Arbitrability of Oppression/Mismanagement Disputes

Modern commercial transactions often lead to complex legal questions. Usually, the shareholders of a company enter into a shareholders agreement setting out in detail the rights and obligations. These agreements, more often than not, contain an arbitration clause. In view of the judgment of *V B Rangaraj v. V B Gopalakrishnan*[1], the company concerned is also made a party to such an agreement and the relevant provisions of the shareholders agreement are reflected in the Articles of Association. This has led to a debate as to whether such a dispute between the shareholders regarding to oppression and mismanagement ought to be determined by the Company Law Board (“CLB”) or an arbitral tribunal.

The complexity of this issue is by virtue of the fact that CLB is conferred jurisdiction by Sections 397 / 398 of Companies Act, 1956[2] (“Companies Act”) to try oppression and mismanagement disputes i.e. jurisdiction is conferred by a statute and not by any agreement between the parties. Section 8 of the Arbitration and Conciliation Act, 1996 (“Arbitration Act”) states that a judicial authority, before which an action is brought in a matter which is the subject matter of an arbitration agreement, will refer the parties to arbitration. It is the mandatory nature of Section 8 of Arbitration Act which has been an issue of much controversy and judicial interpretation.[3] It is pertinent to mention that certain disputes such as divorce proceedings, winding up of companies, insolvency, landlord tenant disputes etc. are not arbitrable and can be determined only by the concerned judicial authority.

The question of arbitrability of oppression and mismanagement disputes was recently considered by the Bombay High Court in the case of *Rakesh Malhotra v. Rajinder Malhotra*[4] (“Rakesh Malhotra Case”). The Bombay High Court concluded that considering the wide and special powers bestowed upon the CLB under Section 402 of the Companies Act, and that the same powers are not available with an arbitral tribunal, the disputes under Section 397 / 398 of the Companies Act are not capable of being referred to arbitration. This judgment has sought to provide much needed clarity on the subject.

The court distinguished a derivative suit instituted by minority shareholders and an action before the CLB under Section 397 / 398 of the Companies Act. The court was of the view that *although a civil court can entertain an action in oppression and mismanagement, it cannot possibly exercise, even under Section 9 of the Civil Procedure Code, the kind of power which the CLB can under Section 402 of the Companies Act. Such a civil suit is almost
always an action in personam. A Section 397 / 398 action before the CLB has some flavour of an action in rem.” This is in furtherance of the court’s reasoning that the special powers of the CLB under Section 402 of the Companies Act are wide reaching and are necessarily required to resolve complex oppression mismanagement disputes.

The court heavily relied upon the Supreme Court’s judgment in the case of Booz Allen[5] where it considered the question of arbitrability i.e. the distinction in law between disputes that are capable of being resolved through arbitration and those that are not. The Supreme Court had held that generally disputes pertaining to rights in rem are not arbitrable and rights in personam are amendable to arbitration. The court also considered the Supreme Court decisions of Sukanya Holdings (P) Ltd v. Jayesh H. Pandya [6] (“Sukanya Holdings Case”) and Haryana Telecom Ltd v. Sterlite Industries (India) Ltd [7] (“Harayana Telecom case”). In Sukanya Holdings Case, it was held that a bifurcation of a cause of action in a suit is an impermissible procedure beyond the contemplation of the Arbitration Act. In Haryana Telecom Case, it was held that the power to order winding up of a company is contained under the Companies Act and the arbitrator would not have jurisdiction to order winding up of a company. In Rakesh Malhotra Case it was held that “It must therefore follow that where a petition under Chapter VI of the Companies Act, 1956 seeks reliefs some of which are in the nature of reliefs in rem and others that are in personam, then it is not possible or permissible to sever one from the other and disassemble such a petition…. Haryana Telecom, to my mind, though in a petition for winding up, and clearly, therefore, a matter in rem, states as a proposition that no agreement between the parties can vest an arbitral panel with the power of winding up. Similarly, no arbitration agreement can vest an arbitral tribunal with the powers to grant the kind of reliefs against oppression and mismanagement that the CLB might.” Thus, the court has considered the very inherent nature and characteristics of oppression and mismanagement disputes and the nature of rights i.e. rights in rem involved therein. The court has combined the ratios of Sukanya Holdings Case and Booz Allen, and reasoned that because oppression and mismanagement disputes involve in rem rights they are not arbitrable. In any case, even if the oppression mismanagement involves some in personam rights, relying upon Sukanya Holdings Case, there can be no severance of the rights involved and hence the dispute cannot be referred to arbitration.

