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CLASS ACTION SUITS: A NEW PROTECTION FOR MINORITY RIGHTS

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ABSTRACT

CLASS ACTION SUITS: A NEW PROTECTION FOR MINORITY RIGHTS

The protection of the minority shareholders within the domain of corporate activity constitutes one of the most difficult problems of contemporary company law. The aim must be to strike a balance between the effective control of the company and the interests of the small individual shareholders. In the words of the Palmer: "A proper balance of the rights of majority and minority shareholder's is essential for the smooth functioning of the company".[1] The modern Companies Act, therefore, contain a large number of provisions for the protection of interests of investors in companies. The aim of these provisions is to require those who control the affairs of the company to exercise their powers according to certain principles of natural justice and fair play.

But the reality is that, most of the times minority shareholders' voices are unheard and they are supressed many a times. So the idea of Class Action suit in par with the oppression suits (**1956 Companies Act**) was brought in the **Companies Act, 2013**. The concept of a class action suit emerged in United States of America in the early 18th Century.[1]

The biggest object behind the "Class Action Suit" is, providing protection to the minority shareholder, members and creditors to file an application before the NCLT[1] on behalf of the all members/ creditors in the event that the management of company was being conducted in a manner prejudicial to the interests of the company or its members or creditors[1], assumed greater importance as a redressal mechanism separate from the traditional oppression and mismanagement application.

Finally, this article will analyse as to what is the peculiar difference between the Oppression suit and Class Action suit and why the idea of class action suit was brought in the 2013, Amendment.

Key Words:*Class Action, Minority Rights, Oppression, Mismanagement.*

INTRODUCTION

Once described as "*the most important procedure, the law has yet developed to police the internal affairs of the corporation"*[1]. Are shareholder class action suits at successive steps in India; Answering this question is very interesting with reference to the Companies Act, 2013. Shareholder activism[1] is an evolving term in India, which means an active participation of shareholders in all aspects of good corporate governance and fighting the fraudulent and incorrect acts of a company, in which the members on behalf of the company act outside the scope of the object clause and which are considered to be Ultra vires acts of the company.

The basic principle relating to the administration of the affairs of a company is

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that "*the courts will not, in general, intervene at the instances of shareholders in matters of the internal administration and will not interfere with the management of a company by its directors so long as they are acting within the powers conferred on them under the articles of the company".* [1] *"Nothing connected with the internal disputes between the shareholders is to be made the subject of an action by a shareholders".*[1]

Usually, individual shareholders do not take legal action against a company, either on the audit accounts for it is very difficult for them to initiate a suit which they find it as economically unaffordable, or because the laws put up certain requirement of members to initiate the suit against a company. These minority shareholders'[1] and small investors generally find it very difficult to invoke the suit against the majority shareholders on the behalf of the company and to protect the company from committing wrong.

So, by looking at the plight of the minority shareholders who are not protected at all, the Companies Act, 2013, subsequently provides for the shareholder activism and protection of investors of every kind. One such provision which is highlighted in the Companies Act, 2013 is Section 245 which exclusively deals with class action, and which has no corresponding provision in Companies Act, 1956. This is considered to be one of the major changes from the earlier Companies Act, 1956.

GENESIS OF THE CLASS ACTION

The history of the Class Action suits in India can be traced back to the Satyam Scam (2009), which is famously known as the "Indian Enron", revealed the inadequacy and ambiguity of the Companies Act, 1956 with regard to the shareholders' protection and prevention of white collar crimes.[1] This case also highlighted on the concept of Corporate Governance and Good practise of the company.

This crises opened the eyes of the Indian investors and brought the need for the small investors and shareholder protection to the forefront. The introduction of the shareholder litigation by way of the introduction of the Class Action suit under Section 245 helped to protect the minority shareholders rights. Since, over a period of time, these small and dispersed investors have become active in protecting their rights taking lessons from the foreign counterparts especially after Rs. 7000 crores satyam fiasco. About three lakh investors in India lost around Rs. 5000 crores in the Satyam case, while the investors in the USA, who filed a class action against Satyam, were compensated to the tune of $125 Million around 675 crores.[1]

So, a class action is a special kind of lawsuit which involves the interests of a large number of people. Only a few plaintiffs are named in the lawsuit to represent the claims of the entire class of people so that each one of them with the same injury doesn't have to file their own separate lawsuit.[1] In some cases, where the individual claims are too small to gain out of lawsuit, class action suits are the only practical way to hold the companies liable for illegalities and irregularities.

