed by the Central Government remain in office. However, such a change may be made after obtaining confirmation of the Company Law Board.

7. Issue of directions by Central Government

Section 408 empowers the Central Government to issue the following directions to the company:

a) A direction that the existing auditor of the company shall be removed and another auditor shall be appointed in his place.
b) A direction that the articles of the company shall be altered in the manner directed by the Central Government. Automatic effect of directions. On theses directions being given, the appointment or removal of the auditor, or the alteration of the articles shall be deemed to have come into effect as if the company has complied with all the applicable provisions of the Act without any further act to be done. Further, the Central

Government has the power to issue such other directions to the company, as it deems fit.

1.3.18 POWER OF COMPANY LAW BOARD TO PREVENT CHANGE IN BOARD OF DIRECTORS (SECTION 409)

I. Who can make a complaint?

The complain can by made by any of the following persons:

(a) The managing director of the company

(b) Any other director of the company

(c) The manager of the company.

As is evident, the benefit of section 409 is not available to the members of the company

2. Nature of complaint

The complaint must state that —

(a) a change in the ownership of any shares held in the company has taken place or is likely to take place;

(b) as a result of such change, a change in the Board of directors is likely to take place; and

(c) if the change is allowed, it would affect prejudicially the affairs of the company.

3. Powers of Company Law Board

After making an inquiry, if the Company Law Board is satisfied that it is just and proper to do so, it may direct that —

(a) any resolution passed; or

(b) any resolution that may be passed; or

(c) any action taken; or

(d) any action that may be taken,

to effect a change in the Board of directors, shall not have effect unless confirmed by the Company Law Board.

4. Effect of the order

The order of the Company Law Board shall have effect notwithstanding anything to the contrary contained in any other provision of this Act or in the memorandum or articles of the company, or in any agreement or resolution.

5. Interim order

The Company Law Board may make an interim order until completion of the enquiry and final order. The provisions of section 409 do not apply to a private company.

1.3.19 LIABILITIES EXCEED ASSETS - WHETHER IMPLIES INABILITY TO PAY DEBTS?

Under section 433(e), a company may be wound up by the Court if it is unable to pay its debts. Section 439 empowers the registrar to file a petition for winding up of the company on the ground that the company is unable to pay its debts. Where the liabilities of a company far exceeded its assets, the Court held that this in itself did not mean that the company was unable to pay its debts because of the following reasons:

- For determining the company's ability or otherwise to pay its debts, it was to be considered whether' the company was able to meet its liabilities as and when they accrued due.
- Section 434 specifies the circumstances in which the company shall be deemed to be unable to pay its debts. None of these grounds were satisfied in this case.
- No complaint had been made by the creditors as regards non -fulfilment of any of their claims.
- The mere fact that certain liabilities might accrue due in future, which could exceed the existing assets of the company, would not necessarily lead to the conclusion that the company would be unable to meet its liabilities when they will accrue due [ROCv Ajanta Lucky Scheme and Investments Ltd (1973) 43 Comp Cas 314].

The facts of the present case are exactly similar to the facts mentioned in the above case and consequently there is no valid ground for contending that M/s. Hush Hush Ltd. is unable to pay its debts. So, the company can defend against the winding up petition field by the registrar and the winding up petition is likely to be failed.

1.3.20 INABILITY TO PAY DEBTS - A FEW CASES

Under section 433(a) to (f). Section 433(e)

(i) Contingent or conditional liability

Prescribed consideration whether payable today or later. A contingent or conditional liability is not a debt, unless the contingency or condition has already happened [Registrar of Companies v Kavita Benefit Private Limitea'(1978) 48 Comp Cos 231].

(ii) Non-payment of dividend declared

On declaration, the dividend becomes a debt payable by the company. Non-payment of dividend entitles the shareholder to apply for winding up of the company [Hariprasad v Amalgamated Commercial Traders (Private) Ltd (1964) 34 Comp Cas 209]. Therefore, non-payment of dividend declared would amount to a debt for the purpose of winding up petition.

