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**AN ANALYSIS OF EXTENDED *LOCUS STANDI* FOR THE DERIVATIVE ACTION AND THE OPPRESSION REMEDY UNDER THE COMPANIES ACT 71 OF 2008.**

by

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Annexure G

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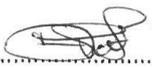
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## CHAPTER 1: INTRODUCTION

### 1.1 Background

The Companies Act 71 of 2008 (hereafter the ‘Companies Act’ or ‘the Act’)<sup>1</sup> came into effect on 1 May 2011 and broadly overhauled the South African derivative action. The Act expands standing for the derivative action to include shareholders, directors and prescribed officers of the company or related company, representatives of employees of the company, and any other person authorised by the court.<sup>2</sup> Standing for the oppression remedy is augmented by the addition of directors to the pre-existing shareholders category.<sup>3</sup> These changes follow the improved companies’ legislations of Canada and Australia, and other commonwealth jurisdictions that recently underwent reform.<sup>4</sup>

Widened *locus standi* for the derivative action and oppression remedy seems to be in accord with the gradual policy shift away from the shareholder primacy theory, otherwise referred to as the enlightened shareholder value approach, which has been the basis of South Africa’s corporate law system since its inception. Under this approach, the directors’ duty to act in the best interests of the company had entailed acting in the best interests of its shareholders<sup>5</sup> collectively, both current and future.<sup>6</sup>

In 2004 the Department of Trade and Industry issued the Corporate Law Reform Paper<sup>7</sup> which set out the basis and laid guidelines for the reform of the South African companies’ legislation. The Reform Paper advocated that companies, in the reformed companies’ legislation, should be run in a manner that accommodates the interests of their stakeholders.<sup>8</sup> This approach of pluralism views shareholders as a constituency among other stakeholders, such as creditors and

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<sup>1</sup> Unless otherwise indicated, references to section numbers in this document refers to sections of the Companies Act 71 of 2008.

<sup>2</sup> Section 165 (2).

<sup>3</sup> Section 163 (1).

<sup>4</sup> Maleka Femida Cassim *The New Derivative Action under the Companies Act* (2016) at 2.

<sup>5</sup> In line with the definition of a profit company in section 1 of the Act.

<sup>6</sup> Irene-Marie Esser and Piet Delpont ‘The Protection of Stakeholders: The South African Social and Ethics Committee and the United Kingdom’s Enlightened Shareholder Value Approach: Part 1’ (2017) *De Jure* 97 at 100.

<sup>7</sup> *South African Company Law for the 21<sup>st</sup> Century-Guidelines for Corporate Law Reform by the Department of Trade and Industry* - Published in the South African Government Gazette 26493 of 23 June 2004 (the Reform Paper).

<sup>8</sup> Esser & Delpont op cit note 6 at 102.

employees, whose interests are also recognized,<sup>9</sup> and is considered to be ‘extending “the interests” that comprise the interests of the company’<sup>10</sup> to include those of its stakeholders.

Consequently, criticism levelled against the pluralist approach for not affording remedies or rights to stakeholders against directors for breaching their duties<sup>11</sup> may be countered by the notion that expanded standing for the derivative action (and the oppression remedy where applicable) places in the hands of stakeholders a remedy against directors for breaching their duties. The extension of *locus standi* for the two remedies is broadening interests that should be protected under ‘interests of the company’ alluded to in section 76 (3) (b).<sup>12</sup>

The derivative action fulfils various key functions within the corporate legal system. It allows for the recovery of damages suffered from harm caused to the company when its directors refuse to do so,<sup>13</sup> and to hold directors accountable for breaches of their duties. It is also a tool with which to thwart out corporate misconduct and inculcate good corporate governance in the company.<sup>14</sup> The efficacy of the derivative action to attain these objectives apparently rests on three connected factors:<sup>15</sup> whether key stakeholders of and persons that are closely connected to the company and its affairs have *locus standi*; the ability of persons with standing to access information they require in order to assess the substance of wrongdoing against the company, essential to obtain leave and to successfully prosecute or defend the derivative action; and finally their aptitude to financing legal costs of the derivative action, or more precisely, how legislation and the courts deal with the issue of costs.<sup>16</sup>

The Companies Act allows access to information by qualified stakeholders that have been granted leave to proceed derivatively,<sup>17</sup> and provides for the board to appoint an independent investigator to investigate the demand made for the commencement or defense of legal proceedings by the company.<sup>18</sup> The courts are given wide discretion to make costs orders

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<sup>9</sup> Ibid at 101.

