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Class Action under Companies Act 2013- A Quagmire in Disguise?

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Very generally speaking, class action lawsuit is a lawsuit that allows a large number of people with a common interest in a matter to sue or be sued as a group.

A Short History

The class action suit began in the equity courts of seventeenth-century England as a *bill of peace*[1]. English courts would allow a bill of peace to be heard if the number of litigants was so large that joining their claims in a lawsuit was not possible or practical; the members of the group possessed a joint interest in the question to be adjudicated; and the parties named in the suit could adequately represent the interests of persons who were absent from the action but whose rights would be affected by the outcome. If a court allowed a bill of peace to proceed, the judgment that resulted would bind all members of the group.

Justice Story, who served on the U.S. Supreme Court from 1811 to 1845 wrote that in equity courts, "all persons materially interested, either as plaintiffs or defendants in the subject matter of a bill ought to be made parties to the suit, however numerous they may be," so that the court could "make a complete decree between the parties [and] prevent future litigation by taking away the necessity of a multiplicity of suits" (*West v. Randall*)[2].

The bill of peace, and later the class action, provided a convenient and efficient vehicle for resolving legal disputes affecting a number of parties with similar claims. Common issues that could have similar outcomes did not have to be tried piecemeal in separate actions, thus saving the courts and the litigants time and money.[3]

Initially, a class action could be brought only in equity cases, disputes in which the parties did not necessarily seek monetary damages but instead might desire some other type of relief. The adoption of Rule 23 of the Federal Rules of Civil Procedure in 1938 broadened the scope of the class action suit, providing that cases in law seeking money damages as well as cases in equity could be brought as class actions. In 1966, the scope of the class action was again clarified and expanded when Rule 23 was amended to provide that unnamed parties to a class action were bound by the final judgment in the action so long as their interests were adequately represented.[4]

Rule 23 of the Federal Rules of Civil Procedure defines three kinds of class actions[5]:

1. The first type is instituted where separate lawsuits might adversely affect other members of the class or the defendant in either of two ways—if the piecemeal

[1] Stephen C. Yeazell, *From Medieval Group Litigation to the Modern Class Action* (New Haven: Yale University Press, 1987), at 38
[2] 29 F. Cas. 718, 2 [C.C.R.I. Mason] 181 [1820] [No. 17, 424]
[3] Yeazell, at 220
[4] Yeazell, at 229
[5] http://www.law.cornell.edu/rules/frcp/Rule23.htm

litigation resulting from separate suits might impose inconsistent standards of conduct on the defendant, or if multiple suits might "impair or impede" the class members from protecting their various interests.

2. In the second type of class action, a class seeks an Injunction or some type of relief compelling the defendant either to cease a certain activity or to perform some other type of action.

3. In the third category of class action lawsuit, there are questions of law or fact common to the entire class that predominate over questions peculiar to each individual plaintiff, and a class action suit is a more efficient means to resolve the controversy. Under this type of class action, individual members of the class may "opt out" of the litigation if they do not want to be bound by the results of the suit. (*Phillips Petroleum Co. v. Shutts*).[6]

The Indian Scenario

The Satyam fallout had created uproar in the country, when the investors of the company abroad brought in several class actions seeking damage, while the investors in India did not have any recourse to legal remedies. This steered the ministry to incorporate and include proactive measures for the protection of the shareholders and investors and thus the provisions of class action suits were incorporated under the Companies Act 2013.

Prior to the enactment of Companies Act 2013, class actions suits have been filed as "representative suits" under Civil Procedure Code 1908 or under the pretext of public interest litigations. The laws were not well defined with respect to class action and thus were unable to be described as "*sui generis*".

This article is an attempt to reflect upon the provisions pertaining to class action as detailed under the Companies Act 2013(Act) and to ascertain the effectiveness of the new redressal mechanism.

Relevant Provisions under Companies Act, 2013

The Companies Act, 2013 introduces the concept of class action under Section 245,detailed in Chapter XVI – Prevention of Oppression and Mismanagement. However, this is not to be misunderstood with provisions governing oppression and mismanagement as set out under sections 241-244. Class actions under 245 are evidently distinctive and separate and were brought in as additional tool for investor protection.