(iii) Default in remuneration to the worker

Default in remuneration to the worker of the company is not a debt for the purpose of section 433(e) [Pawan Kumar Khullar v Kaushal Leather Board Ltd. AIR 1966 MP 85]. However, a contrary decision has been given by the A.P. High Court in which the Court construed the word 'debt as a sum which is to be recovered from a person who is obliged to make the payment and accordingly the Court held that unpaid salary is a debt [8.5. Damagryv VIT Airways Ltd.]. It seems that A.P. High Court judgement is realistic and reflects the intention of the legislature.

(iv) Non-payment to a creditor of a disputed liability

The Court shall consider the following principles:

a) Whether the defence of the company is in good faith and is of some substance.
b) Whether the defence is likely to succeed in point of law.

c) Whether the company has produced prima facie proof of the facts on which the defence depends [Kirpal Singh v Sutlej Land Finance Pvt. Ltd (1989) 66 Comp Cos 841].

1.4. OFFICIAL LIQUIDATOR TO BE LIQUIDATOR (SECTION 449)

1.4.1 THE LIQUIDATOR (SECTIONS 448 TO 453)

The liquidator is a person who represents the company in winding up proceedings. He takes over the administration of the company. He is responsible for realising the assets of the company, paying its liabilities and paying the surplus, if any, to the contributories. The provisions relating to the liquidator explained as under:

1.4.2 THE OFFICIAL LIQUIDATOR

The provisions relating to Official Liquidator are contained in sections 448 to 463 of the Act. These provisions are explained as under:

(a) **Official Liquidator of a High Court.** The Central Government appoints an Official Liquidator with every High Court. Often the resident director is made to be the Liquidator in case the workload is not much.

(b) **Official Liquidator of a District Court.** The one who is held to be the one who shall receive on behalf of the company at the court is appointed as the liquidator.. If there is no such officer, then the Central Government may appoint any other officer as the Official Liquidator of that District Court.

(c) **Deputy and assistant Official Liquidators.** CG may allot an assistive hand. In such a case, the term Official Liquidator shall include a deputy or assistant Official Liquidator.

(d) **Official Liquidator to be liquidator.** In compulsory winding up, only an Official Liquidator can be appointed as liquidator of a company. The Court has no power to appoint a private person as a liquidator.

(e**) describe him by official name.** he shall not be known by his individual name. He shall be described by his official name, i.e., 'the Official I iquidator'.

(f) **Prohibition of appointment of receiver.** The object of this provision is to avoid any question of competition between the receiver and the Official Liquidator.

(g) **Fees to the Central Government.** The Official Liquidator gets his remuneration from the Central Government, and therefore he is not entitled to any further remuneration. For the services rendered by the Official Liquidator, the Central Government is entitled to charge certain fees from the company which is charged against the assets of the company.

(h) **Validity of acts**. Anything which he will do shall be held valid unless something contrary is proven against him which leads to his termination. When his recruitment in itself is not valid then, all his subsequent acts shall be invalid.

(i) **Notice to Income Tax Officer.** The liquidator shall give notice of his appointment to the income tax officer. This notice has to be generated in the time frame of thirty days of his appointment. Thereafter, within 3 months, the income tax officer shall intimate the liquidator the estimated amount to meet the tax liability. The liquidator is required to set aside the amount to meet the tax liability.

1.4.3 DISSOLUTION / REVIVAL - A COMPANY (SECTIONS 481 AND 559)

The provisions relating to dissolution of a company and revival of a dissolved company are contained in sections 481 and 559 respectively. These provisions are explained in the following paragraphs:

I. **Dissolution of a company (Section 481)**

(a) Grounds for dissolution-

(i) in cases where the entire operation of the company is shut and closed.

(ii) in cases where the court is convinced that the following criteria has been met :

• the liquidator cannot proceed with the winding up of a company —

— for want of funds and assets; or

— for any reason whatsoever.

• it is just and reasonable in the circumstances of the case that an order of dissolution of the

company should be made.