<sup>10</sup> Sulette Lombard and Tronel Joubert 'The Legislative Response to the Shareholders v Stakeholders Debate: a Comparative Overview' (2014) 14 (1) *Journal of Corporate Law Studies* 211 at 215.

<sup>11</sup> Ibid at 221.

<sup>12</sup> Ibid at 224.

<sup>13</sup> MF Cassim op cit note 4 at 8.

<sup>14</sup> Ibid.

<sup>15</sup> Maleka Femida Cassim 'The Doctrine of Contemporaneous Share Ownership and Aspects of Locus Standi in the New Derivative Action' (2018) 135 *SALJ* 101 at 112.

<sup>16</sup> Maleka Femida Cassim 'Shareholder Remedies and Minority Protection' in Farouk HI Cassim (ed), Maleka Femida Cassim, Rehana Cassim, Richard Jooste, Joanne Shev & Jacqueline Yeats *Contemporary Company Law* 2 ed (2012) at 792.

<sup>17</sup> Section 165 (9) (e).

<sup>18</sup> Section 165 (4).

relating to the derivative action, whilst retaining the court's prerogative to order the applicant to provide security for costs.<sup>19</sup>

The extension of standing for the oppression remedy to specifically include directors instructs the company's consideration of the interests of directors individually or as a group, in addition to those of shareholders, in the running of the company. As the oppression remedy is a personal action, the interests of directors to be served through the operation of the stakeholder approach denotes their personal interests in relation to the company.

## **1.2 Objectives of the study**

The objective of this study is to analyse standing for the derivative action and the oppression remedy and the components of such standing, determine whether through widened standing the remedies are sufficiently available to such qualified stakeholders, and whether broadened standing would assist the derivative action to achieve its objectives.

## **1.3 Research questions**

- a. What are the profiles of persons that have standing for the derivative action and the oppression remedy under the Companies Act?
- b. Have the South African statutory derivative action and oppression remedy been availed to sufficient categories of stakeholders?
- c. To persons with standing, what potential limitations are there to accessing the derivative action? What interventions are necessary to remedy the anomaly?

## **1.4 Methodology**

The methodology is a desktop comparative analysis, comparing Companies Act provisions relating to standing for the derivative action and oppression remedy to those of equivalent remedies in terms of the Canadian, Australian and United States of America (USA or US) statutes. The Canadian and Australian jurisdictions were selected because minority shareholders' remedies in South Africa, Canada and Australia were rooted<sup>20</sup> in English common law and statutes, and the progression of the derivative action and oppression remedy

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<sup>19</sup> Section 165 (10) and (11).

<sup>20</sup> MF Cassim op cit note 15 at 104.

in these jurisdictions influenced the reformulation of the these remedies in the Companies Act.<sup>21</sup> Comparisons are also made to the company laws of the United Kingdom and New Zealand, wherever relevant. The USA was selected because its derivative action is developed and solid, and has distinctive features to compare to the South Africa action against, some of which influenced aspects of the derivative action in the Companies Act. Where relevant, comparisons are made to predecessors of the Companies Act and the South African common law.

## **1.5 Scope and limitations**

This study analyses *locus standi* and related aspects in respect of the derivative action and the oppression remedy. Key aspects of the derivative action that the study considers are with regard to the barriers of legal costs and access to information. These barriers<sup>22</sup> have a major bearing on the successfulness of a derivative action system, and have in the past had a deterrent effect on the remedy. In this regard, this study examines the progressiveness of the extension of stakeholders' standing by determining whether it is harmonized by apposite costs and access to information provisions in the Act.

The analysis of elements of the remedies, procedures for invocation, and available relief are excluded from the scope of this study.

## **1.6 Overview of chapters**

This chapter 1 focuses on foundational aspects of the study, the background, objectives, methodology and a synopsis of included chapters. Chapter 2 observes the historical evolution of the derivative action, which indicates that the remedy (as it stands) is much improved with regard to causes of action, the nature of the defendant, safeguards against abuse by applicants, and widened *locus standi*.

