Chapter VII

Class Action Suit

7.1 Introduction

This Chapter explores the feasibility of Class Action mechanism provided in the Companies Act, 2013 as an effective tool for the protection of retail investors. While discussing the various remedies available to minority shareholders under the Companies Act, 2013, the focus of this chapter is to explore the viability of class action in protecting retail investors against securities fraud by drawing comparisons with the US Securities Class action framework.

7.2 Lack of shareholder activism:

Lack of activism especially among retail investors is the inherent weakness in the Indian corporate governance framework. Conceptually even though shareholders are the ultimate owners of the company, yet they are unable to exercise control unless they hold majority shares. Ownership structure in the case of majority companies in India, including listed entities, is predominantly family managed and promoter controlled. This closed ownership structure of the corporate firms’ leaves the power in the hands of controlling insider’s. While Investors have been given many rights by virtue of their contract of membership, Retail investors in view of their small holdings, limited knowledge and dispersed presence, remain passive owners. Although they have a proprietary right to disagree with the decisions of the management by voting against the resolutions in the corporate meetings, they prefer to ‘vote with their feet’ and exit the company, by selling their shares, rather than contest the decisions of the controlling shareholders.

It is necessary to discuss the distinction between small shareholders and minority shareholders. While small shareholders are ascertained with respect to their individual shareholding, minority shareholding is collectively determined. Shareholders, who have a

\[ \text{References} \]


268 Jayati Sarkar, ‘Ownership and Governance structure in Indian Firms’

Available at http://www.nseindia.com/research/dynaContent/CG_9.pdf last accessed on 09.03.2014

269 Id note 1
non controlling interest in a company in contrast to controlling shareholders, are to be considered as a minority\(^\text{270}\). The term ‘minority shareholder’ is therefore broad as it includes Small/retail shareholders and in certain cases institutional investors.

### 7.3 Regulatory developments to garner more shareholder participation:

Shareholders enjoy rights which are individual as well as collective. A member of a company limited by shares and holding equity share capital has a right to vote on every resolution placed before the company\(^\text{271}\). For wider participation of dispersed shareholders, recent regulatory reforms in India have provided for alternative methods of voting on matters affecting the interests of shareholders by way of a postal ballot or through electronic means\(^\text{272}\). SEBI amended the listing agreement mandating top 500 listed entities to provide e-voting facility to its shareholders in respect of those businesses transacted through postal ballot\(^\text{273}\). While it remains to be seen to what extent the e-voting facility would garner more shareholder participation, postal ballot mechanism has however not given the desired results owing to its limitations\(^\text{274}\).

The representation of the small shareholder’s interest through an elected representative on the board, as envisaged by the policy makers, through the Appointment of small shareholder’s director Rules, 2001 under the erstwhile Companies Act, 1956 has also remained ineffective\(^\text{275}\). The Companies Act 2013 has limited its applicability to listed companies\(^\text{276}\).

\(^{270}\) For the purpose of the Section 241 of the Companies Act, 2013, minority shareholding have been set as shareholders holding 10% of the shares or a minimum of hundred shareholders, whichever is less in case of companies with share capital; and one-fifth of the total number of its members in case of companies without share capital

\(^{271}\)Section 47 of the Companies Act, 2013

\(^{272}\) Section 110 of the Companies Act, 2013; corresponding section 192 A of the Companies Act, 1956 gives the power to the central government to declare the items of business that can be transacted only through postal ballot

\(^{273}\) SEBI vide Circular no.CIR/CFD/DIL/6/2012 dated 13th July, 2012


\(^{275}\) Jaleel Kishore Tania, ‘As a small shareholder your path to the Company’s Board is blocked” The Business Standard dated 21st August, 2012.

\(^{276}\) Section 151 of the Companies Act, 2013 provides for the appointment of Small shareholder’s director in case of listed companies as against Section 252 of the Companies Act,1956 which limited it to public companies having paid up capital of Rs 5 crore or more or 1000 small shareholders.
and the draft rules issued by MCA stipulate that such a company may suo moto or on a notice by a minimum of 500 or one tenth of small shareholders, elect a small shareholder and such small shareholder can be considered as an independent director.

7.4 Rule of the Majority:

The general principle of Company law is that every member holds equal rights with other members in the same class and any differences amongst the members is decided by a vote of the majority. This supremacy of majority shareholders was upheld in the case of Foss V. Harbottle\(^\text{277}\). It is now a well established rule that, in case of injury suffered by a company, the remedy can be sought by the company itself in the capacity of being the plaintiff.

