

CLASS ACTION SUIT: A NEW TRAJECTORY IN INDIAN CORPORATE INDUSTRY***

Abstract:

The concept of *Class Action Suit* or *Class Suit per se* is not new, however in context of India it has found its legal recognition and enforceability only by the means of Companies Act of 2013. The basic motive behind incorporating this concept in the Companies Act of 2013 is to check the increasing number of cases of corporate frauds in the country. As per the records available, the concept of Class Action Suit was dealt with for the first time in the *Satyam Scam* case wherein a scam related with securities was discovered in the year 2009 which marked its place in the headlines globally. The shareholders approached the Hon'ble Supreme Court of India and claimed relief amounting to Rs. 5000 Crores but to no avail as the court struck down their petition. Here it becomes pertinent to mention that due to lack of adequate provisions in India at that time, the investors couldn't take legal recourse whereas the counterparts in the USA filed class action suit claiming damages from the company and the auditing firm. These reasons thus led the legislature to introduce the concept of Class Action Suit vide Section 245. Section 245 of the Companies Act, 2013 enables members and depositors or any class of them to file an application to the Tribunal i.e. National Company Law Tribunal, on behalf of the members or depositors, if they opine that the management or affairs are being conducted pre-judicial to the interests of the Company. Suit under Section 245 may be filed by members or depositors or any class of them before the National Company Law Tribunal, if they believe that the management or conduct of the affairs of the company prejudices the interest of the company, its members or depositors. Hence, Class Action Suit could be defined as a lawsuit that allows a large number of people with a common interest in a matter, to sue or be sued as a group. The said concept is prevalent in developed countries like the United States, United Kingdom and Singapore. The concept brings with it numerous advantages which, in the long run, would benefit the Indian corporate industry and also the public at large. Thus, it would be right to state that by incorporating the said provision, the legislature aims to encourage the investors and boost their

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confidence in the capital market and thus initiate healthy investments and healthy growth of the economy. Keeping in view the abovementioned points, in this paper we would be dealing with the detailed concept of Class Action Suits along with its genesis and its effects in the context of India's Corporate Industry.

“The idea is like anything in our democracy - the more people you have speaking as one voice, the louder that voice becomes.”¹

- Attorney Christopher Gilreath²

Chapter 1: INTRODUCTION

India's corporate industry is widely known for its diversity. Post independence, the Indian corporate sector saw a multifold increase in the number and types of industries. With the setting up of new industries, the then legislature enacted the Companies Act, 1956 to govern the corporate entities. In the beginning of the 1990s, the Indian government introduced the liberalization, privatization and globalization policies which are commonly known as the *LPG Policy*. Upon incorporation of these policies in the Indian corporate industry, the government threw open the gates for new industries and at the same time allowed the existing industries to expand. While all these activities were taking place, it led to question the credibility of the then Companies Act, 1956. Major countries across the world were then talking about corporate governance, investor protection, ethical governance etc, but back here in India, the legislation was not competent enough to guarantee the issues in question. At multiple occasions, amendments were suggested which led to some notable amendments in the year 1988, 1990, 1996, 2000 and 2011.

In spite of various amendments, in the last 5-6 years, a need was felt to enact more competent, credible and effective legislation keeping in view the latest global trends and the interests of the companies, the investors, economy and the public at large. This gave rise to various Bills which

¹ *Class Action allows stronger collective voice*, Memphis Daily News, Extracted from: www.memphisdailynews.com/editorial/ArticleEmail.aspx?id=31000, extracted on April 14th, 2014 at 11:01 AM.

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were introduced in the Parliament but failed to take the shape of the Act. However, the Bill of 2012 succeeded and thus the Companies Bill, 2012 took the shape of Companies Act, 2013 upon being finally passed by the *Rajya Sabha* on 8th August, 2013³ and assented by the President of India on 29th August, 2013⁴. This new Act replaced the 57 years old Act of 1956 which underwent multiple amendments during its lifetime.

The new Act of 2013 is divided into 29 chapters containing 470 Sections as against 658 Sections in the old Act of 1956. This new Act poses as the trend changer in the Indian corporate industry which has been written keeping in view the demands of the corporate industry in India which includes investor protection, corporate governance, CSR and so on. The incorporation of the provision of *Class Action Suit* is one such wise step towards corporate development as it now offers a new option to the Indian corporate industry to check the increasing corporate frauds and discrepancies in the industry.

Chapter 2: WHAT IS CLASS ACTION SUIT?