(b) Effective date of dissolution. Company shall begin its winding immediately after the court directs it to do so.

(c) Filing the judgement with registrar. In the time frame of thirty days or receiving this judgement the liquidator will register it with the registrar.

2. Revival to a dissolved company (Section 559)

(a) Order of the Court. Where a company has been dissolved, it may be revived by the Court by declaring the dissolution void. The effect of an order under section 559 is that it makes the dissolution void ab initio and all consequences resulting from the dissolution are avoided, including proceedings taken during the interval between when the company solemly dissolves and when it states its intention to dissolve.

(b) Who can make the application? Following persons are eligible to apply for winding up:

(i) Liquidator

(ii) Any other interested person. Which can be the following listed below:

• Creditors.

• contributory.

• The Income Tax Officer who makes a final assessment after dissolution of the company.

• An unpaid landlord.

(c) Time limit. Section 559(1) of the Act reads as under:

Two different views have been expressed while interpreting section 559. According to one view, the application shall be made within 2 years from the date of dissolution of the company, although the order of the Court may be passed even after the expiry of two years [Re, Scad Ltd (1941) 2 All ER 466; Income Tax Officer v Vemulapalli & Sons Private Ltd, (1967) 37 Comp Cas 686 (AP)]. However, a conflicting view has been expressed according to which the order

under section 559 must be passed within 2 years from the date of order of dissolution [ITO, Ernakulam v Mambad Timber and Estates Ltd. (1973) 43 Comp Cas 332]. The former view appears to be more in consonance with justice and common sense.

(d) Filing a copy of order wills the registrar. The Court may extend the time limit for filing the said copy from thirty days to more as it deems fit from case to case and has to be filed with the registrar.

(e) Discretionary power of the Court. The Court has wide discretion under this section and it shall consider each case On its own merits. Following points need consideration:

(i) Where the applicant alleged and proved fraud in the winding up proceedings, the Court declared the dissolution void [Barrett v African Products Ltd. AIR 1928 PC 261].

(ii) Where the assets were realised by the liquidator after the company was dissolved, the Court passed an order declaring the dissolution void [Henderson's Nigel Co. 105 LT 370].

(iii) The mere fact that misfeasance proceedings had been started did not itself amount to a ground for declaring the dissolution void [Lewis and Smart (1954) 1 WLR 755].

1.4.4 FRAUDULENT PREFERENCE (SECTION 531)

Meaning and essentials of fraudulent preference-

Involuntary acts do not amount to fraudulent preference. Payments made under pressure shall not be treated as fraudulent preference. Payments made to a creditor solely with a view to avoid civil or criminal proceedings do not amount to fraudulent preference [Re, Blackpool Motorcar Co. Ltd (1901) I Ch. 77]. Payments made by the directors under pressure and to keep good relations with the creditor do not amount to fraudulent preference. Purpose must be to give preference to a creditor. Any transaction would amount to a fraudulent preference only if the intention is to give priority over the creditors. It is not enough to show that preference was given to a particular creditor, it must also be shown that it was done with a view to give him the favoured treatment. If the dominant motive of the transaction is tainted with an element of dishonesty, it amounts to fraudulent preference. Fraudulent preference cannot be inferred by mere suspicion. The fraud must be clearly alleged, proved and established and there should be a legal evidence [M. Kushler Ltd. (1943) 2 All ER 22].

• There is no fraudulent preference when a debtor's dominant intention is to benefit himself rather than to confer an advantage on his creditor. Thus, where a company created a legal mortgage in favour of a bank in the hope that by keeping good faith with the bank it could get further advance from the bank which could be utilised to revive the company, the mortgage was held not to be a fraudulent preference even though the mortgage was created after it was fairly clear that the company had become insolvent [Re, FL E. Holdings Ltd. (1967) 3 All ER 553].

