SUMMARY

A crucial prerequisite for a derivative action is that the applicant must be acting in good faith in terms of section 165(5)(b)(i) of the Companies Act 71 of 2008 in order to obtain the leave of the court to bring the proposed derivative action. Both the Supreme Court of Appeal and the High Court have recently made important pronouncements of legal principle on the approach that the courts would take to the determination of good faith for the purposes of the statutory derivative action under section 165 of the Companies Act. These judicial findings relate not only to the complex issue of how to prove good faith but also to the meaning and content of the requirement of good faith. The courts have now reached a crossroads in delineating the content of good faith and how it is to be proved. This two-part series of articles critically evaluates these judicial pronouncements. While the focus of these articles is mainly on the tangled requirement of good faith, relevant judicial findings on the other prerequisites for a derivative action under section 165(5)(b) read with (7) and (8) of the Companies Act are also discussed. A comparative approach is adopted that takes into account the jurisprudence developed in Australia, Canada and Singapore. This article, the first in the series of two articles, focuses on the test of good faith. The proof of good faith will be discussed in the second article.

1 INTRODUCTION

Several important pronouncements of legal principle have recently been made by both the Supreme Court of Appeal\(^2\) and the High Court\(^3\) on the approach that the courts will take to the determination of good faith for the purposes of the statutory derivative action under section 165 of the Companies Act 71 of 2008 (hereinafter “the Act”). These judicial findings relate not only to the complex issue of how to prove good faith but also to

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1 The author is grateful to the National Research Foundation (“NRF”) for funding this research.
2 In Mbethe v United Manganese of Kalahari (Pty) Ltd 2017 (6) SA 409 (SCA).
3 In Mbethe v United Manganese of Kalahari (Pty) Ltd 2016 (5) SA 414 (GJ); see also Mouritzen v Greystone Enterprises (Pty) Ltd 2012 (5) SA 74.
the meaning and content of the requirement of good faith. A crucial prerequisite for a derivative action is that the applicant must be acting in good faith in terms of section 165(5)(b)(i) of the Act in order to obtain the leave of the court to bring the proposed derivative action. The courts have now reached a crossroads in delineating the content of good faith and how it is to be proved. This two-part series of articles critically evaluates these judicial pronouncements. While the focus of these articles is on the requirement of good faith, relevant judicial findings on the other prerequisites for a derivative action under section 165(5)(b) read with (7) and (8) of the Act are also discussed. A comparative approach is adopted which takes into account the jurisprudence developed in Australia, Canada and Singapore, all of which have influenced the relevant provisions of the South African Act. This article, the first of the series of two articles, focuses on the test of good faith. The proof of good faith will be discussed in the second article.

2 THE DECISION IN MBETHE V UNITED MANGANESE OF KALAHARI (PTY) LTD

2.1 The factual matrix

Mbethe v United Manganese of Kalahari (Pty) Ltd (hereinafter “the United Manganese case”) concerned an applicant who, in his capacity as chairperson and director of United Manganese of Kalahari (Pty) Ltd (hereinafter “United Manganese”) sought the leave of the court under section 165(5) of the Act to institute a derivative action in the name and on behalf of the respondent, United Manganese. The proposed derivative action – “although dressed up in the noble cause of promoting good corporate governance and the upliftment of the Kuruman community” – essentially concerned the retention of a contract that had been concluded during 2013 between United Manganese and Zastrospace (Pty) Ltd (hereinafter “Zastrospace”), a provider of mobile crushing and screening services required for the processing of manganese ore. United Manganese, being one of the largest producers of manganese ore worldwide, required the services of Zastrospace in order to supplement its own production capacity and to satisfy the high global demand for manganese ore at the time. The applicant, Mr Mbethe, had promoted the services of Zastrospace to the respondent, on the basis that it would enable the respondent not only to obtain services it needed at a competitive cost but also to provide financial benefits to local communities in Kuruman. The Zastrospace contract was notably a very lucrative one. Just over a year later, the respondent had terminated the Zastrospace contract, allegedly on purely commercial grounds due to an economic downturn and a drop in the demand for iron ore. Aggrieved at this decision, the applicant demanded in terms of section 4, 5, 6, 7.

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4 Mbethe v United Manganese of Kalahari (Pty) Ltd 2016 (5) SA 414 (GJ) par 38; Mbethe v United Manganese of Kalahari (Pty) Ltd 2017 (6) SA 409 (SCA) par 24.
5 Mbethe v United Manganese of Kalahari (Pty) Ltd 2016 (5) SA 414 (GJ) par 10.
6 Mbethe v United Manganese of Kalahari (Pty) Ltd 2016 (5) SA 414 (GJ) par 15.
7 Mbethe v United Manganese of Kalahari (Pty) Ltd 2016 (5) SA 414 (GJ) par 11, 23; Mbethe v United Manganese of Kalahari (Pty) Ltd 2017 (6) SA 409 (SCA) par 3.
165(2) of the Act the reinstatement of the Zastrospace contract and sought an order granting leave in terms of section 165(5) of the Act to institute derivative legal proceedings in the name of and on behalf of United Manganese.

The applicant had also made several other demands that formed the basis of the proposed derivative action relating to the good corporate governance of United Manganese and the upliftment of the Kuruman community. The court, however, found this to be mere window-dressing and concluded that the matter was “essentially all about the retention of the Zastrospace contract”. The retention of the Zastrospace contract could not be justified on commercial grounds, but the applicant sought to pin his case for the retention of the contract on the respondent’s obligation to promote the interests of the community in line with Black Economic Empowerment principles, which it contended, was in the interests of good corporate governance. The court, however, found very little evidence to support the applicant’s contention that the local Kuruman community had in fact benefited from the Zastrospace contract. The court likewise found no evidentiary basis for the applicant’s contention that the termination of the Zastrospace contract, being a substantial part of the respondent’s Black Economic Empowerment requirements, had placed in jeopardy the respondent’s mining rights.

The factual matrix in the dispute was further complicated by attempts by several parties to skim off the substantial profits generated by United Manganese, through the use of management contracts and other contracts. On the one hand, a substantial management fee, comprising 30% of all payments made to Zastrospace, was paid to a longstanding friend of the applicant, Mr Roelofse, through Mr Roelofse’s management company Cytopix (Pty) Ltd. On the other hand, the respondent’s commercial manager, Mr Lourens, himself earned, through his single-member close corporation, a substantial management fee from United Manganese, which was paid in terms of a Business Consultant Agreement signed on United Manganese’s behalf by two signatories, one of whom was Mr Lourens himself.

