CLASS ACTION SUITS – GENESIS, ANALYSIS AND COMPARISON

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Abstract

The concept of a class action suit emerged in United States of America in the early 18th century. This course of litigation grew in popularity with an increasing number of claimants seeking restitution and often retribution under Rule 23 of the United States Federal Rules of the Civil Procedure for sundry claims ranging from corporate fraud to air flights delay.

In the aftermath of the collapse of Satyam Computer Services Limited, Clause 217, providing the right of members or creditors to file an application before the NCLT on behalf of the all members/ creditors in the event that the management of the company was being conducted in a manner prejudicial to the interests of the company or its members or creditors, assumed greater importance as a redressal mechanism separate from the traditional oppression and mismanagement application. This provision was enacted as Section 245 of the Companies Act, 2013.

There has been little scholarly debate on Section 245 primarily due to its unfamiliarity on Indian shores. However, it is necessary to critically examine this provision in order to ascertain its fallacies, if any, and suggest amendments if necessary.

This chapter is divided into three broad sections. The first section provides a brief background on the origin of the class action suits in India and briefly describes the events concerning Satyam in December 2008. The second section enumerates the lacunas and fallacies of the said provision, also discusses how this provision may be misused by shareholders and creditors. The third section provides recommendations in order make the provision on class action suits effective and efficacious in the India.

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I. INTRODUCTION

The Companies Act, 2013, in its final form, brings about a number of changes from its earlier iteration in 1956[1]. Most of these changes either make changes to existing substantive or procedural provisions as necessary[2]. However, there are rare changes made, bringing in concepts and rights or processes that were not present in the 1956 version. The right of a collection of shareholders or depositors to raise and maintain a suit as a class of claimants is one of them.

This paper explores the inclusion of Section 245 of the Companies Act, 2013, providing shareholders and security holders with the right to file class action suits. Much like other provisions in company law which have been transplanted from the United Kingdom or the United States[3], the concept of class action suits in its present form has also been inspired by similar provisions in these jurisdictions. We will begin by examining the genesis of class action suits, not just in the United Kingdom and the United States, but also its similarity to Indian provisions of public interest litigation. This paper shall also delve into the events that led to the inclusion of class action suits in the Companies Act, 2013 and will be followed by a detailed analysis of the provision. Finally, a comparison with similar provisions in the United States would set up a description of the lacunae in the section. A possible roadmap for the future of class action suits in India would also be suggested as a conclusion.

II. GENESIS OF CLASS ACTION SUITS

At its very core, it may be argued that a class action suit is a modified version of a public interest litigation. Public interest litigation possibly owes its origins to Emperor Jahangir. In the *Tuzak-e-Jahangiri-* his autobiography, he describes his famous *Zanjir-e-adl*, a gold chain that hung in his courtyard. Supplicants would tug at the chain and a bell would ring in the emperor's apartment following which Jahangir himself would appear and adjudicate the matter in person[4]. In more

[1] *Legislative Brief, The Companies Bill, 2009*, PRS Legislative Research, http://www.prsindia.org/uploads/media/Company/Legislative%20Brief--companies%20bill%202009.pdf last seen on 31/01/2015

[2] For example, consider the inclusion of key corporate governance provisions which were hitherto part of Clause 49 of the Bombay Stock Exchange Listing Agreement in Chapters XI and XII of the Companies Act, 2013

[3] Consider for example, other provisions relating to Independent Directors, Board Committees, Auditor responsibilities and liability which have been transplanted from the Sarbanes Oxley Act and the Cadbury Committee Report

[4] M. Hidayatullah, *"Highways and Bye- Lanes of Justice"*, (1984) 2 SCC (Jour) 1

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modern times, the early 1980's saw the emergence of a new jurisprudence- the 'jurisprudence of the masses'[5]. The concept of public interest litigation deals with the fact that the rights of citizens are closely linked with social justice and that it is through the actualisation of these rights that justice can be done to the 'have nots'. This becomes possible if the law is interpreted creatively by the courts departing from the traditional Anglo-Saxon jurisprudential norms of administration of justice[6].

Of course, with public interest litigation suits, there remains a question of injury caused to the claimant and whether the claimant has any ground to seek remedies or damages. A person aggrieved must be one who has suffered a legal grievance, a man against whom a decision has been pronounced which has wrongfully deprived him of something or wrongfully refused him something or wrongfully affected his title to something[7]. However, in order to remedy this, the Supreme Court has adopted a more liberal view of the concept of locus standi in recent times. In the *Fertiliser Corporation Case*[8] as well as in *S.P. Gupta v. Union of India*, the Supreme Court, agreed that the traditional view taken by the Courts needed redefinition and that "… whenever there is a public wrong or public injury caused by an act or omission of the State or a public authority which is contrary to the Constitution or the law, any member of the public acting bona fide and having sufficient interest can maintain an action for the redressal of such public wrong or public injury"[9].

The keystone of class action suits remains the same, promoting a mechanism by which a number of 'have-nots', may seek redressal against the 'haves' consequent to an injury or damage caused. However, as we will see in the following sections, the requirement of *locus standi* is somewhat diluted due to the very nature of class action suits.

