JUDGEMENT SHEET

IN THE ISLAMABADHIGH COURT, ISLAMABAD
JUDICIAL DEPARTMENT

Companies Original No. 07/2021

Anwar Baig, Chairman Conservancy Management Committee (CMC) & others.
Versus
Government of Pakistan through its Secretary Ministry of Climate Change & others

PETITIONERS BY:	Qazi Ghulam Dastgir and Mr. Ghazanfar Abbas Jaffari, Advocates.
RESPONDENTS BY:	MNA Rehan, Advocate for respondent No.2. Mr. Adeel Peter, Advocate for SECP. Mr. Azra Batool Kazmi, Assistant Attorney General. Mr. Naeem Ashraf Raja, Director, and Syed Ali Raza Zaidi, Deputy Director (Legal), Ministry of Climate Change.
DATE OF HEARING:	13.10.2022

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BABAR SATTAR, J.- This is a Company Original Petition under Section 286 of the Companies Act, 2017 ***("Companies Act")***, filed by five members of the Board of Directors of respondent No.2 representing conservancies in the Northern Areas of Pakistan.

2. The learned counsel for the petitioners stated that respondent No.2 has been subjected to mismanagement. Respondent No.2 was created in 2004 for purposes of conservation of four designated conservancies and an endowment fund was consequently created and interest accrued to the funds invested was to be utilized for purposes of conducting projects in pursuance the objects for which

respondent No.2 had been licensed under Section 42 of the Companies Act. He submitted that no fund has been released since the creation of the company in 2004. In the 28th meeting of the Board of Directors of respondent No.2, which was conducted through Zoom and the petitioners could not participate due to poor connectivity in the Northern Areas, a special resolution was passed approving in principle the merger and amalgamation of respondent No.2 with another Section 42 Company i.e. Fund for Protected Areas ***("FPA")***. He further submitted that FPA was constituted for conservation of protected areas and the object of such company as well as the territories upon which it is to focus is different for that of respondent No.2. He further submitted that in the 38th Board meeting of the FPA, it was decided by its Board of Directors that FPA is discharging its functions in accordance with its objects and constituent documents and the Board thus rejected the idea of a merger with respondent No.2. He further submitted that the Federal Government had not contributed any resources to either company since the creation of respondent No.2 and FPA and that the argument that respondent No.2 was not being managed efficiently was no ground to order the merger of respondent No.2 with another Section 42 company. The Board of Directors of respondent No.2 largely comprised members belonging to the public sector and instead of fixing the management issues in respondent No.2 the Board had decided to merge the company with FPA. He stated that this would undermine the objects for which respondent No.2 was created.

3. The learned counsel for respondent No.2 raised an objection to the maintainability of the petition. He submitted that the petition had been filed by five Directors and not by shareholders holding ten percent of the issued share capital of the company and consequently had no standing to file a petition under Section 286 of the Companies Act. He further submitted that as the company was a Section 42 guarantee company, which did not have a share capital, and a petition for prevention of oppression and mismanagement could not be filed by any member in relation to such company. He further submitted that the petitioners were Directors of the company and it had been held by the learned Lahore High Court in ***Nadeem Kiani vs. Messrs American Lycetuff Private Limited and others (2021 CLD 7)*** that Directors had no locus standi to file a petition under Section 290 of the Companies Ordinance, 1984 ***("Companies Ordinance")***, which provision had taken the form of Section 286 of the Companies Act. He submitted that the petition was also not duly authorized as it had been filed by five petitioners claiming to be Directors of the company and had only been signed by one Director. He lastly submitted that given that the company was a Section 42 company and it could only carry out its activities pursuant to a licence issued by the Security and Exchange Commission of Pakistan (SECP), the appropriate remedy for any aggrieved Director would be to file an application before the SECP for its consideration as to whether or not the company's Section 42 licence ought to be revoked. But such Director could not file a Section 286 petition before the court.

4. The learned counsel for the SECP submitted that Section 286 of the Companies Act was meant for the protection of rights of minority shareholders and not to settle disputes between Directors of a company. He submitted that there was a threshold test provided under Section 286 of the Companies Act and only members holding at least ten percent of the issued share capital of the company could file a Section 286 petition. And in the event that such threshold test was not met, even a shareholder did not have standing to file a Section 286 petition. He submitted that similar threshold tests were provided in other provisions of the Companies Act as well. The purpose of such threshold test was to ensure that a lone shareholder or member does not drag a company's internal affairs into litigation, which could hurt the interests of the company as well as consume valuable time of the courts. He further submitted that the company in question was a Section 42 company and the effect of revocation of its licence was provided under Section 43 of the Companies Act, pursuant to which the winding-up of the company and striking of its name from the register of the company was an automatic consequence of the revocation of the licence issued by the SECP.

