

Class Action Suits: Notified yet Ambiguous

Introduction

On June 1, 2016, the Ministry of Corporate Affairs, notified section 245 of the Companies Act, 2013 (“**CA 2013**”), enlisting the provisions of class action suits in India. A class action suit is one where the shareholders of a company collectively institute a suit against the company. While such provision was inserted in CA 2013 at the time of its creation, it was only notified in June 2016.

The requirement for this provision was felt in 2009 when the Satyam scam¹ occurred. The shareholders in Satyam Computers Services Limited (“**SCSL**”) were unsuccessful in claiming damages (worth millions) due to the absence of the provision for filing a class action suit under the Companies Act, 1956. While the Indian shareholders suffered a loss, the American investors were able to claim their part of damages in the US courts through a class action suit against SCSL. It was felt class action suits will safeguard the interests of shareholders, whenever the company or its directors participate in any fraudulent, unlawful act, or commit an act which is against the interest of the shareholders. In fact, such suits would be the most effective remedy for raising the voice of the company’s shareholders.

This newsletter discusses the current position of class action suits in India, analyzes the scope and extent of section 245 of CA 2013 and related substantive and procedural aspect of the same.

1. Legal Framework

The legal framework for class action suits is covered in section 245 of CA 2013 as well as National Company Law Tribunal Rules, 2016 (“**NCLT Rules**”). Section 245 permits members² and depositors³ to file a petition against the company, its directors, auditors or advisors with the National Company Law Tribunal (“**NCLT**”) in case they commit any act which is prejudicial to the interest of the company. Banking companies are excluded from its purview.

Section 245 contains ten different sub clauses and the framework of the section covers the procedure as well as the reliefs which can be sought. The ambit of the section is very wide because it permits shareholders to seek relief where the interests of the company may be jeopardized. What will be prejudicial to the interest of the company, its shareholders or depositors is not clarified and, until jurisprudence evolves under this section, due consideration will have to be paid to the provisions of the erstwhile Act of 1956 as well as the judge-made law thereunder. To avoid potential class action suits a company has to (a) ensure it operates within

¹ Mr. Ramalinga Raju, the Chairman of SCSL, publicly acknowledged that he was involved in manipulation of the financial accounts of SCSL.

² Member is defined under Section 2(55) of CA 2013 to mean a person who is a subscriber to the memorandum of the company, has agreed in writing to become a member, holds shares and his/her name is entered as a member in the register of members.

³ Depositor refers to any member of the company who has made a deposit with the company as per Section 73(2) of CA 2013.

the confines of its charter documents, (b) it should not suppress material facts from its shareholders or misrepresent to them or the depositors, (c) operate in accordance with all applicable law.

Where a company violates the foregoing, a class action suit can be filed. For companies with a share capital, 100 members or a prescribed percentage of 10%,⁴ whichever is less or member(s) holding at least 10% shareholding in the company. It is imperative that the member should have paid all calls and dues. For a company without share capital, 1/5th total members is sufficient to launch proceedings. In case of depositors, minimum 100 or at least 10% of the total depositors, whichever is less or a depositor to which company owes 10% of the total deposits.

The aggrieved members can secure different remedies ranging from:

- seeking injunctive orders, restraining the company from committing acts which either violate or which are ultra vires of its charter documents, or any law or action which may be contrary to adopted resolutions;
- declaration that resolutions are void when they are rooted in misrepresentation or suppression of material facts;
- claiming damages⁵ or other appropriate action from directors, auditors, external advisors or any other person who made incorrect statements or who engaged in suppression of material facts or fraudulent conduct;
- seek any other remedy.

2. The Brief Process

An application for a class action suit has to be filed in Form NCLT 9 along with application fee of INR 5,000 (about USD 74⁶). The NCLT will consider the following, amongst other things, while reviewing the application – whether it has been filed in good faith; check if there is evidence of involvement of third parties i.e. other than directors or officers of the company. Apart from the provisions of section 245(4) of CA 2013, other elements are prescribed in Rule 85 of the NCLT Rules which include an assessment of whether:

- the class action suit is a better option than individual suits;
- there are questions of law common to the class; and
- the representative parties will protect the interest of the class.