The idea of class action was brought from the US, first originated in the year 1938, a class action suit [1] is an old but certainly underutilized tool in the hands of the investors.A class action suit in US law is used to describe a "Sui generis" area of litigation. Federal Rules of Civil Procedure give comprehensive guidelines for the Class action suits under Rule 23[1].

CLASS ACTION SUIT – NEED OF THE HOUR

At common law, minority shareholders in a corporation had a very little protection in the face of the conduct by the majority or by directors controlled by the majority.If an act was claimed to be wrongful it could be ratified by the majority at a general meeting of shareholders, neither the corporation nor an individual shareholder could sue to redress the wrong.[1]

The underlying principle of the Company law that existed prior to the companies Act 1956, states that every member holds equal right with other members in the same class and any differences amongst the members is to be decided by a vote of the majority. This is called as the **Rule of Majority** or **Supremacy of Majority,** this was upheld in the case of *Foss v Harbottle.* [1] Court had observed that:

> "*Courts are reluctant to interfere in the internal management affairs of the corporation".*

The protection to minority shareholders is generally not available in the statute, when the majority does anything in exercise of the powers for the internal administration of the company. It can be ratified by the majority at the general meeting. The minority shareholders have no *locus standi.*[1]This rule, also reiterated in the case of *Burland v Eagle* [1] and *Pavildes v Jemsen* [1] all these decision concentrates on the Majority shareholder's decisions and the protection to the minority and their voices are unheard and there is no right to decision on the side of the Minority shareholders.[1]

Even in India, the Honourable Supreme Court in the case of *Rajahmundry Electric Supply Co v Nageshwara Rao* [1] observed that:

> *"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."*

EXCEPTIONS TO THE RULE OF MAJORITY

The principle of majority rule has certain well established exceptions and these are generally said to be the exception of rule laid down in *Foss v Harbottle.*

When Minority shareholder can intervene:

1. **Ultravires and Illegality Acts**: Directors cannot take any action which is Ultravires the company or which is illegal. In such cases, every shareholder has a right to restrain company from doing such an act, by

bringing an injunction suit against the majority acts.[1]

2. **Breach of Fiduciary Duties**: Actions can be brought against promoters or directors for breach of their fiduciary duties to the company; if they can prevent the company from suing them.[1]

3. **Fraud on Minority**: Majority shareholders cannot sue their powers to defraud the minority.[1] "Fraud on minority" means taking decisions and passing resolutions which would discriminate between majority and minority shareholders, so as to give undue advantage to the majority shareholder.[1]

Hence, strict application of the *Foss* case would be unfair to the minority shareholders in many cases. Hence, provisions of **oppression and Mismanagement** was introduced in the 1956 Companies Act. These are not derivative actions in the sense that these are not on behalf of the company.

Any member can approach the company law board for relief in case of mismanagement or oppression by those in control of the company. For Examples like allotment of shares, appointment of the new director, dismissal of the director are considered to be few important examples of oppression by majority over the minority shareholder.

OPPRESSION REMEDY

Prior to the introduction of the Class Action, the idea of Oppression remedy was only prevalent in India. The Act does not define what oppression is. Normally, oppression means violation of conditions of fair play. The complaining members must be under a burden which is unjust, harsh or tyrannical. It involves lack of probity or fair dealing to a member in the matter of his right as a shareholder.[1]

There must be unfair abuse of powers and impairment of confidence in the probity with which the company's affair are being conducted. The scope and meaning of the "oppression" with reference to the corresponding Section in the English Act, Section 210, in the famous case of *Harmer (HR) Ltd, Re*[1], the court held that:

1. *It is to be observed first, that the person permitted to apply to the court under Section 210 is any member of the company.*
2. *The Member of the company must show that the affairs of the company are being conducted in a manner oppressive to the some part of the members; including himself.*
3. *This further indicate that the oppression complained of must be complained by a member of the company and must be oppression of some part of members in their or his capacity as members or as members of the company".*

The term oppression is again defined in the case of *Elder v Elder & Watson Ltd*[1],

"*the term oppression means a string intent to defraud, fraud, misfeasance or other misconduct and the essence of matters seem to be that the conduct complained of should be at the lowest involve a visible departure*

from the standards of fair dealing and of violation of the conditioners of fair play on which every shareholder who entrusts his money to the company is entitled to get."