Also of significance to the court was that while the respondent insisted that the Zastrospace crushing contract had been terminated purely for commercial reasons, its crushing contract with another mobile crushing
operator, African Mining Contractors (hereinafter “AMC”) had not been terminated.\(^\text{18}\) The court noted that when the board of United Manganese, “having realised that it could not credibly defend the termination of the one crushing contract and not the other\(^\text{19}\) eventually resolved to also terminate the AMC crushing contract, it put in place as compensation a scheme for the purchase of AMC’s equipment for a vast sum of R40-million, which equipment United Manganese did not really require at the time and would effectively “mothball for a rainy day”\(^\text{20}\).

\[2.2\] The decision of the \textit{court a quo}

The United Manganese case was a classic case for the invocation of the statutory derivative action. As explained by the \textit{court a quo}, in a well-reasoned judgment by Wentzel AJ, the derivative action is required “to protect the company from (wrongdoing by) those who control the running of its affairs”.\(^\text{21}\) On the facts of the United Manganese case, the alleged wrongdoers whose conduct formed the basis of the complaint of the applicant, Mr Mbethe, were precisely those who had controlled the affairs of the respondent company, United Manganese. The derivative action originated as an exception to the general principle set out in \textit{Foss v Harbottle}\(^\text{22}\) that the company is the correct party (or “proper plaintiff”) to bring an action to redress a wrong done to it.\(^\text{23}\) The statutory derivative action contained in section 165 of the Act makes provision for legal proceedings to be commenced or continued in the name of and on behalf of the company by “defined individuals and representatives or employees of a company”.\(^\text{24}\) The section abolishes and substitutes any right at common law of a person other than a company to bring or prosecute legal proceedings on behalf of the company.\(^\text{25}\) As so usefully explained by the High Court in \textit{Lewis Group Limited v Woollam}:\(^\text{26}\)

“\[t\]he label ‘derivative’ was applied because although the litigation was instituted and prosecuted in A’s name, the right of action concerned was derived from B. Moreover, the benefits of any judgment obtained in favour of A in such an action, accrue to B, not A”.

The \textit{court a quo} acknowledged and accepted the modern rationale of the derivative action in the United Manganese case, which recognised that the derivative action is not only a remedy by means of which minority shareholders may obtain redress for the company, but is also a fundamental

\(^{18}\) \textit{Mbethe v United Manganese of Kalahari (Pty) Ltd} 2016 (5) SA 414 (GJ) par 23.

\(^{19}\) \textit{Mbethe v United Manganese of Kalahari (Pty) Ltd} 2016 (5) SA 414 (GJ) par 34.

\(^{20}\) \textit{Mbethe v United Manganese of Kalahari (Pty) Ltd} 2016 (5) SA 414 (GJ) par 34–36.


\(^{22}\) (1843) 2 Hare 461, 67 ER 189.

\(^{23}\) \textit{Mbethe v United Manganese of Kalahari (Pty) Ltd} 2016 (5) SA 414 (GJ) par 15; \textit{Mbethe v United Manganese of Kalahari (Pty) Ltd} 2017 (6) SA 409 (SCA) par 14.

\(^{24}\) \textit{Mbethe v United Manganese of Kalahari (Pty) Ltd} 2017 (6) SA 409 (SCA) par 6.

\(^{25}\) S 165(1) of the Act; \textit{Mbethe v United Manganese of Kalahari (Pty) Ltd} 2016 (5) SA 414 (GJ) par 40; \textit{Mbethe v United Manganese of Kalahari (Pty) Ltd} 2017 (6) SA 409 (SCA) par 6.

\(^{26}\) 2017 (2) SA 547 (WCC) par 27 citing MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion (2016) 5–6.
tool to enforce good corporate governance. This undoubtedly is, with respect, lucid reasoning by Wentzel AJ. It would have been useful, though, had the court taken it a step further by defining corporate governance, bearing in mind the varying connotations and nuances of the nebulous term “corporate governance”. The court could have usefully spelt out the contribution that the derivative action could make to “good corporate governance”. It is essentially the deterrent value of the derivative action that bodes well for good corporate governance, in that an effective and functional derivative action provides an avenue for shareholders to hold directors and managers accountable for breaches of their fiduciary duties and obligations to the company and, in so doing, deter directors from improper conduct and thereby also maintaining and enhancing investor confidence. Furthermore, the availability of an effective derivative action gives teeth to shareholder monitoring of the board of directors, as it provides shareholders with a remedy should their monitoring unearth wrongdoing.

Mr Mbethe’s application for leave to institute a derivative action in the name and on behalf of United Manganese was, however, dismissed by the court a quo, which concluded that he had failed to prove that he was acting in good faith and had thus failed to establish the essential requirements for leave as laid down in section 165(5)(b) of the Act. In this regard, section 165(5)(b)(i) – (iii) states that the court may grant leave to an applicant to bring a derivative action only if the court is satisfied that:

(i) the applicant is acting in good faith;
(ii) the proceedings involve the trial of a serious question of material consequence to the company; and
(iii) it is in the best interests of the company that the applicant be granted leave.

The object of these three requirements for leave is to protect the company against frivolous or vexatious claims or claims that are without merit. The three leave criteria are not disjunctive but conjunctive so that all three criteria must be satisfied in order for the court to grant leave to an applicant to bring a derivative action. As for the converse situation, if all three leave criteria are satisfied, must the court grant leave to the applicant for derivative proceedings? The court a quo opined that if all the leave requirements under section 165(5) were satisfied, a court would be bound to grant leave to the applicant; it would have no residual discretion to refuse leave. On appeal, however, the Supreme Court of Appeal, correctly with respect, rejected the view of the court a quo by declaring that the court always retains a residual discretion to refuse leave notwithstanding the applicant’s fulfilment of all the

27 Par 66–72 adopting the view of MF Cassim 2013 3 SALJ 500 504.
28 Par 150, 188–189.
31 Par 190–191.
leave criteria listed under the subsection.\textsuperscript{32} This is clear from a literal reading of section 165(5) of the Act which states that the “the court may grant leave only if...”; the legislature’s use of the word “may” – as opposed to “must” – makes it manifestly clear that the court indeed retains a residual discretion to withhold leave.\textsuperscript{33} Even so, the legislature’s reasons for granting to the judiciary the residual discretion to refuse leave to an applicant who has satisfied all the requirements of section 165(5) of the Act are obscure, opaque and murky. As a matter of policy, the courts ought to be most circumspect in the exercise of their residual discretion, which should be strictly reserved for extraordinary circumstances only.\textsuperscript{34}

2.2.1 The presumption of the best interests of the company

The third criterion for leave is linked with an important presumption. In this regard, the court a quo in the United Manganese case stressed that the third criterion for leave, section 165(5)(b)(iii), viz that the grant of leave must in the best interests of the company, is linked with a presumption contained in section 165(7) and (8) of the Act that the grant of leave is not in the company’s best interests where the proposed derivative proceedings, inter alia, involve a third party.\textsuperscript{35} The rebuttable presumption contained in section 165(7) and (8) of the Act applies only when the proposed derivative action that the applicant seeks to institute or defend on behalf of the company is a derivative action in which a “third party” is the defendant or plaintiff, as the case may be.\textsuperscript{36} The presumption commendably does not operate where the applicant seeks to bring derivative proceedings against an alleged wrongdoer who is related or inter-related to the wronged company, in the sense of having control of the exercise of a majority of the voting rights associated with the company’s securities.\textsuperscript{37}

The court a quo in the United Manganese case seems to have made an error in its discussion of s 165(7) and (8) of the Act in its statement that:\textsuperscript{38}

“[section] 165(8)(a) specifically excludes from third parties, and thus the operation of the presumption, any applicant who is related or inter-related to the company, which must thus exclude an application by a shareholder, a director or trade union of the company. The presumption thus must only apply to persons other than those upon whom locus standi is conferred in terms of subsection (2)” (emphasis added).

