Arbitrability of Oppression and Mismangement

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Introduction

The subject matter of disputes that can be referred to arbitration has always been a vexed issue for Indian judicial system. In absence of an unambiguous provision in the Arbitration and Conciliation Act, 1996 with respect to the same, one has to rely upon courts interpretation to ascertain as to what is arbitrable and what not. The Apex court in case of Swiss Timing some time back held fraud to be arbitrable, rendering the earlier judgment per incuriam.

Joining the bandwagon, another interesting question was tabled before the Single Judge of Bombay High Court with regard to arbitrability of disputes under sections 397-398 and 402 of Companies Act, 1956, in case of Rakesh Malhotra v. Rajinder Malhotra1.

The case

Though multiple parties were impleaded in the petition but the contest was between Rakesh Malhotra (“Appellant”) on one side, and his father, Rajinder Kumar Malhotra (“Respondent”) and family on the other.

The contestation is for control over the Supermax corporate entities. This group is manufacturer of razor blades and allied products. Rakesh and Rajiv, the two sons of Respondent and Mrs. Veena Malhotra, engaged in the business, handled different spheres of activity. Among the several companies in this group, some were Indian others were overseas. Prior to 2010, a restructuring was proposed in 2008. The Indian companies, before the restructuring in 2010, were all entirely held by Respondent and Mrs. Veena Malhotra.

The Indian companies’ assets, businesses, and plants were to be transferred to a newly incorporated company under Appellant’s control. The Indian companies were to receive substantial funds in consideration. Respondent, his wife and Rajiv would continue to hold the equity in these Indian companies. Private equity capital infusion into the overseas entities or holding companies was also envisaged. A consultancy/ advisory firm was engaged. It identified a private equity investor. The principal object of the proposed restructuring was to allow Respondent and Rajiv an exit from full-time involvement in the affairs of the Supermax group, while Appellant was to assume control of the business.

A Subscription and Shareholder Deed and, later, a Supplementary Deed were executed in 2010. The principal Deed had an arbitration clause providing for a London Court of International Arbitration in Geneva. There followed certain business restructuring agreements effecting the principal and supplementary agreements. Appellant was given sole authority to represent the family in all these transactions. He also had exclusive bank

1 Company Appeal No. 15 of 2013.
http://bombayhighcourt.nic.in/generatenewauth.php?auth=cGF0aD0uL2RhdGEvanVlZ2VyZWN0cy8yMDE0LyZmbmFtZT1PU0NPQVBQMTAxNjMy5wZGY0MzY1mbGFnPVk=
account operating authority. Though Rajiv, too, had a similar authority, his was jointly with Appellant.

Respondent contended that after the transfers were effected, Appellant, using his sole authority, deployed the funds received by the Indian companies held by Respondent not only to grant loans (a matter contemplated by the agreements under certain conditions), but also to guarantee bank loans and facilities to the newly formed Indian company under Appellant’s control. These funds were also used to pay the financial consultants’ fees.

A peculiar situation thus resulted following the restructuring and transfer agreements: the directors of the Respondent held Indian companies were now all employees of the entities controlled and held by Appellant. On finding that these liabilities had been incurred and funds deployed, Respondent attempted to gain information from the directors of his own companies, the ones he controlled. They refused to divulge this information, being beholden to the Appellant.

Respondent thus filed 4 company petitions before the Company Law Board in Mumbai and one before the Company Law Board in Chennai under section 397 and 398 read with section 402 of the Companies Act, 1956 alleging oppression and mismanagement. After an ad-interim order was obtained but before these matters could move further, Appellant obtained an *ex-parte* ad-interim anti-suit injunction from the Commercial Court of the Queen’s Bench Division of the Royal Courts of Justice in the United Kingdom. That action was contested. Ultimately, such an injunction was dissolved by a judgment dated 30th October 2012.

Before the Company Law Board in Mumbai, Appellant then filed applications invoking arbitration clause in the main agreement and seeking a reference to arbitration of all disputes, under section 45 of the Arbitration & Conciliation Act, 1996. One of the key considerations before the Company Law Board (CLB) Mumbai was whether disputes under sections 397-398 and 402 are at all arbitrable or not. The CLB, Mumbai on 31st January 2013, dismissed Appellant’s applications upholding that such disputes are not referable to arbitration.

One of the questions among others, framed by the Company Law Board was whether disputes under sections 397-402 are at all arbitrable. The Company Law Board held that such actions are not referable to arbitration regard to the nature of sections 397, 398 and 402 of the Companies Act, 1956.

The Company Law Board also found that it was not bound by the decision of the UK Court, and that the disputes and was free to address the issue independently.