Examples of fraudulent preference

A director of a company had given guarantee for certain overdrafts granted to the company on the agreement that the company would give him security over the assets whenever called upon by him to do so. The agreement was not registered. The director later received a debenture charging the assets of the company. Within a month thereafter, the company proceeded the resolution to be shut down. Held, charge created on assets was a fraudulent preference and was void [Re, Jackson & Bassford Ltd. (1906) 2 Ch 467].

A shareholder advanced money to the company on the condition that the company would execute formal mortgages in his favour whenever asked by him. Time when they could not pay mortgages were executed by the company in his favour. Two months later, the company went into voluntary liquidation. Held, the mortgages created in favour of the shareholder amounted to a fraudulent preference and were therefore void [Re, Eric Holmes (Property) Ltd. (1965) 2 All ER 3331.

A transaction is declared as a fraudulent preference, any person who is fraudulently preferred company gives a fraudulent preference to a creditor so as to benefit a person who has stood as a guarantor or surety for payment of that creditor, following consequences shall follow:

• The creditor shall be liable to refund to the liquidator the amount paid by the company.
• The creditor legally seek right to claim this from the surety or guarantor.
• The winding up Court shall be empowered to order that the surety or guarantor shall make the payment to the creditor.

1.4.5 FLOATING CHARGE TO BE INVALID IN CERTAIN CASES (SECTION 534)

Section 534 prevents an insolvent company from creating a floating charge on its undertaking to secure past debts or for moneys which do not come into the hands of the company. the money was paid in consideration of the fact that charge is creaked. In other words, it will be treated as if the cash has been paid to the company in the following cases:

• Where the cash is paid to the company simultaneously with creation of the charge.

• Where the cash is paid a few days before the charge is created provided it was paid in reliance upon the promise to create the charge.

• Where the cash is paid to the company subsequent to the creation of charge provided the c would not have been paid to the company had the company not given the security (by way creation of floating charge).

1. Effect of section 534 Unless a floating charge is covered in the two exceptions, it is invalid. However, the debt is not affected But, it becomes an unsecured debt.

2. company before winding up commenced, the sum paid cannot be recovered by the liquidator under

section 534 [Re, Parkes Garage (Swadlincote) (1929) 1 Ch 1391. However, if the transaction falls under any other section (e.g., section 531), the liquidator may proceed under that section.

1.4.6 WHETHER LEGAL REPRESENTATIVE OF A DIRECTOR

misfeasance proceedings initiated under section 543 against a director of a company in winding up can be continued on his death against his legal heirs for the purpose of determining and declaring the loss or damage caused to the company[16]. The amount declared to be due in the misfeasance proceedings shall be realised from the estate of the deceased in the hands of his legal representatives [Official Liquidator v Parthasarathi Sinha (1983) 53 Comp Cas 163 (SC)]. However, such liability shall not extend to any sum beyond the value of the estate of the deceased in their hands.

[16] PwC India- "Companies Act, 2013: Key highlights & analysis" Significant changes & implications, Pg-37

1.4.4.DELISTING OF THE COMPANY-

This is common to see that the controlling shareholder often opts this method to save the company from being regulated under the SEBI Regulation ,2009 on delisting rules and provisions which helps the controlling shareholder to prevent direct application of these laws and thus just simply convert into a private company overriding the interest of the minorities and resulting in a squeeze out of them but resulting in the betterment of the company. Another advantage of this is that the company can operate under lesser obligations under law and in simple words it can avoid the compliance statutory.

Delisting regulation under section 8 says that there has to be a certain majority to be met for the approval of such a scheme. It must have approval from atleast seventy-five percent majority of the shareholders and with respect to public shareholder, it is ought to receive atleast two- third of majority. This is a situation where an arrangement is made between the two companies in which one get the control over the other, and the company under the control withdraws its shares at the prescribed exit price which is offered[17] by the one exercising this control. But how exactly does this operate, this procedure varies from situation to situation.

1. The company exercising the control can offer an exit price to the controlled minority giving no leverage to the company to exercise a straight interaction. Here the person having the control operates indivisually.