[6] 472 U.S. 797, 105 S. Ct. 2965, 86 L. Ed. 2d 628 [1985]

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Who Can Sue for Class Action?

Section 245(1) now empowers the members, depositors or any class of them to proceed with a class action suit if they are of the opinion that the management or affairs of the company are being conducted in manner that is pre-judicial to the interests of the company or its members or depositors. Section 245(3) further provides for a minimum number of class actioners for perusing a class action as below:

Type of Company	Requisite Shareholders	Requisite Depositors
Company with Share Capital	100 members of the Company or 10% of total no. of members	100 depositors of the Company or; 10% of total no.of depositors or; Any depositor or depositors to whom the company owes 10% of total deposits of the company
Company without Share Capital	$1/5^{th}$ of total no.of members	

It is pertinent to note the language of the section to a substantial extent is similar to what has been provided under oppression and mismanagement under section 241 of the Act. Section 241 provides that a member can move an application for oppression and mismanagement if "*the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to him or any other member or members or in a manner prejudicial to the interests of the company".* Thus with respect to members, one can see that Act the outlines of two sections are not distinct from each other.

The Act incorporated class action provisions to provide members with additional rights against abuse of powers by the company. The member now thus has a right to proceed under section 241 as well as section 245 separately and distinctly, *if the affairs of the company are being conducted in a manner prejudicial to the interests of the company.* Thus, the section apparently gives the member a right to initiate two proceeding on same subject matter. This is diabolically opposed to the principle of *res judicata* as provided under Civil Procedure Code, 1908.

Also, the Act empowers only members and depositors to proceed under class action. It has grossly failed in its attempt to include creditors, debenture holders and other stakeholders of the company.

Section 245 further provides that an application for class action suit can be filed before the Tribunal "*on behalf of the members or depositors*". Will this apparently mean that such an action is brought on behalf of all the members? If the answer were in affirmative, would the damages be awarded to the class as whole or to only those who brought the

action? If the answer were negative, then how would the same classify as "*class*" with respect to class action[7].

Even if one assumes that it included all members, then, it would also include those members who were or might be behind the wrongs complained of. In such a case how would the Tribunal ensure just and proper distribution of monetary compensation[8]. The Act thus grossly fails to reflect upon the above questions and absence of such clear demarcations would only result in confusion having wide implications.

Who can be sued for Class Action?

As per the provisions of section 245 (1) (g) a class action suit can be brought against:

1. The company
2. Directors of the company
3. Auditors and audit firm of the company for any false and misleading statement in the audit report or for fraudulent, unlawful or wrongful conduct.
4. Any expert or advisor or consultant or any other person for misleading statements made to company or any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part.

Upon perusal of the section, one finds that class action suits under the Act can be brought against third parties also. It will thus be very difficult to escape the provisions by the professionals and to take any stand as the words used in the clause have a very wide meaning and includes any wrongful act or conduct on part of professional[9].

This is prima facie in violation with the principles of privity of contract, which states that only parties to the contract can sue each other to enforce their rights or claim damages. One has is pertinent to note here that there exist separate contracts- one between the members and the company and the other between the company and the consultant/expert. There exists privity between the member and the company and between the company and the member.

Even if one was to assume that the members being the beneficiaries of such contracts had the authority to bring an action in equity, the same would not hold good under common law principles as such actions in equity are always claimed through a party to the contract

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[7] *http://indiacorplaw.blogspot.in/2013/09/class-actions-in-companies-act-2013.html*

[8] *http://indiacorplaw.blogspot.in/2013/09/class-actions-in-companies-act-2013.html*

[9] *Class Action under Companies Bill 2012: Wide ranging injunctive and punitive powers against companies- http://india-financing.com/Class_Action_under_Companies_Bill_2012.pdf*

who either holds the position that of a "*cestuique trust*" or that of a principal suing through an agent[10]. What appears instantly from the perusal of the section is that members and depositors are directly claiming damages from third parties rather than claiming through the company.

This indeed is opposed to common law principles and would thus create confusion with respect to implementation of the section.

The intention to introduce class actions was to provide an additional tool in the hands of the members and to recognize the same as a supplementary remedy. But sadly the provisions have been introduced without even comprehending as to how it would accommodate the already existing remedies under common law. This surely comes across, as work of haste, which will eventually open the Pandora's box and will give rise to serious analytical and interpretational issues.

