

# Yes, Governance Matters.

August 22, 2024

## ARE CURRENT CLASS ACTION SUIT PROVISIONS IN INDIA SUFFICIENT FOR ESG RELATED DISPUTES?

- *Class Actions Suits introduced as a remedy for shareholders, but remains underutilized in India, especially in ESG-related disputes*
- *The Indian CAS system draws inspiration from the U.S. but has stricter requirements, making it challenging to initiate and sustain such suits.*
- *Lack of awareness, difficulty in class formation, preference for out-of-court settlements, and availability of other remedies hinder the effectiveness of CAS in India.*
- *Global trends indicate a rise in ESG-related CAS, and India may see similar growth, driven by increasing shareholder activism.*

## INTRODUCTION :

Recently, multiple class action lawsuits were initiated following what is being called the largest breach of Personally Identifiable Information (PII) to date of over 200 gigabytes of data, encompassing nearly 3 billion records with sensitive information such as Social Security numbers and criminal records, from National Public Data, a data brokerage firm based in Florida. The breach affects an undetermined number of individuals from the U.S., Canada, and the UK.<sup>1</sup>

Even in India, the class action suits have finally taken off with the cases of Jindal Poly Films and ICICI Securities highlighting the growing use of class action suits, to address corporate mismanagement and protect minority shareholders. In the Jindal Poly Films case, minority shareholders with a 4.99% stake allege financial mismanagement leading to losses of Rs 2,500 crore, seeking judicial intervention to investigate irregular transactions. Meanwhile, the ICICI Securities case, led by portfolio manager Manu Rishi Guptha, involves a class of 100 investors claiming deliberate undervaluation of I-Sec, benefiting the parent company, ICICI Bank. Both cases underscore the limitations of the current legal framework, which restricts class action rights to members or depositors, excluding other stakeholders who may also suffer financial losses due to corporate mismanagement.<sup>2</sup>

A class action suit simply means that a group of people with a common objective against one or more individuals / entities brings an action for a remedy, with the class being treated as a single entity. In this article, we discuss Class Action Suits under Section 245 of the Companies Act, 2013 (**CA 2013**), analyzing the need for improvement in the current regime.

Section 245 was introduced in India for the first time in the CA 2013, however, the concept of the suit is not alien to the legislative system of India but has been existing under different laws for a long time and has been an effective remedy under, for individuals other than shareholders for a claim arising out of:

1. **Code of Civil Procedure, 1908-** A representative suit may be filed under Order 1 Rule 8 of the Code by one or more persons, i.e. any number of aggrieved individuals having similar interest in the suit. This is a civil remedy and cannot be imposed for liabilities arising out of a criminal action.
2. **Competition Act, 2002-** A group of aggrieved individuals in the relevant market may file an application in the NCLAT under Section 52(N) for anti-competitive practices.
3. **Consumer Protection Act, 2019-** Under Section 35(1)(c) of the Consumer Protection Act, 2014, can be filed by one of more consumers known as "joint complaint" on behalf of other similarly placed consumers in a representative capacity, i.e. individuals who are consumers of products/ services of a company and a liability arising out of such purchase

To a certain extent, Public Interest Litigations can also be observed as class action suits, however, it cannot be used as a remedy against a private body i.e. Corporate Entities, hence arising the need for Class Action Suits under the CA 2013

## Why Class Action Suit under the Companies Act, 2013?

The remedy under Section 245 is shareholder specific and can only be triggered by a large number of member/ depositors of a company. Shareholders play an active role in decision making of a company, acting as the vigilant watchers against any wrongdoing within the company's affairs. A Class Action Suit ("**CAS**") is one such tool available to shareholders to claim any damages, seek compensation or demand for any suitable action, against:

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1. **The company or its directors** for any fraudulent, unlawful or wrongful act or omission or conduct on its part;
2. **The auditor, including the audit firm (including the liability of each involved partner)** for making any improper or misleading statement of particulars in the audit report or acting in a fraudulent, unlawful or wrongful manner; and
3. **Any expert/ advisor/ consultant** for any incorrect/ misleading statement made to the company or any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part.<sup>3</sup>

## CAS VIA-A-VIS US AND OTHER JURISDICTIONS:

The Satyam debacle, often referred to as India's Enron moment, highlighted the lack of access to class action litigation for Indian shareholders under Indian law. While Indian shareholders had no legal recourse, American investors were able to file a class action lawsuit and received a substantial settlement. The CAS under the CA 2013 is inspired from the US Class Action Suit also known as '*Representative Suit*' which has been in existence since 1983 and have been extensively used by individuals or small communities, aggrieved by the wrongdoings of larger entities.