5. The learned Assistant Attorney General adopted the arguments of the learned counsel for the SECP and stated that the petitioners had no locus standi to file the petition.

6. In rebuttal, the learned counsel for the petitioners relied on dicta from ***Ch. Muhammad Azam Cheema vs. Province of Punjab and others (1997 CLC 970)***, wherein the learned

Lahore High Court observed that if a member of a company complained that affairs of the company were being conducted in an unfair manner, such member could file a petition before the court under Section 290 of the Companies Ordinance.

7. The sole question before this Court at this stage is whether the Directors of a guarantee company that has been issued a licence as a Section 42 company have legal standing to file a petition for prevention of oppression and mismanagement within the company under Section 286 of the Companies Act. Section 286(1) of the Companies Act states the following:-

> ***286. Application to Court.-*** *(1) If any member or members holding not less than ten percent of the issued share capital of a company, or a creditor or creditors having interest equivalent in amount to not less than ten percent of the paid up capital of the company, complains, or complain, or the Commission or registrar is of the opinion, that the affairs of the company are being conducted, or are likely to be conducted, in an unlawful or fraudulent manner, or in a manner not provided for in its memorandum, or in a manner oppressive to the members or any of the members or the creditors or any of the creditors or are being conducted in a manner that is unfairly prejudicial to the public interest, such member or members or, the creditor or creditors, as the case may be, the Commission or registrar may make an application to the Court by petition for an order under this section.*

8. The aforementioned Section affords standing to four categories of prospective petitioners: (i) members holding not less than ten percent of the issued share capital of the company; (ii) creditors having interest equivalent in amount to not less than ten percent of the paid-up capital of the company; (iii) the SECP, if it is of the opinion that the affairs of the

company are being conducted, *inter alia*, in an unlawful and fraudulent manner; and (iv) Registrar of the Companies if he is of the opinion that the affairs of the company are being conducted, *inter alia*, in an unlawful and fraudulent manner. Section 286(1) of the Companies Act does not afford the right to Directors to file a petition for prevention of oppression and mismanagement under Section 286 of the Companies Act. This makes an abundant sense too.

9. The management of a company is rooted in the concept of shareholder democracy. As owners of the company, the shareholders have various statutory rights and general supervisory powers over the management exercised during the general meetings of a company. But the power to manage a company is vested in the Board of Directors and not the shareholders and provisions of the Companies Act as well as the Articles of Association of a company divide the company's powers between its Directors and its members. And while the Directors cannot instruct the members as to how to use their powers, the members also cannot instruct the Directors on how to exercise the powers vested in the Directors. While there is criticism in legal literature regarding the powers vested with the Directors and how they ought to be exercised, it is understood that while the Directors owe fiduciary duties to the company and its shareholders in general they are not agents of the members of the company. This distribution of powers between the Board of Directors overseeing the management of the company and the shareholders of the company then informs the legal standing of shareholders to initiate legal action in relation to the company.

10. ***Foss v Harbottle* (1843) 2 Hare 461** articulated 'the rule in ***Foss v Harbottle***', prescribing the policy of courts to not hear a case concerning the affairs of a company brought by a member or members of the company. The rule was further explained by Lord Davey in ***Burland v Earle* [1902] AC 83** where he observed the following:-

> *"It is an elementary principle of the law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so. Again, it is clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should prima facie be brought by the company itself… It should be added that no mere informality and irregularity which can be remedied by the majority will entitle the minority to sue, if the act when done regularly would be within the powers of the company and the intention of the majority of shareholders is clear."*

Based on this statement three principles related to 'the rule in ***Foss v Harbottle***' have been described in Mayson, French & Ryan on Company Law, 32nd Edition (Oxford University Press; 2015-2016; PP556), which are the following:-

(a) *If a wrong is done to a company (as a person separate from its members), only the company may sue for redress. This is the significant principle stated by Wigram V-C in Foss v Harbottle itself and is known as the 'proper claimant' principle.*

(b) *The court will not interfere with the internal management of companies acting within their powers. This is called the 'internal management' principle. The internal management principle has a 'proper claimant aspect', which is that the court will not determine a question concerning what it regards as the internal*

management of a company except in proceedings brought by the company itself.