Protection to minority shareholders is generally not available when the majority does anything in exercise of the powers for the internal administration of the company. This rule, also reiterated in the case of Burland V. Eagle\(^\text{278}\) and Pavildes V. Jemsen,\(^\text{279}\) preserves the right of majority to decide. The Honourable Supreme Court in the case of Rajahmundry Electric Supply Co V. Nageshwara Rao\(^\text{280}\) observed that

\begin{quote}
The courts will not in general interfere, at the instance of the shareholders, in the matters of internal administration and the management of the company by its directors so long as they are acting within the powers conferred on them under the articles of the company. Moreover, if the directors are supported by majority shareholders in what they do, the minority shareholders can, in general do nothing about it.
\end{quote}

While this principle of non interference by the courts in matters of internal administration of the company has been accepted, a contrary view\(^\text{281}\) has also been taken contesting that, the absolute application of this rationale in the Indian context would not be desirable considering that Indian companies do not involve a large number of small individual investors but have financial institutions funding 80% of the finance though they hold only a small percentage of

\begin{itemize}
\item \(^{277}\) Foss V. Harbottle 67 E.R.189;(1843)2 Hare 461
\item \(^{278}\) Burland V. Earle, (1920) A.C 83
\item \(^{279}\) Pavildes V. Jensen (1956) Ch. 565
\item \(^{280}\) Rajahmundry Electric Supply Co V. Nageshwara Rao AIR1956 SC 213
\item \(^{281}\) Delhi High court in the case of ICICI v.Parasrampuria Ltd,  SSL July 5, 1998
\end{itemize}
shares. Hence it was held that excluding them or rendering them voice less by applying the principle of non interference would be unfair and unjust.

The argument that flows from this judgment is that rule is not absolute but subject to certain exceptions. Recognizing the need to protect minority shareholders against the possible expropriation by the controlling majority, certain safeguards have been provided in the common law and under the erstwhile Companies Act, 1956. These include protection to the minority shareholders under Ultra vires acts, Fraud on minority, wrongdoers in control, Breach of duty and instances of oppression and mismanagement.

7.5 Remedies to Minority shareholders: personal actions

Shareholder remedies can be sought either through personal actions or derivative actions. Personal actions are available to minority shareholders on the grounds of Oppression and Mismanagement wherein the requisite number of shareholders may apply to the National Company Law Tribunal (herein after referred to as NCLT).

Greater protection to minority shareholders is now provided against oppression and mismanagement under section 242 wherein NCLT is empowered to pass orders for the removal of the Managing Director, Manager and Directors of the company, restricting transfer and allotment of shares and for the first time statutorily providing for the recovery of undue gains made by any Managing Director, Manager or Director during the period of his appointment. The money so recovered can either to repaid to identifiable victims or credited to the Investor Education and Protection Fund.

This additional power of NCLT to disgorge the undue gains from the persons in control of the company and repayment to identifiable victims is intended to provide compensation to investors against losses, which was hitherto lacking.

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282 Under section 241 of the Companies Act, 2013; Corresponding sections 397 &398 under the Companies Act, 1956 have been combined under sec 241 of the Companies Act, 2013 and relief sought under Oppression and mismanagement shall be sought through the Tribunal.

283 Under section 244, in case of a company having a share capital, not less than 100 members or not less than 1/10 th of the total members or members holding not less than 1/10 th of the issues share capital.

284 Constituted under section 408 of the Companies Act, 2013; Under the Companies Act, 1956 relief was sought by applying to Company Law Board under section 10FB, 10FC.

285 Sec 242(2)(d) of the Companies Act, 2013

286 Sec 242(2)(i)of the Companies Act, 2013

287 Provided under section 125 of the Companies Act, 2013.
7.6 Derivative actions:

Derivative actions are considered as important weapons of accountability and corporate governance in the field of corporate litigation. Such actions are resorted to by the shareholders on behalf of the company in respect of the loss caused to the company in instances where the directors have breached their duty and the Board does not initiate legal action against them.

While derivative actions are not statutorily provided by law in India, yet the courts have allowed such remedies to check any unfair, influential, malafide actions by persons in control of the company. Derivative actions have been considered desirable in ownership structures which are characterised by dispersed shareholders, high cost of litigation and weak financial markets. However derivative actions in India have been very few considering adjudication delays, costs and collective action problems and have remained ineffective in the redressal of grievances of minority shareholders.