\textsuperscript{32} Par 17–18.
\textsuperscript{33} MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 92–93; Mbethe v United Manganese of Kalahari (Pty) Ltd 2017 (6) SA 409 (SCA) par 18.
\textsuperscript{34} See further MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 92–93.
\textsuperscript{35} Par 89; s 165(7) read with (8)(a) of the Act.
\textsuperscript{36} A “third party” is anyone that is not related or inter-related to the company (s 165(8)(a) of the Act). Related and inter-related persons are defined in s 2 of the Act.
\textsuperscript{37} Or the right to appoint or elect directors who control a majority of the votes at board meetings – see further s 2 of the Act; Lewis Group Limited v Woollam supra par 36.
\textsuperscript{38} Par 87.
It must respectfully be emphasised, first, that section 165(8)(a) does not exclude from the presumption any applicant who is related or inter-related to the company, as mistakenly stated by the court a quo. The term “related or inter-related” refers, not to the applicant, but to the wrongdoer who is alleged to have wronged the company. This is clear from section 165(7)(a) of the Act (which refers not to a related or inter-related applicant, but to proceedings by the company against a person related or inter-related to the company). Secondly, the term “related or inter-related,” does not exclude from the presumption “an application by a shareholder, director, or trade union of the company” or any other persons with locus standi under section 165(2), as erroneously stated by the court a quo in the above quotation. Instead, the term “related or inter-related” persons must be given the meaning set out in the definition of related and inter-related persons contained in section 2 of the Act.

The presumption contained in section 165(7) and (8), was stated by the court a quo in United Manganese, to be:\footnote{\textsuperscript{39}}

“designed to cater for the situation only where the wrongs are committed by third parties or outsiders and not the management of the company or its controllers”.

Startlingly, however, for the purposes of the presumption, the directors of a company fall within the ambit of the definition of “third parties”, not “related parties” to the company. This appears to have been caused by an oversight on the part of the legislature in adopting the Australian statutory provision.\footnote{\textsuperscript{40}} The effect of this egregious error is that the presumption operates in favour of directors, and thus inappropriately shields directors who have wronged the company on whose board they serve. This has elicited criticism that it is:\footnote{\textsuperscript{41}}

“a ‘most disturbing’ weakness in the Act ‘as it overlooks the cardinal point that derivative actions in the majority of cases are brought to protect the company against its own errant directors’”.

It is, however, encouraging that in its consideration of the presumption contained in section 165(7) and (8), the court a quo in the United Manganese case found the presumption to be inapplicable to the facts of the case\footnote{\textsuperscript{42}} and boldly declared that:\footnote{\textsuperscript{43}}

“[t]he presumption … is not designed to assist the respondent in an action like the present, which is aimed at wrongdoings done by its own directors where the presumption has no application”.

\footnote{\textsuperscript{39}} Par 88; MF Cassim \textit{The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion} 106–111, 128–129.
\footnote{\textsuperscript{40}} MF Cassim in FHI Cassim \textit{Contemporary Company Law} 789; MF Cassim \textit{The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion} 110–111; Lewis Group Limited v Woollam supra par 38 fn 35.
\footnote{\textsuperscript{41}} Lewis Group Limited v Woollam supra par 38 quoting MF Cassim \textit{The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion} 110–111.
\footnote{\textsuperscript{42}} Par 89–90.
\footnote{\textsuperscript{43}} Par 90.
The liberal approach taken by Wentzel AJ in the *United Manganese* case is in line with the intention of the learned judge to “give (section 165) such teeth.” 44 The robust approach of Wentzel AJ in the *United Manganese* case may be contrasted with that of Binns-Ward J in *Lewis Group Limited v Woollam* (hereinafter “the *Lewis* case”), who opined as follows: 45

“[the] presumption that leave to proceed derivatively (against a wrongdoing director of the company) should not be granted when the company elects not to proceed against (the said director,) … amounts to no more than a reiteration … of the common law requirement … (of wrongdoer control. It indicates) an intention by the legislature to keep the codified derivative action remedy within recognisably similar bounds to those that delimit its availability under the common law.”

The legislative approach articulated in the *Lewis* case may, with respect, be criticised on several grounds. First, simply based on principle, there palpably should be no presumption that the court must refuse leave for a derivative action if the company had elected not to proceed against a wrongdoing director. This is because the organ of the company that wields the decision-making power to proceed or not to proceed against wrongdoers is the board of directors, which now for the first time in South African company law is endowed with original authority and original management powers by section 66(1) of the Act. 46 The board may be the best persons to decide whether or not the company should litigate against an outsider, but the board are manifestly not the best persons to decide whether or not to litigate against one or more of their own number. The board may desist from taking legal action for a number of reasons, for instance, the majority of the board could be the wrongdoers, or those who control the board could be the wrongdoers or the non-erring directors may have become friendly with the miscreant director, or the miscreant director could be the dominant director on the board, or the wrongdoer could have influence over the non-erring directors’ career paths or over their financial interests, or the non-erring directors could be swayed by empathy in favour of the miscreant, or even by a subconscious bias in his or her favour. 47 It is thus only logical that there should be no presumption that judicial leave for a derivative action under section 165(5) must be refused if the board had elected not to proceed against a fellow director. The real effect of the presumption contained in section 165(7) and (8) is to shelter (potentially) biased or conflicted decisions made by the board not to proceed against one or more of their own.

Secondly, insofar as Binns-Ward J stated in the *Lewis* case that the presumption in section 165(7) and (8) is a mere reiteration of the common law concept of “wrongdoer control” and that it evinces a legislative intention to retain this concept under the new statutory derivative action regime, 48 it must be emphasised that the concept of “wrongdoer control” at common law was fundamentally problematic and eminently worthy of abandonment.

