Satyam - Asatyam: Appreciating the Class Action provision in the Companies Act, 2013 and its impact on Investor Protection

Subhro Sengupta, Hidayatullah National Law University
Siddharth Tiwari, Hidayatullah National Law University
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SUBHRO SENGUPTA & SIDDHARTH TIWARI

B.A. LLB PROGRAMME
HIDAYATULLAH NATIONAL LAW UNIVERSITY, CHHATTISGARH


Published by Punjab University as a part of the Surana and Surana Corporate Law Essay Competition, 2014.
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Keywords: Companies Act, 2013, Class action suits, Satyam Securities Class Action, PriceWaterHouseCoopers, Midas Touch Investor Association, U.K Law on Class action, U.S. Law on Class Action

Abstract: This essay tries to fully appreciate the introduction of the class action clause in the Companies Act, 2013 and to identify the changes in terms of remedies for investor pre and post the statutory provision. In doing so, we analyze the U.S. District Court judgement on Satyam that currently provides one of the best academic discourses on the Indian class action scenario. We go through the provisions of the SEBI Act and the Securities & Contract (Regulations) Act which previously barred class action, and further delving into the legal provisions & alternatives in India, U.K. and U.S. We look into the definition of class and its applicability to future class actions. In conclusion we try to understand the application of class action in the Indian scenario, and the dire need for a statutory provision to satisfy the disgruntled Indian investor.

The Companies Act, 2013 (hereinafter mentioned as the Act) comes in the wake of hara-kiri amongst Indian investor’s, who are desperately seeking measures for statutory provisions safeguarding their interest against Companies1.

In such times, the provision for class action suits comes as a late, but much needed, relief2. The seeds for this were sown in the recommendations of the J.J. Irani Committee, and the


For details of the Satyam Scam see: Madan Bhasin, Corporate Accounting Frauds: A case study of Satyam Computers Limited, INTERNATIONAL JOURNAL OF CONTEMPORARY BUSINESS STUDIES VOL: 3, No: 10. (2012);


2 Class Action has been defined under Section 245 of the Companies Act, 2013. Further Securities Class Action is defined under Section 37 of the Act. Both are jointly mentioned under Section 125 which provides for the
plant hurriedly grown in the wake of investors unrest post Satyam\textsuperscript{3}. The origin of the class action is in Britain\textsuperscript{4} (ironically it does not operate in the U.K. any more where derivative action is common\textsuperscript{5}) and the best examples can be found today in the United States\textsuperscript{6}. The introduction of the class action provision fills the procedural lacunae that existed in the Indian company law which put the Legislature under pressure from investor groups post the Satyam fiasco\textsuperscript{7}. The only judicial analysis of the Indian class action scenario post Satyam has been in the United States\textsuperscript{8}. This essay in steps tries to understand the need for a class action mechanism in India, from being a mere procedural entry to a life saving clause. We start by

establishment of the Investor Education and Protection Fund, which mandates that the reimbursement of any legal expenses incurred by a member, debenture holders or depositors, who choose to file a class action suit against a Company under Section 245 or Section 37, is to be paid from this fund.

\textsuperscript{3} ¶10.1 of the Committee’s Report says: Class Action / Derivative Suits - 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 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. 10.2 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; See The J.J. Irani Committee, Report on Company Law, 2005(March 10\textsuperscript{th} , 2014), http://www.primedirectors.com/pdf/JJ%20Irani%20Report-MCA.pdf.

\textsuperscript{4} The origin of Class action lies in representative action which was prevalent in England from 1200 A.D. onwards.

\textit{See} STEPHEN C. YEAZELL, FROM MEDIEVAL GROUP LITIGATION TO THE MODERN CLASS ACTION 38 (1987).

\textsuperscript{5} U.K. still has a jurisprudential base for the remedial actions provided to investors. As per the rule in \textit{Foss v. Harbottle} if there is mismanagement or fraud on the part of the directors of a company, an individual shareholder cannot bring an action in respect of the irregularity if the irregularity is capable of being waived or ratified by an ordinary resolution of the company in a general meeting. When such ratification is not possible the exceptions to the rule come into play, and the shareholder can sue the management on behalf of the Company for the losses caused to the Company. Therefore, the proper plaintiff in an action in respect of a wrong alleged to be done to a Corporation is prima facie, the Corporation. This is known as derivative action. It has been codified under Sections 26-269 of the Companies Act, 2006 of U.K.