After admission, under Rule 87 the NCLT shall serve a public notice⁷ in Form NCLT 13 to all the members and depositors of the class. The applications of similar subject matter will be consolidated and a lead applicant will be in charge. The NCLT will not consider two class actions having the same cause of action. Its orders will be binding and any contravention by the

⁴ Prescribed percentage has been defined as 10% under Rule 6(2) of the Companies (Prevention of Oppression and Mismanagement) Rules, 2016 which, however, is yet to be notified

⁵ Under section 245(2), the liability to pay damages for misleading statements in the audit report shall be on the audit firm as well as its partners involved in providing misleading statements in the report

⁶ 1 USD = INR 68

⁷ This notice contains the name of the lead applicant, grounds of application, relief sought, statement that application has been filed by the requisite number, etc.

company, its members, depositors or auditors shall attract fiscal and penal consequences. The fine will be payable to the company and defaulting officers – for the former, it ranges from INR 500,000 to INR 2.5 million (about USD 7,400 to 37,000) and for the officers, it is a range of INR 25,000 to INR 100,000 (about USD 370 to 1,500). Further, the statute also prescribes imprisonment of three years. Additionally, where NCLT feels the application is frivolous and vexatious then it can order the applicant to pay a maximum of INR 100,000 (about USD 1,500) to the other party.

3. The Potential Impact

3.1 *Costs:* The expectation is that cost of filing a class action suit would be lower than individual law suits against a company. Court fees, cost of hiring lawyers can be shared equally by all the members or depositors instituting the suit. The NCLT Rules provide that the entire cost for publication of the public notice shall be borne by the applicant in case the action is not proved against the defendant and the applicant shall pay a fine when the application is found to be frivolous. Thus, all these financial elements can be shared by the aggrieved parties.

3.2 *Benefit for minority shareholders:* Usually, the minority shareholders have fewer rights individually and often perceive themselves to be suppressed. With section 245, hopefully, in genuine cases of oppression they will be empowered and will be able to come together to institute suits to protect their rights and will be able to claim damages as well from the company, directors, auditors, experts and advisors. Whenever an individual files a suit, he may not be able to enforce his rights in a manner which he will be able to exercise while filling a combined suit.

3.3 *Volume of Cases & Time:* Past experience has shown that in the absence of the ability to launch class action suits, there is greater probability of multiple cases by individuals leading to an increased burden on the judiciary and the length of time it takes to resolve cases, has added to an enormous backlog. A combined suit by shareholders covering same subject matter ought to assist in lowering that backlog as it would eradicate the time in evaluating individual cases.

3.4 *Role of NCLT:* Currently, there is no clear definition of “good faith” and based on existing jurisprudence as well as equitable principles, the concept is fact and conduct specific. Given the obligation imposed on NCLT to scrutinize if the suits are filed in good faith, presumably, in due course, the concept will be refined with greater clarity in the context of class action suits. There is a high degree of responsibility on NCLT to assess and scrutinize, at threshold levels, the *bona fide* of the suit and the applicants in order to minimize misuse by them. While reviewing the evidence to substantiate that no personal interest or gain is present, NCLT will act as a watch dog over the minority shareholders as well and protect the company and its directors from becoming a victim of their personal interest. The shareholders need to prove that their rights have been affected and such suit would benefit the company. Further, the ambit of liability is widened and now it can be affixed on “any other person” and not merely the management. This, eventually, means that all third parties will have to exercise caution when dealing with companies.

Conclusion

Notification of class action suits by Ministry of Corporate Affairs has been big news for the shareholders, member and depositors. Apart from giving more teeth to the minority shareholders to come together, this may be a step for heightened attention and care by the company to act properly and correctly, all of which is good for corporate India in the long term. External advisers too and all third parties too will be more careful in their dealings. Covering the auditors and experts liable for any misrepresentation will, hopefully, ensure better results in their reporting and lead to greater good corporate governance. Further, there will be a higher onus on shareholders as well as NCLT to ensure that class action suits are not used as a ruse to promote self-interest or personal gain of minority shareholder and, thereby, avoid unnecessary litigation.

It has been almost six months since the section was notified and four months since the NCLT Rules were notified. There is hardly any data available demonstrating the practical application of this section. These are early days to come to a definite conclusion about the efficacy of the section, the Rules as well as NCLT. However, in short, the NCLT will play a very important role in the evolution of class action suits.

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