Class Action Suits

Companies Act, 2013

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Section 245 of the Companies Act, 2013

Class Action. [Notified on 01.06.2016] — (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.

Introduction of Class Action Suit in India

- During the 'Satyam Scandal', Satyam Computer Services Limited or SCSL faced serious fraud charges. In its aftermath the (minor) shareholders of SCSL failed to claim damages due to absence of any class or group action mechanism in India under the Companies Act, 1956.
- Thus, the government decided to introduce class action suits in India in line with the United States and other progressive nations in order to secure the interest of the public at large (especially minor share holders). The rationale given was that individual claims amount to meager sums but class action would help pool resources as well as reduce pendency of suits.
- Section 245 and 246 of the Companies Act, 2013 (**'Act'**) specifically deals with the class action suits. These provisions permit members and depositors to approach the National Company Law Tribunal (**'NCLT'**) if they believe that the affairs of the company are being conducted in a manner detrimental to the interest of the company and its shareholders.

What is a Class Action Suit?

- A class action, a class suit, or a representative action is a form of lawsuit in which a large group of people collectively bring a claim to court and/ or in which a group of defendants is being sued.
- Class action suits have several advantages, essentially the economics of aggregation. Furthermore, class action suits minimize litigation by avoiding multiple suits. The amount of compensation being claimed by each claimant maybe too small to warrant individual pursuit.
- This concept originated in the US in 1938 when the Federal Rules of Civil Procedure were amended to accommodate representative suits. Though it is to be noted that early iterations like group litigation existed in the UK and elsewhere.
- Section 245 widens the scope of the concept of "Prevention of oppression and mismanagement" under the Act by providing a right to file class action suit.

Who Can File Class Action Suit?

Section 245 has been included in Chapter XVI Prevention of Oppression and Mismanagement of the Act. As per sub-section (3) of Section 245 of the Act, when the prescribed threshold is met then a class action suit can be instituted.

The requisite number of members or depositors as per Section 245(3) and MCA Notification dated May 8, 2019 are -

Notified Threshold:	**Requisite No. of Members/ Depositors**	**Percentage of Members/ Depositors**	**Percentage of Shareholding/ Deposits owned.**
Members (in case of a company having share capital)	100	5%	2% for a listed company. 5% for an unlisted company.
Depositors	100	5%	5%

Invoking Class Action and Liability Therein

Sub-section (2) of section 245 of the Act states that:

- where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, in such matter, a class action can be brought upon satisfaction of prerequisites of sub-section 3 of section 245.

- the liability lies on 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.

Application Before the Tribunal

Rule 84 of the NCLT Rules lists out the requisites for filing application under Section 245:

- An application under sub-section (1) of section 245, read with sub-section (3) of section 245 of the Act, shall be filled in Form NCLT-9.

- Furthermore, a copy of every application under sub-rule (1) is to be served on the company, other respondents and all such persons as the Tribunal directs.

- This application process may commence when the requisite threshold given under sub-section (3) of section 245 is satisfied.

Admission of a Class Action Suit

I. General requirements while considering application before NCLT:

The general requirements listed below arise out of sub-section (4) of section 245. These are:

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

b) any evidence 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 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.

II. Requisites outside the Act:

Sub-rule (1) of rule 85 of the NCLT Rules gives further grounds for evaluating admissibility of application:

(a) whether the class has so many members that joining them individually would be impractical, making a class action desirable;

(b) whether there are questions of law or fact common to the class;

(c) whether the claims or defences of the representative parties are typical of the claims or defences of the class;

(d) whether the representative parties will fairly and adequately protect the interests of the class.

III. Desirability over individual or separate action:

Sub-rule (2) of rule 85 of the NCLT Rules further exemplifies grounds for the purposes of clause (c) of sub-section (4) of section 245 while considering the desirability of an individual or separate action as opposed to a class action.

The Tribunal takes into account, in particular, whether admitting separate actions by member or members or depositor or depositors would create a risk of :

a) inconsistent or varying adjudications in such separate actions; or

b) adjudications that, as a practical matter, would be dispositive of the interests of the other members;

c) adjudications which would substantially impair or impede the ability of other members of the class to protect their interests.

