Preparing securities claims in India

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Claims

General climate

Describe the nature and extent of securities litigation in your jurisdiction.

The Companies Act 2013 (the 2013 Act) provides for a statutory cause of action to any person who has subscribed for securities of a company offered through a prospectus and has suffered losses by relying on any statement in the prospectus that was untrue or misleading or owing to omission of any matter in the prospectus. However, rarely has any such litigation been initiated in the recent past.

In addition to the above, securities litigation also arises owing to enforcement actions initiated by Securities and Exchange Board of India (SEBI), being the securities market regulator in India. SEBI has the power to conduct investigations and pass orders prohibiting individuals or entities who were involved in matters pertaining to market manipulation and price rigging, issue-related manipulation, insider trading, takeovers and other matters.

Most of the securities litigations in India have dwelt upon the enforceability of restriction on transfer of shares of the company until substantial provisions of the 2013 Act were brought into force. Prior to the coming into effect of the 2013 Act, the Companies Act 1956 (the 1956 Act), which was the governing statute dealing with shares and securities, provided that the shares or debentures and any interest therein of a company shall be freely transferable subject to the provisions of the 1956 Act. Commercially, restrictions on transfer of shares are common and often form the basis of joint venture or investment arrangements. The enforceability of restrictions on transfer of shares of the company was unclear following the rulings of various High Courts in India. There was considerable confusion on whether restrictions on transfer of shares of a public company are enforceable if these are not included in the articles of association of the company. This position was settled by the 2013 Act, which permitted share transfer restrictions between inter se shareholders of the company under a contract.

In addition, the central government in 2015 also notified the Commercial Courts, Commercial Division and Commercial Appellate Division of High Courts Act 2015 (Commercial Courts Act) pursuant to which commercial courts have been established to expedite adjudication of matters arising out of various commercial transactions including joint venture agreements and shareholders' agreements.

There have also been litigations involving oppression and mismanagement. The 2013 Act provides a right to the shareholders of the company to approach the National Company Law Tribunal (NCLT) in case of oppression and mismanagement. Pursuant to the 2013 Act, shareholders constituting not less than 100 members of a company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one-tenth of the issued share capital of the company may approach the NCLT to complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members and to accordingly seek specified reliefs.

Further, with the notification of the Insolvency and Bankruptcy Code 2016 (IBC), which is meant to introduce a time-bound and systematic mechanism for resolution of insolvencies while ensuring that the interests of all stakeholders are protected, questions have arisen in situations of a conflict between the non-obstante provisions of the IBC and enforcement powers of SEBI, especially during the moratorium period under the IBC.

Available claims

What are the types of securities claim available to investors?

Section 35 of the 2013 Act provides for statutory cause of action to any person who has subscribed for securities of a company offered through a prospectus and has suffered losses because of relying on any statement in the prospectus that was untrue or misleading or owing to omission of any matter in the prospectus. An investor can make a claim for compensation under section 35 of the 2013 Act against the company, its directors, promoters, expert referred in the prospectus and any person who has authorised the issue of prospectus. This statutory right is in addition and does not diminish or reduce the right of an investor to file a criminal complaint under sections 34, 36 and 447 of the 2013 Act.

The provisions of the 2013 Act do not omit or diminish any liability that any person may incur under general law or under other provisions. The investor is entitled to terminate his or her contract for subscribing the securities of the company and seek repayment and compensation under the provisions of the Indian Contract Act 1872 (the Contract Act) if there is a misrepresentation or an omission in the prospectus.

Shareholders of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members can approach the relevant forum for specified reliefs provided that such members are eligible to file such complaints in terms of the provisions of the 2013 Act. Further, such specified number of members or depositors or any class of them can initiate a class action suit if they are of the opinion that the management or conduct of affairs of the company are being conducted in a manner prejudicial to the interest of the company, its members or its depositors, and may, inter alia, seek appropriate reliefs against the company, its directors, auditors, or any expert, adviser or consultant for any fraudulent, unlawful or wrongful act or conduct.