\textsuperscript{6} In the United States federal courts, class actions are governed by Federal Rules of Civil Procedure Rule 23 and 28 U.S.C.A. § 1332(d). U.S. Class action can be broadly classified into two groups: Securities Class Action & Consumer Class Action or Employees Class Action.

\textit{See} Amish Tandon, \textit{Will Class Action suits become a reality in India?}, BUSINESS STANDARD, September 10, 2013 (March 10\textsuperscript{th} , 2014) \url{http://www.business-standard.com/article/companies/will-class-action-suits-become-a-reality-in-india-113091000412_1.html};

\textit{Further see}, Class Action Provision in Companies Bill to compensate Investors, TAXMANN (March 10\textsuperscript{th} , 2014), \url{http://www.taxmann.com/Datafolder/news/News6295.htm}.

\textsuperscript{7} In re Satyam Computers Ltd. : Securities Class Action, No. 1:09-MD-2027 (S.D.N.Y September 13, 2011).
analysing the U.S. District Court judgement to establish the lack of a class action mechanism prior to 2013 and the dire straits in which the investors lay. Further, we analyze the options available to investors for grievance readdressal in case of misconduct by a company. Lastly we try to ascertain where class action fits in today, in terms of all the remedies available to the Indian shareholder. This would help the reader appreciate better, the inclusion of the class action provision in the Companies Act, 2013.

**ANALYSING THE UNITED STATES DISTRICT COURT DECISION IN “IN RE SATYAM COMPUTER SERVICES LTD. SECURITIES LITIGATION”** 9

The United States District Court of the Southern District of New York heard the class action suit filed by the holders of the American Depository Shares, of Satyam, in 2010. This case answered some of the most basic questions as to the existence of class action in India while trying to determine the faith of the foreign investors of Satyam. The primary plea raised by the defendants PriceWaterHouseCoopers (hereinafter mentioned as PwC), Lovelock and Lewes and Satyam Computers, was that of *forum non conveniens* 10, or the fact that India would be a better forum for a class action against Satyam. The prime debate therefore, ensued on whether India was suitable as a forum for investor class action, and whether Indian laws provided scope for such a measure. Both the parties relied extensively on expert witnesses who elaborated the class action provisions in India11.

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9 First identified as Aekta Baen Patel et. al. v. Satyam Computer Services Ltd. et. al. later consolidated with Global Institutional Investors Group (this was a group comprising the biggest investors Public Employees Retirement System of Mississippi, Mineworkers Pension Scheme, SKAGEN AS and Sampension KP Livsforsikring) becoming Lead Plaintiff in “In re Satyam Computer Services Ltd. Securities Litigation” (March 10th, 2014), [http://securities.stanford.edu/filings-case.html?id=104205](http://securities.stanford.edu/filings-case.html?id=104205).

10 The Legal Information Institute of Cornell University defines *Forum non conveniens* as: It is a discretionary power that allows courts to dismiss a case where another court, or forum, is much better suited to hear the case. This dismissal does not prevent a plaintiff from refilling his or her case in the more appropriate forum. This doctrine may be invoked by either the defendant, or by the court. When determining whether or not to exercise forum non conveniens, courts consider several factors, including: (i) The residence of the parties (ii) The location of evidence and witnesses (iii) Public policy (iv) The relative burdens on the court systems (v) The plaintiff’s choice of forum (vi) How changing the forum would affect each party’s case (March 10th, 2014). [http://www.law.cornell.edu/wex/forum_non_conveniens/](http://www.law.cornell.edu/wex/forum_non_conveniens/).

The debate that ensued established four constructive’s: Firstly, Class action litigation was not possible in India due to statutory bar under the SEBI Act, 1992 and the Securities & Contract (Regulations) Act, 1956. Secondly, there was no scope for a representative suit for fraud, which seemed to be the closest alternative to an investor class action. Thirdly, there would be a problem of enforceability of award (arguendo, if there is one) for members of the class who are un-named in the suit. Lastly, there lies no remedy in a representative suit for fraud as defined under Section 17 of the Indian Contracts Act, 1872, and even if it does, it is only for shareholders who bought the shares directly from the company, and such remedy would preclude the investors who had bought shares from the secondary markets.


12The answer to this lies in Section 15Y and 20A of the SEBI Act, 1992 and Section 22E of the Securities & Contracts (Regulation) Act, 1956 which preclude any civil courts jurisdiction over matters, in which the Securities Appellate Tribunal or any adjudicating officer, appointed under the SEBI Act, are empowered to determine. This means that no civil court was empowered post Companies Act, 2013 to entertain a suit whether representative or derivative (oppression and mismanagement will form the subject of the suit) filed by any aggrieved member of the company, where the SAT had the authority to take action.