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44 Par 71–72 adopting the view of MF Cassim 2013 3 SALJ 504.
45 Par 38.
46 FHI Cassim in FHI Cassim Contemporary Company Law 187.
48 Par 38.
“Wrongdoer control” was a central element of the troublesome concept of “fraud on the minority”, which was a ground for the (now abolished) common law derivative action. In order to bring a common law derivative action, the minority shareholder was required to prove that the wrongdoers were in “control” of the company, so that those who had wronged the company, being in control of it, would not allow the company to sue them.49 The test of “control” laid down in Pavlides v Jensen50 was a strict test of de jure control, which required the wrongdoers to control more than 50% of the company’s voting shares. This strict test could rarely be satisfied in the case of wrongdoing by directors of public companies in view of their widely dispersed shareholders, rendering the common law derivative action virtually obsolete in the case of public companies. In recognition of this dilemma, Vinelott J in the first instance judgment in Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)51 developed a more flexible test for control, that included not only de jure control (in the sense of control over more than 50% of the voting shares) but also de facto control by the alleged wrongdoing directors. Regrettably, however, the Court of Appeal in the Prudential Assurance case52 overturned Vinelott J’s test of de facto control and essentially required control of more than 50% of the votes – a decision that elicited much scholarly criticism.53 In short, the effect of the concept of “wrongdoer control” was to make derivative actions almost impossible to bring except in small private companies (where the shareholders of the company were also its directors). The concept of “wrongdoer control” was long identified as an undesirable and unwarranted obstacle to the derivative action at common law.54 Even in the United Kingdom, to which the notion of “wrongdoer control” owes its origin, the drafters of the new Companies Act of 2006 resolutely abandoned this troublesome concept.55 Insofar as the South African Act retains the concept of “wrongdoer control” in the form of the presumption in favour of wrongdoing directors contained in section 165(7) and (8), it epitomises a retrograde approach by the legislature. It evinces a failure to recognise that the modern raison d’etre for the derivative action is that it is both a remedial mechanism as well as a valuable mechanism to promote good corporate governance practices, as discussed above. To continue to limit the availability of the codified derivative action through the use of outdated and widely rejected concepts like “wrongdoer control” in the form of the defective presumption contained in section 165(7) and (8) is neither acceptable, nor in the interests of modernising the South African company law regime and harmonising it with those of the leading

49 Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204; Russell v Wakefield Waterworks (1875) LR 20 Eq 474; Burland v Earle [1902] AC 83.
50 [1956] Ch 565.
51 [1980] 2 All ER 841.
52 [1982] Ch 204; see also Smith v Crotty [1988] Ch 114.
54 See eg, MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 1, 9–10.
55 See the new United Kingdom statutory derivative action in terms of ss 260–264 of the Companies Act, 2006.
jurisdictions. The glaring anomaly in section 165(7) and (8) of the Act must be amended by the legislature without delay.

2.3 The decision of the Supreme Court of Appeal

In upholding the decision of the court a quo, the Supreme Court of Appeal in the United Manganese case declared that the applicant had failed to establish the three vital criteria for leave in terms of section 165(5)(b)(i) – (iii) of the Act. The Supreme Court of Appeal reached a similar conclusion to the court a quo on the facts and found that Mr Mbethe had failed to satisfy the court, as required by section 165(5)(b)(i) of the Act, that he was acting in good faith in seeking to have the Zastrospace contract reinstated, bearing in mind that not only was the respondent legally entitled to terminate the Zastrospace contract but furthermore that not doing so in view of the decline in the demand for manganese ore at that time would have been financially irresponsible. The Supreme Court of Appeal also considered, in its determination of the applicant’s (or appellant’s) good faith, the fact that Zastrospace employed a mere twelve individuals from the local community, the absence of any evidence to indicate the benefit of the Zastrospace contract to the local community, and the absence of any basis for the applicant’s contention that United Manganese was in danger of losing its mining rights.

It is notable that the Supreme Court of Appeal made no pronouncement on whether the presumption contained in section 165(7) and (8) would or should apply on the facts of the United Manganese case, where leave to proceed derivatively was sought against the directors of the company. The Supreme Court of Appeal instead determined the third criterion for leave, namely whether the grant of leave to the applicant was in the best interests of the company in terms of section 165(5)(b)(ii) of the Act, primarily with reference to the issue of the availability of an alternative remedy to address the applicant’s grievance that would produce substantially the same redress – a factor that the High Court in Lewis Group Limited v Woollam also emphasised as a “central factor in determining” the leave criterion contained in section 165(5)(b)(iii).

Crucially, in arriving at their respective decisions in the United Manganese case, the High Court and the Supreme Court of Appeal made several important pronouncements of legal principle on the tangled issue of good faith in the statutory derivative action in terms of section 165(5)(b)(i) of the

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56 See further MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 111–112. Until such time as the defect in s 165(7) and (8) is amended, there are several tools that the judiciary may use to circumvent the application of the presumption when the wrongdoers who have harmed the company are its own directors – see further MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 112–131.

57 Par 31, 39.

58 Par 30.

59 Ibid.

60 Ibid.

61 Par 48 fn 46 quoting with approval the submission made by MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 84–85.
Act. It is telling that the High Court and the Supreme Court of Appeal differed not only on the intricate question of how good faith is to be proved but also on the fundamental test of good faith and its constitutive elements. Deftly unravelling the knotty problem of good faith is essential at this crossroads for the courts.

Good faith forms the focus of this article. Paragraph 3 below discusses the test of good faith and its constitutive elements. It includes a discussion of whether the absence of an ulterior or collateral purpose is a self-standing requirement of the good faith enquiry. This will be followed by a discussion of the proof of good faith in the second article in this series of two articles.

3 The Test of Good Faith

The Supreme Court and the High Court in the United Manganese case took drastically divergent approaches to the test of good faith and the essential elements of the enquiry into good faith. For a court to grant leave to an applicant to bring a derivative action on behalf of a company the court must be satisfied, in terms of section 165(5)(b)(i) of the Act, that "the applicant is acting in good faith". The South African High Courts thus far have consistently held that there are two factors in determining good faith: first, the applicant must honestly believe that a good cause of action exists and that it has a reasonable prospect of success; and secondly the applicant must not be seeking to institute the derivative action for a collateral purpose.

The High Courts have consequently regarded the enquiry into good faith as a two-part inquiry. The court a quo in the United Manganese case, with reference to the Australian case of Swansson v RA Pratt Properties Pty Ltd as quoted with approval by the South African High Court in Mouritzen v Greystone Enterprises (Pty) Ltd likewise declared that:

"[T]here are two inter-related questions in determining good faith. First, the applicant must honestly believe that a good cause of action exists and that it has a reasonable prospect of success…. (Secondly) the applicant must also show that the application is not brought for a collateral purpose."

On appeal, however, the Supreme Court of Appeal in United Manganese rejected the second part of the good faith enquiry. According to the Supreme Court of Appeal, an applicant's good faith for the purposes of section 165(5)(b)(i) must be determined with reference only to the (first) question whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success. In stark contrast to the previous decisions of the High Courts, the Supreme Court of Appeal declared that:

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62 Mbethe v United Manganese of Kalahari (Pty) Ltd 2016 (5) SA 414 (GJ) par 154; Mouritzen v Greystone Enterprises (Pty) Ltd supra par 51; see also MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 38–41; MF Cassim in FHI Cassim Contemporary Company Law 785–786.
64 Supra par 51; see also MF Cassim in FHI Cassim (ed) Contemporary Company Law (2011) 708–709.
65 Par 154.
66 Par 20.
67 Par 11.
"The presence or absence of a collateral or ulterior purpose on the part of an applicant... (is not) a self-standing requirement of the good faith enquiry."