Class Action Suits have been a common practice in other common law following countries whereas the Indian CAS is majorly inspired from the US Class Action. In US, a CAS can be brought pursuant to Rule 23 of the Federal Laws of Civil Procedure, where one or more persons, as a direct suit may sue or be sued against a large corporation as representative parties on behalf of all the class members. There is no minimum limit which should form a class, however, the prerequisites of observing whether the individuals form a class are the same as the Indian CAS requirements.<sup>4</sup>

This in comparison to CAS in India is different as it allows formation of sub-classes within a single class, which may constitute of individuals who may or may not be shareholders of the company. However, whether the group of people bringing such claim forms a class or not will have to be decided by the courts following the same parameters as have been borrowed by the Indian CAS. The tests to be satisfied in terms of Rule 23(a) are Numerosity test, Commonality test, Typicality test, and Adequacy of Representation test. A failure to establish any one of the four factors precludes certification.<sup>5</sup>

Under Section 245, to file a CAS, a class shall mandatorily constitute of:

- **In case of a company having share capital:** (a) at least 100 members / 5% of total members (whichever is lesser) or (b) members holding 5% of the issued share capital in case of an unlisted company/ members holding 2% of the issued share capital in case of a listed company.
- **In case of a company not having a share capital:** not less than 1/5th of the total number of its members.

Further, to ascertain the admissibility of the CAS, the NCLT shall take into account whether such members forming such application form a class or not basis the following factors:-

1. whether the class has so many members that joining them individually would be impractical, making a class action desirable;
2. whether there are questions of law or fact common to the class;
3. whether the claims or defences of the representative parties are typical of the claims or defences of the class;
4. whether the representative parties will fairly and adequately protect the interests of the class.<sup>6</sup>

The two sections although appear similar have material differences, the US provisions being broader in nature.

## CLASS ACTION SUIT V. OPPRESSION & MISMANAGEMENT SUIT UNDER THE COMPANIES ACT, 2013:

A CAS provides an option to a large number of members/ depositors of the company (*other than a Banking Company*), having a common grievance, to collectively initiate litigation for claiming a remedy 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. Section 245 of the CA 2013 (*notified on June 1, 2016*) read with Rule 84-87 of the National Company Law Tribunal Rules, 2016 governs the procedure of admission and conduction of a CAS. A class is represented by one or more representative(s) of the class, who can claim various remedies under the provision.

A suit for Oppression & Mismanagement ("**O&M**") is brought for the protection of minority shareholders against any harsh, unfair, wrongful act committed by the management or the majority or conduct of affairs prejudicial to the public interest or in a manner oppressive to such members being 100 or 1/10<sup>th</sup> of the total number of members of a company having share capital or 1/5<sup>th</sup> of the total number of members in case of a company not having share capital.<sup>7</sup> This limit of number of members has been waived by the Tribunal in catena of judgments where application was filed by such members.<sup>8</sup>

The primary difference between the two suits are:-

- CAS has a wider scope than O&M and is mainly focused upon interest of the company or such members/ depositors bringing such claims whereas in an O&M suit, a depositor may not be able to bring such a claim.
- The requirement of number of members who can bring such a claim is flexible in O&M while in case of a CAS, the statutory limit is rigid.
- The remedy in O&M can only be sought against the company or its directors for any particular act of oppression of affairs being against public interest, while a CAS can be brought against auditor/ auditing firm of the company as well as any expert/ advisor who makes a misleading statement, wherein interest of the company and the members/ depositors are concerned.

In a nutshell, an O&M suit can be brought for instance or act which is oppressive and against public interest, whereas

a CAS suit can be brought for a wide range of acts like lapse in duty of directors, improper financial statements, misleading statements etc. which in general may as well cause future depletion in interest of the shareholders, which makes CAS a better option for shareholder activism to rise in India.

## CURRENT SITUATION IN INDIA:

From a Governance perspective, CAS serve as an important tool in hands of the shareholders. However, to the surprise of the legal fraternity, it has not been explored enough, which is evident from the lack of precedence to determine viability/ timelines of such suits. This lack of interest in CAS may be attributable to several reasons including:

1. **Lack of awareness:** there is a general lack of awareness on the existence of the remedy. This may be attributable to the negatively low number of orders and no precedence available under the remedy, rendering the shareholders to explore remedies under other provisions of law;
2. **Difficulty in class formation:** the requirement of formation of class is strict and difficult to achieve in comparison to the procedure followed by other common law countries, which also makes it impractical for different number of shareholders to pursue a suit where they may have different interests in claims arising from the same action;
3. **Settlement agreements:** It is a common phenomenon that larger entities would not wish to continue litigations and prefer to settle the costs/ remedies outside the court. In a recent report, in US CAS Regime, a record-breaking sum of settlements of \$4.4 billion was paid in the year 2023<sup>9</sup>; and
4. **Availability of other remedies:** there are several other shareholder remedies available under the Companies Act, where a shareholder may file an application for securities class action, liquidation, fraud against the company or for O&M.

## SUGGESTIONS AND WAY FORWARD:

CAS, contrary to its legislative intent, has not been actively explored by the Indian Shareholders, questioning the legislature to explore the need to not only revise the procedure, but also to shape it as an active remedy for the future. Representative Actions are very common in the US and going forward as the Indian Shareholder Activism develops to understand the importance of governance issues other than profitability, we believe CAS will be a valuable tool to tighten the grip of shareholders to bring better governance structures, thereby improving affairs and internal management of Indian companies.

