Minority Shareholders Buying Out Majority Shareholders – An Analysis

M. Rishi Kumar Dugar*

Corporate world continues to suffer from the much prevalent disputes between shareholders. It definitely is not a phenomenon specific to India but is and has always been a universal problem. Allegations by the minority shareholders against the majority reverberate in courtrooms throughout the world. Indian law provides for various reliefs for oppression and mismanagement but how effective they are is a point of debate. This article would highlight one of such reliefs; as the title suggests – minority shareholders buying out the majority shareholders. To aid understanding this right under Indian law, various decisions are analyzed on this point while highlighting the principles of substantive law relating to oppression and mismanagement.

The case of *Needle Industries (India) v. Needle Industries Newey (India) Holding Ltd*.[1] is a landmark case on this subject and the Supreme Court's decision in this case continues to be an authority on the subject. In this case, the foreign majority alleged oppression by the Indian minority shareholders as the minority appointed additional directors and issued further shares. The Company Law Board [hereinafter "CLB"] and the High Court held such acts of the minority shareholder as oppressive. In appeal, however, the Supreme Court observed that even if a case of oppression fails, the court has power to do substantial justice in the matter and therefore on the facts and circumstance of the case, the Supreme Court while rejecting the plea of oppression, directed the minority Indian shareholders to purchase shares held by the majority foreign shareholders.

Despite the aforesaid Supreme Court judgment, traditionally in matters under sections 397/398 (which sections deal with oppression and mismanagement under company law in India which have been touched upon later in the article) of the Companies Act, 1956 [hereinafter "the Act"], the CLB has ordered exit of the minority shareholders, as it has been perceived that if the minority shareholders

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* The author is a Chennai-base lawyer. The author is thankful for the valuable inputs provided by Mr. P. Giridharan, Advocate, Madras High Court.

1 Needle Industries (India) v. Needle Industries Newey (India) Holding Ltd., AIR 1981 SC 1298 (Supreme Court of India) [hereinafter "*Needle Industries*"].

exit, no disputes would arise in running the day to day affairs of the company and the company can be run by the majority efficiently and as the majority may please. In *Yashovardhan Saboo v. Groz-Beckert Saboo Ltd*.[2] the CLB went on to hold that even if a case of oppression is not established, to provide a relief to do substantial justice between the parties, whose relationship has reached a stage where reconciliation was difficult, it is the majority which has the right to purchase the shares of the minority. It was also held that the majority should never be forced to sell its shares to a minority.

As can be seen from the above, majority rule is the hallmark of democracy. This equally applies to corporate democracy. The majority rule however, is not free from misuse or abuse. Corporate democracy is more vulnerable to such misuse because it is reckoned with the number of shares that a shareholder holds and not with the number of individuals involved. Sections 397 to 409 of the Act are specifically devoted to the subject of prevention of oppression and mismanagement.

The chapter on prevention of oppression and mismanagement in the Act is a self contained code. When the courts used to have jurisdiction, a composite petition under sections 397/398 read with section 433(f) was allowed to be filed. The jurisdiction thereafter got transferred from the courts to the CLB and currently the jurisdiction under sections 397/398 resides with the CLB. However, the jurisdiction under section 433(f) continues to remain with the court. CLB has wide powers under section 402. There is a proposed amendment to transfer the powers of the CLB and the court to a Tribunal, but this is yet to come into effect.

Very briefly, let's understand what the terms 'oppression' and 'mismanagement' mean under Indian law. The term 'oppression' is not defined under the Act. It has been understood as an act or omission on the part of the management (which obviously implies majority, inasmuch as it is the majority which holds or controls the management). It is needless to state here that, though the ownership and management are distinct in the eyes of law, in reality the majority ownership and management are synonymous.

Some of the principles evolved over the years and instances considered by the courts as 'oppression' are briefly:

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[2] Yashovardhan Saboo v. Groz-Beckert Saboo Ltd, (1995) 83 Comp. Cas. 371 (Company Law Board).