2. The company exercising the control could simply takeover and thereafter nullify there shares and result in the consolidation of his position as being the only equity handler. Here the person having the control cannot operates indivisually rather does not become a part of this entire scene at all.

3. They can at last come to an agreement to combine their shares and thus, work together in a newly developed arrangement.

Either of these methods could be adopted to bring this in operation but the fact still remains that the person having the control in a company over the other becomes very powerful and the only

[17] Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003);

person to decide that how, when and where will this happen and this decision doesn't take the minorities collective choices instead they are directed the way they deem fit.

Now the result need to be understood here that it can lead to a very distressing situation where the minority will become reluctant to put their money in the company for they think that there interest may not be looked after as efficiently as it should or demand a lesser price then the original keeping in mind that they eventually now or then have to exit anyways. This would disturb the entire financial regulation in the company and thereafter of the entire financial markets. Thus, there is a strong need to look at this concern and resolve.

But not all the results are ill. It also results in betterment of the company at various times. Often when the company is not able to live up to the legal structure and statutory compliance needs, it can simply remove the minors and avoid the excessive operational costs .thus, both pros and cons are attached to this mechanism.[18]

By the determination of reverse book price, an exit price is thus given to the minorities by which they are expected to accept that price and withdraw there share in the favour of the controlling shareholder. Bids are offered on the internet and whichever is the highest becomes the final exit price. But this process with it brings an undue advantage on the acquiring company over the minorities.

2. COMMON WAYS BY WHICH THIS MECHANISM OPERATES-

a) Compromise, reconstruction, arrangement-

The expression 'compromise' has not been defined by the Companies Act. It implies the existence of a dispute. There can be no compromise unless there is a dispute. The settlement of the dispute results in a compromise. In other words, 'compromise' denotes an agreement between two or more persons for the ascertainment of their rights when there is some question in controversy between them or some difficulty in the enforcement of their rights.

Meaning of 'arrangement'

[18] Umakanth Varottil, *Squeezing Out Minority Shareholders: A Recent Judgment*, INDIACORPLAW BLOG (May 6, 2009), available at http://indiacorplaw.blogspot.sg/2009/05/squeezing-out-minority-shareholders.html

The term is wider in scope than the word 'compromise'. It includes any form of internal reorganisation of the company or its affairs, as well as scheme for amalgamation of two or more companies. A few examples of arrangement are as follows:

(a) Issue of fully paid up shares to pay off debentures.

(b) Creditors agreeing to waive a part of their dues.

(c) Preference shareholders surrendering their right of arrears of dividend.

(d) Exchange of company's assets for shares in a newly formed company.

The words **'compromise' and 'arrangement'** imply that both the parties make concessions and give up something[19]. A total surrender of the rights by one party would not amount to a compromise or arrangement. As such, where it was proposed that members should abandon all their rights without any compensating advantage, it was held not to be a compromise or arrangement and hence the Court had no jurisdiction to sanction it [Re, N.F.U. Development Trust Ltd. (1972) I WLR 1 548].

Generally, the expressions 'reconstruction' and 'reorganisation' are used where one company is involved and the rights of its shareholders or creditors are varied. The term 'amalgamation' is used where two or more companies are fused into one by merger[20] or by one taking over the other.

Meaning of 'reconstruction'

'Reconstruction' implies that substantially the same business shall be carried on by substantially the same persons. As such, the same company comes in a new form with the same members and creditors. 'Reconstruction' can be resorted to for the following purposes:

(i) To reorganise capital.

(ii) To compound with creditors.

(iii) To extend the objects of the company.

(v) To compel the members of a company to contribute further capital by taking new shares.

[19] PwC India- "Companies Act, 2013: Key highlights & analysis" Significant changes & implications, Pg-37
[20] Kamal Preet Kaur , E-Newsline PSA legal- "Merger Regime Under The Companies Act, 2013" Pg-2

(vi) To revive a sick unit.

