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Do Class Action Suits Improve Quality of Corporate Governance?

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Abstract: Corporate governance refers to steering an organization in the desired direction. Corporate law in India too has undergone changes in relevant rules and regulations due to corporate frauds and failures. Regulators expected the more stringent corporate governance laws to improve the governance climate, resulting in better financial performance of companies, thereby winning stakeholders' confidence as well. The Class Action Suits under Companies Act, 2013 will redress the grievances of members and depositors in case of fraudulent actions on the part of the company.. Class action mechanism is a potent remedy for shareholders. The device allows the courts to manage law suits jointly, who have suffered the same wrong at the hands of the defendant, named as plaintiff. This will create enormous confidence in the minds of investors in India and overseas as these investors are very much concerned about sound procedures and good governance practices. This will lead to more flow of capital into India, in the form of modernization and expansion of the existing projects and also new projects. At the same time, there would be a greater transparency and accountability by Board of directors/ Audit firms/ Advisors/ Consultants. This article focused on how the Class Action Suits under Companies Act, 2013 will redress the grievances of members and depositors in case of fraudulent actions on the part of the company through NCLT and improves the quality of corporate governance.

Keywords: Corporate governance, frauds and failures, NCLT, Class Action Suits, stakeholders' confidence.

I. INTRODUCTION

Corporate governance issues have attracted considerable attention world due to financial scams or corporate failures that highlighted the need for tighter surveillance over corporate behavior. Corporate law in India too has undergone changes in relevant rules and regulations due to corporate frauds and failures. Regulators expected the more stringent corporate governance laws to improve the governance climate, resulting in better financial performance of companies, thereby winning stakeholders' confidence as well. The Class Action Suits under Companies Act, 2013 will redress the grievances of members and depositors in case of fraudulent actions on the part of the company

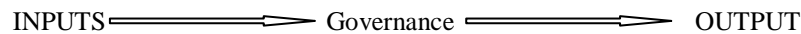
II. REVIEW OF LITERATURE

The term 'governance' is derived from the Latin word 'gubernare' which means "to steer." Thus, corporate governance refers to steering an organization in the desired direction. Corporate governance is essentially concerned with the process by which companies are governed and managed. It is a set of standards which aims to improve the Company's image, efficiency, effectiveness, and social responsibility. It is a specially designed framework of legal, institutional, and cultural factors shaping the patterns of influence that shareholders (or stakeholders) exert on managerial thinking and decision-making process.

Governance relates to the management of all such processes that, in any society, define the environment which permits and enables individuals to raise their capability levels and also provide opportunities to realize their potential and enlarge the set of

available choices. Governance is the sum of the many ways individuals, institutions, public and private manage their common affairs.

Governance as channel



A key element of good governance is transparency projected through a code of good governance which incorporates a system of checks and balances between all stakeholders.

III. DEFINITIONS OF CORPORATE GOVERNANCE

According to the Institute of Company Secretaries of India (ICSI), corporate governance is “the application of best management practices, compliance of law in true letter and spirit, adherence to ethical standards for the effective management, and distribution of wealth, discharge of social responsibility for sustainable development of all stakeholders”. DPE Guidelines (2010) stated that corporate governance is the acceptance by management of the in-alienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about business conduct and about making a distinction between personal and corporate funds in the management of the company. The Organization for Economic Cooperation and Development (OECD) provided a functional definition of corporate governance as “the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as Board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance.” (Desai, 2011).

Table 2.1 Corporate Governance – Evolution in India

Period of origin	Ownership	Dominance
Pre-independence	Family	Eco-centric
1947-1981- Rule of Thumb	Government	Social altruism
1981-1991- License Raj	Professional Ownership	Social Justice
1991-Present-Liberalization era	Allowing foreign Owner ship	Egocentric

Source(Gupta.V and Kamala.G , 2006)

At the time of Independence, India had a functioning stock market, an active manufacturing sector, a fairly developed banking sector and also a comparatively well developed British-derived convention of corporate practices. From 1947 to 1991, the Government pursued markedly socialist policies. Faced with a fiscal crisis, the Government of India initiated major economic reforms in 1991. Accordingly, a new Industrial Policy was adopted. The office of the Controller of Capital Issues was abolished. Firms were encouraged to access capital markets for their financing needs. Since then, remarkable developments in capital issue volumes, trading volumes and resultant increase in gross domestic product (GDP) growth have taken place. There was a substantial growth in the year-on-year in-bound and out-bound Foreign Direct Investment (FDI) flows. Foreign institutional investment inflows also increased as India is viewed as an attractive emerging market destination. This necessitated improvements in corporate reporting systems for the benefit of investors. Corporate governance reforms and major corporate governance initiatives began in the mid 1990s, as the process of globalization of the economy gained momentum. Corporate disclosures had to be ‘adequate, fair and full’ (Sareen and Chander, 2009).