The class action suit was an 'Invention of Equity'[10] arising out of the Bill of Peace[11] of the United Kingdom which allowed English courts to bring together multiple claims related to the same cause

[5] Upendra Baxi, *"Taking Suffering Seriously: Social Action Litigation in the Supreme Court of India*", 8 Delhi Law Review 107, L. Rev. (1979)
[6]Kailash Thakur, Environmental Protection Law and Policy in India 308 (2003)
[7] Ex parte Sidebotham (1880) 14 Ch. D. 458
[8] Fertiliser Corporation Kangar Union v. Union of India, AIR 1981 SC 344
[9]S. P. Gupta v. Union of India, AIR 1982 SC 149, 190
[10]William Weiner, Delphine Szyndrowski, *The Class Action, From The English Bill of Peace to Federal Rule of Civil Procedure 23: Is There a Common Thread*, 8 Whittier Law Review 935, 936 (1986-1987)
[11] Chafee, Zechariah. "Bills of peace with multiple parties." Harvard Law Review (1932): 1297-1332.

of action, within a common legal proceeding[12]. The two primary reasons justifying the use of the class action device are as follows:

- Multiplicity of actions is avoided, time and energy are saved as large and unmanageable number of persons club and join their grievances in a single suit; and
- Law provides a right to get redress against the wrongs that are not worth pursuing individually[13].

These rationales have their roots in a case in which each member of the multitude had the same interests as every other member, involving the common question of law and facts. It was considerably more economical to get all parties subject to a single chancery suit and settle common questions simultaneously[14]. Although the primary concern of the Chancery Court was the propriety of the suit, there was a realization that the relationship between the represented and the representative was important given that the representative of the group is required to represent the common interests of all[15]. It was in the case of *Cockburn v. Thompson*[16] that Lord Eldon fostered and set his imprint upon the class action doctrine. It was on these lines that the American doctrine of class action suits evolved[17].

The concept of the class action suit emerged in United States of America in the early 18th century. This course of litigation grew in popularity with an increasing number of claimants seeking restitution and often retribution under Rule 23 of the United States Federal Rules of the Civil Procedure for sundry claims ranging from corporate fraud to air flights delay. The amendment in the year 1966 brought about a change in the way class action practice and litigation was perceived and this invited much required scholarly attention.

In India the enabling concept of class action suits was first endorsed in the Dr. Jamshed J Irani Report (2005)[18]. The report suggests that in case of fraud on the minority by wrongdoers, who are in control and prevent the company itself bringing an action in its own name, derivative actions in respect of such wrong non-ratifiable decisions have been allowed by courts. Such derivative actions

[12] Rowe Jr, Thomas D. "Distant Mirror: The Bill of Peace in Early American Mass Torts and Its Implications for Modern Class Actions, A." Ariz. L. Rev. 39 (1997): 711.
[13] Supra n. 10
[14]Stephen C. Yeazell, *Group Litigation and Social Context: Toward a History of the Class Action*, 77 No. 6 Columbia Law Review 866, 868 (1977)
[15] James Wm. Moore and Marcus Cohnt, Federal Class Actions, p 308
[16]16 Ves. Jr. 321
[17] Supra n.15
[18] Expert Committee on Company Law, Ministry of Corporate Affairs, Government of India, *Report on Company Law*, May 31, 2005, available at http://resource.cdn.icai.org/8315announ854.pdf (last accessed on Sep 4, 2015)

are brought out by shareholder(s) on behalf of the company, and not in their personal capacity(ies), in respect of wrong done to the company. Similarly the principle of "Class/Representative Action" by one shareholder on behalf of one or more of the shareholders of the same kind have been allowed by courts on the grounds of persons having same *locus standi*. Though these principles have been upheld by courts on many occasions, these are yet to be reflected in Law. The report stressed upon the need for recognition of these principles.

The purpose of introducing such a provision in the Companies Act, 2013 (which replaced the earlier Act of 1956) was primarily to offer protection to small shareholders, fix higher accountability on auditors and guard against possibilities of corporate frauds and scams. The rationale offered by the Ministry of Corporate Affairs for insertion of this provision was to see that "the shareholder feels like a king" in matters such as managerial remuneration[19].

However, the events following Mr Ramalinga Raju's confession on January 7, 2009 brought into sharp focus, the urgent and pressing need to adopt a class action mechanism in India. We will now discuss the issues relating to financial wrongdoings and fraud at Satyam Computer Services Limited which led to the inclusion of Section 245 in the Companies Act, 2013.

[19] *Class Action Suits To Ensure Shareholder Democracy*, The Hindu, Nov 8, 2009, available at http://www.thehindu.com/todays-paper/tp-business/class-action-suits-to-ensure-shareholder-democracy/article134987.ece (last accessed on Sep 4, 2015)

III. THE SATYAM DEBACLE – NEED FOR CLASS ACTION SUITS

The need for a provision allowing for class action suits came out of a series of incidents involving Satyam Computer Services Limited. Satyam Computer Services Limited (now merged with Tech Mahindra) was a leading information, communications and technology (ICT) Company providing top-class business consulting, information technology and communication services[20]. A substantial portion of its clients were based in the United States[21]. It was listed on the Bombay Stock Exchange, the National Stock Exchange as well as the New York Stock Exchange.