It is, with respect, disappointing that the Supreme Court of Appeal has strayed from the course that was being set by the High Courts in delineating the contours of the good faith requirement for the purposes of a derivative action in terms of section 165. Notably, the above ruling of the Supreme Court of Appeal is an obiter dictum, which is not binding on future courts but is of persuasive force only. It is submitted that there are several reasons for supporting the two-part enquiry into good faith that the High Courts have adopted, rather than the truncated test of good faith suggested by the Supreme Court of Appeal. These reasons are discussed in turn below.

First, although good faith is a concept that is difficult to define, it is by no means a concept foreign to company law. It is trite that the directors of a company are subject to a fiduciary and statutory duty to exercise the powers conferred on them in good faith and in the best interests of the company. Directors are also subject to a duty to exercise their powers for a proper purpose, which constrains directors from exercising their powers for a collateral or ulterior purpose. It is significant that the director’s duty not to exercise his or her powers for a collateral purpose has been linked with the duty to act in good faith. In this regard, the fiduciary duty of directors to act in good faith in common law is regarded not only as separate but also as cumulative with the duty to act for a proper purpose. In Re Smith and Fawcett Ltd, for instance, the English Court of Appeal stated that where a director exercises his or her powers for an improper collateral purpose, he or she would not be acting in good faith for the benefit of the company as a whole. The statutory statement of directors’ duties contained in section 76 of the Act has further bolstered the link between the two duties of good faith and proper purpose in South African law. The statutory statement of the duties of directors conjoins, in section 76(3)(a), the duty to act in good faith with the duty to act for a proper purpose, as opposed to a collateral or ulterior purpose. The implication of section 76(3)(a) thus, is that the absence of a collateral purpose is indeed part of good faith in South African company law. As such, the good faith enquiry for the purposes of the derivative action under section 165(5)(b)(i) of the Act ought indeed to include a self-standing enquiry into the absence of a collateral purpose.

Secondly, the nature of the derivative action makes it all the more important to scrutinise the applicant’s motives, intentions and purposes in seeking leave under section 165. The grant of leave to an applicant under

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68 The applicant was found by the Supreme Court of Appeal to lack good faith on the basis of his failure to satisfy the first part of the test (i.e. that the applicant must honestly believe that a good cause of action exists with a reasonable prospect of success).
69 FHI Cassim in FHI Cassim Contemporary Company Law 523–524; s 76(3)(a) and (b) of the Act.
70 FHI Cassim in FHI Cassim Contemporary Company Law 525; s 76(3)(a) and (b) of the Act.
72 [1942] Ch 304 (Ch) 306; FHI Cassim in FHI Cassim Contemporary Company Law 514. It is significant in this regard, that English law formed the basis of South African common law under the previous company law regime.
section 165 involves the vesting of an extraordinary power in the applicant to subject the company to legal action and, in so doing, to override the decision of the board of directors not to litigate the matter. An applicant who applies for leave to bring a derivative action thus, so to speak, steps into the shoes of the directors of the company by taking on a role of the company’s directors. It consequently is sensible that the duty of good faith expected of company directors (which includes the absence of a collateral purpose) must equally be expected of the derivative litigant. Moreover, the company director and the derivative litigant assume a similar relationship to the company – both shoulder the responsibility and the power of acting, not for themselves, but on behalf of the company and in the conduct of the company’s affairs. It is thus logical and fitting that both the director and the applicant under section 165 are subject to the same duty of good faith, which embraces the absence of an ulterior or collateral purpose.

Thirdly, one must consider the purpose of the good faith requirement in section 165(5)(b)(i). It is trite that the purpose of the derivative action is to remedy a wrong done, not to the applicant him- or herself, but to the company; the purpose of the remedy thus is to achieve justice for the company, and not to serve the personal or private objectives of an applicant who brings the action derivatively on the company’s behalf. The “good faith” requirement in section 165(5)(b)(i) serves the vital purpose of promoting the litigation of genuine claims that are brought to protect the interests of the company, and of preventing claims that are motivated by the pursuit of the applicant’s own personal or private purposes rather than the interests of the company. It would consequently seem fallacious to state that an applicant who seeks to bring a derivative action, not with the intention of litigating it to finality in the interests of the company, but for the primary collateral purpose of pressuring the defendant directors to buy his shares at an inflated price in exchange for which he would discontinue the derivative litigation, is nonetheless in “good faith” as long as he genuinely believes that the company has a good cause of action with a reasonable prospect of success. Yet this is the effect of the emaciated test of good faith proposed by the Supreme Court of Appeal in United Manganese! An applicant cannot be said to be “acting in good faith” if his or her pursuit of the derivative action is not genuinely motivated by the proper purpose of vindicating the company’s rights and promoting the company’s interests – no matter how objectively meritorious the action may be. The role of collateral purpose is thus pivotal to good faith.

Fourth, an important facet of the good faith requirement in section 165(5)(b)(i) relates to the question whether the applicant is a suitable person to represent the company. An applicant who has a collateral purpose in seeking to use a derivative action for the primary purpose of extracting a

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73 See eg, Mouritzen v Greystone Enterprises (Pty) Ltd supra par 60, in which the High Court stated that “[the] fiduciary duty entails, on the part of every director, the same duty as required of an applicant under s 165(5)(b), namely to ‘act in good faith’ and ‘in the best interests of the company’”.


75 See eg, Nurcombe v Nurcombe [1985] 1 All ER 65 (CA).
personal benefit for him or herself is clearly not a proper person to be given the exceptional control and power to litigate the derivative action on the company’s behalf and in the company’s interests. To permit this would be to permit an abuse of the derivative action by such applicant. It must be borne in mind that an application for leave under section 165 is merely the start of derivative proceedings; if the court grants leave, the next step is the derivative action itself in which the applicant litigates the substantive claim on the company’s behalf. It is crucial that the applicant who is vested with the power to represent the company has proper intentions, purposes and motivations so that he or she will litigate the matter in the company’s interests and for the company’s benefit. Other examples of a collateral purpose in the context of the derivative action include the use of a derivative action by an applicant whose primary purpose is to pressurise the defendant directors into a settlement of the claim with the applicant personally, or whose purpose is to force the defendant directors to pay dividends. The use of a derivative action solely to pursue a personal vendetta against the defendant likewise amounts to a collateral purpose, as does the use of a derivative action as a strategy in a fight for control of the company. A derivative action that is brought with the primary object of disrupting the company’s business (by diverting the time and attention of the company’s directors, its management and its employees away from the business by having to focus on the litigation,) as a tactic to benefit a competitor is similarly a bad faith derivative action that is motivated by a collateral purpose. Business competitors may also attempt to institute bad faith derivative actions as a tactic to access confidential information by means of discovery. A collateral or ulterior purpose is thus present if the applicant’s dominant purpose in bringing a derivative action is the pursuit of private interests other than those of the company itself, or the pursuit of some personal agenda for which the derivative action was not designed. This is not to say that an applicant with a commercial interest in the claim or with some benefit to be gained (outside of the company’s benefit) cannot be in good faith. As long as the applicant’s dominant or primary purpose in bringing the claim is to benefit the company, the claim is brought in good faith and not for a collateral purpose. As correctly pointed out by the court a quo in United Manganese, an applicant’s self-interest in the outcome of the derivative action does not of itself destroy his or her good faith; nor does personal animosity or hostility between the parties.