As an additional protective measure for listed companies, SEBI has formulated the SEBI Complaints Redressal System (SCORES), which mandates all listed companies to redress the grievance of the shareholders raised on the SCORES platform and inform them about the steps taken within 30 days of the receipt of the complaints. The company failing to file the action taken report under SCORES within 30 days as aforesaid is liable under the provisions of Securities and Exchange Board of India Act 1992.

Offerings versus secondary-market purchases

How do claims arising out of securities offerings differ from those based on secondary-market purchases of securities?

In the case of secondary market purchases, the investor would have a remedy under section 36 of the 2013 Act, which is a generic provision covering all instances of misstatements or fraud.

Section 35 of the 2013 Act provides for statutory cause of action for misrepresentation in the prospectus as discussed in question 2. Under section 36 of the 2013 Act, any person who knowingly makes any statement, promise or forecast that is false or misleading or deliberately conceals a material fact to induce an investor to purchase securities would be guilty and liable for consequence under section 447 of the 2013 Act. Additionally, an investor would have a remedy under the Contract Act for seeking damages for breach of contract.

Investors who have purchased shares from a secondary market can also file a complaint with SEBI against the company on the SCORES platform and a general complaint can also be filed against any wrongdoing in relation to a particular scrip or raise their grievance with the company on the SCORES platform.

Public versus private securities

Are there differences in the claims available for publicly traded securities and for privately issued securities?

The rights of an investor to file a criminal complaint under section 34 and seek compensation under section 35 of the 2013 Act are limited to untrue or misleading statements made in the prospectus and thus are not available to investors who have purchased securities that were issued on private placement. However, such investors have a right to proceed under sections 36 and 447 of the 2013 Act against any person who knowingly makes any statement, promise or forecast that is false or misleading or deliberately conceals a material fact inducing an investor to purchase securities. The right under section 36 is in addition to the rights available to the investor under general laws.

Additionally, in case of publicly traded securities, the investors may seek recourse from SEBI in case of any damages suffered by the investor due to any non-compliance by the company of any of the regulations prescribed by SEBI, such as: insider trading norms under the SEBI (Prohibition of Insider Trading) Regulations 2015; fraudulent and unlawful trade practices under the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003; or any non-compliance under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011. The investor may also seek redressal under the SCORES platform.

Primary elements of claim

What are the elements of the main types of securities claim?

The principal elements of a securities claim are as under the following.

Misrepresentation and omission (section 35 of the 2013 Act)

- Subscription of securities by an investor acting on misleading representation or omission or incorrect statement.
- The investor suffering any loss or damage because of relying on such statement, misleading representation or omission or incorrect statement.

A claim can be brought against the company, its directors, promoters, expert referred in a prospectus and any person who has authorised the issue of prospectus. If it is proved that the prospectus has been issued with intent to defraud the investors then the company, its directors, promoters, expert referred as such in the prospectus and any person who has authorised the issue of prospectus are personally liable without any limitation of liability for all or any of the losses suffered by the investors.

Fraudulent actions (section 36 of the 2013 Act)

- Knowingly or recklessly making any statement, promise or forecast that is false, deceptive or misleading or deliberately conceals a material fact.
- Inducing the investor to enter into any agreement for acquiring the securities.

Refusal for registration (section 58 of the 2013 Act)

Refusal of a public company to register a transfer without sufficient cause within 30 days of receipt of the instrument of transfer from transferee.

Oppression and mismanagement (sections 241 of the 2013 Act)

- Affairs of the company are being conducted in the manner prejudicial to public interest or prejudicial or oppressive to the interest of the members or to the interest of the company will have to be demonstrated.
- Complaints to be filed by members who are eligible to file such complaints in terms of the provisions of the 2013 Act.

Rescinding from a contract (section 19 of the Contract Act)

- Consent for entering into the transaction was obtained by fraud, coercion or misrepresentation.
- The fraud could not have been discovered with ordinary diligence by the party whose consent was taken through such misrepresentation.