In December 2008, a meeting of the Satyam board was called to consider a proposal to acquire Maytas Properties Limited and Maytas Infra Limited. It must be noted that this acquisition required a vote of approval by majority, as it was a related party transaction.[22] The promoter family owned more than 30% shares in both the companies. Both Maytas firms were engaged in real estate, which was an unrelated business area for Satyam. Further, this was a related party transaction as the Raju family owned shares in excess of 30% in both the companies.

Although the independent directors did raise some objections during the course of the meeting, the resolution was passed unanimously[23]. However, the shareholders of Satyam did not accept this decision of the board and the share prices of Satyam plunged immediately[24]. Subsequently, a meeting of Board of Directors was scheduled on January 10, 2009 to consider (i) strengthening the governance structure of the Company, (ii) reviewing the Company's strategic options to enhance shareholder value and (iii) addressing issues arising out of possible dilution in the Promoters stake[25].

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[20] Directors Report 2008-2009, Mahindra Satyam, pg 31, available at http://www.techmahindra.com/sites/resourceCenter/Financial%20Reports/mahindra-satyam-annual-report-2008-09-and-2009-10.pdf (last accessed on Sep 4, 2015)

[21] These clients included Unilever, Nestle, DuPont, Cisco Systems, GE, Sony and Applied Materials. *See* Bibhu Ranjan Mishra, Satyam Clients Likely to Re-Evaluate Contracts, Business Standard, Bangalore, Dec 18 2008

[22] Ahmad, Tabrez and Tabrez, Malawat and Kochar, Yashovardhan and Roy, Ayan, Satyam Scam in the Contemporary Corporate World: A Case Study in Indian Perspective (August 23, 2009), IUP Journal, 2010

[23] Varottil, Umakanth, Evolution and Effectiveness of Independent Directors in Indian Corporate Governance (February 6, 2010). Hastings Business Law Journal, Vol. 6, No. 2, p. 281

[24] Supra n.22, at page 7

[25] Supra n. 20 at page 11

In the meantime however, on 7th January 2009 Mr. Ramalinga Raju, the then Chairman of the Company, confessed to financial mismanagement and the 'Maytas scheme' to try and cover it up[26]. While the Satyam board had to withdraw its decision to acquire the Maytas' firms, it later came to light that the Maytas acquisitions were being carried out to manipulate past financial misrepresentation done by Satyam. For years, Satyam had been inflating profits by showing fictitious assets.[27] The share price of Satyam fell from Rs 304.80 on the 31st of November 2008 to Rs 54.05 on the 31st of Jaunary 2009 resulting in a major loss to shareholders wealth[28].

While the promoters, certain members of the board and other key managerial personnel were prosecuted under the SEBI Act 1992, the SEBI (Prohibition of Fraud and Unfair Trade Practices) Regulations 2003 and the SEBI (Prohibition of Insider Trading) Regulations 1992, these prosecutions sought only to enforce existing penal clauses within the gamut of securities regulation in India[29]. There were no provisions to compensate shareholders for their loss in shareholding value.

Seeking a redressal to this loss of shareholding value, a number of investors approached the National Consumer Disputes Redressal Commission as well as the Supreme Court of India but their claims were rejected for the absence of an extant law that allowed recovery of shareholding value in such cases[30]. Indian shareholders, along with Midas Touch, a consumer protection organization failed in their attempts to recover monetary relief before the National Consumer Disputes Redressal Commission (NCDRC) which rejected their claim, on the grounds that "We do not have the infrastructure to deal with such kind of petition […] CBI and CLB (are) already seized with the matter"[31]. Even upon appeal, the Supreme Court of India refused to overturn this outcome.[32]

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[26] For the full text of the letter issued by Mr Raju, see "Full text: This letter Ramalinga Raju wrote uncovered the Rs 4,676 cr Satyam scam", Firstpost, Apr 9, 2015 available at http://www.firstpost.com/business/full-text-this-letter-ramalinga-raju-wrote-uncovered-the-rs-4676-cr-satyam-scam-2190559.html (last accessed on Sep 4 2015)

[27] Supra n. 22 at page 7

[28] Supra n. 20 at page 25

[29] Order bearing no. WTM/RKA/SRO/64 - 68 /2014 under sections 11(1), 11(4) and 11B of the Securities and Exchange Board of India Act, 1992 in the matter of Satyam Computer Services Ltd, JULY 15th, 2014

[30] Samar Srivastava, *Class Action Suits Are Up Against Challenges***,** Forbes India (25/02/2013), available at- http://forbesindia.com/article/breakpoint/class-action-suits-are-up-against-challenges/34781/1 last seen on 15/08/2015

[31] Consumer body rejects Satyam shareholders' compensation plea, Economic Times, May 12, 2009, available at http://articles.economictimes.indiatimes.com/2009-05-12/news/27651532_1_retail-shareholders-satyam-scam-satyam-shareholders (last accessed on Sep 4, 2015)

[32] Midas Touch Investors Association v. M/S Satyam Computer Services Ltd. & Ors, Civil Appeal No. 4786 of 2009, in the Supreme Court of India, 10/08/2009

On the other hand, holders of American Depository Receipts (ADRs) listed on the NYSE were able to claim $125 million from the company[33]. In the case of In re Satyam Computer Services Ltd. Securities Litigation[34] a sum of $125 million was paid as settlement by Mahindra Satyam to United States investors who held ADRs as a result of the erstwhile promoters of the company admitting to a fraud. Tech Mahindra, which subsequently took over Satyam, was required to settle all pending litigations with several investors who had claimed losses due to the shares of the firm plunging on the stock exchanges[35].

