Volume 1 Issue 3 ISSN NO : 2582-6034

LEGALFOXES LAW TIMES

In Search of Democracy: Majority Rule v. Minority Rights

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Abstract:

The Administration of a company is vested in the Board of Directors and other officials, who are answerable to the shareholders for the acts of the company. In all meetings, the resolution/decision taken by the majority is final and binding on all the members. Therefore, the decision of the majority shareholders in the General Body Meetings is binding on all.

Sometimes, the majority view may affect the interests of the remaining minority shareholders. Then the minority shareholders can protect their interests through law. The protection of the minority shareholders is the responsibility of Company Law. The aim of the Company Law must be to strike a balance between the effective control of the company and the interests of the small individual shareholders. As stated by Palmer. "A proper balance of the rights of majority and minority shareholders is essential for the smooth functioning of the company."

Shareholder's Democracy:

The concept of shareholders' democracy in the present-day corporate world indicates that the shareholders' supremacy in the governance of the business and affairs of the corporate sector either directly or through their elected representatives.

Under the Companies Act, 2013 the powers of any company have been divided between two segments: one in the Board of Directors and other is of Shareholders. The directors exercise their powers through the meeting of the board of directors and shareholders exercise their powers through General Meetings. Although, constitutionally all the acts relating to the company can be performed in General Meetings most of the powers in regard therein are delegated to the Board

of Directors by virtue of the constitutional documents of the company viz. the Memorandum of Association and Articles of Association.

Thus, the Companies Act has tried to demarcate the area of control of directors as well as that of shareholders. Basically, all the business to be transacted at the meetings of shareholders is by means of resolution i.e. an ordinary resolution or a special resolution[1].

" In a democracy the poor will have more power than the rich, because there are more of them, and the will of majority is supreme." - Aristotle

The courts have ascertained two broad duties to be performed by a director[2]:

1. Director must to observe utmost care and skill in managing the affairs of the company or else be liable for damages.
2. Directors also have Fiduciary duty to act bona fide in the interest of the company, not to exercise powers for the collateral benefit and not to earn profit from the position as a director.

Powers of Majority:

It is a cardinal rule of the company law that the majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs. But this is subject to two very important limitations[3]:

1. The powers of the majority of the member are subject to the provisions of the Company's memorandum and articles of association. A company cannot legally authorise or ratify any act which is being outside the ambit of the memorandum, it will be considered as ultra vires of the company [Ashbury Rly. Carriage and Iron Co. v. Riche,].
2. The resolution of a majority must not be inconsistent with the provisions of the Companies Act, 1956 or any other statute, or constitute a fraud on minority depriving it of its legitimate rights.

Rule of Majority:

[1] Gaurav Pingle: Understanding Companies (Amendment) Act, 2017: 1ST Edition
[2] Taxman's: Company Law
[3]https://www.jstor.org/stable/1070028?seq=1#page_scan_tab_contents

The principle of rule by the majority has been made applicable to the management of the affairs of companies only. The members pass resolutions in any company, on various subjects either by simple majority or by the three-fourth majority. Once a resolution is passed by the required majority, then it is binding on the members and managementof the company. As a consequence, the court will not intervene to protect the minority interest affected by such resolution passed by majority, as on becoming a member of the company, each person implicitly consents to submit to the will of the majority of the members. Thus, if wrong is done to the company, it is the company which is the legal entity having its personality, and that can only institute a suit against the wrongdoer, and members individually do not have a right to do so. The aforesaid rule was laid down in the leading case of Foss v. Harbottle.

The Principle of Non-interference:

The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held equally forthe proper functioning of the company. In case of any difference amongst the members, the issue will be decided by a vote of the majority. Since the majority of the members are in an advantageous position to run the company according to their will, the minorities of shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority in such a situation. But the protection of the minority is not generally available when the majority does anything in the exercise of the powers for the internal administration of a company. The court will not ordinarily intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. In other words, the articles of association are the protective shield for the majority of members who compose the Board of directors for carrying out their object at the cost of the minority of members.

The basic principle of non-interference with the internal management of the company by the court is laid down in a celebrated case of Foss v. Harbottle[4],'that no action can be brought by a

[4]67 E.R. 189; (1843) 2 Hare 461

member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action'.

Foss v. Harbottle [(1843) 67 ER 189]:[5]

An action was brought by two shareholders, A and B, of the company, on behalf of themselves and all other shareholders against the directors and solicitor of the company, alleging that by concerted and illegal transactions they had caused the company's property to b lost. It was alleged that the directors were acting in concert and effecting various fraudulent and illegal transactions whereby the property of the company was misapplied and wasted. It was prayed that the defendant might be decreed to make good to the company the losses. The question was as to the maintainability of the suit.

The court held that the action could not be brought by the minority shareholders. The wrong done to the company was one which could be ratified by the majority members. The company was the proper plaintiff for wrongs done to the company, and the company can act only through its majority shareholders. The majority of the members should be left to decide whether to commence proceeding against the directors or not.

