

THE ROLE OF THE COURT IS TO PROTECT THE INTERESTS OF CREDITORS AND SHAREHOLDERS, CLASS ACTION SUITS, AND DERIVATIVE ACTIONS

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ABSTRACT

Capital raised by a company or enterprise includes both equity and debt capital. Those who provide capital in the form of equity are shareholders and if the same is provided in the form of debt capital then they are called creditors. Both players are equally important to the company. These people make up the stock market and are the only reason the stock market works. They form the backbone of the stock market and play an important role in determining the value of shares in the market. Once funding is made, profits are expected. To satisfy this need, the company provides interest to shareholders and creditors. To resolve issues such as violations of corporate obligations, oppression of minority shareholders, and disagreements about corporate governance procedures, shareholders often turn to the courts. Finally, judicial review promotes a culture of responsible corporate conduct by acting as an essential tool to hold corporate officers and directors accountable. Additionally, the brief discusses important court decisions and prior rulings that impact knowledge on shareholder and creditor protection. It draws attention to how the law changes over time and how the courts can evolve to respond to new issues in the business world.

Journal of Legal Research and Juridical Sciences

Keywords: Creditors, Shareholders, Rights, Companies Act, Supervisory Authorities, Courts, Protection Of Interests.

INTRODUCTION

A company is a legal entity governed by law. This organization has two essential entities: creditors and shareholders. It is the company's investors who contribute to the company's capital allocation. A creditor is a natural person or legal entity that provides capital to the company in the form of debt. A shareholder is someone who owns shares of a company and receives dividends from those shares. Common stock represents shareholder ownership in the company as it is used to raise capital and equity in the company.

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Equity is used to describe a party's contribution to the business in the form of effort, rather than financial equity which is a contribution in the form of capital. The parties that contribute to its efforts are called Sweat Equity Investors. In a partnership, some partners may simply add capital to the business, while others simply put up equity.¹

Investors provide capital in exchange for a percentage return on investment or participation in the company's management decisions. Investors typically pool their assets, unlike venture capitalists who collectively manage other people's money in a professionally managed shop.

Different entities, creditors, and shareholders have different expectations, rights, and interests. When providing financing to a company through loans or other credit arrangements, creditors want to be confident that their investment is safe and will deliver the promised returns.

In contrast, shareholders seek to maximize their investment through fair treatment, honest financial reporting, and responsible management because they are co-owners of the company. A strong regulatory framework is necessary due to the complexity of financial transactions, business decision-making, and market dynamics. Courts act as impartial arbiters, interpreting and enforcing the laws governing corporate conduct and protecting the interests of shareholders and creditors. In times of economic hardship or trade conflicts, the function of the court.

CREDITOR AND SHAREHOLDER PROTECTION PROVISIONS

1. Section 62 of the Companies Act 1956 determines civil liability in the event of errors or inaccuracies in the prospectus. In the case of a prospectus inviting people to buy shares or debentures of a company, the directors, promoters (and the person approving the issue of the prospectus will be liable to pay each purchaser of shares or debentures). Any loss or damage which he may suffer because of any misrepresentation therein. Any individual who has purchased shares contrary to the issue of public performance and suffering loss or damage as a result of such failure is eligible for compensation under this particular section.

2. Section 63 of the Companies Act, 1956 imposes criminal liability for fraud or misrepresentation in the prospectus. Any person who approves the issuance of a prospectus containing a false statement shall be liable to imprisonment for a term which may extend to two years or to a fine which may extend to Rs.50,000 or both.

¹ lexpeeps, "Role of Courts in Protection of Shareholders and Creditors" (*Lexpeeps*, November 21, 2020) <<https://lexpeeps.in/role-of-courts-in-protection-of-shareholders-and-creditors/>> accessed February 27, 2024

3. Section 34² of the Companies Act, 2013 provides that where a prospectus contains a false or misleading explanation as to its structure or the context in which it is incorporated or where any consideration or disqualification Except for any matter that may cause misunderstanding, each person who approves the issuance of such prospectus shall be punished with imprisonment for at least 6 months but which may extend to 10 years, and shall also be liable to an unjust fine. equal to the amount related to the issuance of that prospectus, fraud, but can be up to 3 times the amount involved in the fraud.