Additionally, there was a substantial failure on the part of Satyam's auditors (Price Waterhouse Coopers India) to detect the fraud and manipulation of financial accounts[36]. Much like in the case of Enron and their auditors Arthur Andersen, auditors would accept the claims of their clients at face value without minimal checks due to immense competition between auditors to increase and retain market share and particularly, with high income clients[37]. Additionally, the fact that Satyam represented a significant revenue stream for PWC India may have created powerful incentives for PWC India's managers to give Satyam the accounting treatment it wanted[38]. There were fake customer identities, fake invoices which were created by the global head of the internal audit to inflate the revenue amount[39]. The fraud was also perpetrated by forging board resolutions and by obtaining loans using illegal means for the company; it went to an extent that the cash received from the American Depository Receipts were not even shown in the balance sheet[40]. The most troublesome aspect was that despite of being the auditors of Satyam from 2000 till 2009 (scam was exposed) they overlooked without any test or verification the flagrant amount of $ 1.04 billion (claimed by Satyam to be in its balance sheet in 'non-interest bearing' deposits)[41]. The fictitious sources of income created by Satyam was never even detected as fraud by the auditors and this

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[33] Samar Srivastava, *Class Action Suits Are Up Against Challenges***,** Forbes India (25/02/2013), available at- http://forbesindia.com/article/breakpoint/class-action-suits-are-up-against-challenges/34781/1 ,last seen on 15/08/2015

[34] 712 F.Supp.2d 1381 (2010)

[35]*Satyam Computers' United States investors have to pay about Rs 200 cr tax settlement: AAR*, The Economic Times (29/08/2012), available at http://articles.economictimes.indiatimes.com/2012-08-29/news/33476332_1_mahindra-satyam-lead-plaintiffs-satyam-computer-services , last seen on 20/08/2015

[36] *Reading the Satyam Scam* , 44 No.3 , Economic and Political Weekly 5, 5(2009), available at http://www.jstor.org/stable/40278394 , last seen on 5/03/2015

[37] Toffler, Barbara Ley, and Jennifer Reingold. Final accounting: Ambition, greed, and the fall of Arthur Andersen, Broadway Business, 2004, p 48

[38] *Supra* note 21 at p 6

[39] Madan Lal Bhasin, *Corporate Accounting Fraud: A Case Study of Satyam Computers Limited*, 2 Open Journal of Accounting 26, 30 (2013)

[40] *Ibid*

[41] *Id at* 31

conduct of PWC has raised questions as to whether it was complicit in this scam as Satyam paid it twice the amount than the other firms[42].

In spite of this, the auditors, expert advisors and other professionals engaged by Satyam were left largely untouched as they could not be held liable or accountable for financial misstatements in the books of accounts. Under the erstwhile Companies Act, 1956, auditors were engaged by companies and shareholders had no privity with the auditors. Consequently, no claim could be raised by Indian shareholders against the auditors of Satyam.

On the other hand, PWC was made a party to a class action suit by the ADR holders of Satyam. The arguments raised by PWC included that the appropriate forum to file class action suit was India raising much debate as to whether India was an appropriate forum for foreign investors[43]. There has been support for the argument that Order 1 Rule 8 of the Civil Procedure Code, 1908[44] which allows plaintiffs having identical interests to file a single representative suit. Under this provision, the Court is required to ensure that the interests of all class members is protected and the same review procedure that applies to individual law suit is applied. Therefore, it may be argued that this rule is wide enough to encompass the class action suit filed by the foreign investors of United States against Satyam[45].

While Indian shareholders and investors suffered due to lack of a provision on class action suits, the interests of their counterparts in United States were safeguarded by a settlement of $125 million from Satyam and $25.5 million from PwC[46]. The disparity with which Indian and American security holders of Satyam were dealt, renewed the interest of the Ministry of Corporate Affairs in

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[42] *Ibid*

[43] Subhro Sengupta & Siddharth Tiwari, *Satyam - Asatyam: Appreciating the Class Action provision in the Companies Act, 2013 and its impact on Investor Protection* 1, 3 in Selected Essays In Company Law, (Prof. Nishtha Jaiswal and Dr. Rajinder Kaur ed., 2015)

[44] Order 1 , Rule 8, The Code of Civil Procedure , 1908 provides adequate remedy to numerous parties to file a representative suit who will be served notice through public advertisement and the ensuing decree of the Court is binding

[45] In Re Satyam Computer Services, Ltd., Securities Litigation, No. 1:09-md-2027 (BSJ), Memorandum Of Law In Support Of Motion To Dismiss For Forum Non Conveniens, submitted before the United States District Court Southern District Of New York on November 9, 2009 on behalf of PricewaterhouseCoopers Private Limited, Price Waterhouse, and Lovelock & Lewes (Defendants), pg 6, available at http://amlawdaily.typepad.com/satyamforumnon.pdf (last accessed on Sep 4, 2015)

[46] Varottil, Umakanth, The Protection of Minority Investors and the Compensation of Their Losses: A Case Study of India (February 11, 2014). NUS - Centre for Law & Business Working Paper No. 14/01; NUS Law Working Paper No. 2014/001

class action suits. The inability of shareholders and creditors to place liability upon the auditors also found its way into Section 245.