Chapter 3 provides an analysis of each of the persons granted standing under section 165 (2) of the Companies Act. A comparison to the Canadian, Australian and US jurisdictions show that the remedy could be broadened by giving standing to holders of beneficial interests. The

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<sup>21</sup> MF Cassim op cit note 4 at 2.

<sup>22</sup> Maleka Femida Cassim 'Costs Orders, Obstacles and Barriers to the Derivative Action under Section 165 of the Companies Act 71 Of 2008 (Part 1)' (2014) 26 *SALJ* 1 at 1.

chapter concludes that the conditions for the court to grant leave on a discretionary basis unduly restrict the remedy's accessibility to an applicant.

Chapter 4 considers standing and applicable capacity for the oppression remedy, and concludes that there are more categories of persons to whom to extend standing to attain equity. Chapter 5 explores the long-standing barriers of costs and access to information for the derivative action, and it determines that the provisions of the Companies Act relating to these barriers are depriving the derivative action the opportunity to attain greater reach. It concludes that the removal of these barriers is key to ensuring real access to the derivative action; and chapter 6 provides concluding remarks on the preceding chapters, and recommendations.

## CHAPTER 2: DERIVATIVE ACTION OUTLINED

### 2.1 Introduction

The South African derivative action recently underwent a massive overhaul that resulted in extensive changes to key aspects of the remedy. Before embarking on an exploration of *locus standi* for the derivative action, it is imperative to first provide an outline of this remedy and an overview of its historical evolution from which the need for its reform had also emanated.

Company law has its foundation on the notion that a company has separate legal personality<sup>23</sup> distinct from its subscribers, shareholders or directors,<sup>24</sup> which entitles it to sue and be sued in its own name. Stemming from this is the proper plaintiff rule in terms of which it is the company that can assert its claims where it has been wronged,<sup>25</sup> and that shareholders or other persons have no standing to do so on the strength of their shareholding in or other relationship with the company. Per Lord Davey in *Burland v Earle*:<sup>26</sup>

‘It is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so. Again, it is clear law that, in order to redress a wrong done to the company or to recover money or damages alleged to be due to the company, the action should prima facie be brought by the company itself.’

The company’s board of directors is entrusted with the authority to exercise all the powers and manage and perform any function of the company;<sup>27</sup> and the board obtains authority through the exercise of the majority vote. It is the principle of majority rule that shareholders are bound by the lawful decisions of the majority,<sup>28</sup> even where such decisions are prejudicial to their rights as shareholders.<sup>29</sup> Linked to this principle is the doctrine of non-interference, also referred to as the internal management principle, which entails that it is not the function of the court to interfere with the internal affairs of the company regarding the commercial rationale

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<sup>23</sup> Rehana Cassim ‘The Legal Concept of a Company’ in FHI Cassim et al op cit note 16 at 29.

<sup>24</sup> *Salomon v Salomon and Co.* [1897] AC 22 (HL) at 51; s 19 (1) (b) of the Act.

<sup>25</sup> This was asserted in the landmark English case of *Foss v Harbottle* (1843) Hare 461 which led to this principle being referred to as the ‘rule in *Foss v Harbottle*’.

<sup>26</sup> *Burland v Earle* [1902] A.C. 83 at 93.

<sup>27</sup> Section 66 (1) of the Act. See also MF Cassim op cit note 4 at 6.

<sup>28</sup> *Mbethe v United Manganese of Kalahari (Pty) Ltd* (503/2016) [2017] ZASCA 67 para 59.

<sup>29</sup> MF Cassim op cit note 4 quoting *Samuel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) 678.

of an action or decision at the insistence of a disgruntled minority.<sup>30</sup> The court is therefore not capacitated to interfere with the running of the company whilst the majority is acting lawfully.<sup>31</sup>

Amidst these interrelated foundational principles is the unwavering need to balance two conflicting canons: the judicial non-interference with decisions taken by the majority while ‘acting within their powers’,<sup>32</sup> and protecting the minority (shareholders) concerning the majority’s decision not to seek redress for wrong done the company.<sup>33</sup> To pursue redress for harm suffered by the company notwithstanding the contrary decision of the majority, the derivative action allows shareholders<sup>34</sup> to representatively assert the company’s claim against its wrongdoers.<sup>35</sup>