13Representative action is only a procedural remedy offered under the Code of Civil Procedure. It presupposes a right to sue. It does not create a right to sue in a situation where there is a specific bar by statute.

14And even if such a representative suit stands, it doubtful whether any of the un-named parties would be able to recover their losses. A doubt has been raised whether such parties will need to file a separate suit and use the principle of res judicata or file for enforceability of the same representative suit.


15The argument against the debarment clause was a direct suit under the provisions of the Indian Contract Act, 1872 [See ¶34 of Ahmedi’s Declaration]. Section 17 of the said act provides the definition for "Fraud". The argument made was: a fraud action may proceed against a company based on the common law principle of vicarious liability such as agency and alter ego.

Considering such action stood, there come two problems (i) The Indian law does not recognize the principle of fraud on market [See Basic, Inc. v. Levinson, 485 U.S. 224 (1988) ] which essentially covers any fraud that has been committed on a secondary market. This waives the requirement that a fraud must be engage in by a party to a contract. Thus in the Satyam case, if a suit for fraud was filed, it would only serve the purposes of those shareholders who bought the shares directly from the company. Anyone buying the shares from a secondary market will be precluded under the definition.

For an action under the Contracts act to stand it is necessary that the plaintiff should have acted in reliance on the statements contained in the prospectus. Misrepresentation should be at least one of the inducements for his contract of taking shares. It is for this reason that a purchaser of shares in the open market cannot proceed against the company, unless the company had done something to induce him to purchase in the market.
The conviction of the U.S. District Court, as to India being an unsuitable location for a class action, was further strengthened by the fact that the Indian Judiciary and quasi judicial bodies had already rejected what seemed to be the first of its kind class action initiative in India by a Kanpur based investors group, Midas Touch Investor Association. This led to rejection of the forum non conviniens argument and a settlement in the U.S. which was worth $ 125 million on Satyam’s side, and worth $25.5 million on the side of PwC. All this happened as the Indian investor looked on, just for the lack of a procedural remedy.

THE POSSIBILITY OF CLASS ACTION IN INDIA, BEFORE THE COMPANIES ACT, 2013:

The U.S. District Court established the lack of a class action mechanism in India, although not conclusively. For a conclusive understanding one needs to look further into the remedies available to a shareholder before the introduction of the Companies Act, 2013. The grievance readdressal mechanisms that could be used by a shareholder against a company were: (a) A suit against the company for Oppression and Mismanagement (b) A suit for derivative

16 Midas Touch Investor Association approached both the National Consumer Disputes Readdressal Commission Forum (NCDRC) as well as the Supreme Court of India. The NCDRC rejected the plea saying it did not have infrastructure to listen to the plea of 300,000 shareholders and the Supreme Court rejected the plea as withdrawn. See Midas Touch Investors Association v. M/S Satyam Computer Services Ltd. & Ors, (Civil Appeal No. 4786 of 2009).

17 A classic dichotomy over here is between the majority – minority rule and that of shareholders democracy. The majority-minority rule as propounded in Foss v. Harbottle precludes the minority investor from filing against the Company. However, both India and England have found a way around it. The English way to seek a remedy is through derivative action, which is counted among one of the exceptions of the Foss rule, whereby the minority rights are violated through fraud, misrepresentation etc. Derivative action maintains a jurisprudential stance by allowing the shareholder to file against the management on behalf of the Company i.e. upholding the fact that only the corporate body can be a party in a suit against mismanagement. In India class action makes a preliminary assumption of fraud, whereby the power of the minority to sue comes into play. Therefore one needs to understand what the majority-minority rule stands for (Corporate control). Fraud, misrepresentation etc. would be counted as an exception to such rule.

See A H VATAR SINGH, COMPANY LAW 117 (14th Ed., 2004) See also Peek v. Gurney, (1873) 43 LJ Ch 19.


See Section 241 of the Companies Act, 2013 corresponding to Sections 397, 398, 401, 402, 403 and 404 of the 1956 Act.
action against the management\textsuperscript{18} and (c) A representational action suit under Order I Rule 8 of the Code of Civil Procedure\textsuperscript{19}.