(c) *A member cannot sue to rectify a mere informality or irregularity if the act when done regularly would be within the powers of the company and if the intention of the majority of members is clear. This is called the 'irregularity' principle.*

11. Over time various exceptions to 'the rule in ***Foss v Harbottle***' have also evolved. It was explained in ***Edwards v Halliwel [1950] 2 All ER 1064*** that 'the rule in ***Foss v Harbottle***' does not apply where the act complained of is ultra vires of the company or where an individual shareholder brings a derivative action on behalf of the company against wrongdoers, who were in control of the company and have committed fraud on the minority of shareholders.

12. The exceptions to 'the rule in ***Foss v Harbottle***' were articulated by Lord Jenkins in ***Edwards v Halliwel***, which have been restated in Alan Dignam & John Lowery Company Law, 4th Edition (Oxford University Press; 2006; PP178) as follows:-

(i) *where the act complained of is illegal or is wholly ultra vires the company;*

(ii) *where the matter in issue requires the sanction of a special majority, or there has been non-compliance with a special procedure;*

(iii) *where a member's personal rights have been infringed;*

(iv) *where a fraud has been perpetrated on the minority and the wrongdoers are in control.*

13. In English Law, traditionally, the standing of a shareholder to sue with regard to the management of a company

was not recognized. The exceptions as stated above continued to emerge and finally Section 122(1)(g) of the Insolvency Act, 1986, gave a statutory basis to aggrieved minority shareholders of a company to seek winding-up of the company on 'just and equitable grounds'. The Companies Act, 1980, also created a remedy for minority shareholders, subsequently reflected in Section 459 of the Companies Act, 1985, on the ground that, *"the company's affairs are being or have been conducted in a manner, which is unfairly prejudice to the interests of some part of the members…"* Likewise, Sections 994 to 999 of the Companies Act, 2006, give a court vide ranging powers to remedy the conduct of a company's affairs *"that is unfairly prejudicial to the interests of its members generally or some part of its members."* Much jurisprudence has been produced to give meaning to the words "unfairly prejudicial" in the English law. But that debate is not relevant for our present purpose.

14. Much like Section 459 of the Companies Act, 1985, Section 290 of our Companies Ordinance provided a remedy to minority shareholders holding at least twenty percent of the issued share capital of the company to petition for seeking prevention of oppression and mismanagement in a company. Section 286 of the Companies Act retained such right for minority shareholders and reduced the threshold test from twenty percent of the issued capital of the company to ten percent. The underlying rationale for prescribing a threshold to establish the locus standi of minority shareholders to petition the court and seek prevention against the oppression and mismanagement is to ensure that not every grievance of an

individual member is brought before the court, as the rule of indoor management remains alive and well. Through distribution of powers between the management and the shareholders defined within the Companies Act and the constituent documents of the company, there exists an internal mechanism for resolution of grievances. However, where a significant minority that wields at least ten percent of the total shareholding of the company is convinced that its interests are being undermined due to the oppression or mismanagement by the Board, Section 286 of the Companies Act provides such members a remedy before a court.

15. In relation to Section 286 of the Companies Act the court is vested with significant powers under Section 287 of the Companies Act, which includes, *inter alia*, the power to set-aside any agreements between the company and members of the management, the power to set-aside transactions of certain types that a company has engaged in, and the power to change the management of the company if doing so is found just and equitable by the court. In simpler terms there might be circumstances where the interests of the minority shareholders are not served by seeking winding-up of the company and court intervention is guided by what is just and equitable for the company and its shareholders. It is for such purpose that Section 286 of the Companies Act provides a mechanism empowering the court to interfere with the management of a company without requiring that the company be wound-up. The purpose of such provision is to protect the interests of certain stakeholders, such as minority shareholders and creditors who

have no general ability to exercise supervisory authority over the Board of Directors or avail the processes available within shareholders democracy to protect their interests.

16. It is in this context that the legal right to file a petition for prevention of oppression and mismanagement is vested in shareholders, who satisfy a certain threshold, and creditors, who satisfy a certain threshold in relation to the paid-up capital. Likewise, the SECP and the Registrar of Companies are also vested with the authority to petition a court to seek intervention in the internal affairs of a company. Such right to petition is, however, not vested in the members of the Board of a company. The members of a Board of a company have a collective right to manage the company. But any difference of opinion between the members of the Board does not confer legal standing on the dissenting Directors to bring such dispute to a court for its resolution. It is thus that the members of the Board of a company have not been granted legal standing to petition a court to prevent oppression and mismanagement in the affairs of the company.