Governance in Corporates - Indian Perspective - Key Milestones

1999	• Constitution of Kumar Mangalam Birla Committee
2000	• SEBI- Introduction of Clause 49 in Listing Agreement
2003	• Narayana Murthy Committee DPE Guidelines on Corporate Governance
2004	• J.J. Irani Committee Report
2006	• SEBI REvision of Clause 49
2010	• DPE Guidelines on Corporate Governance
2012	• Issuance of voluntary Guidelines
2013	• Revised Companies Act- Provisions on corporate Governance and Class Actions.
2014	• SEBI- New Corporate Governance Norms

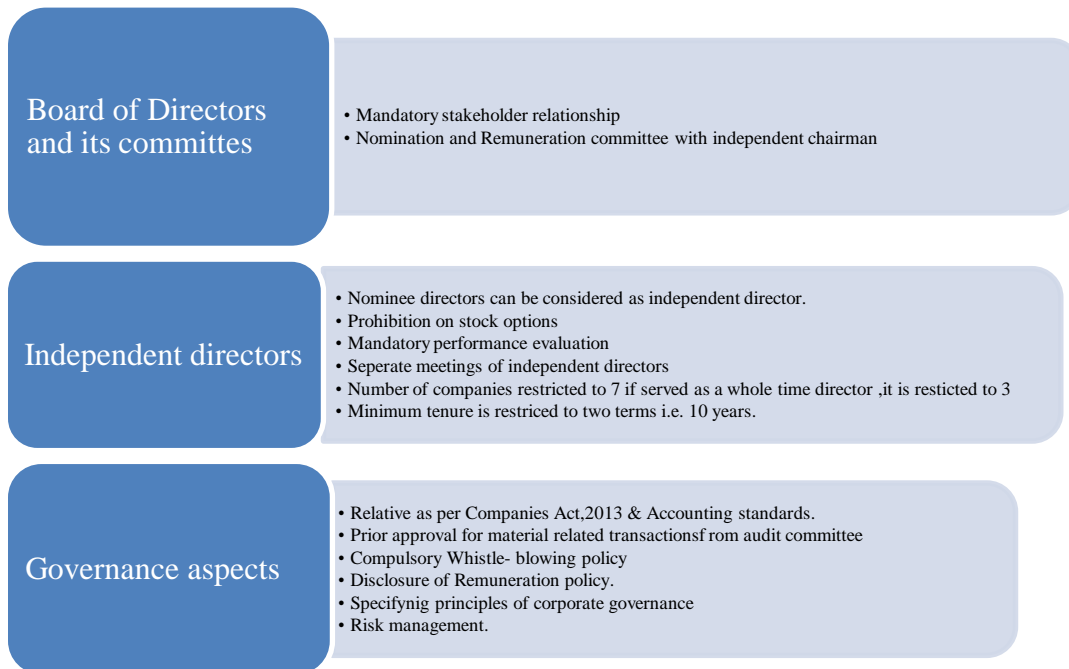
Protection of Stakeholders Interests: With respect to shareholders, the following provisions were worth mentioning:

- ✓ Provisions relating to prohibition of associations and partnerships exceeding a specific number;
- ✓ Provisions dealing with framing, amending the documents like Memorandum and Articles of Association;
- ✓ Provisions for levying penalties for violation of conditions of incorporation, contents of prospectus;
- ✓ Provisions relating to allotment of shares, debentures, their transfers, and transmissions;
- ✓ Provisions relating to payment of dividends and other provisions relating to day to day management of the companies.

Creditors - Some of the provisions important from the view point of creditors are: creation of charges on the property of the company, powers to remove undesirable managerial personnel, prevention of oppression and mismanagement, appointment of receivers and managers, provisions relating to winding up, constitution and working of company courts, and tribunal.

Employees: In respect of employees the provisions worth mentioning were relating to: employees' securities and provident funds, financial discipline - commissions and discounts, further issue and reduction of capital, audit requirements, investigations by central government. The above are expected to improve the protection of the interests of employees.

General Public: These provisions in the Act requiring: the filing of various forms and returns, the maintenance of various registers and books of accounts; the finalization of annual accounts and publication thereof; the conduct of audit of accounts; are some of the provisions towards promoting the interest of general public.



CLASS ACTIONS: A class action is a procedural device that permits one or more plaintiffs to file and prosecute a lawsuit on behalf of a large 'group or class'. It is one of the mechanisms used for enforcement of corporate law wherein shareholders take action against the company/ Management for breach of their duties and obligations which are owed to shareholders or to the company. On 1st June 2016, the provisions of class actions under Section 245 of the Companies Act, 2013 are notified. This section provides relief to the investors against large set of wrongful actions committed by management / other consultants and advisors who are associated with the company. However Class action suit is not permitted for matters which the members/ depositors could pursue in his own right rather than through section 245.