Where Class Action Suits are instituted?

Section 245(1) provides that all class action suits shall be instituted in the Tribunal. Tribunal as defined in Section 2 (90) of the Companies Act, 2013 means the National Company Law Tribunal.

The Tribunal being a quasi-judicial body shall consist of a President and such number of judicial and technical members as the Central Government may deem necessary. All appeals from an order of the Tribunal shall lie before an Appellate Tribunal and appeals from order of the Appellate Tribunal shall lie before the Supreme Court.

Civil courts under section 430 of the Act have no jurisdiction to entertain any proceeding in respect to any matter, which the Tribunal or the Appellate Tribunal is empowered to determine. The section further provides that any court or any other authority in respect of any action taken or to be taken by the Tribunal shall grant no injunction.

It is very surprising to note here that the jurisdiction of a quasi –judicial body has been empowered tremendously to the extent that it has ousted the jurisdiction and powers of a judicial body per se.

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[10] *Treatment of "doctrine of privity" by Indian Judiciary by Priyesh Sharma-* *https://www.google.co.in/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&sqi=2&ved=0CCgQFjAA&url=http%3A%2F%2Fwww.vaishlaw.com%2Fnew%2Farticles_corporate%2F_Aricle%2520on%2520privity%2520of%2520contracts%2520(18052013)%2520-clean.docx&ei=BBjAUoeHC4juiAfO0oDQDA&usg=AFQjCNFgteN5QrzcY-uzjjWyXnhxE_UutQ&bvm=bv.58187178,d.aGc&cad=rja*

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How can class action suits be instituted?

Sections 245(4) and 245(5) provide for procedure to be followed while instituting the class action suits under the Act.

As per section 245(4) the Tribunal while considering a class action shall take the following into account –

- Whether the member or depositor, while seeking relief under class action, is acting in good faith;
- Any evidence as to the involvement of any person other than directors or officers of the company.
- 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;
- Any evidence before it that corroborates that the members or depositors of the company have no personal interest in the matter being proceeded as class action;
- Where the cause of action is yet to occur, the Tribunal shall duly consider all acts and circumstances that would be likely (i) authorized by the company before it occurs; or (ii) ratified by the company after it occurs;
- Where the cause of action has already occurred, the Tribunal shall duly consider and evaluate all acts and circumstances that would be likely ratified by the Company.

Once the Tribunal admits an application as class action, the following procedure shall in terms of section 245(5) be followed:

- A public notice shall be served to all the members or depositors of the class;
- All similar applications in any jurisdiction shall be consolidated into a single application and a lead applicant shall be appointed from amongst them;
- No two class actions for the same cause of action shall be allowed; and
- The company and any other person responsible for the oppressive act shall pay for the cost and expenses connected with class action suits.

Section 245(5) provides that the costs and expenses in connection with class action suits shall be borne by the company and the person responsible for the "*oppressive act*". It is pertinent to note here that the section casts the liability to bear costs of application upon the person who does or is responsible for the oppressive act. This could possibly mean that the member or depositor who is moving the application is aggrieved of an oppressive

act. Insofar as the member is concerned, they already have a right to proceed under section 241 for oppression. This section, thus grossly fails to demarcate or distinguish circumstances when a member can proceed under section 241 and when can reliefs be sought under section 245. In absence of such distinguishing factor, the underlying principle of class action, which aims at reducing multiplicity of suits, gets frustrated and nullified. The Act thus confers rights upon members and depositors to initiate two proceeding with regard to same subject matter.

What are the Reliefs?

Section 245(1) sets out the kinds of relief that the Tribunal can grant in a Class Action:

- Restrain the company from committing an act, which is *ultra vires* the Articles or Memorandum of the company.
- Restrain the company from committing breach of any provision of the company's Memorandum or Articles.
- 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, and thus restrain the company and its directors from acting on such resolution;
- 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;
- Restrain the company from taking action contrary to any resolution passed by the members;
- Claim damages or compensation or demand any other suitable action or remedy that the Tribunal may deem fit.