Modes of effecting reconstruction

Reconstruction may be carried out by any of the following methods:

I. Sale of the company under the powers

2. Sale undertaking

3. Acquire shares in another company (Takeover of a company) — Section 395.

5. Reconstruction of a company which is under members' voluntary wound up — Section 494.

6. Reconstruction of a company which is under creditors' voluntary wound up — Section 507.

7. Reconstruction by a scheme of arrangement with the creditors by a company in voluntary winding up —Section 517.

All these modes of reconstruction have been discussed in the succeeding paragraphs.

Meaning of 'amalgamation'

The term amalgamation has not been defined by the Act. In amalgamation, two companies are joined to form a third entity or one is absorbed into or blended with another. Under an amalgamation, assets of the two companies become vested in one company which has as its shareholders all or substantially all the shareholders of the two companies.

Amalgamation can be effected by —

(a) following the procedure as specified under sections 391 to 394.

(b) a takeover bid as specified under section 395.

Amalgamation can resort to for the following purposes:

(i) To effect economies.

(ii) To avail tax concessions and benefits.

(iii) To revive a sick unit.

(iv) To diversify or expand business.

(v) To eliminate competition.

(vi) To make full use of the unutilised capacity.

(vii) To mobilise resources or improve cash flow.

(viii) To acquire assets at discount.

b) Acquisition made mandatory

This is a common method by which the shares of the minorities are taken over by the company and there is no need of court to approve this scheme prior however, the minorities have the right to appeal if they feel there right have been violated or under looked. To make a valid takeover their must be a majority of ninety percent by those to whom the offer was made and thus accepted by them.

Its sometimes difficult to obtain this as in the example-

Xyz wishes to squeeze out the minority from the company but these minorities hold 40% of shares while the controlling shareholder has 60 %. Now so as to squeeze out these set of minorities, it has to make an offer to them which must gather approval of atleast 90% of 40%.

c) Significant decrease in the capital structure of shares in the company[21]-

What happens in his method I that the company takes over some of its shares and then it simply destroys, nullifies or dissolve those shares resulting in the reduction in the share capital. However, the law demands that such an act must on certain prescribed grounds.

This happens in the following steps-

Step 1-

Put forward this scheme of decreasing the share structure in the board.

Step 2-

This scheme must get consent of the board.

Step 3-

[21] Hemant Goyal & Sandhya Aggarwal , Global Jurix, Advocates & Solicitors- "Supremacy Of Shareholders & Their Democracy In Line With New Act, 2013"

By special resolution in the general meeting.

Step 4-

Seventy-five % of votes.

Step 5-

Apply in the high court which this scheme.

Step 6-

Upon satisfaction of the high court, receive approval.

My personal note here is that when it comes to this kind of arrangement the minorities are the most under risk member who's rights and position can be significantly affected by such schemes. There has been so far no such ruling in saying that the minority should be out rightly protected thus significant reforms are needed to be taken to treat these set of shareholders as a different class altogether .

3. ANALYSIS OF ALL THESE METHODS-

	Right to vote	**Access to company's money**	**Exit price**	**Judicial approval**	**SEBI**
Acquisition made mandatory	Ninety percent votes	no	original proposal made to the shareholders ,is the exit price	After the acquisition scheme is internally approved and thus, not very strong.	Shall exercise control only until listed in the stock exchange .
Compromise, reconstruction, arrangement	Seventy five percent votes in favor from each section of shareholders.	YES	Exit price is determined by making a report on its calculation by a person with expertise.	Approval is needed by the court before the scheme is executed but is not very strong.	Shall exercise control only until listed in the stock exchange .