IV. SECTION 245 – OVERVIEW AND ANALYSIS

Section 245 of the Companies Act, 2013 provides as follows:

(1) 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, namely:—

(a) to restrain the company from committing an act which is ultra vires the articles or memorandum of the company;

(b) to restrain the company from committing breach of any provision of the company's memorandum or articles;

(c) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;

(d) to restrain the company and its directors from acting on such resolution;

(e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;

(f) to restrain the company from taking action contrary to any resolution passed by the members;

(g) to claim damages or compensation or demand any other suitable action from or against—

(i) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;

(ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or

(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;

(h) to seek any other remedy as the Tribunal may deem fit.

(2) Where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

(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;

(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.

(4) In considering an application under sub-section (1), the Tribunal shall take into account, in particular—

(a) whether the member or depositor is acting in good faith in making the application for seeking an order;

(b) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a) to (f) of subsection (1);

(c) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;

(d) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;

(e) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—

(i) authorised by the company before it occurs; or

(ii) ratified by the company after it occurs;

(f) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

(5) If an application filed under sub-section (1) is admitted, then the Tribunal shall have regard to the following, namely:—

(a) public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed;

(b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side;

(c) two class action applications for the same cause of action shall not be allowed;

(d) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

(6) Any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company.

(7) Any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five lakh rupees but which may extend 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 which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

(8) Where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost, not exceeding one lakh rupees, as may be specified in the order.

(9) Nothing contained in this section shall apply to a banking company.

(10) Subject to the compliance of this section, an application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1).

We shall now proceed to analyze the individual aspects of Section 245.

a. Grounds upon which a class action suit may be filed-

The incorporation of Section 245 in the Companies Act, 2013 gives the member of company to initiate proceedings against the company on similar lines as of Section 241, dealing with oppression and mismanagement.

The grounds on which a member can file a suit of oppression and mismanagement under Section 241 of Companies Act, 2013 are that:

(a) the affairs of the company have been or are being conducted in manner which proves to be prejudicial to the public interest or to the interests of the company or oppressive to him or other shareholders; or

(b) there has been a material change in the management or control of the company by an alteration in the Board of Directors, or manager, or in the ownership of the shares of the company, or in any other manner which by which the affairs of the company will be conducted in a manner prejudicial to its interests or shareholders or class of shareholders.

The provisions of Section 241 correspond to Sections 397 and 398 of the erstwhile Companies Act, 1956. However, there is a slight modification in terms of their import into Section 245 of the 2013

Companies Act. A claim under Section 241 of the Companies Act, 2013 may be made after the prejudicial act has taken place against the members or the company.

On the other hand Section 245 provides three kinds of rights to shareholders and depositors as follows:

- To restrain the company or its board of directors;
- To declare a resolution of the company which altered the MoA or the AoA as void; and
- To claim compensation

While Section 241 does not provide for anticipatory suits for restraint, Section 245 does. A company or its board of directors may be restrained from:

- committing an act which is ultra vires or in breach of the articles or memorandum of the company or ;
- acting on a resolution passed by suppressing material facts, or by misleading the shareholders and creditors through a misstatement;
- committing an act which is contrary to the provisions of the Companies Act, 2013 or any other law for the time being in force;
- taking action contrary to any resolution passed by the members;

Additionally, Section 245 also provides a claim to set aside a resolution passed by the company which was obtained through suppression of material facts or obtained by misstatement. Finally, as a direct result of Satyam, the section also provides for compensation from directors, auditors and expert advisors for acts, omissions or conduct that are in nature or likely to be in nature of fraud, or are wrongful, unlawful.

According to Section 245(1)(g) of Companies Act, 2013, a class action suit may be filed against the company, directors, auditors, audit firm, any expert or advisor on the grounds that misleading statement was provided or that their conduct was fraudulent. However, the lack of privity of contract between applicant shareholders/ depositors and directors, auditors, audit firm, any expert or advisor raises certain issues. A contract exists as between the company and the directors, auditors, audit firm, any expert or advisor and not between the shareholders and such third parties. Therefore, it is clear that this right to file a class action suit is not limited by contract as far as the shareholder is concerned.

b. Eligibility to file a class action suit

Section 245(3)(i) of the Companies Act, 2013 provides for certain minimum requirements for shareholders to file a class action suit:

(a) In a company having a share capital, where not less than one hundred of its shareholders or not less than the prescribed percentage of the total number of its shareholders, whichever is lesser between them, or any shareholder or shareholders not holding less than the prescribed percentage of its issued share capital, provided that all the applicants have paid up their shares in full;

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

Section 245 (3) (ii) provides that the number of depositors shall not be less than one hundred or not less than the prescribed percentage of the total number of depositors, whichever is lesser between them, or any such depositor towards whom the company owes such prescribed percentage of total deposits.