- the act/omission should not only be prejudicial but also unfair, harsh and burdensome to the minority shareholders;
- it is not unfair prejudice to the minority if it is equal prejudice to all members of the company;
- there has to be an advantage to one at the cost of the other for being unfair prejudice;
- there should be lack of probity and good faith;
- the act which otherwise in accordance with the law and procedure but mala fide with intent to deny legitimate expectations of minority is oppression; and
- mere technical irregularity or illegality would not by itself amount to oppression.

Courts while exercising their powers to prevent oppression have also applied principles of quasi-partnership and equity to uphold legitimate expectations of the parties concerned looking beyond the memorandum and articles and even provisions of the Act in some instances.

'Mismanagement' is neither defined nor is really required to be defined, as the meaning is quite obvious. However, the said expression is used only in the headings in the said chapter of the Act and not in the body of the sections. Some of the instances or situations held as 'mismanagement' are:

- absence of basic records;
- failure to hold general meetings for adoption of accounts;
- failure to finalize/get the accounts audited; and
- failure to file documents with the Registrar of Companies.

Providing a remedy against the acts of oppression is a very difficult exercise of balancing. It is necessary that such acts should constitute a ground for winding up the company and should be a just and equitable ground. At the same time winding up should be unfairly prejudicial to the members. In many cases, any amount of judicial intervention cannot meet the minds of the parties. It is in situations like these that the courts have been constrained to oust one of the warring groups from the company with, typically, compensation being offered to the other group. It is pertinent to note that the requirement of winding up is not applicable in case of remedy on the ground of mismanagement alone.

Additionally, these applications under sections 397/298 of the Act before the CLB are not like a suit before the civil court which can be compromised or withdrawn. This application is representative in nature. Once the CLB ascertains that there is oppression or mismanagement, it has powers to remedy the situation and the petitioner is not permitted to compromise unless the respondents have remedied the situation alleged against.

The specific provision of the Act dealing with reliefs in these cases and relevant in the context of this article is section 402. This section provides for specific kinds of orders that can be passed by the CLB, such as:

- regulation of conduct of affairs;
- purchase of shares of member by other members or even by the company;
- consequential reduction in capital;
- termination/modification of contract with managing director, manager or director;
- terminations of any contract/arrangement with other parties;
- setting aside of any transfer of goods or payment made within 3 months immediately prior to filing an application; and
- any other order on a just and equitable ground.

It is well known that the conventional way of interpreting a statute is to seek the intention of its makers. If a statutory provision is open to more than one interpretation then the court has to choose that interpretation which represents the true intention of the legislature. This task often is not an easy one and several difficulties arise on account of a variety of reasons, but at the same time, it must be borne in mind that it is impossible even for the most imaginative legislature to forestall exhaustively all situations and circumstances that may emerge after enacting a statute, where its application may be called for. It is in such situations that the court's duty to expound arises with caution and that the court should not try to legislate.

In majority of the cases filed for oppression and mismanagement, there is hostility between the groups and it is difficult to make them work together by orders and hence purchase of shares by one group is provided for. Let's analyze some of the judicial pronouncements in particular dealing with minority shareholders buying out majority shareholders.

In the case of *Dale and Carrington Investment (P) Ltd. v. P.K.Prathapan*[3] the Supreme Court reiterated the principles laid down in *Needle Industries.* In this case the CLB provided for purchase of shares, but this time of the minority shareholders by the majority shareholders, even after holding that the allotment of shares in question was an act of oppression. The High Court and the Supreme Court set aside the allotment of shares and applied the principle that a wrong doer/ oppressor cannot be allowed to take further advantage of his/their own wrong and that the oppressor cannot be permitted to buy out the oppressed.