4. Section 88(1)(a) of the Companies Act, 2013 provides that everybody must maintain a register of its representatives independently in respect of each class of capital and preference shares held by each member living in India or abroad.

5. Article 88 (5) punishes the failure to maintain such a register. If an organization fails to maintain a register of members, the organization and each of its officers in default shall be penalized with a minimum fine of Rs.50,000, however it can go up to Rs.3 lakh and in case of persistent errors, with additional fines up to Rs 1,000 per day thereafter.

6. Corresponding section of the Companies Act, 1956, under section 150. In case of failure to maintain a register of its members, the organization and each officer of the organization in default shall be liable to imprisonment. The fine can be extended to Rs. 500 for each day the violation occurs.

OTHER IMPORTANT REGULATIONS TO PROTECT INVESTORS

- o Restrict or prohibit insider trading in securities
- o Electronic voting
- o No annual meeting at midnight – Meeting convening time The General Meeting of Shareholders is determined to be during working hours,
- o Quorum – fixed according to the number of members of the association instead of a fixed number regardless of the size of the association.
- o Minutes of meetings, Board of Directors meetings, and other meetings and resolutions are approved by postal voting.
- o Maintain and review documents in electronic format.

² Hayes A, “Class Action Definition, Lawsuits, Types, Benefits, Example” *Investopedia* (November 18, 2003) <<https://www.investopedia.com/terms/c/classaction.asp>> accessed February 27, 2024

THE COURT'S ROLE IN PROTECTING THE INTERESTS OF SHAREHOLDERS AND CREDITORS

The Court plays an important role in protecting the interests of creditors and shareholders, which is discussed below:

- The National Company Law Tribunal, or NCLT, is a quasi-judicial tribunal body established by the Central Government of India under the Companies Act, 2013. It deals with matters related to disputes between businesses and companies. It has broad jurisdiction over matters as diverse as insolvency, liquidation³, class actions, oppression, and mismanagement, mergers and acquisitions. This court protects the interests of creditors and shareholders because they can sue companies if their interests are threatened.
- Under the Creditor Protection Act, the courts formally protect the interests of creditors and investors.
- Courts use the legislative process to help creditors settle debt through insurance companies.
- Investors are also protected by law to maintain their quality of life.
- Investors have many options to return money to creditors as directed by the court.
- Creditors and shareholders have the right to be heard in court and shareholders have the right to sue corporations if necessary.

CASE LAWS

R v. Lord Kylsant

In this case, a table in the prospectus revealed that the company had paid dividends between 8% and 10% in previous years, except for two years without dividends. The prospectus stated that the company in question was in good financial standing, but the truth was that the company had suffered significant trading losses in the seven years preceding the date of the prospectus and dividends had been paid from the proceeds within an unusual period. War rather than

³ Shaw B, D'Souza SC and Puskas C, "Should Directors Consider Creditors' Interests When a Corporation Is near Insolvency?" *McCarthy Tétrault LLP* (October 31, 2022) <<https://www.lexology.com/library/detail.aspx?g=5d24df4d-0904-43fd-89c5-a5ffdc38f7bc>> accessed February 27, 2024

current income. The prospectus was found to be false because it misrepresented a fact necessary to understand the statements in the prospectus.

Bharat Insurance Company v. Kanhaiya Lal⁴

This case falls under the exception to the majority rule which holds that major shareholders have more power than minority shareholders. In this case, the defendant is the company and the plaintiff is one of the company's shareholders. One of the objectives of the company was to "advance interest for the security of land, buildings, machinery and other assets in India". A shareholder filed a lawsuit, alleging that the company made certain investments without adequate security and in violation of the terms of the memorandum. The court ruled that he could sue because the majority rule did not apply to ultra vires law.