The main purpose of the derivative action is to obtain compensation for harm suffered by the company, and to deter future wrongdoing within the company.<sup>36</sup> It enables a person with *locus standi* to pursue redress on behalf of the company when those entrusted with decision making powers fail or refuse to do so,<sup>37</sup> while inculcating good corporate governance. The action or remedy is dubbed ‘derivative’ because the applicant derives the right of action from the company.<sup>38</sup> This remedy has been crucial to addressing the anomaly created where the harm suffered by the company was caused by those who have the authority to decide on whether or not to redress it.<sup>39</sup>

## 2.2 Evolution of the derivative action in South Africa

### 2.2.1 Common law

Owing to the action to redress harm committed against the company belonging to the company, the common law did not provide the shareholder with an automatic right to institute an action

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<sup>30</sup> *Yende v Orlando Coal Distributors (Pty) Ltd* 1961 (3) SA 314 (W) at 316; Vuyani R Ngalwana ‘Majority Rule and Minority Protection in South African Company Law: A Reddish Herring’ (1996) 113 *SALJ* 527 at 528.

<sup>31</sup> MF Cassim op cit note 4 at 6.

<sup>32</sup> *Burland v Earle* supra note 26.

<sup>33</sup> MF Cassim op cit note 4 at 1; see also Ian M Ramsay & Benjamin B Saunders ‘Litigation by Shareholders and Directors: An Empirical Study of the Australian Statutory Derivative Action’ (2006) 6 *Journal of Corporate Law Studies* 397 at 401.

<sup>34</sup> Minority shareholders as ‘traditional applicants’ in derivative actions, but the nature of applicants has been widened to include other stakeholders of the company.

<sup>35</sup> MF Cassim op cit note 4 at 5.

<sup>36</sup> MF Cassim op cit note 15 at 102.

<sup>37</sup> MF Cassim in FHI Cassim et al op cit note 16 at 775.

<sup>38</sup> *Ibid* and *Mbethe* supra note 28 para 58 citing *Esmanco (Kilner House) v Greater London Council* [1982] 1 WLR 2 (QB).

<sup>39</sup> MF Cassim op cit note 4 at 7.

on its behalf,<sup>40</sup> but allowed him in certain circumstances to ‘step into the company’s shoes and to seek in its right the restitution he could not demand on his own’.<sup>41</sup> These circumstances, the exceptions to the rule in *Foss v Harbottle*, included instances where directors’ actions were illegal, ultra vires the company or constituted fraud of the minority.<sup>42</sup> The principle was later developed by disabling the minority from suing derivatively where the alleged harm was ratifiable by the majority of the company’s shareholders.<sup>43</sup> This had implied that the common law action could be initiated if an unratifiable wrong was committed to the company.<sup>44</sup>

Shortcomings of the common law action included uncertainty as to the scope of the rule in *Foss v Harbottle*. Boundaries and fulfilment criteria for the exceptions were not clearly defined.<sup>45</sup> Furthermore the wrongdoers in control the company also controlled documents required for the litigating shareholder to substantiate the derivative claim,<sup>46</sup> frustrating the core of the derivative action. Principally, minority shareholders bore the risk of being burdened by the costs of the derivative action as there was no certainty that the company would reimburse their costs for bringing the action for relief that belongs to the company.<sup>47</sup> These factors had inadvertently led to the disuse of the remedy in South Africa.<sup>48</sup>

### 2.2.2 Companies Act 61 of 1973

The Van Wyk de Vries Commission (the commission)<sup>49</sup> was established and mandated to review existing company laws of South Africa. Among others, the commission found that there was a need for a remedy to compel delinquent directors to compensate the company for loss suffered from wrongs they committed,<sup>50</sup> and paved way for the maiden statutory derivative

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<sup>40</sup> Helena H Stoop ‘The Derivative Action Provisions in the Companies Act 71 of 2008’ (2012) 129 (3) *SALJ* 527 at 529.

<sup>41</sup> *Ibid* citing *Lewis v Knutson*, 699 F.2d 230 (5th Cir. 1983) at 237-238.

<sup>42</sup> JT Pretorius (ed), PA Delpont, Michele Havenga, and Maria Vermaak *Hahlo’s South African Companies Act Through the Cases* 6ed (1999) at 382.

<sup>43</sup> Matthew Berkahn ‘The Derivative Action in Australia and New Zealand: Will the Statutory Provisions Improve Shareholders’ Enforcement Rights’ (1998) 10 *Bond Law Review* 74 at 76.