Similar observations can be seen in *Sangramsinh P. Gaekwad and Ors. v. Shantadevi P.Gaekwad (Dead) through L.R.s and Ors*,[4] in which case the dispute was regarding issue of additional shares and issues concerning fiduciary duties of directors. While interpreting section 397 read with section 402 of the Act and the jurisdiction of the court, it was observed that there are wide powers to the court while exercising jurisdiction under section 402, but it is not in all cases that relief can be provided. Relief must be provided depending upon the exigencies of the situation and a decision can be arrived at only on analyzing the materials. It was further observed that the jurisdiction of the court to grant appropriate relief under section 397 is indisputably of wide amplitude. It is also beyond any controversy that the court while exercising its discretion is not bound by the terms contained in section 402, if in a particular situation a further relief or reliefs, as the court may deem fit and proper, are warranted. The same principles were reiterated in a recent decision of the Supreme Court in *M.S.D.C. Radharamanan v. M.S.D. Chandrasekara Raja and Anr*.[5]

In some of the recent decisions of the CLB, where the minority shareholders were wholly in charge of the management and day to day affairs of the company, the CLB has ordered the majority to exit the company, to protect the interest of the company as the minority would have the expertise to run the company. In *Shri Gurmit Singh v. Polymer Papers Ltd.*,[6] and in *Chander Mohan Jain v. CRM Digital Synergies P. Ltd.*,[7] while laying down the principle that in unusual circumstances

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3 Dale and Carrington Investment (P) Ltd. v. P.K. Prathapan, (2005) 1 SCC 212 (Supreme Court of India).

4 Sangramsinh P. Gaekwad v. Shantadevi P.Gaekwad, (2005) 11 SCC 314 (Supreme Court of India).

5 M.S.D.C. Radharamanan v. M.S.D. Chandrasekara Raja, AIR 2008 SC 1738 (Supreme Court of India).

6 Gurmit Singh v. Polymer Papers Ltd., (2005) 123 Comp. Cas. 486 (Company Law Board).

7 Chander Mohan Jain v. CRM Digital Synergies P. Ltd., (2008) 142 Comp. Cas. 658 (Company Law Board).

the majority may be directed to sell its shares to the minority, it is interesting that, it also observed that the majority should never be directed to sell its shares to the minority. In view of the facts of the matter, since the majority did not participate in the affairs of the company and acted completely detrimental to the interest of the company and since interest of the company is the paramount rule of company law, the minority were directed to buy out the majority.

The Madras High Court and the Karnataka High Court, in *Probir Kumar Misra v. Ramani Ramaswamy and Ors*.[8] and *Namtech Consultants Pvt. Ltd. v. GE Termometrics India Pvt. Ltd*. respectively,[9] have also gone to the extent of directing the purchase of shares by one among the warring group of shareholders, through determining the value of shares by an independent expert valuer and by way of competitive bidding respectively, not taking into consideration whether it was majority or minority shareholders.

To conclude, the concept of minority shareholders buying out the majority shareholders though not new, in view of the decision in *Needle Industries*, is also an evolving phenomenon in Indian company law decisions as can be seen from the trend followed by Indian courts and tribunal. The duty of the court/CLB under sections 397/398 read with section 402 of the Act, is to primarily protect the interest of the company. It is the duty of the court/CLB to see that the company does not suffer due to the various altercations/disputes between the shareholders. Hence, while exercising its powers under the aforesaid provisions and providing relief of ordering/directing the exit of a certain group of shareholders, the court/CLB has to always keep in mind the paramount rule of company law, which is that the interest of the company should always prevail and must be protected and that there are no more conflicts among the shareholders in order for the company to function efficiently and profitably.

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8 Probir Kumar Misra v. Ramani Ramaswamy and Ors., MANU/TN/2194/2009 (High Court of Madras).

9 Namtech Consultants Pvt. Ltd. v. GE Termometrics India Pvt. Ltd., ILR 2008 Kar 1187 (High Court of Karnataka).