Though the concept of Class Action Suit *per se* is not new, but in Indian context it is a nascent concept and it is among the many novelties introduced by the new Act of 2013.⁵ In India, Class Action Suit has found statutory recognition and enforceability only by the means of Companies Act, 2013.

Class Action Suit also known as Class Suit has been defined as a lawsuit that allows a large number of people with a common interest in a matter, to sue or be sued as a group. This concept is prevalent in developed countries comprising the United States, United Kingdom and Singapore. This provision is a boon for investors or stakeholders as it gives them an edge in retrenching their rights. It is a procedural device enabling one or more plaintiffs to file and

³ *Companies Bill Passed*, The Hindu, August 8th, 2013, Extracted from: <http://www.thehindu.com/business/Industry/companies-bill-passed/article5003777.ece>, Extracted on April 14th, 2014 at 11:11 AM.

⁴ *The Gazette of India*, August 30th, 2013, Extracted from: <http://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf>, extracted on April 14th, 2014 at 11:15 AM.

⁵ Dhanapal, CS., *Class Action Suits under Companies Act, 2013*, CAclubindia, December 14, 2013, Extracted on April 14th, 2014 at 11:21 AM.

prosecute litigation on behalf of a larger group or class, wherein such class has common rights and grievances.⁶

Under the Companies Act, 2013, the Class Action Suit has been defined under Section 245 which explains that, an application can be filed before the Tribunal⁷, in case where the members or depositors or any class of them are of the opinion that the management or conduct of the affairs of the company are being conducted in such a way that is prejudicial to the interests of the company or its members or depositors, and relief or reliefs could be sought which may include, restraining the company from committing an act which is *ultra vires* or beyond the scope of the articles or memorandum of the company,⁸ restraining the company from committing breach of any of provision of the company's memorandum or articles,⁹ declaring a resolution to alter the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by miss-statement to the members or depositors,¹⁰ restraining the company and its directors from acting on such resolution,¹¹ restraining the company from doing an act which is contrary to the provisions of the Act or any other law for the time being in force,¹² restraining the company from taking action contrary to any resolution passed by the members,¹³ claiming damages or compensation or demand any other suitable action from or against the company or its directors, the auditor including audit firm of the company, or any expert or advisor or consultant or any other person, for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on their part¹⁴ and lastly seeking any other remedy as the Tribunal may deem fit¹⁵.

As per Section 245(3), the requisite number of members for bringing in the suit, in case of company having a share capital, shall be not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed and

⁶ *Ibid*, Footnote 4.

⁷ "Tribunal" means the National Company Law Tribunal constituted under Section 408, Section 2(90), Companies Act, 2013.

⁸ *Indian Companies Act, 2013*, Section 245 (1)(a).

⁹ *Indian Companies Act, 2013*, Section 245 (1)(b).

¹⁰ *Indian Companies Act, 2013*, Section 245 (1)(c).

¹¹ *Indian Companies Act, 2013*, Section 245 (1)(d).

¹² *Indian Companies Act, 2013*, Section 245 (1)(e).

¹³ *Indian Companies Act, 2013*, Section 245 (1)(f).

¹⁴ *Indian Companies Act, 2013*, Section 245 (1)(g).

¹⁵ *Indian Companies Act, 2013*, Section 245 (1)(h).

whichever is less.¹⁶ Secondly, in the case of a company not having a share capital, the requisite number of members shall not be less than one-fifth of the total number of its members.¹⁷ Also, the requisite number of depositors under sub-section (1) of Section 245, shall not be less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever is less, or any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed.¹⁸

It must be noted that, under Section 245, any order passed by the Tribunal is binding on the company and all its members, depositors and auditors including the audit firm or expert or consultant or advisor or any such person associated with the company.¹⁹ If a company fails to comply with an order passed by the Tribunal under Section 245, is liable to be punished with fine ranging from five lakh rupees to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine ranging from twenty-five thousand rupees to one lakh rupees.²⁰ However, the provision of Class Action Suit doesn't apply to a banking company as is defined under Section 245(9) of the Act.

Thus, it could be inferred from the text available under Section 245 of the Companies Act of 2013 that the legislature intended to apply this concept in the strictest sense possible so as to protect the interests of a certain section of stakeholders and depositors and also to keep a check on the increasing corporate fraud cases. This provision has been specifically introduced keeping in view the interests of the creditors and depositors and to ensure public confidence in the companies which ultimately would help boost the economy.