Section 245, Companies Act, 2013:

- Class action suit can be filed against any type of company whether Public/ Private Sector, incorporated under Companies Act 1956/ 2013. However, the Central Government is empowered to exempt any company / class of companies from the provisions of the Act. Banking companies are also exempted from these provisions.
- The said can be initiated i. against company/ its directors; ii. Individual auditor & audit firm/ Limited Liability Partnership & its individual partners; and iii. Any expert/ Advisor / consultant/ any other person for any misleading statement or for any unlawful, fraudulent or wrongful act or conduct on their part. The persons include merchant bankers, Chartered Accountants, Company secretaries, and such other practicing professional, law firms or subsidiaries.
- The members/ Depositors/ A person or association representing such members/ depositors, who fulfill the criteria read with Rule 99 of the Draft National Company Law Tribunal (NCLT RULES) and The Companies (Prevention of Oppression and Mismanagement) Draft Rules.
- In case of company having share capital, the members/ Depositors who choose file a class action should comprise:
 - a. 100 members or 10% of the total number of members depositors, whichever is less or
 - b. Any member/ members holding singly or jointly not less than 10% of issued share capital of the company and the members should have paid all calls and other sums due on the shares held by them.
 - c. In case depositors, to whom the company owes 10% of the total value of its outstanding deposits, The depositor shall have the same meaning as given under Rule 2 (c) (xiv) (c) of companies (Acceptance of Deposit) Rules, 2014.

- In case, company not having share capital, the members should comprise not less than one-fifth of total number of its members, to file a class action suit.
- Section 245 permits a representative/ NGO/ any investor association / public spirited citizen to file a suit for representing aggrieved persons.
- The Act also provides that all similar applications existing in all the jurisdictions should be consolidated into a single application and class action members / Depositors are allowed to choose 'lead applicant', if not, Tribunal shall appoint a lead applicant, who shall be in charge of the proceedings from the applicants side. However, this clubbing is possible to the Tribunal only the cause of action is similar to justify consolidation of class actions.
- **Guidelines for filing an application for a class action suit under Section 245:** NCLT will receive application after analyzing guidelines closely such as i. whether application is brought in **Good faith**; ii. Whether there is an **evidence** before it as to the involvement of any person other than directors or officers of the company on any other matters provided in class action before making them a party and before continuing class against them; iii. Whether there are actions maintainable as such harmful to the entire group of members; iv. **Views** of the members of the company who have no personal interest direct or indirect in the matter being proceeded under this section; v. **Cognizance** of past, present and future wrongful actions and volatile actions that are proposed by the company; and vi. **public notice** to the members /depositors of the class actions. However, two class action application forms for the same cause of action are not allowed.

Relief in class action suits under section 245(1), Companies Act, 2013: The aggrieved investors can demand / claim damages/ compensation under this Act, against any/all of the following activities under class action:

- An ultra vires act to the articles / Memorandum of Association can be restrained.
- A company committing breach of any provision of its articles/ Memorandum can be restrained.
- An order restraining the company / its directors from passing a resolution by suppressing material facts or making misstatements to the members / Depositors.
- The company can be restrained from doing an act contrary to the provisions of Companies Act or any other law for the time being in force.
- A fraud or any wrongful act in the company which occurs with the assistance of insiders and/ outsiders.

Effect of Orders passed under Class Action (Sec 245): The order under class action is in the nature of 'an order in rem'. It means the order is binding on the company and its members and Depositors, who are not party to the suit. These parties/ persons are specified under section 245(6). Any company which fails to comply with the orders passed by NCLT under section 245(7) read with Section 425, then it shall be punishable with a fine not less than Rs. 5lakhs which may extend to Rs.25lakhs and every office who is in default shall be punishable with imprisonment for a term which may extend to three years and with a fine which shall not be less than Rs.25,000 which may extend to Rs. 1lakh. The members/ depositors who have spent money on class action shall be reimbursed. The persons who are found to misuse the mechanism of class action shall be punishable with a fine of Rs.1lakh under the provision of this Act.

IV. CONCLUSION

The Securities class actions, where investors file a suit against company, are common in many countries like US, Canada, Austria etc. Class action mechanism is a potent remedy for shareholders. The device allows the courts to manage law suits jointly, who have suffered the same wrong at the hands of the defendant, named as plaintiff. Although class action suits have not yet been tested, certainly it will change the litigation landscape for potential claimants, their lawyers and defendants. It will

be easier for claimants to bring collectives actions for breach of law, minimises legal costs and gives mutual benefit from the successful settlement. This will create enormous confidence in the minds of investors in India and overseas as these investors are very much concerned about sound procedures and good governance practices. This will lead to more flow of capital into India, in the form of modernization and expansion of the existing projects and also new projects. At the same time, there would be a greater transparency and accountability by Board of directors/ Audit firms/ Advisors/ Consultants. Professional Bodies and other organizations such as FICCI , Government Departments need to work together to bring growth in the various dimensions of corporate governance and also for ease of doing business and take effective steps to spread awareness among various stakeholders. The procedure for granting the relief decree/orders will be definitely more viable and less time consuming, so that the confidence of the various sections of the people will nurture in the Tribunal. In this dynamic global world, merits of Tribunal cannot be denied in initiating the shareholders/ stakeholders activism in corporate governance.

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