Expert Expressions

Corporate Governance Demystified

Excellence Enablers Private Limited

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A series of interfaces with the entire range of stakeholders of Corporate Governance, has given rise to a number of questions, issues, concerns and, happily, some suggestions and solutions. In each issue of this monthly newsletter, we will be getting two experts to articulate their thoughts on a specific topic. The sixth issue is now with you. Needless to add, we welcome your feedback.

Editor

CLASS ACTION SUITS – POTENT, YET PROBLEMATIC?

M. Damodaran
Chairperson, Excellence Enablers
Former Chairman, SEBI, UTI and IDBI

"Now let it work.
Mischief, thou art afoot.
Take what course thou wilt!"
(Mark Antony in "Julius Caesar")

Class Action Suits, the new kid on the block in Indian corporate law, best illustrates the saying: "Where you stand depends on where you sit." Those who are potentially at the receiving end, are seeing the dark clouds of despair. Those who are empowered, see a ray of hope. Will the already endangered species of IDs vanish from Boardrooms as soon as the first suit is filed? Jerry Rao and Sandeep Parekh share their perspectives.

When minority investors get shafted - which is not unusual in modern capital markets, the transaction costs are way too high for someone with just a thousand shares to sue the company or its management. The angry and frustrated shareholder simply sells out, curses her fate and moves on. Class Action Suits, by aggregating the plaintiffs, who individually may be lethargic, but who collectively can make an impact has emerged as a useful way to redress the asymmetries. This way even the small shareholder gets some recompense. More importantly, it keeps indifferent managements on their toes.

So of course all of us should be welcoming Class Action Suits. But tarry a minute. One only wishes it were that simple. These kinds of legal actions work when the judicial system is efficient and reasonably fast. If between endless adjournments and multiple appeals, legal actions result in verdicts after twenty years - mind you in the twenty years, many companies may have disappeared and several managers would have gone on to meet their creator - then it is not clear that the so-called "wronged" and "deserving" small investor is helped. But one thing is for sure-we will now suddenly have a spate of frivolous suits. This is especially so because in our country there are virtually no penalties for vexatious litigation. These frivolous/ vexatious suits will simply drive up the cost of capital even for honest and competent management groups and increase the problems of doing business in India - something that one hopes we want to prevent.

While conceding the principle involved in Class Action Suits, we must wait. Until legal and judicial processes are reformed in a manner that reduces delays and inhibits frivolous lawsuits, it is better to be a frustrated investor and simply sell out, rather than make India even more difficult as a place to do business in. After all, then investors will have nowhere to invest!

After the Satyam fraud, India, as a country, realized that shareholders, of Indian companies, who have faced fraud, could not be made whole. In contrast, the international shareholders could obtain US $125 million by filing a class action suit at a US court. The Irani Committee proposed the inclusion of class action law suits in the then proposed Companies Act.

Section 245 of the Companies Act provides a right to members and depositors to bring an action against the company, its directors, auditors, experts, or consultants, for any fraudulent act or omission committed or likely to be committed by them. This has so far remained a dead letter since we have not yet seen a single class action law suit since 2014. This is primarily because of what economists call the tragedy of the commons. An investor must fight alone bearing the costs of, and delays in, litigation, but the benefits are enjoyed by all investors. In addition, the provision is clumsily drafted, complete with a glaring typo, provides barely any benefit, puts an onus of collecting a sufficient number of investors or depositors, and even has a provision for imposing costs in some cases.

For class actions to be effective, the right place to introduce a beneficial provision is in the Civil Procedure Code and the provisions should have clear benefits, deal with the tragedy of commons, reduce the burden on the litigating investor/depositor and finally, for this to really succeed, there will need to be an introduction of contingent fees payable to lawyers.

READERSPEAK

"Nawshir Mirza, Independent Non-Executive Director on Boards and Former Senior Partner, M/s S. R. Batliboi & Co."
"Management brings knowledge; knowledge of the business, of relevant technology, of the environment, of competition and of all the other ingredients that go into the clinical development of strategy. The board then mixes wisdom into it; the special ingredient that turns it into a successful formulation."

"V. Subramanian, Former Secretary, Government of India"
"Risk mitigation, as a component of strategy, is getting short shrift in Boardrooms. Without Boardroom deliberations, managements may have to fall back on astrologers."

"Suneet Maheshwari, Former Group Executive Vice-President, L&T Financial Services and Former MD & CEO, L&T Infrastructure Finance Company"
"Board members, in my view, will lose their moral authority to critique if they co-own (ie, co-develop) the strategy."

Do let us know of any specific issues you would like to see addressed in subsequent issues.