However, it is important to note that as on the date of this paper, the Ministry of Corporate Affairs is yet to notify rules pertaining to class action suits. Rule 16.1 of the Draft Companies Rules 2013, provides that the shareholders of the company shall not be less than one hundred or not below ten percent of total number of the shareholders of such company, whichever is lesser between them, or shareholder or members who individually or jointly hold a minimum of ten percent of its issued share capital, provided that all the applicants have paid up their shares in full. Similarly, the depositors shall not be less than one hundred in number or a minimum of ten percent of the total of all the depositors, whichever is lesser between them, or depositors individually or jointly holding minimum of ten percent of its total outstanding deposits.

One of the most apparent lacuna which can be analysed from this provision is that only shareholders and deposit holders may file a class action suit. However, it completely excludes other stakeholders such as creditors and workmen. The recommendations of the Standing Committee on Finance in its 57th Report on the Companies Bill, 2011stated that: "*It has been felt that since creditors can enforce their claims through contracts/ agreements with borrow companies, they may not be given statutory right for class action. On the other hand since depositors do not have any contractual*

rights and are mainly of unsecured nature, they are being proposed to be empowered with right to file class action petitions before Tribunal.[47]"

Although the provision limits the eligibility to claim remedies under Section 245 to shareholders and depositors there seems to be some ambiguity as to the definition of a depositor. According to Section 31 of Companies Act, 2013 "deposit" includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India. While there is some clarity that the RBI does permit certain loans or advances to be treated as deposits. However, the issue of whether such a lender will nonetheless be considered a depositor remains open ended. An argument may be made that the exclusion from certain categories of amounts from the definition of 'deposits' permit a deviation from the provisions of as mentioned in Chapter IV (Acceptance of Deposits) but this does not disentitle the concerned lender from claiming remedies under Section 245 of Companies Act, 2013.

There also seems to be a typographical error in Section 245(1) which provides that "*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)…*" Section 245(2) provides that "*where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner*. Section 245(3) provides the requisite number of members, depositors required to initiate a class action suit. Therefore, it is not Section 245(2) but Section 245 (3) that enumerates the requisite number as mentioned in Section 245(1).

c. <u>Directions to the NCLT as to the treatment of class action suits</u>

The other clauses of the provision provide to restrain a company from acting ultra vires, or against resolutions or acting on resolutions passed on suppression of material facts or misrepresentation. But a careful reading of Section 245(1)(e) exhibits the wide powers granted to the National Company Law Tribunal that can oust the jurisdiction of the civil courts by creating an express bar on the same. Section 245(1)(e) provides that class action suits can arise in order to *restrain the*

[47] Standing Committee on Finance , Lok Sabha, *The Companies Bill, 2011*, *Fifty- seventh Report* , 2011-2012

company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force.

Section 245(4) also directs the NCLT to take into account certain circumstances surrounding the facts of the matter. The NCLT must establish that the applicant has approached the Tribunal under Section 245 in good faith and whether the cause of action actually warrants a class action suit or whether it could have been pursued by the applicant as an individual. The NCLT must take into account evidence of the involvement of persons other than directors or officers of the company in the cause of action as well as the views of the members or depositors of the company who have no direct or indirect personal interest in the matter. The NCLT must also consider the preponderance and likelihood of the matter in question being authorised or ratified by the company[48].

d. Procedure of a class action suit

The NCLT is required to take into account the procedure prescribed in section 245 (5), which lays down certain requisites to while filing a class action suit. Firstly, a public notice must be communicated to all the members of the class when the class action has been admitted, in such manner as prescribed. Rule 16.2 of the Draft Companies Rules 2013 provides for publication of the notice within seven days of the application being admitted by the Tribunal. Such publication shall at least once be in the principal vernacular language of a vernacular newspaper of the state in which the company's registered office is situated. Also, there shall be a publication at least once in the English language in an English newspaper which is in circulation in that state. It also prescribes that the notice be placed on the websites of the company, the NCLT, the MCA, the concerned Registrar of Companies as well as the stock exchange where the company is listed (if any).

The public notice must include the following information:

(i) name of the lead applicant;
(ii) brief particulars of the grounds of application;
(iii) relief sought by such application;
(iv) statement to the effect that application has been made by the requisite number of members/depositors;

[48] Varottil, Umakanth, The Protection of Minority Investors and the Compensation of Their Losses: A Case Study of India (February 11, 2014). NUS - Centre for Law & Business Working Paper No. 14/01; NUS Law Working Paper No. 2014/001

(v) statement to the effect that the application has been admitted by the Tribunal after considering the matters stated under sub-section (4) of section 245 and it is satisfied that the application may be admitted;

(vi) Informing other members or depositors that they can also join the applicant, if they so wish;

(vii) date and time of the hearing of the said application;

(viii) time within which any representation may be filed with the Tribunal on the application; and

(ix) such other particulars as the Tribunal thinks fit.

Interestingly, under the Draft Companies Rules, 2013, an application under Section 245 of the Companies Act, 2013 cannot be withdrawn without the leave of the Tribunal.