- The fraud or misrepresentation should have a direct relation with the consent received from such party to enter into the transaction.

Damages (section 73 of the Contract Act)

- Breach of any of the terms or conditions of the contract;
- breach should result into a damage or loss to the investor; or
- such loss or damage should not be remote or indirect loss.

Materiality

What is the standard for determining whether the offering documents or other statements by defendants are actionable?

The plaintiff will have to demonstrate that there was a misstatement in the prospectus, either through a positively inaccurate statement contained in the prospectus or the omission of a statement of fact that ought to have been contained in the prospectus to give a right of claim under section 35 of the 2013 Act. In case, any claim is raised on account of fraud then the plaintiff will have to demonstrate the culpable state of mind of the person against whom the claim is made. If the plaintiff has to proceed under section 36 of the 2013 Act then he or she will also have to demonstrate that the defendant had knowingly or recklessly made the statement, promise or forecast that was false, deceptive or misleading or deliberately concealed a material fact.

Scienter

What is the standard for determining whether a defendant has a culpable state of mind?

The person making the claim under section 35(1) of the 2013 Act is not required to demonstrate a culpable state of mind of the defendant. However, if the claim is raised on account of fraud under section 35(3) of the 2013 Act then the plaintiff will have to demonstrate the culpable state of mind of the person against whom the claim is made. While there are no specified thresholds, the courts and tribunals generally look into the facts and circumstances surrounding the claim in order to ascertain the motivation and intention of the parties and whether there existed a culpable state of mind.

Reliance

Is proof of reliance required, and are there any presumptions of reliance available to assist plaintiffs?

Section 35 of the 2013 Act does not require the claimant to demonstrate that he or she had placed reliance on the prospectus or any misstatement in the prospectus or omission of any matter in the prospectus. However, the claimant will have to establish that the loss or damage was caused due to the relevant misstatement in the prospectus or owing to any omission of material fact in the prospectus.

In the event that directors, promoters or persons-in-charge have been convicted for any of their past conduct of then, a presumption may also be drawn regarding their involvement in subsequent violations.

Causation

Is proof of causation required? How is causation established?

Section 35 of the 2013 Act provides that the loss should have been caused as a consequence of the misstatement in the prospectus or due to omission of any matter in the prospectus. As such, the claimant will have to establish that the loss or damage was caused owing to the relevant misstatement in the prospectus or owing to any omission of material fact in the prospectus.

Even under common law, a claimant needs to demonstrate that the loss or damage suffered was due to the misrepresentation by the defendant.

Other elements of claim

What elements present special issues in the securities litigation context?

In terms of misstatement in the prospectus or omission of any matter in the prospectus, the challenge has always been in establishing the alleged non-disclosures or misrepresentation in the prospectus, which resulted in losses to the claimant and the quantum of compensation.

Securities litigation also presents a unique situation in the sense that once an investor has made a claim for losses against any company, and where such claims generally have a material impact on the reputation of the company, such a claim further affects the market price of the securities, causing a twofold loss to the company as well as to the investors.

Further, in case of publicly traded securities, where interests of the public stakeholders are also involved, the tribunal or the regulator would bear in mind the interests of such stakeholders, before passing any orders in favour of the complainant.

Lastly, securities litigation generally proves to be a time-consuming process in India.

Limitation period

What is the relevant limitation period? When does it begin to run? Can it be extended or shortened?

The limitation period for a securities claim on the ground of fraud or misleading statement or misrepresentation in the prospectus is three years from the date on which such fraud or misleading statement or misrepresentation was discovered. Statutorily prescribed period of limitation cannot be shortened by way of agreement between parties. However, the period of limitation can be extended by the court or relevant tribunal, in cases where ‘sufficient cause’ for delay in instituting proceedings is satisfactorily explained to such court or relevant tribunal. There is no limitation period prescribed for regulatory action that may be initiated by SEBI.

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