7.7 Class action suit:

In addition to the existing remedies available to minority shareholders through personal actions and derivative actions, representative actions by a class of members may also be exercised to check the any acts of oppression by the people in control of the company.

The Class action suit is essentially a representative law suit that seeks to combine people seeking remedies for the same cause of action to jointly bring an action in the court against defenders in contrast to a conventional law suit where the plaintiff represents himself. While in case of a derivative action suit where the benefits go the company, in case of class action the plaintiff’s are the beneficiaries. The effectiveness of class action as a powerful device to

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290 The Bombay High Court in the case of Victor Fernandes and Ors V. Raghav Bahl of Noida &Ors Appeal No.442 of 2008
291 Supra note 29 at p 370
292 Supra note 29 at p 380
protect investors has been argued on the grounds that in ‘a large number of cases where a large number of individuals have a common claim, fragmented and meritorious claims will neither be litigated because of the imperfections of the legal systems nor tackled by the regulatory systems’.\textsuperscript{293} In such cases, collective action consolidating such small claims appears feasible.

7.8 Class Action: the position in the US:

While Class actions are an important aspect of the continuing debate on corporate governance in the U.K, the US, Australia and many other jurisdictions worldwide, this form of group litigation originated in the US in the mid-19\textsuperscript{th} century\textsuperscript{294}.

Class action suits by representative parties are permitted under the US Federal rules\textsuperscript{295} when, (1) the class is so numerous and the joinder of all members is not practicable, (2) the questions of law or fact are common to the class, (3) the claims or defences of the representative parties are typical of the claims or defences of the class and (4) the representative parties will fairly and adequately protect the interests of the class.

Class action is a well defined area of litigation in the US and it can be broadly classified into Securities class action, Consumer class action and Employee class action. The Securities class actions are predominantly instituted by shareholders against violations of Section 11 of the Securities Act, 1933 dealing with liability for misstatements in the registration statement\textsuperscript{296} and Rule 10b-5 of the Securities Exchange Commission Act, 1935 which pertains to fraud in connection with sale and purchase of Securities both in primary and secondary market.

During the period 1980 to 1990, many securities class actions have been filed by investors in the US prompting the enactment of the Private Securities Litigation Reform (PSLR) Act, 1995 to check the rapid escalation of Securities Fraud class actions and discourage non

\textsuperscript{293} Jürgen G. Backhaus et al(Ed) ‘THE LAW AND ECONOMICS OF CLASS ACTIONS IN EUROPE: LESSONS FROM AMERICA,(2011)
\textsuperscript{294} Hensler, Debrah R.,Nicholas M.Pace, Bonnie Dombey- Moore, Elizabeth Giddens, Jennier Gorss and Erik Moller, “Class action Dilemas: Pursuing public goals for private gain” 969, ICJ(2000)
\textsuperscript{295} Rule 23(a) of the US Federal Rules of Civil procedure provide
\textsuperscript{296} The Registration Statement is the equivalent to the Prospectus filed at the time of public issue of securities
meritorious class action filings\textsuperscript{297}. While the enactment of the PSLR Act, 1995 was intended to check the swift filings of class action, empirical evidence however indicates that, the enactment of the PSLR Act, 1995 improved the quality of the filings. There has been no net reduction in the number of cases filed, indicating the possibility of either an increased fraudulent activity in the market or a better strategy by plaintiff attorneys in detecting fraud\textsuperscript{298}. Class actions in the US are also fuelled by support from the plaintiff lawyers who initiate the suit and are rewarded based on the outcome of the case by way of fees called as ‘Contingency Fees’. Hence the zeal to pursue a class action suit comes more from the plaintiff lawyers than from the class themselves.

7.9 Class action against IPO irregularities- the US experience:

Under Section 11 of the Securities Act, 1933 of the US, if the investors who have invested in an IPO feel that they have made an investment decision based on misleading and false information, they may sue the firm, the underwriter or any person who signed the Registration statement. These suits which are in the nature of class action law suits, donot require the plaintiffs to prove that they have relied on the misleading and deceitful information in the registration statement. This makes it easier for investors to file suits under section 11\textsuperscript{299}. Damages in such cases are limited to the loss of investment as determined by the fall in the value of the securities as compared to the issue price.