In the case of *Stadmed Pvt. Ltd v Kshetra Mohan Saha*[1], the Lord Keith observed that:

"*It is not lack of confidence between the shareholders perse that brings section 210 (*corresponding section 399 of 1956 Act and section 241 of the 2013 Act*) into play; but lack of confidence springing from oppression of a minority by a majority in the management of company's affairs and oppression involves, I think at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as shareholders".*

The oppression dealt in this section is only oppression of members in their "**character as such**" and it is only in that character they can invoke this section, the idea of oppressing the minority is in the personal behaviour and not in the company sense. The oppression remedy is a **personal remedy** available to a complainant where a corporation, a board or a corporate affiliate acts in a manner oppressive or unfairly prejudicial to or which unfairly disregards that complainant's individual interests.[1]

The important speciality of this section is that oppression of a person as a director and not as a member is thus outside the purview of the section. For example if the majority of the Board over rides the minority directors the latter cannot resort to claim under the oppression remedy.[1] The complaint was by a director and related to not holding the board meeting; held director cannot invoke this section.

Again in the famous case of *Chatterjee Petro Chemical (I) Pvt Ltd v Haldia Petro Chemicals Ltd*[1]*;* in para 61 and para 62, the court emphasised that:

"*It had been emphasised that the oppression complained of had to be shown as having been brought about by majority of members exercising a predominant voting power in the conduct of the company's affairs and must relate to the manner in which the affairs of the company were being conducted. Such conduct must also be shown as being oppressive to a minority of the members in relation to the shareholding in the company. The person complaining of oppression must show that he has been constrained to submit to a conduct which lacks probity, conduct which is unfair to him and which causes prejudice to him in the exercise of his legal and proprietary rights as shareholder."*

In the case of*Dale and Carrington Invt. Pvt. Ltd v P.K. Prathapan and Others*[1], the court pointed out in P. 12 that:

"*It was held that if a member who holds the majority of shares in a company is reduced to the position of minority shareholder in the company by an act of the company or by its board of directorsmalafide, the said act must ordinarily be considered to be an act of oppression to the said member."*

In the case of *Needle Industries (India) Ltd. V Needle industries Newey*[1], the Supreme Court pointed out that:

> "*The illegal acts may not be oppressive and even illegal acts could be oppressive. Oppression claimed of must relate to the manner in which the affairs of the company are being conducted and the conduct complained must be such as to oppress the minority members".*

DRAWBACKS OF OPPRESSION REMEDY

One of the main limitations of the oppression remedy is that the minority shareholders cannot bring a representative suit on behalf of the company, rather they can only file an individual remedy namely oppression suit.

In order to bring a collective action by the minority shareholder against the company, there was no such provision till 2013, the idea of protecting minority shareholder rights as a class, when their rights are infringed and many cases where small investors/ shareholders gets easily defrauded;one such example is the Satyam scam where over 3 lakhs small investors and minority shareholders got defrauded and they could not get back the money, but whereas the investors in the USA, who filed a class action against Satyam and because of such suit they could able to get a compensation of $125 million dollars which is around 675 crores.[1]

So, there is an alarming need to bring a class action suit in India, in order to protect minority shareholder rights and also by ensuring that the minority shareholder, has the right to bring collective representative suit [1] on behalf of the company, in order to make sure the company does not act which is outside the object clause.

CONCEPT OF CLASS ACTION SUIT

By the amendment in Companies Act, 2013, the concept of "Class action" was brought in, which aims in protecting the rights of the small investors and shareholders. The concept was strongly rooted in the Indian context in the aftermath of the Satyam Corporate Scandal which is famously called as "Indian Enron – Satyam Fiasco Case" where in numerous number of small investors of Satyam Groups in India were unable to seek an effective relief against the corporation (Satyam's management) as against their counterparts in the US who brought class action suits against satyam an made their loss.[1]

A class action suit is a kind of lawsuit that allows a large number of people as a class with a common interest in a matter to sue or be sued as a group. It is a procedural device enabling one or more plaintiffs to file and prosecute a litigation on behalf of a larger group or class, wherein such class has common rights and grievances. Class actions are particularly good for all small investors, depositors and minority shareholders who may not be able to afford experienced and highly competent attorney on their own. At the same time, they increase the efficiency of the legal system by reducing the number of rulings for the same issue, thereby saving time and resources. It provides them with a medium to fight as one unit against the errant company or management, thereby reducing multiplicity of suits, costs of litigation and

increasing their chances of success in the process.[1]

The idea of incorporating class action in the companies act was first highlighted in the JJ Irani Committee report, where the committee pointed out for the protection of minority rights and held that:

