

## **MEANING OF “DERIVATIVE ACTIONS” -UNDER COMPANIES ACT, 2013**

*Dear Friends,*

*As you are aware that Board of Directors of a company has given powers to run day to day business and take decisions on routine matters. Sometime Board members, generally called directors of the company due to their personal interest deviates themselves from their fiduciary duties towards the company. Since their duty is start proceedings on behalf of the company, to save interest and benefits of the company. The management /Board of Directors of the company is duty bound to protect interest and reputation of the company by instituting suits or starting legal proceedings against third parties.*

*Sometimes it happens that Management /Board of Directors are not keen to start any action to protect interest of the company against directors/officers of the company due to their vested interest. In this case Companies Act, 2013 has given wide powers to the shareholders of the company to act against the directors and the management of the company.*

### ***Now we can define – Derivative Actions as***

*A suit brought by a shareholder on behalf of a corporation or by a member on behalf of an association to assert a cause of action usually against an officer which the corporation or association has itself failed to assert for its injuries— called also derivative suit, shareholder's derivative suit*

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*A lawsuit brought by a shareholder of a corporation on its behalf to enforce or defend a legal right or claim, which the corporation has failed to do.*

*A derivative action, more popularly known as a Stakeholder's Derivative Suit, is derived from the primary right of the corporation to seek redress of legal grievances through the courts.*

**DERIVATIVE ACTION SUIT:** *Such a suit is brought against insiders i.e., the directors, management and/or other shareholders of the corporation and the suit often involves fraud, mismanagement, self-dealing or dishonesty that are either perpetrated or ignored by officers and Board of Directors of a Corporation.*

*In effect, the suing shareholder claims to be acting on behalf of the corporation, because the directors and management are failing to exercise their authority for the benefit of the company and all of its shareholders.*

*Derivative suits permit a shareholder to bring an action in the name of the corporation against the parties allegedly causing harm to the corporation. If the directors, officers, or employees of the corporation are not willing to file an action, a shareholder may first petition them to proceed. If such petition fails, the shareholder may take it upon himself to bring an action on behalf of the corporation. Any proceeds of a successful action are awarded to the corporation and not to the individual shareholders that initiate the action.*

*In most jurisdictions, a shareholder must satisfy various requirements to prove that he has a valid standing before being allowed to proceed. The law may require the shareholder to meet qualifications such as the minimum value of the shares and the duration of holding such shares by the shareholder.*

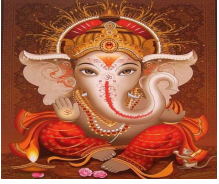
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## **PROVISIONS OF COMPANIES ACT, 2013 –**

**SECTION 179:** - empowered the Board of Directors of a company;

### **SECTION 179: POWERS OF BOARD.**

*(1) The Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do:*

**PROVIDED THAT** *in exercising such power or doing such act or thing, the Board shall be subject to the provisions contained in that behalf in this Act, or in the memorandum or articles, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting:*

**PROVIDED FURTHER THAT** *the Board shall not exercise any power or do any act or thing which is directed or required, whether under this Act or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting.*

*(2) No regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.*

*(3) The Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board, namely: —*

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- (a) to make calls on shareholders in respect of money unpaid on their shares;*
- (b) to authorise buy-back of securities under section 68;*
- (c) to issue securities, including debentures, whether in or outside India;*
- (d) to borrow monies;*
- (e) to invest the funds of the company;*
- (f) to grant loans or give guarantee or provide security in respect of loans;*
- (g) to approve financial statement and the Board's report;*
- (h) to diversify the business of the company;*
- (i) to approve amalgamation, merger or reconstruction;*
- (j) to take over a company or acquire a controlling or substantial stake in another company;*
- (k) any other matter which may be prescribed:*

**PROVIDED THAT** *the Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a*

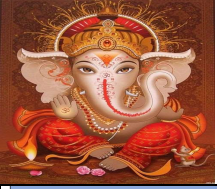
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*branch office of the company, the principal officer of the branch office, the powers specified in clauses (d) to (f) on such conditions as it may specify:*

**PROVIDED FURTHER THAT** *the acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of this section.*

*Explanation I.—Nothing in clause (d) shall apply to borrowings by a banking company from other banking companies or from the Reserve Bank of India, the State Bank of India or any other banks established by or under any Act.*

*Explanation II. —In respect of dealings between a company and its bankers, the exercise by the company of the power specified in clause (d) shall mean the arrangement made by the company with its bankers for the borrowing of money by way of overdraft or cash credit or otherwise and not the actual day-to-day operation on overdraft, cash credit or other accounts by means of which the arrangement so made is actually availed of.*

*(4) Nothing in this section shall be deemed to affect the right of the company in general meeting to impose restrictions and conditions on the exercise by the Board of any of the powers specified in this section.*

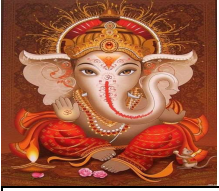
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## **RULE 8 OF THE COMPANIES (MEETING OF BOARD AND ITS POWERS)**

**RULES, 2014** prescribes additional powers which can also be exercised by the Board of Directors only by means of resolutions passed at meetings of the Board-

1. to make political contributions;
2. to appoint or remove key managerial personnel (KMP);
3. to appoint internal auditors and secretarial auditor.