The proliferation of the class action law suits in the US against the irregularities in the IPOs can be inferred from the Securities Class action Clearing House report\textsuperscript{300} which states that 1,915 Class action law suits were filed during the period 1996 through 2003 in the US and


\textsuperscript{299}Stanford University, ‘The determinants of IPO-Related shareholder litigation: The Role of CEO Equity Incentives and Corporate governance’; Also Noam Sher, ‘Underwriters civil liability for IPOs-An Economic analysis Available at http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=1195&context=jil last accessed on 24.03.2014

\textsuperscript{300}http://www.securities.stanford.edu last accessed on 21.03.2014
The majority of the law suits pertained to IPO irregularities involving Underwriters with respect to overpricing and misallocations in the allotment process. Another study conducted by the Stanford Law School and Cornerstone Research (2013) found that while the percentage of class action filings under Section 11 declined with the reduction in the IPO activity between the period 2009-2013, the filings under Rule 10b-5 increased and were highest in the year 2013.

Class actions was initiated against the Promoters of Facebook Inc. that launched its IPO in the year 2012, when shares of the company fell on listing eroding the wealth of thousands of shareholders. Class actions were filed against its promoters and underwriters on the grounds of sharing inside information regarding the overvaluation of the stock price to select clientele to help them exit before offloading shares to the unsuspecting public.

Securities Class action suits against Issuers for overpricing, misleading information and fall in the price of the stock consequent to listing are a regular phenomenon in the US. Empirical evidence suggests that IPOs in the US are underpriced as a form of insurance against future litigation costs arising from class actions. A study conducted to examine the link between litigation risk and under pricing of IPOs across 34 countries using a sample of 6,326 IPOs between 1995-2002 concludes that Issuers in the countries possessing higher litigation risk underprice their IPOs more in order to avoid future legal liability.

The absence of class action mechanism to redress the grievances of investors in securities fraud in India was emphasized when retail shareholders of Satyam Computer Services Ltd lost wealth due to the revelations of the accounting fraud and the consequent fall in the prices of Satyam shares quoted on the NSE and the BSE. In contrast, the holders of the American Depository Receipts (ADR) of Satyam listed on the NASDAQ sought relief through class

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301 Unlike in India where retail and individual investors directly buy the shares from the issuer, in the US the Issue is initially taken up by Underwriters who in turn offer it to retail and other investors.
306 Herein after referred to as Satyam
actions law suits against Satyam and the Managing Director on the grounds of misleading financial information and the consequent loss to the depository receipt holders resulting from the fall in the value of their holdings. Claims were also filed against the auditors for reckless disregard of the multiyear accounting fraud by the management and Satyam agreed to pay USD 125 million and the auditors, USD 25.5 million towards fulfillment of the settlement claim\(^\text{307}\).

7.10 Class action under the Companies Act, 2013:

The JJ Irani Committee has in its report on the Company Law\(^\text{308}\) stated that

“In case of fraud on the minority by wrongdoers who are in control and prevent t 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 are brought out by shareholders on behalf of the company and not in their personal capacity (ies), in respect of the wrong done to the company. Similarly the principles 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 some locus standi. Though these principles have been upheld by courts on many occasions, these are yet to be reflected in law. The Committee expresses the need for recognition of these principles”.

Based on these recommendations, the Companies Act 2013, while bringing in many provisions enhancing the protection of minority shareholders also made way for the inclusion of class action under Section 245 of the Companies Act, 2013\(^\text{309}\) for the protection of small investors through a legal basis.

7.11 Collective actions recognized the under Indian Laws

While the concept of class action, as ‘sui generis’ area of litigation, has been recognized for the first time in the Companies Act, 2013, representative and collective actions by a group of claimants have been allowed under various substantive and procedural laws in the Indian

\(^{307}\) Mahindra Satyam agrees to settle Class action suit’ The Hindu dated 17th February, 2011 available at http://www.thehindu.com/business/mahindra-satyam-agrees-to-settle-class-action-suit/article1464576.ece last accessed on 25.03.2014 ; herein after referred to as ‘Satyam’


\(^{309}\) in Chapter XVI under Prevention of Oppression and mismanagement
Jurisprudence. Some of the laws which make a reference to representative actions are discussed below:

7.11.1 Under the Consumer Protection Act, 1986

Sec 12(1) of the Consumer Protection Act, 1986 provides that a compliant in relation to any goods sold or delivered or agreed to be sold or delivered, services provided or agreed to be provided, may be filed with the district forum by:

- Any recognized consumer association whether the consumer to whom the goods sold or delivered or agreed to be sold or delivered, services provided or agreed to be provided is a member of such association or not;  
- One or more consumers, where there are numerous consumers having the same interest, with the permission of the District Forum, on behalf of, or for the benefit of all consumers so interested.