Reliance Industries Limited vs. Securities and Exchange Board of India Reliance Industries Limited,

Held over 5% stake in the target company, Larsen and Toubro Limited, since 1988-89 and two employees Members of this company are not officers. -Chief Executive Officer of L&T Board of Directors. The Securities and Exchange Board of India has notified the Substantial Takeover and Share Acquisition Regulations, 1994 requiring disclosure of ownership above 5%. RIL continued to buy L&T shares on the stock market when its ownership ratio reached 10. The court held that the appellant, RIL, had a duty or obligation under Regulation 7 to inform the target company that its shareholding exceeded 5%.

RECENT DEVELOPMENTS

In November 2022, the Securities Exchange Board of India, or SEBI proposed a framework to protect the interests of public shareholders in the case of listed companies. Listings are subject to the Corporate Insolvency Resolution Process (CIRP) under the Insolvency and Bankruptcy Code (IBC)[19]. It aims to protect public shareholders during the winding up of a company. It addresses various concerns such as the treatment of public shareholders during corporate bankruptcy proceedings. He also talked about proposed measures to protect public shareholders.

⁴ Khattar K, "How to Protect the Interest of the Creditors" (*iPleaders*, January 9, 2019) <<https://blog.ipleaders.in/how-to-protect-the-interest-of-the-creditors/>> accessed February 27, 2024

The framework aims to create a safer and fairer environment for shareholders of listed companies in difficulty. In 2023, to protect the interests of shareholders and creditors, SEBI authorized stock brokers and depository institutions such as Central Depositories Services India Ltd. (CDSL) and National Securities Depository Company Limited. (NSDL) maintains websites that regularly update detailed information to ensure transparency in the stock market.

CLASS ACTIONS UNDER VARIOUS ACTS

Class Actions Under Companies Act, 2013:

1. A suit may be filed or any other action may be taken by any individual, group of persons, or any association of persons affected by any false statement or inclusion or omission of any matter in the prospectus by the following provisions of the Act. (Part 37) Part 34 – Criminal liability for inaccuracies in prospectus Part 35⁵– Civil liability for inaccuracies in prospectus Part 36 – Penalties for Fraudulent act of soliciting investment of money.

2. A class action may be brought by the members or depositors of the company or by any of them if it is alleged that the affairs of the company are being conducted in such a manner that is harmful to the company's interests or member or depositor. (Art. 245) Class actions under the Code of Civil Procedure: There are no limitations in this regard, except for actions that cannot be brought in civil court at all, e.g. sued for poor management. Anyone with a common interest in the lawsuit can file a class action lawsuit.

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Class action under the Competition Act:

A group may claim an agreement results in a significant negative impact on competition in India or is an abuse of a company's dominant position. Any person, consumer, or their association, can sue.

For example. Price Fixing Class Actions Under the Consumer Protection Act: Proceedings under this Act are limited to disputes relating to goods and services sold/supplied or delivered or agree to sell/supply or deliver goods. Consumers of damaged goods or services may sue under this law.

⁵ Hayes, A. (no date) *Class action definition, lawsuits, types, benefits, example, Investopedia*. Available at: <https://www.investopedia.com/terms/c/classaction.asp> (Accessed: 17 December 2023).

ELIGIBLE ENTITIES UNDER THE COMPANIES ACT, 2013

A class action can be brought against the following persons to claim damages or compensation or seek any appropriate action otherwise from or against:

- the company or its directors for any fraudulent, illegal, or wrongful act or omission.
- auditor/auditing firm for any inappropriate or misleading statement made in the audit report or for any fraudulent, illegal, or wrongful act or conduct.
- any professional or advisor or consultant or any other person for any inaccurate or misleading statement made to the company or for any fraudulent act or practice, any illegality or wrongdoing, or any potential act or conduct on the part of that person.