The court had opined that "The conduct with which the defendants are charged is an injury not to the plaintiffs exclusively, it is an injury to the whole corporation. In such cases, the rule is that the corporation should sue in its own name and in its corporate character. It is not a matter of course for any individual members of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law the corporation and the aggregate of members of the corporation are not the same thing for purposes like this.[6]"

The court dismissed the suit on the ground that the acts of directors were capable of approval by the majority of members and held that the proper plaintiff for wrongs done to the company is the company itself and not the minority shareholders.

Justification and Advantages of Rule in Foss v. Harbottle:

[5] Cs Module: Executive Programme
[6] Ibid 4.

The justification for the rule laid down in Foss v. Harbottle is that the will of the majority prevails in most of the situation. On becoming a member of a company, a shareholder agrees to submit to the will of the majority in all decisions. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted on the day to day basis. If any wrong is done to the company, it is only the company itself, acting, through its majority, that can seek redressal in court and not an individual shareholder.

The main advantages that flow from the Rule in Foss v. Harbottle[7] are of a purely practical in nature and are as follows[8]:

- Recognition of the separate legal personality of the company*:* If a company has suffered some injury or damage, then in such case, not the individual members of the company, it is the company itself that should seek to redress.
- Need to preserve the right of the majority to decide: The principle, in this case[9], preserves the right of the majority to decide how the affairs of the company shall be conducted on day to day basis. It is always fair that the wishes of the majority should prevail in running a company.
- The Multiplicity of futile suits avoided: Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are many shareholders. Legal proceedings would never cease in such a situation, and there would be enormous wastage of time and money of court as well as of company and its member.
- Litigation at the suit of a minority is in vain if the majority does not wish it: If the irregularity complained of, is one which can be subsequently ratified by the majority, then it is futile to have litigation about it except with the consent of the majority in a general meeting.

In the case of Mac Dougall v. Gardiner, the articles of association of a company empowered the chairman, with the consent of members in the meeting, to adjourn a meeting and also provided for taking a poll if demanded by the shareholders. The adjournment was moved, and declared by

[7] Ibid 4.
[8] Avtar Sing; Company Law: EBC; 17th Edition 2018
[9] Ibid 4.

the chairman to be carried; a poll was then demanded by a shareholder and refused by the chairman. A shareholder brought an action for a declaration that the chairman's conduct was illegal. The Court held thatthe action could not be brought by a shareholder; if the chairman was wrong, the company alone could sue the chairman.

The Delhi High Court in ICICI v. Parasrampuria Synthetic Ltd. SSL, has held that an automatic application of Foss v. Harbottle Rule to the Indian corporate cases would be improper. Here the Indian corporate sector does not involve a large number of small individual investors but predominantly financial institutions funding at least 80% of the finance. It is these financial institutions which provide entire funds for the continuous existence and corporate activities. Though they hold only a small percentage of shares, it is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of Foss v. Harbottle Rule would be unjust and unfair in the Indian scenario.

Exceptions to the Rule in Foss v. Harbottle — Protection of Minority Rights and shareholders remedies:[10]

The rule in Foss v. Harbottle is not absolute but it is subject to certain exceptions. In other words, the rule of the supremacy of the majority shareholders is subject to certain exceptions and thus, minority shareholders are not left helpless. They are protected by:

- ✓ the common law; and
- ✓ the provisions of the Companies Act, 2013.

Actions by Shareholders in Common Law[11]

The cases in which the majority rule does not prevail are commonly known as exceptions to the principle in Foss v. Harbottle and are available to the minority. In all these cases an individual member may sue for a declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule of Foss v. Harbottle will not apply in the following cases: -

[10] Ibid4
[11] Ibid 1

1) **Ultra-Virus Acts:** Where the directors representing the majority of shareholders perform an illegal or ultra vires act for the company, an individual shareholder has the right to bring an action against such acts. The majority of shareholders have no right to confirm an illegal or ultra vires transaction of the company. In such a case, a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an ultra vires act.

   Case:

   In Bharat Insurance Ltd. v. Kanhya Lal[12], the plaintiff was a shareholder of the Bharat Insurance Company. One of the many objects of the company was: "To advance money at interest on the security of land, houses, machinery and other property situated in India..." The plaintiff complained that "several investments had been made by the company with inadequate security and contrary to the provisions of the memorandum of association and therefore, prayed for a perpetual injunction to restrain the company from making such investments".

   The Court observed that: "In all matters of internal management, the company itself is the best judge of its affairs and the Court should not ordinarily interfere. But the application of assets of a company is not a matter of internal management. As directors are acting ultra vires in the application of the funds of the company, a single member can maintain a suit against the company".

2) **Fraud on Minority:** Where an act done by the majority amounts to a fraud on the minority, an action can be brought by an individual shareholder or minority shareholders. If those who control the company use their control over the company to possibly to act oppressively to a minority shareholder, the minority shareholders may bring legal proceedings against the oppressive majority shareholders.