7.11.2 Representative action under Civil Procedure Code, 1908

Representative actions have been allowed under Civil procedural laws in India where several persons being affected parties have interests in a common suit. Such suits may be filed or defended with the sanction of the court by a single person for the benefit of all persons so represented.

7.11.3 Public Interest Litigation:

Under Article 226 of the Constitution of India, representative action by way of Public interest litigation (PIL) has been allowed for the enforcement of constitutional and legal rights. PIL, as a representative action, grew in India out of the broad powers of judicial review granted to the Supreme Court and has become an important instrument of social reform. It was held by the Supreme Court in the case of **S.P Gupta V. Union of India** that PIL may be filed by a person or group of persons having sufficient interest for public injury even though they have no locus standi.

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310 Sec 12(1)(b) of the Consumer Protection Act, 1986.
311 Sec 12(1)(c) of the Consumer Protection Act, 1986
312 in the Indian Civil Procedure Code, 1908 under Order-1, Rule-8
313 S.P Gupta V Union of India AIR[1982] SCR 365
While collective actions have been allowed to redress grievances of persons against violations of contractual, personal rights or social rights, yet they have not been effective in cases of securities law violations. The plea of an investor association\(^\text{314}\), modeled on the class action suit prevalent in the US, seeking compensation of Rs 4987.5 crore on behalf of three lakh retail shareholders of Satyam Computer Services Ltd with respect to its accounting fraud and the resultant fall in the price of the shares was dismissed by the National Consumers Disputes Redressal Commission (NCDRC) and also by the Supreme court on an appeal, on the grounds that the Commission does not have the necessary infrastructure to deal with such kind of petition and the matter was already taken up by the CBI.

### 7.12 Legal framework for Class action:

Section 245 of the Companies Act, 2013 provides that:

\(^{(1)}\) “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 remedies:

(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 of the provisions of the company’s memorandum or articles.

(c) To declare a resolution altering the memorandum as void if the resolution was passed by the suppression of material facts or obtained by misstatement to the members or depositors;

(d) To restrain the company from acting on such resolutions

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

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

\(^{314}\) Midas Touch Investor Association V. M/s Satyam Computer Services Ltd\& Ors Civil Appeal No. 4786 of 2009 in the Supreme Court of India

*Also letter to shareholders* [http://www.mtia.in/letter.htm](http://www.mtia.in/letter.htm) last accessed on 20.03.2014
(g) To claim damages or compensation or demand or demand any other suitable action from or against –

i. The Company or its directors for any fraudulent, unlawful 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 misleading statement of particulars made in his audit report or for any fraudulent, unlawful 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 and 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”

Further sec 245(3) provides that

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

   a) In case of a company having share capital not less than one hundred members of the company or not less 10 percent\textsuperscript{315} 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 issued 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 case of a company not having a share capital, not less than one-fifth of the total number of its members

Section 245(4) provides that while considering an application, the tribunal shall take into account:

\textsuperscript{315} The Draft rules on the Companies Act, 2013 set out in Chapter XVI Rule 16.1 have prescribed 10% of the total number of members of the Company as the requisite number for the purpose of this section.
a) Whether the member/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 the directors and the officers of the company on any matter provided in clauses (a) to (f) of subsection 1

c) Whether the cause of action is one which the member or the depositor could pursue in his own right rather than as 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 whether 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 cause of action could be or in the circumstances likely to be –
   1. Authorized by the company before it occurs
   2. Ratified by the company after it occurs

f) Where the cause of action is an act or omission already occurred whether the cause of action could be or in the circumstances likely to be ratified by the company”

7.12.1 Procedure for class action as set out in Section 245(5) provides that:

The essence of class action is participation of all affected parties in a single rejoinder to avoid multiplicity of litigation. For this purpose, a public notice is issued to all the members of a class by the Tribunal on admittance of an application for class action. A lead applicant can be chosen by the members of the class suo moto, failing which the tribunal appoints the lead applicant representing the members. The cost or expenses is to be defrayed by the company or any other person responsible for any oppressive act.