JJIRANI COMMITTEE REPORT

Chapter VI para 10.1 of the Committee Report which talks about "Minority Interests", states that "*The fundamental principle defining operation of shareholders democracy is that the rule of majority shall prevail. However, it is also necessary to ensure that this power of the majority is placed within reasonable bounds and does not result in oppression of the majority and mismanagement of the company. The minority interests, therefore, have to be given a voice to make their opinion*

s known at the decision making levels. The law should provide for such a mechanism. If necessary, in cases where minority has been unfairly treated in violation of the law, the avenue to approach an appropriate body for protecting their interests and those of the company should be provided for. The law must balance the need for effective decision making on corporate matters on the basis of consensus without permitting persons in control of the company i.e., the majority, to stifle action for redressal arising out of their own wrong doing"

The idea of Class Action/ Derivative suits under this, the committee stated that "*In case of fraud on the minority by wrongdoers, who are in control and prevent the company itself bringing an action in its own name, derivative actions in respect of such wrong non-ratifiable decisions, have been allowed by courts. Such derivative actions are brought out by shareholders 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 ground of persons having same locus standi".* Though these principles have been upheld by courts on many occasions, these are yet to be reflected in law. The committee expresses the need for the recognition of these principles.[1]

The minority shareholders rights as a class are not protected prior; but now after the 2013 amendment gives them the idea on Class Action under Section 245 of the Companies Act, 2013.

The main aim of the "*class action are prosecuting, defending or discontinuing the action on behalf of the body corporate, which is considered to be ultra vires. Furthermore, it is an action for "Corporate relief" in the sense that the goal is to recover for wrongs done to the company".*[1]

Class Action is the minority shareholders sword to the majority's twin shield of corporate personality and majority rule.[1]

In order to overcome the wrongful corporate conduct, which are done by the majority shareholders on behalf of the company, resulting in minority shareholders and investors suffer in silence, the idea of Oppression proceeding and Class action

provide corporate stakeholders with statutory rights against corporation. The oppression remedy is a personal remedy which is already highlighted in the previous pages, but on the other hand, class action empowers complainant to commerce an action on behalf of corporation to remedy alleged wrongs done to the corporation itself.[1]

The words of the section 245 of the companies Act states that "*... 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 interest of the company*** *or its members or depositors file an application ...*"

The words of the section itself clearly states that the class action suit can be brought by the members only on behalf of the interest of the company and it is unlike oppression remedy where, section 241 states that "*… the affairs of the company have been or are being conducted in a manner prejudicial to the public interest or* ***in a manner prejudicial or oppressive to him*** *or any other member or members …"*

From the words of the section 241 which clearly highlights that it is an individual remedy and the manner of the company affairs are conducted in such a manner as to causing prejudicial to the public interest and to the member, the particular member who feels oppressed can file an oppression remedy suit under section 241 of the Companies Act, 2013.

The court of Appeal *Rea v Wilderboer*[1], the court said that, *"Class action and oppression remedy are not mutually exclusive. There may be circumstances that give rise to both a derivative action and an oppression remedy. The court affirms that the oppression remedy and derivative action remain distinct remedies with separate rationales and statutory functions and the court held that the class action is a corporate remedy, while the oppression remedy is a personal individual remedy*".

Another important point that has to be taken into consideration is that the class action are considered in cases where the shareholders on behalf of the company if they think fit can bring an action, "***… if they are of the opinion …",*** while on the other section, in case of oppression remedy, it can be taken as a defence only when the act is done to the minority shareholder or being done to him, "***… have been or being conducted …"***

It is important to note here that, the rubric of an oppression proceeding, alleged wrongful conduct must impact the personal interest of the complainant. "*The oppression remedy will not be available simply because the complainant asserts a reasonable expectation that it holds in common with every other shareholder. Instead, the complainant must demonstrate that the alleged wrongful conduct has been oppressive, unfairly prejudiced or unfairly disregarded its personal interests.*"[1]

Section 245, provides for the application for class action suit can be filed before the tribunal "*on behalf of the depositors or members".* But the problem is that will this apparently means that such an action is brought on behalf of all the

members, or is it to certain shareholders of the company only who have violated the object clause of the company.

If the answer are in confirmatory, that it is against all the members of the company, would the damages be awarded to the class as whole or to only those who brought the action, is no who can be sued for class action and who can get the relief out of it.