Conduct after Admission of Application

Sub-section (5) of section 245 lists out that the Tribunal observes or orders the following :

a) public notice to 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 to be consolidated into a single application and the class members or depositors to 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 has the power to appoint a lead applicant, who is in charge of the proceedings from the applicant's side;

c) two class action applications for the same cause of action are not allowed;

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

Opt-Out Mechanism

Rule 86 of NCLT rules provides for opt-out mechanism if a 'member of class' wishes to withdraw from it.

1) A member of a class action under section 245 of the Act is entitled to opt-out of the proceedings at any time after the institution of the class action, with the permission of the Tribunal, as per Form No. NCLT-1.

2) Here, a 'member of class' is someone who receives a notice under clause (a) of sub section (5) of section 245 of the Act, and such person remains class member unless he expressly opts out of the proceedings, as per the requirements of the notice issued by the Tribunal in accordance with rule 38.

3) A class member opting out is not precluded from pursuing a claim against the company on an individual basis under any other law, where a remedy may be available, subject to any conditions imposed by the Tribunal.

Binding Nature and Penalties

I. Binding nature of order

Sub-section (6) of section 245 expressly states that any order passed by the Tribunal is 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.

II. Penalty for failure to comply

Further, sub-section (7) of section 245 provides that any company which fails to comply with an order passed by the Tribunal under section 245 is punishable with fine which is not less than Rs. 5,00,000/- but may extend to Rs. 25,00,000/- and every officer of the company who is in default is punishable with imprisonment for a term which may extend to three years and with fine which not less than Rs. 25,000/- but which may extend to Rs. 1,00,000/-.

III. Penalty for trivial petitions

Sub-section (8) of section 245 says that where any application filed before the Tribunal is found to be frivolous or vexatious, after it is recorded in writing to be so, the tribunal will reject the application and make an order that the applicant has pay to the opposite party such cost, not exceeding Rs. 1,00,000/-.

Remedies Available

Section 245 (1) lists the following remedies :

a) Restrain the company from acting *ultra vires* (beyond one's legal power or authority) to articles or memorandum of the company.

b) Restrain the company from committing a breach of any provisions of the articles or memorandum of the company.

c) Declare resolution altering the memorandum or articles of the company as void because it was done by suppressing the facts and misleading the members or depositors.

d) Restrain the directors of the company from acting on such falsely obtained alteration.

e) Restrain the company from acting against the provisions of the law in force.

f) Restrain the company from taking action against the resolution passed by the members.

g) Claim damages or compensation from or against

1. The company or its directors for a fraudulent, unlawful or wrongful act or omission or order
2. The auditor including his audit firm for furnishing improper and misleading financial statements for the commission of fraudulent, unlawful or wrongful activity in relation to the company
3. The expert or advisor or consultant for giving incorrect or misleading statements to the company for doing any fraudulent or unlawful or wrongful activity

h) Seek any other remedy as the Tribunal deems fit.

Applicability of General Provisions of the Companies Act

Section 246 provides that provisions of Section 337 to 341 shall apply, mutatis - mutandis, in relation to an application made to the Tribunal under Section 241 or Section 245. These provisions are:

- Section 337: Penalty for frauds by officers;
- Section 338: Where improper accounts are kept;
- Section 339: Liability for fraudulent conduct of business;
- Section 340: Power of Tribunal to assess damages against delinquent directors, etc;
- Section 341: Liability under Sections 339 and 340 to extend to partners or directors in firms or companies

Conclusion

- Now that the threshold has been notified, the law permits shareholders to file class action lawsuits against companies allowing minority shareholders and investors to seek remedies such as restraining the company from committing acts which either violate or which are *ultra vires* of the charter documents; restraining companies from committing acts contrary to the Act; claiming damages 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 and other such remedy as the tribunal sees fit.

- This redressal mechanism protects interests of small and minority shareholders. It provides them with a powerful tool to keep companies in check. The end result is that companies and their external auditors, advisors and consultants act more diligently in their activities. Although any substantial utilization of this mechanism is still to be seen but it is likely to have a positive impact on investor confidence.