Chapter 3: REASON BEHIND INCORPORATION OF SECTION 245: SATYAM CASE

Post 1990s, India witnessed a rapid increase in corporate sector which was catalyzed by liberal policies of the government, privatization processes, introduction of foreign direct investments etc. It led to overall growth of the Indian corporate sector. Some of the major sectors

¹⁶ *Indian Companies Act, 2013*, Section 245 (3)(i)(a).

¹⁷ *Indian Companies Act, 2013*, Section 245(3)(i)(b).

¹⁸ *Indian Companies Act, 2013*, Section 245(3)(ii).

¹⁹ *Indian Companies Act, 2013*, Section 245(6).

²⁰ *Indian Companies Act, 2013*, Section 245(7).

which grew tremendously include the telecommunication sector, aviation sector, investment companies, steel companies, IT companies etc. However, the growth of the industry was not exclusive as it brought with itself certain setbacks. With the increase in corporate entities, instances of corporate fraud increased which brought in demand provisions for protection of the rights of investors.

A large number of experts give the credit of introduction of Class Action Suit in Indian corporate law to the *Satyam Fiasco* or the *Satyam Scam* which broke out in January, 2009, when the founder of erstwhile Satyam Computer Services, Ramalinga Raju confessed to have misstated the accounts and the company's stock. During the investigation that followed, the auditors of the company were also found to be in breach of their obligations. The Company Law Board appointed 10 nominee directors and barred the then existing board from functioning any further.

Subsequent to this, through an auction 46 percent of shares of Satyam were brought by Mahindra & Mahindra owned company Tech Mahindra. The retail and small investors suffered enormously due to this scam as the share price of the company fell precipitously resulting in huge losses to more than 3 lakh investors. The investors in India suffered because they had virtually no recourse available against the company for the fraud perpetrated and due to this reason their claim for damages worth Rs. 5000 crores was rejected by the Hon'ble Supreme Court of India.

On the contrary, the American investors who held American Depository Receipts (ADRs) demanded settlement to the tune of USD 125 million by mounting a class action suit and they succeeded reason being the availability of the provision of class suit in the United States.

In light of the example set by *Satyam Scam* it is evident that the legislature intended to boost the confidence of investors, both small and big, in the capital markets and aimed to initiate healthy investments and healthy growth of the economy, by incorporating the provision of class suit. Therefore, the incorporation of the provision of class action suit was highly needed in order to stabilize and ensure effective working of the corporate sector.

Chapter 3: POSSIBLE EFFECTS OF INCORPORATING THE PROVISION

In context of stakeholders, the said provision is of great importance. Until now, filing a case of oppression and mismanagement was the only recourse available to the aggrieved

shareholders, but with the implementation of Act of 2013, certain members or depositors can opt for class action suit which bestows in them additional rights and grounds to fight for their rights and any abuse of powers by the company, its management or to that matter even the auditor and consultant.²¹ Also, the depositors now have a secure position compared to past wherein the only recourse available was to file a civil suit which was time and money consuming. The inclusion of auditors and consultants within the ambit of Section 245 has put in an obligation on them to act diligently and in the best interests of the company failing which they could face a lawsuit and ultimately be penalized for their deeds. It is expected that the said provision would motivate NGOs and social activists to take legal action in favor of the affected people.

Class Action Suit is said to encourage faster action and speedy disposal of matters calling immediate attention. Higher penalties and mandatory imprisonment imposed under this Section would act as a deterrent to any fraudulent, unlawful or wrongful act or for any improper or misleading statement made by the concerned persons.

At the same time, said provision entitles the stakeholders with more rights and powers to seek action against the wrongdoers and it also ensures that the companies become more careful and diligent while performing their duties. With the inclusion of auditors, consultants and experts in this provision, the companies are now bound to seek their advice. Thus, it could be said that by introducing this provision, the legislature has taken a step forward towards a better future of the corporate industry.

Chapter 4: ADVANTAGES AND DISADVANTAGES

As is explained by Section 245, the provision comes with a bundle of advantages. This provision is said to reduce the number of law suits and would allow numerous people with a common interest in the matter to sue or be sued as a group. As the number of law suits would decrease, the cost of litigation would reduce and time could be saved by avoiding repetition of same witnesses, documents and evidences. With the incorporation of this provision, the efficiency of the legal process is set to increase. Apart from opting for a lawsuit for oppression and mismanagement, the said section of stakeholders could opt for filing a class action suit.