17. The facts of this petition also require a brief discussion with regard to Section 42 of the Companies Act. Section 42 of the Companies Act is an extra-ordinary statutory power that authorizes the SECP as the regulator of Companies to grant a licence to an association formed as a limited company to pursue not-for-profit objects. The tool for regulation of a Section 42 company is the licence issued by the SECP. Section 42(5) of the Companies Act then vests in SECP the authority to revoke a

licence on grounds similar to those on the basis of which winding-up of a company can be sought. The effect of revocation of a licence is mentioned in Section 43 of the Companies Act, which states that a Section 42 company is to then stop all its activities, stop receiving donations, and the assets of the company after satisfaction of its liabilities are to be transferred to another licensed Section 42 company with objects similar to those of the Section 42 company whose licence is being revoked. Again, the exercise of such power to revoke a licence in effect sounds the death-knell of a Section 42 company. There might be circumstances where the SECP might wish to petition a court pursuant to Section 286 of the Companies Act to seek court intervention to remove and replace the management of the company instead of revoking its licence and winding-up a Section 42 company. The scheme as prescribed in Sections 42, 43 & 44 of the Companies Act also, however, creates no rights for Directors of a Section 42 company to seek court intervention for the purposes of preventing oppression and mismanagement by fellow Board members.

18. The law relied on by the learned counsel for respondent No.2 supports the contention that Directors of a company have no locus standi to file a petition under Section 286 of the Companies Act. It was held by the learned Lahore High Court in ***Nadeem Kiani*** that, *"if we look at the true intent and spirit of section 286 of the Act, it is an alternative to the winding up of a company and has been incorporated in the law to safeguard the minority shareholders from oppression and mismanagement of majority shareholders and to ensure that the affairs of the*

Company must be conducted in a lawful manner and strictly in accordance with the Memorandum and the Articles." It was further held that, *"Section 290 of the Companies Ordinance (now section 286 of the Act) did not provide any statutory right to any Director, Board of Directors, Chief Executive Officer or any person in management responsible for running affairs of the company, to file an application before this Court; who himself responsible for the management and administrative affairs of such Company and does not meet the strict requirement of the said Section."*

19. The law cited by the learned counsel for the petitioners (i.e. ***Ch. Muhammad Azam Cheema***) for the proposition that any member of a company has a legal right to file a petition, if he believes that the affairs of the company are being conducted in an unlawful and fraudulent manner, is not persuasive. While the learned Lahore High Court did observe that, *"if any member of a company complains or the Registrar is of the opinion that the affairs of the company are being conducted in an unlawful or fraudulent manner or in a manner not provided for in its memorandum may make an application to the Court for an order under section 290 of the Ordinance"*, such comments were made in the context of maintainability of a writ petition impugning the actions of a company limited by guarantee which was owned by the Province of Punjab. The judgment is not binding on this Court. And to the extent that it is cited for the proposition that a member of a guarantee company without any shareholding would have a right to file a petition under Section 286 of the Companies Act (previously Section 290 of the Companies

Ordinance), the precedent is not good law in view of the explicit textual requirement for standing provided within Section 286 of the Companies Act and also appreciated by the learned Lahore High Court in ***Nadeem Kiani***.

20. In the instant case, respondent No.2 is a Section 42 company licensed by the SECP to pursue not-for-profit objects. According to clause (3) of the Articles of Association of the Company, it is a public company limited by guarantee not having a share capital. While the Articles conceive that the company can have members, such members do not own the share capital of the company. As the company does not have a share capital, such members therefore cannot meet the threshold test of owning ten percent of the shareholding of the company as prescribed in Section 286 of the Companies Act. Thus, even if the petitioners were members of the company in addition to being Directors, given that they do not own ten percent of the paid-up share capital of the company, they would not qualify to file a petition under Section 286 of the Companies Act.

21. This Court therefore finds that the petitioners have no locus standi to file this petition under Section 286 of the Companies Act. The petition is therefore ***dismissed for not being maintainable***. Given that the petitioners are independent Directors in a not-for-profit company, who filed the petition in their spirit for public service, and the respondents are also public sector entities and the question before this Court in relation to standing under Section 286 of the Companies Act read together

with Section 42 of the Companies Act was a matter of first impression, there is no order as to cost.

(BABAR SATTAR)
JUDGE

Announced in the open Court on 25.11.2022.

JUDGE

Approved for reporting.

A. Rahman Abbasi.