By passing the resolution at its meeting, the Board may delegate the powers specified in clauses (d) to (f) on such conditions as it may specify to: any committee of directors, the managing director, the manager, any other principal officer of the company or the principal officer of the branch office (in the case of a branch office of the company) It shall also be noted that the acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or making of loans by a banking company within the meaning of this section as the case may be.

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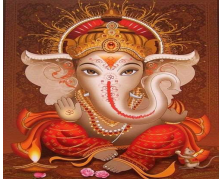
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**PLEASE NOTE THAT:** The powers provided under Companies Act, 2013 to the Board of Directors of the company, which include power to proceed against persons who are damaging the company's interests. Where, for one reason or other directors fail to live up their duties, the courts have been authorizing under a derived authority a shareholder or some of shareholders to sue the company. This is commonly known as "Derivative Action". A shareholders sue the company for his own behalf or on behalf of other aggrieved shareholders on the same matter. This may also be called as Oppression and Mismanagement Action against the company.

### **LET'S CONSIDER SOME DECISIONS-**

Where Derivation Action lies

- 1. Resolution requiring special majority-** Courts do not allow a company to approve or do an act through ordinary majority (Ordinary Resolution), where Article of the Company or the Companies Act, 2013 required approval through Special Majority (Special Resolution). [Baillie Vs. Oriental Telephone & Electrical Co. Ltd. (1915)]
- 2. Ultra Vires an illegal act-** Any act ultra vires the Company's constitution or against the statutory provisions or the requirement of the common law does not allow by the court. Any member of the company can take action against the company to restrain it from taking such action, which is ultra vires.

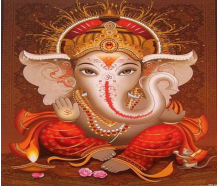
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- 3. Judicial interference in serious irregularities-** An injunction will be granted to the majority shareholders and the management of the company to restrain the company from acting on a resolution passed at the meeting of Board of Directors. The basis for this action was that there had been various irregularities in respect of the meeting of the Board including inadequate notice and failure to obtain his clearance, lack of a quorum of passing of resolutions and making decision were *ultra vires*.
- 4. Fraud-**the courts do not permit the majority or managerial powers to be used for perpetuating a fraud on the minority of shareholders.
- 5. Transfer of Control-** A derivative action lies where a resolution has been passed for transferring the controlling interest in the company, which may involve a complete changeover of the structure of the Company.
- 6. Directors not paying their calls-** directors were prevented from making calls on other shareholders while they were withholding payment of calls on their own shares.
- 7. Sale of assets at undervalue-** where directors are selling assets of the company to themselves undervalued.

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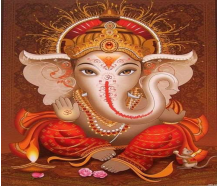
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- 8. Insolvency-** where company is running or was in existence only for winding up and the directors are still paying themselves remuneration and other employment benefits.
- 9. Diversion of funds of the company;**
- 10. Providing improper loans to relatives and associated concerns of directors of the company;**
- 11. Discriminating clause of shareholders/depositors etc.;**
- 12. 1Improper rejection of votes in meetings;**
- 13. Insufficient notice and agenda of the meeting or sending agenda and notice to only those who supports the management;**
- 14. Issuing shares to those so that the majority stake in the company increase and minority share decreases;**
- 15. Discrimination in further issue of shares;**
- 16. 1Exclusion of minority from the management of the company;**
- 17. Where wrongdoers are in control of the company and not allowed any proceedings to be instituted against the culprits;**
- 18. Violation of personal rights of shareholders/ not approval of transfer or transmission of shares;**

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19. ***Expropriation of properties of the company for benefit of members of the management of the company;***
20. ***Breach of duty by the directors and the management of the company;***
21. ***Oppression and mismanagement-*** *it can be raised in petition of Oppression and Mismanagement filed by competent number of shareholders before NCLT.*

**CONCLUSION:** *Derivative Action is a suit filed by a shareholder or more than one shareholder having same grievance against the Board of Directors or the management of the company. If management or board of the company is acting against the interest of the company and not willing to start a legal proceeding or suit against a director or officer of the company, who has done against the interest to the company, then Company Act, 2013 empowers the shareholder or shareholders of the company to file suit against the company for the benefit or to protect the interest of his and other shareholders.*

**DISCLAIMER:** *the article presented here is only for sharing knowledge and interest with the readers. The views are personal. In case of necessity do consult with professionals.*

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