It is to be duly noted that only the provisions for a suit for Oppression and Mismanagement and Derivative action, provide substantive rights to a shareholder. A suit for representative action and class action are only procedural means for a substantive relief\textsuperscript{20}.

Further, statutory provisions only exist for three of the abovementioned actions. Derivative action has been expounded in India by following the dictum of the English Courts\textsuperscript{21} and only recently explained by the Calcutta High Court\textsuperscript{22}.

Interestingly enough, in addition to representative suits even PIL’s have been classified as class action by certain authors in a desperate need to fill the lack of a statutory clause under the Indian laws\textsuperscript{23}.

Civil suits were already barred due to the fact that SEBI had adjudicatory power in such cases\textsuperscript{24}. Ironically, the penalties collected by SEBI via the SAT go to the Consolidated Fund


\textsuperscript{19}Order I Rule 8 of the Code of Civil Procedure, 1908 states that: One person may sue or defend on behalf of all in same interest.

\textsuperscript{20}Rule 8 is a procedural provision. It is regulative and not constitutive. It deals with procedure and does not create any right to sue. It presupposes the existence of a right to sue......thus where a suit is barred by any law; it cannot be maintained merely because it was brought following the procedure prescribed by Order I Rule 8.


\textsuperscript{22}A derivative action has now been accepted to be one where a share-holder sues on behalf of all the share-holders of the defendant company except the recalcitrant share-holders who are arrayed as defendants. The real plaintiff in such action is the defendant company itself and the allegation is that the persons in control of the defendant company would not allow the company to sue to vindicate its stand by reason of their numerical control over the share-holding in the company. In such form of action, the reliefs claimed are, really, for the benefit of the defendant company and ordinarily not for the personal benefit of the plaintiff or the other share-holders except in their capacities as share-holders of the defendant company.

\textit{See Jaideep Halwasiya v. Rasoi Ltd. (2009) Comp. Cas. 1 (Cal).}

\textsuperscript{23}NAVEEN GOEL, \textit{WORLD CLASS ACTIONS: A GUIDE TO GROUP & REPRESENTATIVE ACTION AROUND THE GLOBE,} ED. BY PAUL G. KARLSGODT, 510 (September, 2012).

\textsuperscript{24} \textit{Supra} note 12.
of India\textsuperscript{25}, and not to the shareholders. The future implications of this, for any Company facing class action for securities fraud, would be a double payment, which would be enough to bring any company to its knees: a fine of Rs. Twenty Five crore’s or three times the gains made, whichever is higher\textsuperscript{26}, payable to SEBI and a settlement amount, payable to the shareholders, which is inherently huge due to the nature of class actions\textsuperscript{27}. Thus the Company faces a dual burden in form of a massive penalty payable to the state as well as personal action from the shareholders.

**THE WIDENING OF THE AMBIT OF OPPRESSION & MISMANAGEMENT SUITS, THROUGH THE CLASS ACTION PROVISION IN COMPANIES ACT, 2013**

One needs to keep in mind that the class action is a procedural means to file for a suit for the prevention of oppression and mismanagement of the shareholders. The legislative intent is clear once we see the categorization under the new Act\textsuperscript{28}.

The procedural provision has been successfully used to increase the ambit of operation of such of the protection clause i.e. (i) who can sue: In addition to the members of the company now the deposit holders of the company can sue as well. (ii) Who can be sued: Earlier it was only the Company and its statutory appointees, now the ambit has been increased to Company, any of its directors, auditors as well as audit firm, expert or advisor or consultant or any other person linked with the working of the Company. (iii) Matters for which a suit can be filed: A class action can be filed for present or prospective action (iv) Beneficiaries of such suit: It is for the benefit of a class as opposed to the benefit of the Company as in derivative action or public welfare etc\textsuperscript{29}. Keeping with the overall intent behind the act, class

\textsuperscript{25} Section 15JA of the SEBI Act, 1992.

\textsuperscript{26} Section 15 HA read with Section 151 of the SEBI Act, 1992.

\textsuperscript{27}This can be understood by the fact that Satyam ended up paying $125 million to its U.S. based shareholders and he auditors PwC paid an additional 25.5 million. Under § 1332(d) (2) of the Federal Rules of Civil Procedure the federal district courts have original jurisdiction over any civil action where the amount in controversy exceeds $5,000,000.

