

GAPS IN CLASS ACTION SUITS UNDER COMPANIES ACT, 2013

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Introduction

Shareholders activism is an evolving term in India, which means an active participation of shareholders in all the aspects of good corporate governance and fighting against the deceitful and incorrect acts of a company. Individual shareholders generally do not take legal action against a company, either on account of lack of enough motivation or finding it economically unaffordable, or because the law requires a certain percentage of shareholding for proceeding against a company. Thus, small and retail investors generally find it difficult to be heard and instead their grievances are redressed either from the company or courts in general. Indian Companies Act 2013 (hereinafter, the Act), progressively provides for shareholder activism and protection of investors of every kind. One such provision is that of class action suits under Section 245 of the Act. This is a major change from the earlier regime, which did not have any such provision¹.

The history of class action suits in India can be traced to the Satyam scam, where US counterparts could institute such suits and recover damages, Indian investors were without any recourse, which was a fiasco of around INR 7000 crores. About three lakh investors in India lost around INR 5,000 crore in the Satyam case, while its investors in the USA, who filed a class action against Satyam, were compensated to the tune of \$125 million (around INR 675 crore).²

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¹ Earlier, collective suits were possible under the Civil Procedure Code, Order I, Rule 8- **One person may sue or defend on behalf of all in same interest.**- (1) Where there are numerous persons having the same interest in one suit,—

(a) one or more of such persons may, with the permission of the court, sue or be sued, or may defend such suit, on behalf of, or for the benefit of, all persons so interested

(b) the court may direct that one or more of such persons may sue or be sued, or may defend such suit, on behalf of, or for the benefit of, all persons so interested.

² Minny Narang & Gunjan Jain, *Class Action Suits, a Measure of Progressive Activism in India*, Indian Journal of Research, Vol. 2, Issue 12, 2013, 49-51, 49, available at http://theglobaljournals.com/paripex/file.php?val=December_2013_1388040512_75c39_16.pdf, last accessed 10th September, 2016.

A class action suit refers to a lawsuit that allows a large number of people with a common interest in a matter to sue or be sued as a group. It is a procedural device enabling one or more plaintiffs to file and prosecute a litigation on behalf of a larger group or class, wherein such class has common rights and grievances³. Class actions are particularly good for all small and minority shareholders who may not be able to afford experienced and highly competent attorney on their own. At the same time, they increase the efficiency of the legal system by reducing the number of rulings for the same issue, thereby saving time and resources. It provides them with a medium to fight as one unit against the errant company or management, thereby reducing multiplicity of suits, costs of litigation and increasing their chances of success in the process.

Provisions under the Companies Act, 2013

The provision governing class action suits under the Act is Section 245. The substantive provision reads:

“Such number of member or members, depositor or depositors or any class of them, as the case may be, as are indicated in sub-section (2) may, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors, file an application before the Tribunal on behalf of the members or depositors for seeking all or any of the following orders...”

Gaps in the Provisions Relating to Class Action Suits

2.1 Overlapping of provisions

As per Section 245(1) read with Section 245(3), a Class Action Suit may be filed by:

(3) (i) The requisite number of members provided in sub-section (1) shall be as under:—

(a) in the case of a company having a share capital, 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,

³ S. Dhanpal, *Class Action Suits Under Companies Act, 2013*, available at <http://taxguru.in/company-law/class-action-suits-companies-act-2013.html>, last accessed 10th October, 2016.

whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(b) in the case of a company not having a share capital, not less than one-fifth of the total number of its members.

(ii) The requisite number of depositors provided in sub-section (1) 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.

In the opinion of the author, as far as depositors are concerned, the Act does not provide any definition of the same. Even though, a definition of ‘deposits’ is available, the same is not very helpful in determining who are depositors. The Ministry of Corporate Affairs has passed Companies (Acceptance of Deposits) Rules 2013, under which a depositor is defined as:

- i. Any member of the company who has made a deposit with the company in accordance with sub-section (2) of Section 73 of the Act; or
- ii. Any person who has made a deposit with a public company in accordance with section 76 of the Act.