All similar applications which are filed in any other jurisdiction are required to be moulded into one application. The shareholders or depositors of the class should be given an opportunity to select a lead applicant. In case of a deadlock regarding the appointment of the lead applicant, where the shareholders or the depositors of the class are not able to reach a common consensus then the Tribunal shall have the power to appoint the same. The lead applicant shall act on behalf of the applicants and shall be responsible for the proceedings. It is noteworthy to mention that two class action suits having the same cause of action shall not be permitted

Further, any costs or expenses incurred due to the application of the class action suit shall be borne by the company or any such person responsible for the cause of action.

e. Penalties

The NCLT is also empowered to direct any company which fails to comply with an order passed under Section 245 to be punished with fine of between five lakh to twenty-five lakh rupees. Penalties are also extended to every officer of the company who is in default, to be imprisoned for a term of no longer than three years and with fine of between twenty-five thousand to one lakh rupees. It is interesting to note that no such penalty is provided under in the provisions for oppression and mismanagement of a company.

f. Other Miscellaneous Provisions

In a possible bid to curb unwarranted litigation, frivolous or vexatious applications under Section 245, as may be determined by the NCLT, shall be rejected and such applicants shall be liable to costs, subject to an upper limit of one lakh rupees. Since the terms 'depositors' include all manner of depositors, including retail customers of banking companies, the applicability of Section 245 does not extend to such banking companies. Further, provisions have been made for representative suits being instituted on behalf of affected shareholders and depositors. It is expected that shareholders rights associations and unions will play a significant role in the implementation of Section 245.

V. COMPARATIVE ANALYSIS WITH UNITED STATES RULES OF CIVIL PROCEDURE

Provisions relating to class action suits in the United States of America is embodied in Rule 23 of the Federal Rules of Civil Procedure, 1966 which provides plaintiffs with a means to cooperate and pursue claims collectively in situations where individual claims will be inappropriate or unsuitable. It also supplies a framework to safeguard the rights of all the parties involved.[49]

It stipulates the pre-requisite conditions or criteria that have to be complied with for the trial court to certify a class action.[50] There are four criteria that can be highlighted in this respect, *viz,* (i) the class members must be of a large number; (ii) the suit must involve a question of law or law which is common to the entire class; (iii) the claims of the representative of the class must be typical of the entire class and; (iv) the person who is representing the class must fairly and adequately protect the interests of the class.[51] However it must be noted that under Rule 23(c) (5), if the interests of some of the class members are different from each other, then the class may be further divided into sub-classes, where each sub-class has its own representative.[52]

A class action suit in United States requires certain rules to be followed before it is admitted as a class action. According to Rule 23(c), after the case is filed the court needs to determine whether the suit can be maintained as a class action, and this process is known as class certification. Some of the factors that the judge will look into before certifying a class action are, *viz,* (i) does the court

[49]Christophe Bernard and Sylvain Bourjade, Economic incentives in class actions: an analysis through the United States/EU examples, Global Competition Litigation Review 2013
[50] Ibid
[51] Janet Cooper Alexander, *An Introduction to Class Action Procedure in the United States Conference: Debates over Group Litigation in Comparative Perspective*, Pubs & Blogs Stanford Law School, available at http://law.duke.edu/grouplit/papers/classactionalexander.pdf last seen on 13/01/2015
[52] Ibid

find that there is a question of law or fact common to the members of the class which affects only individual member, (ii) will the individual be able to maintain his claim without the class certification, (iii) is class action superior to other available methods to achieve fair and efficient disposal of the matter, etc. The court is also required to approve any settlement the parties have agreed upon. These procedures often impose significant expenses on class members.

Prior to the Federal Rules of Civil Procedure being amended in 1966, Rule 23 was silent on the possibility of "opting-out" of a class action suit. However, with the new amendment it was made clear that plaintiffs in a class action suit would be permitted to "opt-out" or be excluded from the case.[53] In such a situation a claimant could file the petition on behalf of the other members without their permission and only those who come to know of the litigation would need to submit a form stating that they do not wish to participate in the proceedings.[54] In these cases, the Attorneys through little or no consultation have the power to act for a fairly large group of unseen clients or class members, but have the burden to bear the responsibility to represent in a fair and adequate manner.[55]

Hence it is seen that class actions are useful and important legal tools in United States, and when the individual damages claimed is too small to make it worth filing a suit, a class action helps in unifying the stake of the plaintiffs and making the litigation feasible.[56]

The wording of Rule 23 of the United States Rules does not fix a definitive number (100) as mentioned in Section 245 for filing a class action suit. The United States provision also provides that question of law or fact must essentially be common to the class; it explicitly mentions that the protection of class interest is of paramount importance. Rule 23 provides for injunctive and declaratory relief with respect to the class in detail. It also focuses on the control of the individual, various methods of efficient management of the class, convenience or inconvenience by concentrating litigation in one particular jurisdiction or forum.