A crucial distinction must be drawn between collateral purpose and self-interest of the part of an applicant. A collateral purpose entails more than mere self-interest in the outcome of the derivative action. Where the

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78 See eg, Konamaneni v Rolls-Royce Industrial Power (India) Ltd [2002] 1 WLR 1269 (ChD).
79 Par 178 quoting with approval MF Cassim 2013 3 SALJ 523.
80 See eg, Moutzzen v Greystone Enterprises (Pty) Ltd supra par 59–60; MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 45–47.
applicant’s self-interest coincides with the interests of the company, the applicant usually is not in bad faith, for instance, where a significant shareholder has a self-interest in increasing the value of his or her shares by seeking the recovery of the company’s property in a derivative action. However, on the other hand, if it is shown that an applicant is, in reality, seeking to further his or her own personal or other private interests unrelated to the interests of the company, the applicant acts for a collateral purpose and would be in bad faith. There is undoubtedly a grey area in which distinguishing between self-interest and a collateral purpose may be difficult. It ultimately is a question of fact that depends on the particular circumstances of each case. The court a quo in the United Manganese case incisively acknowledged that the fact that an applicant has some element of self-interest in the outcome of the derivative action may paradoxically go a long way towards showing the absence of a collateral purpose. An applicant who stands to gain from the success of the derivative action has more incentive to sue on behalf of the company and is thus more likely to be acting in good faith. Derivative litigants rarely are entirely altruistic; nor are they required to be so.

The fifth reason to reject the curtailed test of good faith proposed by the Supreme Court of Appeal in United Manganese (ie. that the aspect of collateral purpose is not part of the good faith enquiry), is that it flies in the face of common law precedent. Significantly, analogous considerations of a collateral or ulterior purpose constrained the derivative action at common law. Barrett v Duckett serves as the authority for the principle that an applicant in a common law derivative action would not be in good faith if motivated to litigate by a collateral purpose, or by personal considerations rather than by the interests of the company. It is notable in this regard that the English common law derivative action originally formed the basis of its South African equivalent. In light of the pre-existing precedent on the meaning of good faith in the derivative action at common law, it is surprising that the Supreme Court of Appeal in the United Manganese case, neither gave a reason for diverging from the common law test of good faith nor even made any allusion to it.

The final reason is that most statutory provisions on the derivative action in the common law countries require good faith for derivative claims, including Canada, Singapore and Australia. It is telling that in all these jurisdictions the issue of a collateral purpose is widely accepted as a fundamental aspect of the requirement of good faith.

82 Primex Investments Ltd v Northwest Sport Enterprise Ltd supra (note 76); McAskill v TransAtlantic Petroleum Corp [2002] AJ No 1580 (QB); Abraham v Prosoccer Ltd (1981) 119 DLR (3d) 167 (Ont HC); Vedova v Garden House Inn Ltd (1985) 29 BLR 236 (Ont HC).
83 Par 178 quoting the views of MF Cassim 2013 3 SALJ 523.
84 Ibid.
86 Canada Business Corporations Act, 1985, s 239(2)(b); Singapore Companies Act (Cap 50), s 216A(3)(b); Australian Corporations Act, 2001, s 237(2)(b).
87 See eg, Discovery Enterprises Inc v Ebco Industries Ltd supra; Abraham v Prosoccer Ltd supra; Vedova v Garden House Inn Ltd supra; Swannson v R A Pratt Properties Pty Ltd (2002) 42 ACSR; Agus Irawan v Toh Teck Chye [2002] SGHC 49 (SGHC); Pang Yong Hok v PKS Contracts Services Pte Ltd [2004] SGCA 18 (SGCA).
On the basis of the six reasons above, it is submitted that it is of vital importance for the courts to recognise that the issue of collateral purpose must be a central aspect of the enquiry into good faith in terms of section 165(5)(b)(i) of the Act. The aspect of collateral purpose plays a pivotal role in maintaining the fine balance between providing an effective derivative action for the protection of minority interests and for doing justice to the company while ensuring that opportunistic minority shareholders do not abuse this avenue. The classic test of good faith accepted by the High Court in *United Manganese*, which includes an enquiry into collateral purpose, is thus to be favoured over the truncated test proposed by the Supreme Court of Appeal in *United Manganese*, which purported to wipe out the element of collateral purpose as a self-standing aspect of the good faith enquiry. Fortunately, this was merely an *obiter dictum* of the Supreme Court of Appeal, and will not be binding on future courts though it may be of persuasive force. The enquiry into good faith under section 165(5)(b)(i) should thus be a two-part enquiry involving two inter-related questions:

(i) firstly, the applicant must honestly believe that a good cause of action exists and that it has a reasonable prospect of success; and

(ii) secondly, the applicant must not be seeking to bring the derivative action for a collateral purpose - in other words, a derivative applicant cannot be said to be acting in good faith unless the applicant's dominant purpose in bringing the application under section 165(5) is to protect the legal interests of the company, and not to promote his or her own personal or private purposes.

These two aspects will frequently overlap, but will not necessarily do so. If the applicant does not hold the requisite “honest belief” as required by the first part of the test, the court may conclude from this that the application has been brought for a collateral purpose. Yet in certain cases the applicant may have the requisite “honest belief” that the company has a valid cause of action, yet be primarily motivated to bring the derivative action as a means of obtaining some personal benefit for which the derivative action is not conceived – in which case the applicant’s collateral purpose would cause him or her to fail the good faith requirement of section 165(5)(b)(i). Importantly, the determination of good faith for the purposes of section 165(5)(b)(i) should not be limited to these two questions alone. While the above two questions must always form a central part of the good faith enquiry, there are other considerations that are also relevant to the applicant’s good faith. These additional considerations would depend on the particular factual circumstances of each case. If, for instance, the applicant under section 165 had acquiesced, or had directly participated, with the proposed defendant in the wrong done to the company, such applicant would be in bad faith and should be refused leave to bring a derivative action on the company’s behalf. The two-part enquiry into good faith should thus be

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88 Par 11.
89 Swannson v R A Pratt Properties Pty Ltd supra par 37.
90 See eg, Portfolios of Distinction Ltd v Laird [2004] EWHC 2071 (Ch); Nurcombe v Nurcombe supra; Towers v African Tug Co [1904] 1 Ch 550 (CA); Eales v Turner 1928 WLD 173; see further MF Cassim *The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion* 44–45.
regarded, not as a definitive test of good faith, but rather as a conceptual framework to guide the court in its determination of good faith.