Significant decrease in the capital structure of shares in the company	Seventy five percent votes in favor from each section of shareholders.	YES	Exit price is determined by making a report on its calculation by a person with expertise	Approval is needed by the court before the scheme is executed but is not very strong.	Shall exercise control only until listed in the stock exchange

4. SUGGESTIONS-

After going through the entire paper we can quite significantly find out that the legal structure needs reform in the direction of squeeze out as this is a most prominent allegation against the misuse of power by the controlling shareholder and can prove itself to be the best way or rather a first step in the direction on protection and uplift ment of this class of shareholders. I also believe that its important that there rights are protected so that they are not reluctant in investing in the company and conserve their faith in the financial regulation within the company. In my opinion there are six ways in this direction-

1. **Steering committee for minorities, independent in nature-**

- This committee shall time to time review and scrutinize the regulation of squeeze out mechanism in the company.
- Presently, the power of approval is with the entire board but none who is exclusively acting independently in this direction to review such proposals and the likeliness to such proposal on the position of the minorities.
- The board must appoint some members of the board to act in this direction.
- These members must have the capacity to recruit financial and legal team to render constant guidance to this committee in the direction of balancing the interest of the minorities.
- Companies Act 2013, has put a lot of importance in the independence of the board and their must not be any interest in the transactions of the company otherwise held disqualified. Keeping this perspective in mind I believe if the board incorporates a special committee to look for the betterment of the minorities in every transaction then gradually every of squeeze outs will be fair and benefitting all.
- SEBI also has made regulations in ensuring the independence of directors.

2. **"MoM" voting-**

This means the majority of minority voting system. Based on this system there must be a different say of these set of people to ensure that the majority out of the minority is given a

consideration. This kind of system is very prevalent in USA, UK & Singapore but is yet to be introduced in India.

There are two sides to this-

1. This may lead to the difference of opinion of the majority with respect to minority in the minority class and thus resulting in the same position.
2. Minority is affected only the price at which they exit and the date at which it is due.
3. This means that the behavior of the controlling shareholder or his biasness is of no significance if these minorities are asked to involve in the voting system.

3. list of obligations towards the minorities-

If we enlist a list of duties and obligations on the controlling shareholder upon these set of minorities it would ensure that these minorities rights are kept in consideration while giving approval to certain arrangements leading to squeeze outs. If this is ensured then when the appeal is made against them the adjudicator will have a clear picture to distinguish between right and wrong. CLB does not not redress the grievance quickly so when the adjudication is kept in mind such directions can be an effective tool to control and regulate the behavior.

4. Securities exchange board of India-

We all know that the Securities exchange board of India regulates and supervises this mechanism in India but often to protect itself, Companies undertake the delisting process and thereafter frees itself from having a grip from SEBI. This makes the squeeze outs at the discretion of the controlling shareholder and not by law.

SEBI should also thus have power in respect to squeeze outs even over delisted companies and thus making an attempt to ensure a compliance to be met by companies to uplift these minorities.

5. Cash mechanism-

If the minorities after execution of a squeeze out actually results in just taking away of there vote but give them some extention upon which they can exercise there say of the exit price and the timelines , it would ensure fairness and also give the minorities an opportunity to demand the

price they think they should have prescribed. Also, making them thus a part of this let out so that when they exit, they don't feel that there rights were under looked.

6. amendment in the legal framework-

Although the newly enacted Companies act 2013 has replaced the old Act but except for the provisions relation to the compulsory acquisitions where this mechanism is properly and specifically addressed, the facts show that this provision and procedure has not been used so effectively and thus, rendering this provision ineffective in a way. I believe if "Squeezing out mechanism" is detailed in the Act it would to an extent culminate this violence against rights of the minority and thus, bringing a uniformity in the regulated mechanism.

5. CONCLUSION

Since a long time there has been constant talking about the control over the shareholders as they constitute to be the most important element in the company and over that controlling the minority, the controlling shareholder often looks for his interest way more then what he would bring to them. Laws and legislature in India works with the aim to culminate the evils of this biasness and thereafter uplift the minority's interest. When we refer to 'squeezing out mechanism", it means when the minorities are offered a way out to exit the company by withdrawing their shares to the majority and are offered various methods to pursue that. This is a situation where an arrangement is made between the two companies in which one get the control over the other, and the company under the control withdraws its shares at the prescribed exit price which is offered[22] by the one exercising this control. But how exactly does this operate, this procedure varies from situation to situation.

1. The company exercising the control can offer an exit price to the controlled minority giving no leverage to the company to exercise a straight interaction. Here the person having the control operates indivisually.