It will be interesting to observe, how ESG activism in India will increase CAS litigations in India. Observing the global trends, the shareholder activism in ESG related litigations are being increasingly initiated through CAS regularly by the shareholders of such entities, which are responsible for any damages arising out of their management and actions to the internal as well as external atmosphere which the entity operations in. As per a recent survey report<sup>10</sup> of in-house litigators and general counsels, nearly 1/3<sup>rd</sup> growth in ESG related disputes was observed in 2022 and another 24% increase was estimated for 2023. The practical timelines of culmination of CAS proceedings are also unclear due to a lack of precedence. It will have to be observed how an increase in shareholder activism in India will lead to transformation and development judicial interpretations of the remedy and will be used to implement good governance in large entities.

CAS has been used as a litigation method in cases of emission of greenhouse gases having climatic impacts by the company,<sup>11</sup> false and misleading advertisement having climatic impacts,<sup>12</sup> workplace misconduct and violation whistle-blower protection rules,<sup>13</sup> representations in various statements of investments with incorrect ESG quality review amongst others requiring the companies in violation to provide adequate compensations through settlements<sup>14</sup> for gross governance violations and incorrect practices. Climatic litigations are on the rise and class actions seem to be the way for change in incorrect practices by the companies.<sup>15</sup>

To pace up with the global litigation trends there is an urgent need to provide easier shareholder activism by means of CAS, and the legislature must consider the following suggestions:

- Reduction in threshold of number of persons required to bring in a CAS from 100 to an easier figure of 10-20, upon an application, similar to provisions under Section 244 of the Companies Act, 2013.
- Increase the scope to invoke ESG claims by individuals who are not members/ depositors of the company to include good governance practices. For example, where affairs of a company are conducted wrongfully, the individuals who are not shareholders and effected in the region, effected due to other secretarial matters, employees etc. may be included accordingly.
- Inclusion of Settlement Agreement as a separate clause under Section 245 of Companies Act, with adequate penal measures for fraudulent claims. The process can be adopted as an offer from the wrongdoer directors/ company, or any responsible individual for mismanagement of affairs by advertisement for claims likewise in US. The management of fraudulent claims by imposing penalties will have to be considered given the rise in fraudulent CAS Claims in the US.<sup>16</sup>
- Appointment of a Special Committee for review of the provisions, as the current structure has barely been explored by shareholders.
- Increased accountancy and punitive measures for the benefit of class bringing such action.

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You can direct your queries or comments to the relevant member.

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<sup>1</sup><https://www.biometricupdate.com/202408/data-breach-exposes-3-billion-pii-records-class-action-suits-filed>

<sup>2</sup><https://www.moneylife.in/article/class-action-lawsuits-make-a-beginning-after-11-years-but-significant-reforms-still-needed/74202.html>

<sup>3</sup>Section 245(1) of the Companies Act, 2013

<sup>4</sup>Rule 23 of Federal Rules of Civil Procedure, 2023.

<sup>5</sup>Rule 23(a) of Federal Rules of Civil Procedure, 2023.

<sup>6</sup>Rule 85 of the National Company Law Tribunal Rules, 2016

<sup>7</sup>Section 244 of the Companies Act, 2013

<sup>8</sup>Mewar Hitech Engineering Limited v. Udaipur Chamber of Commerce, 2019 SCC Online NCLT 14839 [22]; Photocon Infotech Pvt. Ltd. v. Medici Holdings Ltd., C. A. (AT) No. 375 of 2017 (April 24, 2018), [15, 16]; Shri Dinesh Sharma and Smt Bina v. Vardaan Agrotech Pvt Ltd, 2009 SCC OnLine Kar 391 [32]

<sup>9</sup><https://woodruffshawyer.com/insights/securities-class-action-year-end#heading-0>

<sup>10</sup><https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/knowledge-pdfs/2023-litigation-trends-survey.pdf>

<sup>11</sup>People v. JBS USA Food Co., No. 450682/2024 (N.Y. Sup. Ct. filed Feb. 28, 2024); <https://ag.ny.gov/sites/default/files/court-filings/jbs-complaint.pdf>

<sup>12</sup><https://www.nbcnewyork.com/news/national-international/today-is-your-last-day-to-claim-money-from-the-keurig-k-cup-recycling-suit-settlement/4037085/>

<sup>13</sup><https://www.sec.gov/files/litigation/admin/2023/34-96796.pdf>

<sup>14</sup><https://www.sec.gov/files/litigation/admin/2022/ia-6032.pdf>

<sup>15</sup><https://plasticslitigationtracker.org/page/3>

<sup>16</sup><https://www.reuters.com/legal/us-class-action-settlements-flooded-with-fraudulent-claims-by-scammers-2024-05-02/>

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