3.1 “Collateral purpose” in the context of the three requirements for leave under section 165(5)(b)

The Supreme Court of Appeal in the United Manganese case gave, as a reason for its dictum that the absence of a collateral purpose is not a self-standing requirement of the good faith enquiry, only the following explanation:91

“...The importation from Australian law of the requirement that an applicant in order to establish good faith must prove the absence of a collateral purpose, is unjustified when the provisions of section 237(2) of the Australian Corporations Act 2001 are compared with the provisions of section 165(5) of the [South African] Act. Section 237(2) provides that a court must grant the application if it is satisfied, inter alia that “the applicant is acting in good faith” and ... “there is a serious question to be tried”. Notably absent from the Australian statute is the provision that the proceedings must involve the trial of a serious question “of material consequence to the company” as is required by s 165(5)(b)(ii) of the [South African] Act. The presence or absence of a collateral or ulterior purpose on the part of an applicant is clearly comprehended by the requirement that the question to be resolved is “of material consequence to the company”. It is, therefore, unnecessary to import this requirement as a self-standing requirement of the good faith enquiry”.

Regrettably, this statement of the Supreme Court of Appeal is, with respect, misguided. The requirement for an applicant to be acting without a collateral purpose in order to be acting in good faith is not an “(unjustified) importation from Australian law”, as erroneously asserted by the Supreme Court of Appeal. There is substantial authority in South African law, as set out in Paragraph 3 above, that the aspect of a collateral or ulterior purpose has long been part of good faith in South African law and continues to be even more so under the new company law dispensation. More importantly, the contention by the Supreme Court of Appeal that the aspect of collateral purpose is comprehended by the requirement contained in section 165(5)(b)(ii) of the Act is not only a bald statement unsupported by any authority, but is sadly also a flawed analysis. It is open to criticism on several grounds. While Paragraph 3 above discussed why the aspect of collateral purpose must form part of the good faith requirement under section 165(5)(b)(i) of the Act, this Paragraph discusses why the issue of collateral purpose cannot suitably form part of the second leave requirement contained in section 165(5)(b)(ii).

First, it is submitted that it is clear from the literal wording of the provisions that there is a difference in perspective between the first and second requirements for leave contained in section 165(5)(b)(i) and (ii) of the Act, respectively. While the assessment of the first leave requirement of “good faith” under section 165(5)(b)(i) relates to the good faith of the applicant him- or herself, the determination of whether the question is “of material consequence to the company” under section 165(5)(b)(ii) relates to the separate issue of the welfare of the company. The focus of the first leave

91 Par 11.
requirement is on the characteristics and circumstances of the applicant him-
or herself, such as his or her subjective motives, intentions and purposes in
pursuing the derivative action, while the focus of the requirement “of material
consequence to the company” is on the company and, as such, is
independent of the applicant. The motives and purposes of the applicant
should consequently bear very little relevance to the enquiry into whether the
matter in issue is “of material consequence to the company”, for the focus
must be and must remain on the company as a separate and independent
legal entity. This acknowledges the basic principle that the true plaintiff in a
derivative action is the company, for it is the company whose rights are
being vindicated and to whom any recovery or damages will flow. It would
thus be inappropriate and out of place to inquire into the applicant’s motives
and purposes – including whether an ulterior or collateral purpose motivates
him or her – when assessing whether the question to be resolved is “of
material consequence to the company”. These questions must be confined
to the first leave requirement.

Secondly, the above dictum of the Supreme Court of Appeal, if adopted,
will give rise to practical problems. It does not follow, as suggested by the
Supreme Court of Appeal, that if an applicant has a collateral or ulterior
purpose, the question to be resolved will not be “of material consequence to
the company”. The fact that a claim is “of material consequence to the
company” as a separate entity, provides no assurance that the purpose for
which the particular applicant seeks to bring the claim is a proper purpose. It
is quite conceivable that a claim may be “in the best interests of the
company” and maybe a meritorious claim involving a “serious question to be
tried”, from which the company potentially stands to benefit, but that a
collateral purpose motivates the applicant who seeks to bring the derivative
claim, for instance, his or her primary purpose in bringing the claim is not to
litigate it to finality to achieve justice for the company but rather to pressure
the defendant directors into purchasing his or her shares at an excessive
price in order to buy-off the derivative litigation. Despite such applicant’s
collateral purpose, from the company’s independent perspective the relevant
claim nonetheless is a good claim that remains “of material consequence to
the company”. The conflation of the two leave criteria by the Supreme Court
of Appeal would thus have the result that the applicant in this type of
scenario would succeed in obtaining leave for a derivative action despite his
or her ulterior or collateral purpose. This amounts to no less than sanctioning
an abuse of the derivative action by the applicant for his or her own personal
advantage. It would flout the elementary principle that the object of the
derivative action must be to obtain justice for the company. If, on the other
hand, the aspect of collateral purpose is treated as part of the requirement of
“good faith” – as it properly ought to be – the practical result is that the
applicant in this scenario will correctly be denied leave under section 165 on
the basis of a lack of good faith in terms of section 165(5)(b)(i).

Thirdly, the crux and the purpose of the second leave criterion in terms of
section 165(5)(b)(ii) is that the claim must involve the “trial of a serious
question”. In assessing the second leave criterion, the spotlight should thus

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92 Par 11.
fall on the legal viability or the merits of the claim. Tagged onto the second leave criterion is the added requirement of “material consequence to the company”. It is submitted that this tagged-on requirement overlaps to a considerable extent with the third leave criterion contained in section 165(5)(b)(iii) of the Act that the grant of leave must be “in the best interests of the company” and, as such, it is taken into account in any event when assessing the third leave criterion. It is not intended to be the primary focus of the second leave criterion. To explain this further, the third leave criterion of the “best interests of the company” (in contrast with the second leave criterion) focuses on the commercial viability of the claim. It recognises that there are practical commercial and business reasons for companies to choose not to pursue legal claims, even if those claims happen to be legally viable or meritorious. Its potential costs and detriment, of both the financial and non-financial kind, could outweigh the potential gains and benefits that may ultimately result from a claim. Importantly, in the assessment of the “best interests of the company” under section 165(5)(b)(iii), there must naturally be some consideration of whether the claim in question is of “material consequence to the company” — the requirement tagged-on to the second leave criterion in section 165(5)(b)(ii). A claim that is not “of material consequence to the company” is unlikely to cross the threshold of commercial viability that is required by the third leave criterion of the “best interests of the company” contained in section 165(5)(b)(iii). For instance, a superfluous claim for the recovery of a trivial amount, or a claim against the company’s directors for a foolish but honest decision that had caused very little damage to the company, would not be “of material consequence to the company” in terms of section 165(5)(b)(ii) and would consequently fail to meet the requirement of commercial viability represented by the third leave criterion of the “best interests of the company” in section 165(5)(b)(iii). It is accordingly submitted that when assessing the second leave criterion the focus should be on the legal viability of the claim and that considerations of whether the claim is “of material consequence to the company” are best left to be scrutinised as part of the assessment of the third leave criterion.