\textsuperscript{28}The Chapter XVI has been named as “Prevention of Oppression and Mismanagement” (Corresponds to Section 397-401 of the 1956 Act) and the substantive definition included in Section 241, and Class action has been placed under Section 245 of the same chapter.

action has also been made a statutory tool to keep the affairs of any company under check. The penal provisions under the new act are harsh enough to make directors, auditors or experts to think twice before committing a fraud. This is because the penalty is now three way; action in the SAT that would be introduced by SEBI and the company would be penalized. Further, penal action would be introduced in a competent court by SEBI, and lastly the investors will introduce a class action in the National Company Law Tribunal (NCLT).


The definition of class is extremely important for future applicability of the provision. The settled definition will guide the Tribunal (NCLT) and the Courts when class action is instituted. There has been the need for judicial interpretation in this area, since statutory provisions in both India and England are fairly new (2013 and 2006 respectively. U.K. still provides for derivative action and not class action), and the statutory provision in the United States predates to 1966 (It was present from 1938 onwards but it is present in its current form only since 1966 after its amendment).

In the Indian context we find that there exists a definition by negation. The Indian Courts have broadly defined members of a class as, those who have been offered substantially different compromises. In terms of shareholders, the Companies Act, 1956 recognizes two

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30 Supra note 26.

31 Section 24 of the SEBI Act, 1992.

32 Section 245 of the Companies Act, 2013.

33 It is the art of defining by what an object is not, rather than by what it is. This helps in giving meaning to something as broad and as abstract as a “Class”. See Definition by Negation (March 10th , 2014) http://english.tjc.edu/jbru/1301/negation.htm;

Further see, DOUGLAS WALTON, FABRIZIO MACAGNO, EMOTIVE LANGUAGE IN ARGUMENTATION 249 (2014); ROBERT B. HUBER, ALFRED C. SNIDER, INFLUENCING THROUGH ARGUMENT 41(2006).

classes, namely, equity shareholders and preference shareholders. The Court has reiterated the same point by saying that a class of creditors must be those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. The Indian Courts have laid down the definition from the English precedents on the same point, which founded the definition of class by negation, based on a class being a conglomerate of people whose rights are similar and who can consult together with a view to their common interest.

The United States, which has been the ground for the birth of the modern class action, provides a précising definition under which the general principle stands that: where the parties interested in the suit are numerous, their rights and liabilities are so subject to change and fluctuation by death or otherwise, that it would not be possible, without very great inconvenience, to make all of them parties, and would oftentimes prevent the prosecution of the suit to a hearing, in such cases for convenience, therefore, and to prevent a failure of justice, a court of equity would permit a portion of the parties in interest to represent the entire body, and the decree would bind all of them the same as if all were before the court. The legal and equitable rights and liabilities of all being before the court by representation, and especially where the subject-matter of the suit is common to all, there can be very little danger, but that the interest of all will be properly protected and maintained. The practical approach in the United States can be understood when we see that the justifications that led to the development of the class action included the protection of the defendant from inconsistent obligations, the protection of the interests of absentees, the provision of a convenient and economical means for disposing of similar lawsuits, and the facilitation of the spreading of litigation costs among numerous litigants with similar claims, and not just representative litigation.

35 State Bank of India v. Alstom Power Boilers Ltd. [2003] 43 SCL 449 (Bom.).
37 It seems plain that one must give such a meaning to the term ‘class’ as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. See Sovereign Life Assurance Co. v. Dodd [1872] 2 QB 573 (CA).
It is advisable that India go by the American definition for class action, which not only seems more practicable, but has also withstood the test of time and multiple class action litigations.

**CONCLUSION: ONE SMALL STEP FOR THE LEGISLATURE, ONE GIANT STEP TOWARDS THE PROTECTION OF THE FUTURE**

A bare reading of the Companies Act, 2013 would reveal that it has tightened the grip of the legislature around the corporate entities. Although corporate freedom is a necessity for the growth of innovation and for economic prosperity, it is also important to understand, in the wake of numerous scams, that the Indian investors need to be protected if we want to create a healthy investment ecosystem. The Class Action provision, although a procedural introduction, will go a long way towards restoring the faith of the disgruntled Indian investor.


There is lot to note in the new Companies Act as it brings in sweeping changes in the way the corporates are governed in India. The 2013 Act enhances significantly the role and responsibilities of the Board of directors by making them more accountable for their actions while protecting shareholder interest. See Grant Thornton, _Implications of the Companies Act, 2013: Governance_ (March 10th, 2014) [http://gtw3.grantthornton.in/assets/Companies_Act-Governance.pdf](http://gtw3.grantthornton.in/assets/Companies_Act-Governance.pdf).


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