²¹ Prashant, CS., *Blazoning the concept of class action suits under the Companies Act, 2013*, CAclubindia, extracted on April 15th, 2014 at 2:15 PM.

As collective suit can be filed, NGOs and other activists can now take up causes for affected people. This provision would now ensure that the companies be more vigilant and more cautious in selecting their experts, advisors and auditors who can give them more sound and accurate advice.

Even though the provision has been drafted with utmost diligence and great care, it has certain shortcomings. A class suit can be filed by members and deposit holders only who jointly make a small section of stakeholders. Other stakeholders such as creditors, bankers, debenture holders etc are deprived of such rights. This means that, creditors, bankers, debenture holders etc haven't been included in the purview of Section 245. Further, the regulatory authorities have also been kept out of the scope of this provision and thus they are not empowered to file class suit against companies.

Chapter 5: CLASS ACTION SUIT vis-a-vis SUIT FOR OPPRESSION AND MISMANAGEMENT

The Act of 1956, vide Sections 397 and 398, allowed filing of petition before the Company Law Board against oppression and mismanagement. Often, people confuse an oppression and mismanagement suit with class action suit; however, there are certain differences between them. A depositor, upon being aggrieved by the actions of a body corporate could file a class action suit but not a suit under Section 397/398 of the old Act. Secondly, oppression and mismanagement suit could be filed against the company and its statutory appointees only²², while a class suit could be filed against an expert or advisor or consultant or any other person for any incorrect or misleading statement to the company and also against an auditor for any improper or misleading financial statements. Thirdly, petitions under section 397/398 of the Act can be filed for past mismanagement and to prevent recurrence,²³ while class action suit could be filed to ask the management or directors of company to desist from one or more particular action that is yet to be taken.

Chapter 5: CONCLUSION

²² Singh, A., *Company Law*, Eastern Book Company, 2005 edition.

²³ *Ibid*, footnote 22.

Undoubtedly, as of now it could be said that the incorporation of the concept of class action suit is a much welcomed step towards the betterment of the Indian corporate industry, however, its success in the industry is still uncertain, reason being the exclusion of a major class of stakeholders comprising of creditors, bankers and debenture holders from its purview. Further, the regulatory authorities have been kept out of the ambit of this section and they are not entitled to file a class action suit, which has been criticized throughout the country.

Another reason which acted as a setback for the public was the exclusion of banking companies from the scope of Section 245. On the basis of mere reading the provision of Section 245 and analyzing it, it could be said that the class action suit may prove to be a potent tool to keep a check on the accountability of a company and to contain any likely prejudice against the minority. However, on the contrary, such a concept may be open to misuse by unscrupulous minority shareholders in furtherance of their vested interest thereby hampering the effective functioning of the company. Keeping this in view, it could be said that the legislature failed to consider the negative outcomes of class action suit as it is evident by the absence of provision to check for misuse of class action suit.

Yet another major setback for the said section of stakeholders is the delay in the constitution of National Company Law Tribunal (NCLT), due to which the potential cases of class action are being filed in the courts which are already overburdened with pending cases. One recent example of this is the filing of a suit by four investors under Civil Procedure Code, against Financial Technologies (India) Limited (FTIL) and National Spot Exchange Limited (NSEL) and forty other related entities to abstain them from selling their assets. This suit has been filed by four investors of which one, Modern India, has invested rupees 30 crores in NSEL.²⁴

In addition to this, considering the case of Securities Class Action²⁵, it could be said that the legislature acted on the toe to introduce this provision but it hasn't yet notified where the claim under this provision would be made. Upon reading the comments of experts on this provision, we are of the opinion that the power to entertain a claim for security class action should be vested with the Securities and Exchange Board of India, however, the same is still unclear.

²⁴ Maheshwari, A., *4 investors file class action suit against FTIL, NSEL*, Moneycontrol.com, January 15th, 2014, extracted from: http://www.moneycontrol.com/news/cnbc-tv18-comments/4-investors-file-class-action-suit-against-ftil-nsel_1025054.html, extracted on 15th April, 2014 at 5:25 PM.

²⁵ *Indian Companies Act, 2013*, Section 37.

Lastly, having said that, though this right of class action suit seems to be a weapon in the hands of the minority shareholders, the real strength of it can be measured only by giving it full effect upon the constitution of NCLT. Till then, it is unjust to say if it is a good step towards a better corporate India or is yet another failure of the legislature, because the answer to this could only be given by time.