The three requirements for leave under section 165(5)(b)(i) – (iii) are thus separate and distinct criteria that must be independently satisfied for leave to be granted. The courts must not conflate the requirements. The facet of collateral purpose should properly be treated as a key part of the good faith criterion under section 165(5)(b)(i) of the Act, and should not be conflated with the second leave criterion in terms of section 165(5)(b)(ii), as proposed by the Supreme Court of Appeal in the United Manganese case. There is ample authority that supports this point of view.

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93 See eg, Ferreira v Levin; Vyenhoek v Powell 1995 (2) SA 813 (W); American Cyanamid Co v Ethicon Ltd [1975] 1 All ER 504 (HL); Chief Nchabeleng v Chief Phasha 1998 (3) SA 578 (LCC) for the meaning of a serious question to tried.

94 MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion chapter 6; see eg, Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch); Lesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch); Fiduciary Limited v Morningstar Research Pty Limited [2005] NSWSC 442; Maher v Honeysett and Maher Electrical Contractors Pty Ltd supra.

95 See Par 3 above.
This, however, does not mean that there is no interplay at all between the three criteria for leave, or that they are to be considered in isolation.\textsuperscript{96} The inquiry into the second and third criteria for leave under section 165(5)(b)(ii) and (iii), respectively, may shed light on the good faith of the applicant for the purposes of the first leave criterion contained in section 165(5)(b)(i).\textsuperscript{97} In this regard, if the proposed derivative action has no merit in the sense that there is no “serious question to be tried” in terms of section 165(5)(b)(ii), a court may (but will not inevitably) be led to conclude that the applicant could not have honestly believed that the company has a good cause of action with a reasonable prospect of success i.e. that he or she lacked good faith. Likewise, if the proposed derivative action is not “in the best interests of the company” as required by section 165(5)(b)(iii), the applicant’s motives and purposes are likely to be suspect and the court may be led to conclude that the applicant has a collateral purpose and is therefore in bad faith for the purposes of section 165(5)(b)(i). There is, moreover, a further link between the second and third leave requirements contained in section 165(5)(b)(ii) and (iii), for the strength of the case has a bearing on whether the proposed action is “in the best interests of the company”.\textsuperscript{98} If the proposed action is a weak one with little prospect of success, it is unlikely to be in the best interests of the company for the court to grant leave for a derivative action under section 165 of the Act. While some of these overlaps between the leave criteria were well encapsulated in the judgment of the court a quo\textsuperscript{99} in United Manganese, the same regretfully and with respect cannot be said of the judgment of the Supreme Court of Appeal. Insofar as the Supreme Court of Appeal in United Manganese described the overlap between the second and first leave criteria as follows:\textsuperscript{100}

“In considering whether the ‘proceedings involve the trial of a serious question of material consequence to the company’, a finding that the applicant possesses a collateral or ulterior purpose will also be of relevance in deciding whether the applicant acts in good faith”

It is submitted that this dictum ought to be rejected as incorrect. As discussed above, the issue of a collateral purpose is properly considered, not under the second leave criterion, but under the first leave criterion of good faith; and the finding of a collateral purpose is not merely “of relevance in deciding” good faith, but is completely destructive of it.

\textsuperscript{96} Mbethe v United Manganese of Kalahari (Pty) Ltd 2017 (6) SA 409 (SCA) par 19; MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 39, 47, 49.

\textsuperscript{97} Mbethe v United Manganese of Kalahari (Pty) Ltd 2017 (6) SA 409 (SCA) par 21; Mbethe v United Manganese of Kalahari (Pty) Ltd 2016 (5) SA 414 (GJ) par 84, 156; MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 39, 40; MF Cassim 2013 3 SALJ 509–510.

\textsuperscript{98} Mbethe v United Manganese of Kalahari (Pty) Ltd 2016 (5) SA 414 (GJ) par 84; MF Cassim The New Derivative Action under the Companies Act: Guidelines for Judicial Discretion 75, 94.

\textsuperscript{99} Par 84, 156.

\textsuperscript{100} Par 19.
4 CONCLUSION

It is submitted that the courts’ enquiry into the good faith of an applicant who seeks leave to bring a derivative action in terms of section 165(5)(b)(i) of the Act must be a two-part enquiry comprising two elements: first, the applicant must honestly believe that a good cause of action exists and that it has a reasonable prospect of success; and secondly the applicant must not be seeking to bring the derivative action for a collateral purpose, i.e. the applicant’s dominant purpose in bringing the application under section 165(5) must be to protect the legal interests of the company, not to promote his or her own private purposes. Importantly, the judicial determination of good faith should not necessarily be limited to these two questions alone, as other considerations may also be relevant to an applicant’s good faith depending on the particular facts and circumstances of each case. Insofar as the South African High Courts have adopted this classic two-part test of good faith, the approach of the High Courts is, with respect, to be preferred over the truncated test of good faith recently proposed by the Supreme Court of Appeal in the United Manganese case. The real effect of the test proposed by the Supreme Court of Appeal is to emaciate the requirement of good faith, by abandoning the element of collateral purpose as a self-standing aspect of the good faith enquiry. This, fortunately, was an obiter dictum of the Supreme Court of Appeal and is not binding on future courts but merely persuasive. On the basis of the six reasons discussed in Paragraph 3, some rooted in legal principle and others anchored in policy, it is submitted that it is essential for the courts to definitively accept that the aspect of collateral purpose must be a fundamental part of the good faith enquiry in terms of section 165(5)(b)(i) of the Act. Collateral purpose plays a pivotal role in maintaining the balance between providing an effective derivative action to protect minority interests and do justice to the company while ensuring that opportunistic minority shareholders do not abuse this remedy.

It seems that it was the difficulties posed by the proof of good faith that drove the Supreme Court of Appeal to make its unfortunate finding, particularly the conundrum of how an applicant is to prove positively on a balance of probabilities that he or she had no collateral purpose. The proof of good faith is undoubtedly a challenging issue, depending as it does on the individual’s subjective state of mind. Part 2 of this article will consider the divergent approaches adopted by the High Court and the Supreme Court of Appeal in United Manganese to the problem of proof of good faith and will include suggestions as to how an applicant is to prove his or her good faith for the purposes of the statutory derivative action.

Finally, insofar as the High Courts in the United Manganese case and the Lewis case advocated vastly divergent policy approaches to the presumption contained in section 165(7) and (8) of the Act, the approach articulated in the Lewis case, with respect, represents a retrograde policy that is no longer acceptable in a modern contemporary corporate law system. The presumption contained in section 165(7) and (8) of the Act must, without delay, be amended by the legislature with a view to excluding directors from its ambit.