2. The company exercising the control could simply takeover and thereafter nullify there shares and result in the consolidation of his position as being the only equity handler. Here the person having the control cannot operates indivisually rather does not become a part of this entire scene at all.

[22] Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003);

3. They can at last come to an agreement to combine their shares and thus, work together in a newly developed arrangement.

Either of these methods could be adopted to bring this in operation but the fact still remains that the person having the control in a company over the other becomes very powerful and the only person to decide that how, when and where will this happen and this decision doesn't take the minorities collective choices instead they are directed the way they deem fit.

Now the result need to be understood here that it can lead to a very distressing situation where the minority will become reluctant to put their money in the company for they think that there interest may not be looked after as efficiently as it should or demand a lesser price then the original keeping in mind that they eventually now or then have to exit anyways. This would disturb the entire financial regulation in the company and thereafter of the entire financial markets. Thus, there is a strong need to look at this concern and resolve.

But not all the results are ill. It also results in betterment of the company at various times. Often when the company is not able to live up to the legal structure and statutory compliance needs, it can simply remove the minors and avoid the excessive operational costs .thus, both pros and cons are attached to this mechanism.[23]

A. Its often debated that this mechanism can bring with it immense monetary benefits to the company as it results in acquisition but that does not undermine the fact that often the minorities are suppressed at the discretion of the controlling shareholder.

B. Keeping our country, India's judicial system around this mechanism, its very recent i.e. since the last 10 years it has shown a rapid growth in our country and in lieu to such

[23] Umakanth Varottil, *Squeezing Out Minority Shareholders: A Recent Judgment*, INDIACORPLAW BLOG (May 6, 2009), available at http://indiacorplaw.blogspot.sg/2009/05/squeezing-out-minority-shareholders.html

speed it will just multiply in the near future. Despite of this fact, there hasn't so far much work done in favor of its regulation and thus by my dissertation report I shall try to strike a balance between the current legislation, reforms made so far and thereafter my suggestions for its benefit and control.

C. **My personal note** here is that when it comes to this kind of arrangement the minorities are the most under risk member who's rights and position can be significantly affected by such schemes. There has been so far no such ruling in saying that the minority should be out rightly protected thus significant reforms are needed to be taken to treat these set of shareholders as a different class altogether .

D. ***THUS,*** this mechanism is an evil against the minorities by the controlling shareholder and need immediate addressed as its rapidly increasing in the country and the other issue is that out of all the ways by which this mechanism can be operated ,what shall be the best way out that shall ensure the interest of the minorities in the best possible way.

E. Therefore, by this research work I have attempted to work out to address the ways in which the squeeze outs operate in India, its consequences and ways by which this position can be strengthened. Minorities are very much the investors in the company and just by virtue of the rule of majority they cannot be thrown out.

REFERENCES-

1. PwC India- Companies Act, 2013: Key highlights & analysis.
2. Grant Thornton India LLP- The Companies Act, 2013: The dawn of a new era.
3. A.N. Gawade & CO. Presentation on new Companies Bill, 2013.
4. Rishi Shroff, Forbes India- Key implementation in CA 2013.
5. Kamal Preet Kaur , E-Newsline PSA legal- "Merger Regime Under The Companies Act, 2013.
6. Vastala Singh (Singh & Associates)- "One Person Company- A Concept For New Age Business Ownership".
7. Anup Koushik Karavadi- "Changing contours of mergers and acquisitions under Companies Act, 2013".
8. Yogesh Malhan (Singh & Associates)- "Merger and Acquisition- transformed rules of the game".
9. Hemant Goyal & Sandhya Aggarwal , Global Jurix, Advocates & Solicitors- "Supremacy Of Shareholders & Their Democracy In Line With New Act, 2013"

Websites

1. www.mca.gov.in
2. www.nseindia.in
3. www.moneycontrol.com
4. http://dpe.nic.in
5. www.bsepsu.com
6. http://economictimes.indiatimes.com.