DERIVATIVE ACTIONS SUITS

Such a suit is brought against insiders, i.e. directors, management, and/or other shareholders of the company and the suit usually involves fraud, mismanagement, self-dealing, or dishonesty by management and the board of directors. Director of a company. Indeed, the shareholder suing claimed to act on behalf of the company because the directors and management failed to exercise their powers for the benefit of the company and all of its shareholders.

Derivative lawsuits allow a shareholder to sue on behalf of the company against parties accused of harming the company. If the company's directors,⁶ officers, or employees do not want to sue, shareholders can request them to sue first. If this petition is unsuccessful, the shareholder can sue on their behalf on behalf of the company. Any proceeds from a successful action will be attributed to the company and not to the individual shareholders who initiated the action.

In most jurisdictions, shareholders must satisfy various requirements to demonstrate good standing before being allowed to proceed. The law may require shareholders to meet conditions such as the minimum value of the shares and the length of time the shareholder holds those shares.

⁶ (No date) *The role of the judiciary in Corporate Law, corporate ... - OECD*. Available at: <https://www.oecd.org/corporate/ca/corporategovernanceprinciples/1857539.pdf> (Accessed: 27 February 2024).

PROVISIONS OF THE COMPANIES ACT, 2013

SECTION 179⁷: POWERS OF THE BOARD OF DIRECTORS

(1) The board of directors of a company shall have the right to exercise all powers and do all work which the company is authorized to do and do: Provided that in exercising this power or in doing any such act or thing, the Board shall comply with the provisions relating to the matter contained in this Act, or in its memorandum or articles of association. Clause, or in any regulations not inconsistent with those regulations and duly made thereunder, including the regulations. by the company in general meeting:

PROVIDED FURTHER THAT the board of directors shall not exercise any power or do any act or thing required or required, whether under the Act by-law or by memorandum or articles of association of the company or otherwise, made or introduced by the company at a general meeting.

2) No regulation made by the company at the general meeting can invalidate a previous act of the board of directors that would have been in force if this regulation had not been enacted.

(3) The board of directors of the company shall exercise the following rights on behalf of the company by resolutions passed at meetings of the board of directors, specifically: -

(a) complaints Complaints against shareholders for unpaid amounts on their shares;

(b) authorizes the repurchase of securities under section 68⁸;

(c) issue of securities, including debentures, whether in India or outside;

(d) loan;

(e) investment of corporate funds;

(f) granting loans or guarantees or warranties on loans;

(g) approval of financial statements and reports of the Board;

(h) diversification of corporate activities;

⁷ Chowdhury, M.R. and Borade, Mr.A. (2023) *Derivative action as a right of the shareholder*, Lexology.

⁸ (No date) *The role of the judiciary in Corporate Law, corporate ... - OECD*. Available at: <https://www.oecd.org/corporate/ca/corporategovernanceprinciples/1857539.pdf> (Accessed: 27 February 2024).

- (i) approval of merger, consolidation, or reconstruction;
- (j) takeover of a company or acquisition of a controlling interest or substantial interest in another company;
- (k) other matters may be prescribed

CONCLUSION

In short, a fundamental element of modern corporate governance is the idea that the courts must protect the interests of creditors and shareholders. Throughout a history characterized by important court decisions, changes in law, and changing forms of business, the legal system has been recognized as an important mediator, promoting fairness, openness, and accountability in the complex interactions between companies and stakeholders. The main question is whether these measures are effective in solving the problem. This idea impacts business behavior, investor confidence, and financial market stability throughout the economy.

Through their role as arbitrators, upholding contractual rights, and overseeing corporate governance procedures, courts promote an atmosphere in which investors and creditors can rely on the rule of law. Laws to protect their capital. The evolution of this idea over time shows a dynamic response to the way the business world has changed, starting with the emergence of stock corporations in the 19th century and continuing with the challenges due to globalization, technological innovation, and increasing attention to sustainability. Legal precedents and the regulatory framework have been revised to address concerns about fiduciary duties, shareholder rights, and fair treatment of all stakeholders.