7.12.2 Class action for misstatement in the prospectus:

Civil liability for misstatements in the Prospectus has been provided under Section 62 of the erstwhile Companies Act, 1956 similar to Section 11 under the Securities Act, 1933 of the US. However while prosecutions have been filed against companies which issued misstatements in the prospectus by the regulators and the DCA, private litigation on the part of retail and small investors has been limited considering the costs and adjudication delays.
Section 37 of the Companies Act, 2013 now provides for collective actions by a group of persons or associations under section 34, sections 35 and section 36 of the Companies Act, 2013. Section 37 provides that

‘A suit may be filed or any other action may be taken under Section 34 or Section 35 or Section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.’

7.12.3 Criminal Liability for misstatement in the Prospectus:

Sec 34 of the Companies Act, 2013 provides that

Where a prospectus, issued, circulated or distributed under this chapter, includes any statement which is untrue or misleading in the form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of the prospectus shall be liable under Sec 447

Civil liability for misstatement in the prospectus:

Section 35 of the Companies Act, 2013 provides that

Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who is mentioned therein under clause (a) to (e) shall be liable to pay compensation to every person who has sustained such loss or damage.

Within the meaning of this section, the director of the company at the time of the issue and who is named therein as a director, the promoter, any person who has authorized the issue of the prospectus including an expert under section 26(5) of the Companies Act 2013 will be liable to pay compensation to every person who has sustained such loss or damage.

Section 36 states that

Any person who either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading or deliberately conceals any material facts, to induce another person to enter into or to offer to enter into:

316 Corresponding section 63 of the Companies Act, 2013
317 Corresponding section 62 of the Companies Act, 2013
a) Any agreement for, or with a view to acquiring, disposing of, subscribing for or underwriting securities or
b) Any agreement the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities or
c) Any agreement for or with a view to obtaining credit facilities from any bank or financial institution;

Shall be liable under 447

Section 447 provides for punishment for fraud which is imprisonment for a term which shall not be less than six months which may be extended to 10 years and shall also be liable for fine not less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

Fraud for the purpose of this section has been defined as

(i) ‘Fraud’ in relation to affairs of a company or any body corporate includes any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the Company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss;

(ii) “wrongful gain” means the gain by unlawful means of property to which a person gaining is not legally entitled;

(iii) “wrongful loss” means the loss by unlawful means of property to which the person losing is legally entitled”

The Companies Act, 2013 now provides for specific provisions related to any act of fraud and in all such instances of fraud, class action can be filed.

7.13 Class action as a tool to retail investors in the Indian Legal Framework:

A strong class action mechanism in the US has empowered investors to sue, the Issuers, Underwriters and all the parties involved in the distribution channel of a public issue for losses arising from misstatements in the prospectus and fraud with respect to dealings in securities. So far in the absence of a statutory provision for class action for the protection of
investors in the Indian legal framework, investors who invested in the IPOs of thousands of companies that vanished during the period 1992 to 1996, were unable to seek any compensation for their loss.

When funds are raised in a public issue on the faith of a Prospectus, it is essential that funds are utilized for the purpose stated. Any departure from the intended use is misleading the investors. Under the erstwhile Companies Act 1956, companies could alter the objects for which the funds are raised in a public issue by passing a special resolution in the general meeting. Considering that majority companies in India are promoter controlled with dispersed minority, passing such resolutions is not a daunting task. Companies that have diverted their issue proceeds towards purposes other than those disclosed in the prospectus have rendered losses to the investors.

Now under Section 37 read with sections 34, 35 and 36 of the Companies Act, 2013, investors including retail investors can individually or collectively, or through their associations file class actions against the directors, promoters, experts or persons responsible for the issue of prospectus for misstatements, inclusion or omission of any matter in the prospectus and diversion of funds.

The risk of a class action from minority shareholders could instill more responsibility on the Issuers to fulfill the purpose for which the funds are raised. Studies conducted elsewhere (Alexander, 1993), (Hui Ling Lin, et al, 2003) have indicated that the threat of a class action has disciplined the pricing strategy of the Issuers and Underwriters.

Presently while Merchant Bankers have a lead role to play in the public issue process with respect to pricing, underwriting and due diligence, they are not made accountable as signatories to the prospectus. While the directors, promoters, experts and any person who has authorized the issue of the prospectus are jointly and severally made liable, the liability does not extend to the Lead Merchant Bankers.

