Business Line

**Date:26/03/2009 URL:
http://www.thehindubusinessline.com/2009/03/26/stories/2009032650240900.htm**

Back Litigation in the case of fraud

While the recourse available against a company under the Indian law would either be penal charges or liquidation, the US law facilitates shareholders to recover their loss from the company or the directors.

The new law does not recognise shareholders' right to claim damages from the company.

Vyapak Desai
Vedant Shukla

In the past decade, the capital market in India witnessed a huge expansion both in terms of the size and capital of corporate entities. Apart from corporates, one other aspect of the capital market that has grown significantly is corporate governance. However, recent developments in the corporate sector have initiated a debate pertaining to adherence to the principles of corporate governance. Current developments have also made shareholders apprehensive about the p rospect of claiming damages for loss suffered by them on account of fraud by the directors of companies.

This article focuses on the legal remedies available to shareholders both in India and the US.

Indian Perspective

An Indian listed company and its directors may undergo both civil as well as criminal trials. The civil trial would be instituted by the shareholders of the company and they can approach the court under Section 397 of Companies Act, 1956, for oppression and mismanagement.

However, in a suit under Section 397 , the tribunal has power to grant limited relief under Section 402 — regulation of the conduct of the company's affairs in future. However, the maximum relief that may be granted by the tribunal is passing a winding up order against the company. The Companies Act also provides for penal actions under Sections 209 233 and 628 wherein an imprisonment of up to two years and/or a fine of Rs 10,000 may be imposed.

Shareholders in India do not have any legal remedy under which damages can be claimed from the company or directors for the loss suffered by them in such circumstances. However, the Code of Civil Procedure, 1908 under Order 1 Rule 8 does provide for filing of a 'Representative Suit', but this may not be applicable in such cases.

Apart from the above, the State may also initiate criminal litigation against the company under the Indian Penal Code, 1908 (IPC) through Sections 463, 464 and 465 for forgery, Section 477 A for falsification of accounts, and Sections 418 and 420 for cheating. In a listed company, the provisions of Clause 49 of the Listing Agreement apply, wherein the CEO/CFO is required to review the financial and cash flow statements and affirm that the same are accurate to the best of their knowledge and belief.

In the event of a breach of the Listing Agreement provisions, the stock exchange can take appropriate remedy, which includes de-listing of the company. The Securities and Exchange Board of India (SEBI) under Section 15HA, read along with Section 24 of Securities and Exchange Board of India Act, 1992, may also impose a penalty for fraudulent and unfair trade practices to the tune of Rs 24 crore or three times the amount of profits made out of such practices, whichever is higher.

It is important to note that Indian shareholders would not be able to file any suit in US courts against the company because the courts there may dismiss the case on the grounds of forum non-convenience.

In the *UCIL* case, the court affirmed a dismissal on similar grounds, stating that an adequate remedy for Indian plaintiffs could be afforded by Indian courts.

Section 216 of the Companies Bill, 2008 provides for a class action suit by any one or more stakeholders, if they are of the opinion that the affairs of the company are not being managed efficiently and the same may hamper the interests of the stakeholders. However, the relief that the tribunal is empowered to grant are not damages, but to restrain the company from doing certain acts.

Thus, even the new law does not recognise the shareholders' right to claim damages from the company.

US Law

On the other hand, the US shareholders are better-off compared to their Indian counterparts. In case of frauds, the US shareholders can initiate two types of actions against companies for mismanagement or fraud: a derivative suit and a class action suit.

A derivative suit is one brought by a shareholder on behalf of the corporation against directors, when the corporation has suffered a loss. For harms that affect a class of shareholders, they may bring a class action suit against the directors on behalf of all the shareholders who suffered the harm.

A class action will be brought under Rule 10b-5 of General Rules and Regulations promulgated under the Securities Exchange Act, 1934 (SEA) which prohibits manipulative and deceptive practices in connection with the purchase or sale of any registered security.

Some other sections of SEA, such as Section 20A, which provides for Liability of Contemporaneous Traders for Insider Trading, may also be used to impose additional liability on the company and to implicate those officials of the company who have either made huge profits or avoided losses by virtue of their position in the company.

Apart from shareholders' litigation, the company or its officials accused of defrauding the shareholders, would have to face investigation by Securities and Exchange Commission (SEC). The SEC has extensive powers to investigate securities violations and if the company is found guilty in the investigation, there can substantial monetary as well as penal consequences. As far as jurisdictional issue is concerned, US courts and regulators would have jurisdiction to entertain a suit against the company since its American Depository Receipts are listed in one or more stock exchanges in the US.

Damages

As opposed to a derivative suit where the damages go to the corporation, damages arising from a class action go directly to the shareholders. Compensatory damages are measured as either out-of-pocket or benefit-of-the-bargain damages. To provide some reference, though it was a unique situation, independent directors in both WorldCom and Enron agreed in a settlement to personally pay damages, and which could not be reimbursed by insurance, of $18 million and $13 million respectively.

Enforcement of Foreign Awards in India

Once the shareholders get a favourable judgment from the US courts, the only remaining hurdle left is the enforcement of the suit, if the entity is in India is the enforcement of the foreign award in India.

The law related to enforcement of foreign awards is enshrined in Sections 13, 14 and 44A of Code of Civil Procedure, 1908. Since US has not been notified as a reciprocating jurisdiction by the Central Government, the decrees passed in the US cannot enjoy the benefit of Section 44A and thus would have to obtain a decree in a competent court in India and file for an execution proceeding for enforcement of the decree.

A simple comparison of Indian law vis-À-vis the US law reveal the stark differences between the approaches followed by the legal systems in the respective countries. On the one hand, the Indian law suggests that the recourse available against the company would either be penal charges or liquidation, but on the other the US law emphasises more on shareholders' rights and facilitates the shareholders to recover their loss from the company or the directors.

Even the Companies Bill, 2008 has failed to take into consideration Indian shareholders' right to claim damages for the loss suffered by them. While it is manifest that the company would incur heavy liability in class action suits filed against the company in the US, it is yet to be seen as to how the Indian regulator would tackle the unprecedented situation.

(Vyapak Desai leads the Litigation and Dispute Resolution practice at Nishith Desai Associates and Vedant Shukla is an associate with the firm.)