As per section 245 (1) (g), a class action can be brought against: ***The Company, Directors of the Company, Auditors and Audit firm of the company for any false and misleading statement in the audit and finally any expert or advisor or consultant or any other person for misleading statements made to the company or any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part".***[1]

In absence of such distinguishing factor, the underlying principle of class action, which aims at reducing multiplicity of suits, gets frustrated and nullified. It is also important to note that, no two class action can be entertained on the same issue.

The conditions for the instituting the suit remains same from the Section 399 of the Companies Act, 1956, whereas the only difference is that, oppression remedy is for the individual relief, whereas class action is for the corporate relief, to protect the company from wrongful acts of the members which are Ultra vires to the company.

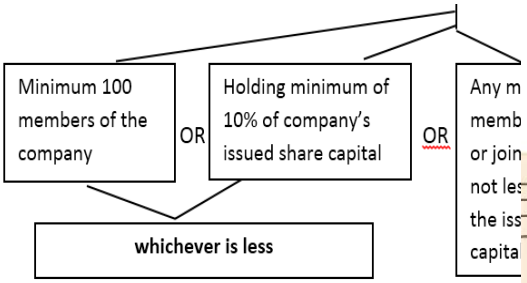
DIFFERENCE BETWEEN THE APPLICABILITY OF THE SECTION 241 AND SECTION 245 OF THE COMPANIES ACT, 2013

SUBJECT MATTER	OPPRESSION REMEDY	CLASS ACTION REMEDY
Filing of Application	Members of the Company	Members as well as deposit holders of the company
Filing of the Application is done against	Company and its statutory appointees	Company, Any of its directors Auditor, including audit firm Expert or advisor or consultant or any other person
Subject Matters for which application can be filed/ entertained	Any current or past activity or to prevent recurrence	Any current, past or future activity, including desisting from one or more particular action that has not been taken yet.
Nature of the Remedy claimed	Individual Remedy	Corporate Remedy

In the case of the persons eligible to file the suit;

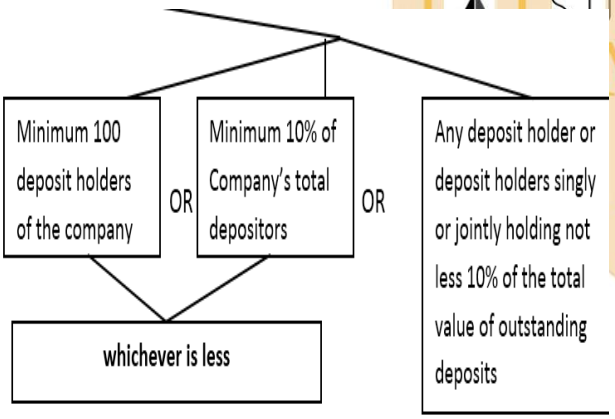
A) MEMBERS:

1. For the corporation having share capital, subject to the condition that all are fully paid shares:



2. For the company not having share capital; not less than 1/5th of the Total number of its members.

B) DEPOSIT HOLDERS:



The above flow chart is the conditions for filing oppression remedy under 1956 Act (Section 399 – Right to apply under Section 397 and 398 [Filing for Oppression Remedy]now it is added in the Section 245 for the filing of Class Action Remedy, no changes in it.

CONCLUDING OPINION & SUGGESTIONS

It is concluded that the Class Action suit is a better platform the minority shareholders, investors and depositors to raise their grievances against the management of the company. The author feels that the:

> "*Class action suits maybe undertaken as a redressal tool by minority shareholders having common interest for promotion of transparent corporate governance".*

But, upon perusal and deep interpretation of the Section 245, it is understood that, the provisions are neither purely "Class Actions" as prevalent in US nor purely "Derivative Suit" as prevalent in UK. The interpretations of the section overlap with remedies that are already applicable under Section 241 of the Act.

The introduction of concept like class action is certainly beneficial for the investors of the company. It provides them with a medium to fight as one unit against the errant company, thereby ensuring less cost of litigation, reducing multiple suits on same subject matter and increasing their chances of success in the process.

Especially, the depositors, who had no option but to file a civil suit so far now, can take class action suit as a defence for any wrongful act by the company or the members of the company. These help in increasing the accountability of a company or its management towards its stakeholders and in containing any likely prejudice against the minority.

In order to make the class action more effective in India, it is necessary to modify it to fit into the Indian Legal and Procedural system. The role of investors associations and SEBI should be strengthened more in order to increase the shareholder activism and investors protection.

"We Want To Change, We Want To See, We Can"

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