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[53] Fed. R. Civ. P. 23(c)(2)(B)(v)
[54] *All American Airways, Inc. v. Elderd*, 209 F.2d 247, 249 (2d Cir. 1954)
[55]William W. Schwarzer, *Structuring Multiclaim Litigation: Should Rule 23 Be Revised?,* 94 No. 4 Michigan L Review 1250, 1250 (1996)
[56]Janet Cooper Alexander, *An Introduction to Class Action Procedure in the United States Conference: Debates over Group Litigation in Comparative Perspective*, Pubs & Blogs Stanford Law School, available at http://law.duke.edu/grouplit/papers/classactionalexander.pdf last seen on 13/01/2015

It is noteworthy to mention that section 245 of CA 2013 only provides for issuing a public notice as prescribed. The fact that individual notice must be given is completely absent which can create future hurdles. Individual importance cannot be undermined. The importance of notice plays a relevant role in determining the individual choice and autonomy which must not be discarded at any cost. In the cases which involve substantial harm to individuals even then viewing the class as the sole litigating party does not underestimate the value of individual notice be given to all those who can be easily identified with reasonable effort[57]. Rule 23 also talks about the possibility of subclasses and each subclass be treated as a class. Such mention is completely absent in Section 245

Under U.S. law, much like in India, the court must permit the class action i.e. the court certifies the same. After such certification the members of the class are given notice, and the opportunity to exclude themselves or opt out from the proceedings[58]. Thus, those who opt out will not be bound by the judgement[59]. In order to prevent any abuse of class action suits based on securities laws the United States Congress has passed two statutes known as Private Securities Litigation Reform Act of 1995, and the Securities Litigation Uniform Standards Act, passed in 1998. There is also existence of Class Action Fairness Act, 2005 in order to address and correct certain abuses of class action without adversely affecting the positive role that class actions is exhibiting[60]. The absence of an opt-out clause in Section 245 is conspicuous and opens up possibilities for coordination failure.

In India, SEBI has taken the initiative to introduce a regulatory procedure for class action suits i.e. according to Regulation 5 (2) of SEBI (Investor Protection and Education Fund) Regulations, 2009 provides that Investor Protection and Education Fund created by SEBI may, inter alia, be used for aiding investors' associations recognized by SEBI to undertake legal proceedings (not exceeding seventy five per cent. of the total expenditure on legal proceedings) in the interest of investors in securities[61]. However, this regulation is beset with its own set of problems like what kinds of class action suit will fall within this category, what will be the basis to determine and ascertain the

[57] *Ibid*
[58] *Class Action*, Tech Law Journal, available at http://www.techlawjournal.com/glossary/legal/classaction.htm, last seen on 5/04/2015
[59] *Ibid*
[60] *Class Action*, Tech Law Journal, available at http://www.techlawjournal.com/glossary/legal/classaction.htm, last seen on 5/04/2015
[61] *Consultative Paper On Review Of Corporate Governance Norms In India*, Securities and Exchange Board of India, available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1357290354602.pdf, last seen 18/06/2015

amount for vast number of class action suits, what will be the basis to determine fees of the attorney etc.

VI. CONCLUSION

While the foray of the Indian legislature in providing class action relief to shareholders and depositors is well-lauded, the provisions of Section 245 are not without lacunae. This concluding section offers some suggestions as to the future of the class action suit law in India.

To begin with, the wording of the section includes the terms 'as may be prescribed', five times. Given the considerable levels of delegated legislative responsibility bestowed upon the Ministry of Corporate Affairs, the notification of the relevant rules of the Draft Companies Rules, 2013 becomes somewhat urgent. While the procedural basis for class action suits exist in Order 1 Rule 8 of the Code of Civil Procedure, 1908[62], it must be noted that the provisions of the CPC are generic and need not specifically apply to class action suits against companies. Further, under Order 1 Rule 8, the permission of the court is required prior to instituting a suit arising out of the same cause of action, by separate parties.

The Draft Companies Rules, 2013 in its present form provide only for the minimum number of shareholders or depositors and the publication of the notice. Other important aspects as to the timelines for the determination of the suit, division of claims, opt-out provisions, engagement of experts and counsel, etc could be considered before notification of rules pertaining to class action suits.

Another glaring oversight that seems to dilute the provisions of Section 245 is the omission of creditors from the list of eligible claimants. While it is true that companies do have contractual obligations towards creditors, the same could be said of depositors and shareholders as well. The provisions of Section 245 simply ensure a straightforward remedy to a set of aggrieved stakeholders of a company. To oust creditors from that set of stakeholders would be unjust and detrimental to them.

[62] One person may sue or defend on behalf of all in same interest

While shareholder derivative actions are rare in India[63], the proper application of Section 245 may somewhat alleviate that situation. Delays in the Indian judicial system, high costs of bringing civil suits, and the prohibition on success-based fees which typically motivate counsels for the plaintiff all lead to the minimal utilization of shareholder derivative suits in the Indian context. However, it is unclear as to whether Section 245 would address derivative actions as well[64].

Class action suits are a relatively new phenomenon in India and it will be interesting to see how the Indian parliament and the Ministry of Corporate Affairs further refine and improve the provisions of Section 245. Equally interesting will be the treatment of the provisions by the judiciary.

[63] Vikramaditya Khanna & Umakanth Varottil, The Rarity Of Derivative Actions In India: Reasons And Consequences, in Dan. W. Puchniak, Harald Baum & Michael Ewing-Chow, The Derivative Action in Asia: A Comparative and Functional Approach (2012), at 380

[64] http://indiacorplaw.blogspot.in/2014/12/derivative-action-for-patent.html