The court has thereafter also considered the wide scope of reliefs which can be granted by the CLB. It examined the proposition that the powers of the CLB under Section 402 of the Companies Act are wide enough to permit it to interfere with the normal corporate management of a company and to
supplant the entire corporate management. Considering that these reliefs cannot be given by an arbitral tribunal, the court concluded that “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.”

However, though Section 397 / 398 disputes are not amenable to arbitration, does not preclude the CLB from entertaining an application under Section 8 / 45 of the Arbitration Act for reference of a matter to arbitration. In this regard, the court held that “a petition that is merely ‘dressed up’ and seeks, in the guise of an oppression and mismanagement petition, to oust an arbitration clause, or a petition that is itself vexatious, oppressive, mala fide (or, at any rate, not bona fide) cannot be permitted to succeed. In assessing an allegation of ‘dressing up’, the Section 397 and 398 petition must be read as a whole, including its grounds and the reliefs sought.” The court further held 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 that the reliefs sought are such as can be resolved by a private arbitral tribunal.” It is pertinent to note here that it is not sufficient to merely establish that the reliefs sought before the CLB comes within the scope of relief that may be granted by an arbitrator. The applicant has additionally to prove that the company petition under Section 397 / 398 of the Companies Act has been filed with a dishonest intention to evade the arbitration clause.

The Bombay High Court has laid down the general rule that per se disputes pertaining to oppression and mismanagement are not amenable to arbitration, subject to the exception set out above. However, categorically laying down that oppression mismanagement disputes are not arbitrable may be considered an extreme approach. If a section 397 / 398 dispute primarily emanates from a breach of the shareholders agreement or a joint venture agreement i.e. the dispute is principally a breach of contract and no special relief under Section 402 of the Companies Act is claimed, then in that case there is no reason why the arbitration agreement between the parties should not be honoured. Therefore, if the grievance of the petitioner substantially rests upon the breach of the shareholders agreement and infringement of the rights under the shareholders agreement, then it may be possible for the dispute to be referred to arbitration. Such cases can very well be referred to arbitration under Section 8 / 45 of the Arbitration Act. There may also be a situation where a certain set of facts, may give rise to a situation where a party is able to claim two separate and distinct reliefs: one special relief under Section 402 of the Companies Act in a company petition for
oppression and mismanagement and another, for breach of contract / damages by way of arbitration. These two remedies are distinct and pursuing them simultaneously is not barred in any case. The same may well proceed concurrently.

Another important aspect is that there is no objective test laid down to determine as to when a company petition can be termed as “dressed up” or “vexatious”. This would lead to uncertainty for parties claiming a reference to arbitration under Section 8 / 45 of the Arbitration Act. One of the tests to determine the question as to whether a particular question is to be determined by the CLB or through arbitration, would be whether one can make out the case of oppression and mismanagement *de hors* the shareholders agreement. If the same can be, the CLB may be approached to determine the matter. However, if the same cannot be, it is likely to be a contractual issue arising out of an agreement and therefore will be arbitrable. The second question to be answered would be whether the reliefs being sought in the matter can at all be granted by an arbitrator, or can be granted only by the CLB in exercise of its special power under Section 402 of the Companies Act. Though there can be no single all-encompassing test, this would however, act as a good guide.

This Bombay High Court decision in Rakesh Malhotra Case does away with confusion and obscurity by pronouncing a definite position of the law that *per se* oppression mismanagement disputes are not arbitrable, subject to certain exceptions. A conclusive all-encompassing judgment of the courts would be highly welcome.

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The corresponding Sections 241 and 242 of the Companies Act, 2013 have not been notified yet.

-P Anand Gajapathi Raju v. P V G Raju 2000 4 SCC 539

-Company Appeal (L) No 10 of 2013

-Booz Allen & Hamilton v. SBI Home Finance (2011) 5 SCC 532

-(2003) 5 SCC 531

-(1999) 5 SCC 688