   Case:

   In the case of Menier v. Hooper's Telegraph Works[13], it was observed by the Court that, it would be a surprising thing if the majority of shareholders are allowed to put something or any benefit into their pockets at the expenses of the minority. In this case, the majority of members of company 'X' were also members of company 'Y', and at a meeting of

[12]A.I.R. 1935 Lah. 792

[13](1874) L.R. 9 Ch. App. 350

company 'X' they passed a resolution to compromise an action against company 'Y', in a manner alleged to be favourable to company 'Y', but unfavourable to company 'X'. The Court held that the minority shareholders of company 'X' could bring an action to have the compromise set aside.

3) **Wrongdoers in Control:** If the wrongdoers are in control of the company, the minority shareholders' representative's action for fraud on the minority will be entertained by the court. The reason for this is that, if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue. [Par Jenkins L.J. in Edwards v. Halliwell[14]].

   Case:

   In the case of Glass v. Atkin[15], a company was controlled equally by the defendants and the plaintiffs. The plaintiff brought an action against defendants alleging that they had fraudulently converted or used the assets of the company for their private use. The Court allowed the action and observed: "While the general principle was that, the company itself can only bring an action, where it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action."

4) **A Resolution requiring Special Majority but is passed by a simple majority:** A shareholder can sue if an act requires a special majority but it is passed by a simple the majority. Simple formalities are to be observed if the majority wants to give validity to an act which purports to affect the interest of minority. An individual shareholder has the right of action to restrain the company from acting on a special resolution to which the insufficient notice is served and where other formalities are not followed. [Baillie v. Oriental Telephone and Electric Co. Ltd.,[16]]
5) **Personal Actions:** If the company under majority control deprives a member of his rights of membership, he may sue the company to enforce his rights. [Joseph v. Jos].

[14](1950) 2 All E.R. 1064, 1067
[15](1967) 65 D.L.R. (2d) 501
[16](1915) 1 Ch. 503 (C.A.)

Case:

In NagappaChettiar v. Madras Race Club, (1949) 1 M.L.J. 662 at 667, it was observed by the Court that "An individual shareholder is entitled to enforce his individual rights against the company, such as his right to vote, the right to have his vote recorded, or his right to stand as a director of a company at an election.

6) **Breach of Duty:** The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company. [Daniels v. Daniels]
7) **Prevention of Oppression and Mismanagement**: The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement. These are the statutory rights of the minority shareholders.

Case:

In the case of Bennet Coleman & Co. and Ors. v. Union of India &Ors.[17], the Division Bench of the Bombay High Court held that Sections 397 and 398 of the Companies Act, 1956 are intended to avoid winding up of the company if possible and keep it going while at the same time relieving the minority shareholders from acts of oppression and mismanagement or preventing its affairs from being conducted in a manner prejudicial to the public interest. Thus, the Court has wide powers to supplant the entire corporate management by resorting to non-corporate management which may take the form of appointing an administrator or a special officer or a committee of advisers etc., who will be in charge of the affairs of the company.

Statutory Remedies (under the Companies Act)[18]:

The Companies Act, 2013, extends protection to the minority by granting various rights to minority shareholders which are given as below:

A. **The variation of class rights:** The rights attached to the shares of any class can be varied under Section 48[19] with the consent in writing of the holder of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a

[17](1977) 47 Com Cases 92 (Bom)
[18] Companies (Amendment) Act, 2017
[19]Companies Act, 2013

separate meeting of the holders of the issued shares of that class. But the holders of not less than 10% of the shares of that class who had not assented to the variation may apply to the Court/Tribunal for the cancellation of the variation under Section 48.

B. **Schemes of reconstruction and amalgamation:** The minority is accorded protection in cases where they do not consent to the scheme of reconstruction or amalgamation. They are given an option of the way out.

C. **Oppression and mismanagement**: A member, who complains that the affairs of the company are being conducted, in a manner oppressive to some of the members including himself, or against the public interest, he may apply to the Company Law Board by petition under Section 397 and Section 398 of the Companies Act 1956 for redressal.

D. **An Investigation by the Government:** The Central Government is authorised to appoint one or more competent person or persons as inspectors to investigate the affairs of any company and to report thereon in such manner as the Central Government may direct:

   i) Where in case of a company, on a report by the Registrar, under Section 206 of the Companies Act 2013.

   ii) Where –

   in the case of a company having a share capital on the application either of not less than 100 members or of member holding not less than one-tenth of the voting power thereof; and

   in the case of a company not having a share capital, on the application of not less than one fifth in the number of persons on the company's register of members.

Conclusion:

As it can be seen that there are many instances of the minority and majority clashing with one another, this leads to the question of why we need to balance the rights of the majority and the minority. One of the basic ideas of democracy is that of majority rule which is an idea that says, the side with the most support or votes wins, this side is the majority. Yet there is also another group of people i.e. the minority. Usually, the minority is large in size but not larger than the other side, the majority. This means that the minority has a tendency to be suppressed by the minority. This worry brings up the issue of trying to prevent the majority from having supreme power which would lead to many conflicts between the minority and majority as the majority

tries to control the minority. So, in order to prevent this and to support an equal society, the government will usually enact bills of rights to protect rights of the majority while trying to limit the impact these laws have on the majority. It is important that we try to support the minority while still accepting the power and rights of the majority as supporting one side more than the other can only lead to