This is a circuitous definition and brings us back to the Act itself. Further, in the context of class action suits by depositors, it is observed that there is an overlap between Section 75⁴ and Section 245 (1)(g)(i). The former provides for damages for fraud and the latter for damages, compensation or any other suitable action against the company or its directors for any fraudulent, unlawful or

⁴ Section 75 Companies Act- Damages for fraud- (1) Where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified in sub-section (1) of that section or such further time as may be allowed by the Tribunal under sub-section (2) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in subsection (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

(2) Any suit, proceedings or other action may be taken by any person, *group of persons or any association of persons who had incurred any loss* as a result of the failure of the company to repay the deposits or part thereof or any interest thereon (emphasis supplied)

wrongful act or omission or conduct or any likely act or omission or conduct on its or their part. Thus, there is possibility of duplicity of suits on the same cause of action.

2.2 Plaintiffs in case of class action suits

Further, the Act does not provide any remedy to other stakeholders under the provision for class action. Thus, creditors, consumers, employees etc. cannot organise themselves as a group and demand for compensation or damages from the company. In the USA however, the different stakeholders too can file class action suits against incumbent companies.⁵

2.3 Distribution of damages and compensation

Under Section 245(1)(g), class action suits can be filed for claiming damages or compensation for certain acts or omissions of directors, auditors, consultant or any other person. Although this is a noble endeavour, the problem lies in the fact that the Act does not provide how these damages and compensations will be distributed amongst the claimants. As far as members are concerned, some may claim to have suffered more injury due to the high percentage of their holdings in comparison to the others. There is no guideline in the Act that would help the Tribunal to determine how to distribute the monetary rewards.

Further, it has been noted in various class action suits that that victims receive no compensation or benefits for their association. Sometimes it is felt that the compensation awarded may have been greater if the case was pursued by an individual rather than a group.

A possible solution to the same could be coming out with a formula that would divide the damages and compensation on the basis of the shareholdings of the aggrieved parties. This would ensure an equitable distribution of damages is made and each member is compensated in proportion to her holding.

2.4 Wide Implication

Amongst the orders which can be sought in a proceeding under Section 245(1)(g) as follows:

⁵ Class Action Fairness Act of 2005 expanded the horizon of class action suits in the sense that it has wide applications. Now, class action suits are filed by the consumers in case of any defect or deficiency in any product or services, shareholders for destruction of wealth due to mismanagement and employees for breach of employment terms or unfair trade practice

“to claim damages or compensation or demand any other suitable action from or against—

(iii) 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 his part...” (emphasis supplied)

In the opinion of the author, this casts a very wide net on the persons who can be implicated in a class action suit. Common sense does not allow one to say that *any other person* would mean any person even remotely related to the impugned action. However, the Act does not make it clear what could be a possible cause of action in case such a person is made a defendant.

2.5 Other problems

2.5.1 Unscrupulous Minority Shareholders

Such actions are open for misuse by unscrupulous minority shareholders in furtherance of their vested interest thereby hampering the efficacy of the entire corporate and legal system of a country.

At 100, the Act sets a low limit for the number of people required for a class action suit. This number can even reduce, if the percentages required to be set by the Act itself⁶, lower the number of shareholders. Thus, very few shareholders could join hands, and seek judicial remedy in the form of class action, even though the transaction might actually be beneficial for the company as a whole.

2.5.2 Contingency Model

In the US, plaintiff law firms⁷ work on a contingency model, where they take no fees upfront and usually collect a third of the settlement amount. In India, the Bar Council prohibits a contingency

⁶ Section 245(3) (i) The requisite number of members provided in sub-section (1) shall be as under:— (a) in the case of a company having a share capital, 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, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares

⁷ These are law firms which organise litigants together and file the suit on their behalf. They also advertise heavily. Since there are prohibitive costs of filing suits in India and delays within the legal system, there is little incentive for law firms in India to act as plaintiff law firms.

model. It is therefore, unlikely that law firms would have any incentives to fight cases.⁸

⁸ Samar Srivastava, *Class Action Suits are up Against Challenges*, Forbes India, 25th February 2013, available at <http://forbesindia.com/article/breakpoint/class-action-suits-are-up-against-challenges/34781/1>, last visited 7th September 2016