Consequences of Class Action Suits

The order passed by the Tribunal shall be binding on the company, its members, depositors, auditors, advisors, consultants, experts and other persons associated with the company. Any failure of company to comply with the order shall be liable to a fine of Rs. 5 Lakh extendable up to Rs. 25 Lakh and every officer in default shall be punishable with an imprisonment of 3 years and with fine of Rs. 25 thousand extendable upto Rs. 1 Lakh.

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Consequences of Frivolous Action

Section 245(10) states that 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 Rs. 1 lakh, as may be specified in the order. Given that a minimum of 100 members can join together to file a class action, this comes down to a maximum cost of Rs. 1000 each member. The cost would be much less if more members join. Such minimal amount may not be enough to deter frivolous litigation.

Can a plaintiff opt out of a Class Action?

In the US, Courts have held that the principle of "Due Process" requires that absent class members be given adequate notice, adequate representation, and adequate opportunity to opt out, before they can be bound by a final judgment in the suit. (*Phillips Petroleum Co. v. Shutts)*[11]

Under Companies Act 2013, there is no provision for opting out.

Effect on Subsequent Litigation

What is the effect of class actions on subsequent litigation? The general rule of *res judicata* requires that each and every cause of action should be litigated only once. To require the same case to be litigated more than once on the merits is a waste of the court's time, without offering any assurance to either side that the outcome in the second trial is any better than that in the first. So, the legal system has to make sure that one trial is done well, after which the parties and their privies are bound. For example, if the trustee has lost the suit against the third party, then his beneficiary should be bound by that initial litigation, for otherwise the beneficiary has the incentive to hang back at the outset and then intervene if and only if the trustee loses the first suit. No legal system should encourage the proliferation of suits by several persons who have partial interests in the same basic claim.

In the US, there is a bar on subsequent suits and it will be interesting to see whether the same principle will be applied by NCLT as well.

[11] Supra note 6

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Conclusion

The provision for class action suit was brought in to provide stakeholders an edge in retrenching their rights. The provisions were introduced to bring together stakeholders with common interest on a shared platform so as to lower costs of litigation and boost the efficiency of the legal adjudication.

Upon perusal of the sections pertaining to class action as contained under the Act, one finds that the provisions are neither purely "class actions" as prevalent in US nor purely "derivative" as prevalent in UK. The interpretations of the sections overlap with remedies already available under section 241 of the Act and also intersect and are opposed to provisions provided under common law. The language of the section at numerous places lacks clarity, for which one would have to depend upon the courts to finally come up with right and just interpretations.

It is highly ironical that one hand the section completely banishes the jurisdiction of the civil courts to try class action and on the other one will have to resort to the wisdom of the courts to finally get a clarity regarding interpretation of the section. On one hand class actions aim to minimize litigation by reducing multiplicity of suits, while on the other the ambiguous provisions leave no option for commoners than to look up to the courts for clarity of such provisions.

Also, the Act is also silent upon how the class litigation shall be funded. In US, all class actions lawyers work on contingency model i.e.; they retain a portion of the settlement amount and charge no fees upfront. In absence of provisions with respect to funding, actioners would have to succumb to the prevailing costs of suit filing and adjudication expenses. Moreover, this does not provide an incentive to the lawyers to take up class action cases and fight them.

The intention behind introducing the class action provision was indeed a noble one expected to benefit the stakeholders by empowering them additionally to proceed against the company with minimal costs of litigation. But sadly, the idea forthwith loses its nobility when one peruses the provisions only to find them unclear, ambiguous, vague and hazy. In absence of discreet clarity what comes across is a fuzzy and lax remedy in place of a robust and concrete provision. Further, lack of clarity could lead to widespread abuses of legal procedure. For example, class actions can become a means for plaintiffs' lawyers to make a lot of money on issues of dubious merit.

It is also important to ask here whether there is really any social and legal value in class action lawsuits. In small claims class actions, there would be little value of supporting litigation in which individual class members have trivial interests. The individual claimants, because they have so little at stake, would not exercise any control over the litigation or would elect to opt out of the class and pursue individual claims. In these kinds of litigation, it is ultimately the plaintiffs' lawyer who is in total control and has the largest interest in the suit's outcome, even if the suits result in minimal payouts to the

class members. The legislation and court rules should have given more power to the courts to examine class action applications. Courts should carefully review the applications and deny class status to small claims cases with little social value in the adjudicating the claims.

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