The Companies Act, 2013 now provides that any variation in the terms of the contract or objects in Prospectus by the company is subject to the approval of the company by way of a special resolution in the general meeting. 318 It further provides that the notice of the special resolution should be widely disseminated with a clear justification for such variation. Additionally dissenting shareholders who do not consent to the variation shall be provided an

318 Section 27 of the Companies Act, 2013
exit opportunity at an exit price as determined by SEBI, by the promoters and controlling shareholders. This is expected to make the promoters, directors more committed to the objects of the IPO.

**7.14 Funding for class action:**

Retail investor individually or collectively may file class action suits against erring companies. SEBI (Investor Education and Protection Fund) Regulations, 2009 created under Section 11 provide for aiding investor associations recognized by SEBI in taking up legal proceedings in the interests of the investors in securities that are listed or proposed to be listed.  

Legal proceedings are defined as “any proceedings before a court or a tribunal where one thousand or more investors are affected or likely to be affected by:-

(i) Misstatement, misrepresentation or omission in connection with the issue, sale or purchase of securities,
(ii) Non receipt of securities allotted or refund of application monies paid by them
(iii) Non-payment of dividend
(iv) Default in redemption of securities or in the payment of interest in terms of the offer document
(v) Fraudulent and unfair trade practices or market manipulation
(vi) Such other market misconduct which in the opinion of the Board may be deemed appropriate

But does not include proceedings where the Board is a party or where the Board has initiated any enforcement action.

The regulations provide for aid to the extent of 75% of the total expenditure. The regulations further provide that the legal aid would not be provided for more than one legal proceeding in a particular matter.

**7.14.1 The Investor Education and Protection Fund (IEPF)**

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319 Clause 5(2)(d) of the SEBI(Investor Education and Protection Fund)Regulations 2014
The Investor Education and Protection Fund established under Sec 125 of the Companies Act, 2013 specifically provides for the utilization of the fund under section 123(3) for the following purposes:

(a) The refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest there on

(b) Promotion of investor’s education, awareness and protection

(c) Distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, depositor holders who have suffered losses due to wrong action by any person, in accordance with the orders made by the court which has ordered disgorgement.

(d) Reimbursement of legal expenses in pursuing class action under Sec 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the tribunal

(e) Any other purpose incidental thereto

The Ministry of Corporate Affairs has also issued guidelines for funding NGOs for the purpose of taking up class action suits. Reimbursement for legal expenses to the extent of 80% is provided only in the cases where the judgment is in favour of the investors subject to an overall limit of 5% of the budget for that year

7.15 Summary of Discussions:

- Small and retail investors who would otherwise not have asserted their rights through litigations under existing remedies owing to costs and adjudication delays have an effective redressal tool in the form of class action. The Class action mechanism through the strength of collective action empowers small investors to seek settlement of their small claims, which may not otherwise warrant individual action. This mechanism will serve as an alternative to regulatory enforcement of investor protection laws.

- As the remedies now available to investors under Section 245 of the Companies Act, 2013 are preventive, corrective and compensatory in nature; they accord more protection than the earlier remedies under oppression and mismanagement.

- An important implication of the section 245 is that the liability extends to the auditors and the firm with respect to fraudulent and unlawful acts committed along with directors and experts.
• While there is now a statutory provision for class action, initiating such action needs a strong vigilance on the part of retail investors to stay alert to the actions of the management. As the remedies are punitive and injunctive in nature, Retail investors through participation in the company management can help in prevention of any irregularities that might impact the valuation of shares.

• Class action litigation as an avenue for private enforcement of securities laws in the US is attributed to the payment of contingency fees to the plaintiff’s lawyers that acts as an incentive to pursue class action case. As the same is not admissible in India, the momentum for class action can come with activism on the part of investor associations. Activism in the past on the part of investor associations has successfully lead to many amendments in the existing laws be it the case of vanishing companies or the governance failure in the case of Satyam. Investor associations also can serve to integrate all the small investors to qualify for filing a class action suit. Investor associations may initiate class actions and become key players in private enforcement of investor protection laws.

However as per the records of SEBI, presently there are 26 investor associations recognized and most of these associations are concentrated in the areas where the equity cult is high. A dispersed presence of the investor associations and a merit based funding of these associations are needed to effectively use this tool. The strength of the class for negotiating the terms of settlement can be enhanced by the investor associations.