The decision was challenged and was thus placed for consideration before the Bombay High Court.
The issues for consideration

a) Whether a dispute brought before the Company Law Board invoking the provisions of sections 397, 398 and 402 of the Companies Act, 1956 at all are referable to an arbitral panel for resolution?

b) Would a decision of a foreign court on the question of whether a dispute is covered by an arbitration agreement bind the Company Law Board?

c) Whether the disputes in the Company Petitions before the CLB are covered by the arbitration clause in the Shareholders Subscription Deed?

Judgment

The Court placing reliance on various precedents held as follows:

A regular civil suit by a minority shareholder claiming oppression and mismanagement is always maintainable. The nature of reliefs sought in an oppression and mismanagement petition in 397, 398 and their cognate sections of the Companies Act, 1956 are actions in rem and the CLB has express power to pass in respect of ancillary matters in as much against parties who are not before the CLB. Therefore, the disputes in a petition properly brought under Sections 397 and 398 read with Section 402 are not capable of being referred to arbitration, having regard to the nature and source of the power invoked. The non-arbitrability of disputes validly brought under Sections 397/398 read with Section 402 of the Companies Act, 1956 is that it is not enough for an applicant seeking a reference to arbitration merely to show that there exists an arbitration agreement. He must, in addition, establish before the CLB that the petition is mala fide, vexatious and ‘dressed up’ and a private arbitral tribunal can resolve that the reliefs sought are such as.

With regard to the questions in (b) and (c) above, the Court held that the decision of UK Commercial Court was not covered by any of the exceptions to Section 13 of the CPC therefore bound the CLB. The disputes before the CLB were outside the purview of the arbitration agreement as they related to matters not covered by the Subscription Share Deed.

Our Analysis

The Bombay High Court has upheld the findings of the Company Law Board affirming that the actions in question, i.e., disputes under section 397-402 Companies Act 1956, are not referable to arbitration. In other words, such are not arbitrable. But the court has subjected this affirmation to a caveat that the oppression and mismanagement petition must be found to be not mala fide, oppressive, vexatious and an attempt at ‘dressing up’ to evade an arbitration clause.
We also concur with the decision of the High Court in holding that oppression and mismanagement disputes are non-arbitrable. Powers of CLB under section 397-398 of Companies Act, 1956 are wide and exclusive in as much as it ousts the jurisdiction of civil courts, which would include arbitral tribunal as well. Disputes under sections 397/398 action are such that they demand the exercise by the CLB of its powers under Section 402. These are not powers that can be exercised by a civil court and certainly not by arbitral tribunal.

Sections 8 and 45 of the Arbitration and Conciliation Act, 1996 provide for when a judicial authority may refer parties to arbitration. On perusal of both the sections one finds that the action must be in a **matter**, which is subject of arbitration agreement. Therefore only such “matters” can be referred to arbitration in respect of which there is an arbitration agreement. In an oppression and mismanagement “matter” before the CLB, is the one that lies under sections 397 and 398 and invokes the CLB’s powers under those sections, including section 402. Reliefs claimed under oppression and mismanagement is a relief *in rem* i.e.; reliefs that are also sought against persons who are not parties to a suit. Consequently, the matter covered within the scope of the arbitration clause of the Subscription and Share Deed certainly does not include actions claimed under sections 397-398. The nature of disputes under oppression and mismanagement are not one-time action or conduct that may merely arise out of an agreement but rather a series of actions. On the contrary the acts claimed to oppressive are continuous in nature. There are umpteen judgments, which uphold that oppression is a continued activity and unless a relief is granted shall remain a continued one.

A petition under Sections 397 and 398 of the Companies Act, 1956 always alleges to a pattern/series of clandestine conduct or surreptitious actions that result in the mismanagement of the company’s affairs or in the oppression of the minority shareholders, or both. Any such act, stands entirely outside the Subscription Share Deed or for that matter any agreement/deed and cannot be covered by the arbitration clause contained therein. Merely because an arbitration agreement exists does not mean that every single act complained of must, *ipso facto*, relate to that arbitration agreement or that or that all parties’ rights and remedies are circumscribed by that agreement.

The scope and purpose of sections 397 and 398 read with section 402 is to protect minority share-holders from the acts of oppression and mismanagement, to prevent the affairs of a company being conducted in a manner prejudicial to the interest of the public, while at the same time attempting to avoid winding up of a company to the extent possible. There are wide powers that CLB may exercise under section 402, including regulating any future conduct of the company’s affairs or providing for any other matter which it thinks just and equitable. It can further supplant the ordinary corporate management of the company. Thus, these are matters that fall within the purview of Sections 397-402 and cannot possibly be left to an arbitral panel.
Nonetheless, in absence of clarity in the Arbitration and Conciliation Act, 1996 with regard to arbitrability of disputes and its nature, one has to look up to the traditional courts for an interpretation on this issue. This not only results in burdening the traditional courts further but also stalls the intrinsic deliverables of speedy justice. Even though traditional courts have to a major extent been pivotal in upholding the inherent objective of the said Act, however, it often happens that arbitration related proceedings get caught up and loses its vigour in entirety.

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