<sup>44</sup> MF Cassim op cit note 4 at 9-10.

<sup>45</sup> Sarah Watkins ‘The Common Law Derivative Action: An Outmoded Relic’ (1999) 30 *Cambrian Law Review* 40 at 43.

<sup>46</sup> Ngalwana op cit note 30 at 531.

<sup>47</sup> MF Cassim op cit note 22 at 1.

<sup>48</sup> HS Cilliers, ML Benade, JJ Henning, JJ Du Plessis, PA Delpont, L De Koker & JT Pretorius *Corporate Law* 3 ed (2000) at 307.

<sup>49</sup> Commission of Enquiry into the Companies Act, *Main Report* RP45/1970 as referenced in MS Blackman (ed) RD Jooste, GK Everingham, JL Yeats, FHI Cassim & R De la Harpe *Commentary on the Companies Act* (2002) [Revision Service 6, 2009] at 9-177.

<sup>50</sup> *Ibid*.

action founded in section 266<sup>51</sup> of the of Companies Act 61 of 1973 (the 1973 Act). This statutory remedy intended primarily to address procedural challenges of the common law action and to overcome the shareholder's lack of access to records of the company due to him being outside of the management of the company,<sup>52</sup> whilst putting measures to deter frivolous and vexatious proceedings through the appointment of a *curator ad litem*.<sup>53</sup>

The statutory action had supplemented the common law action,<sup>54</sup> and the coexistence of these actions enabled a plaintiff to choose a remedy that best supported his course; for example, it would be opportune for a shareholder to bring a statutory derivative action where the wrong complained of had been ratified by the majority. This is because section 266 allowed a derivative action regardless of the wrong having been ratified, whereas such ratification under the common law action immunised the wrongdoing from derivative redress.<sup>55</sup> Blackman summarized the difference between the two actions:<sup>56</sup>

‘The common law action is essentially a remedial device that permits the member to enforce the company’s rights in order to obtain redress for infringements of rights that he has against the company...The statutory derivative action...in effect empowers him to transfer from the company to the court the power to decide whether to enforce the company’s right of redress against those directors and officers.’

The main shortcoming of the statutory remedy was its availability in limited circumstances: only shareholders of the company had standing to invoke it, recourse was available against the company’s past and present directors and officers respectively, and in respect of wrongdoing that related to directors’ breach of trust and breach of faith from which the company suffered loss or damages, or was deprived of benefits.<sup>57</sup> The result was that if a wrong committed by a director did not correspond with the section 266 (1) cause of action, a shareholder desirous of

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<sup>51</sup> Read with sections 267 and 268.

<sup>52</sup> Blackman et al op cit note 49 at 9-177.

<sup>53</sup> Ibid.

<sup>54</sup> Meskin, PM Galgut, B Kunst, JA Delport, PA & Vorster, Q *Henochsberg on the Companies Act 61 of 1973* (1994 last updated June 2011) at 510.

<sup>55</sup> Cilliers & Benade op cit note 48 at 306.

<sup>56</sup> Blackman et al op cit note 49 at 9-178.

<sup>57</sup> Section 266 (1) of the 1973 Act.

seeking redress for the company was forced to navigate the rule in *Foss v Harbottle* and its dubious exceptions for a basis to proceed derivatively.<sup>58</sup>

### 2.2.3 Companies Act 71 of 2008

The Companies Act 71 of 2008 abolished the common law derivative action<sup>59</sup> and repealed the statutory action under the 1973 Act.<sup>60</sup> It has been emphasised that section 165 (1) abolished exceptions to the rule in *Foss v Harbottle*, but that the proper plaintiff rule in *Foss v Harbottle* continues to apply as an overarching principle.<sup>61</sup> The new statutory derivative action is an overhaul of the derivative action and improves the remedy in various respects, including the following: First, the abolition of the common law action eradicates the problematic exceptions to the rule in *Foss v Harbottle*. This clarifies that section 165 is the only basis on which derivative actions may be brought in South Africa.<sup>62</sup>

Secondly, the significance of the section 165 (2) demand is to bring the wrongdoing or harm into the knowledge of the company's decision makers for them to take relevant steps to protect the company's interests.<sup>63</sup> The demand requirement thus compels an applicant to first beseech the company as the proper plaintiff, to pursue redress on its own.<sup>64</sup> Therefore, unlike section 266 of the 1973 Act that required the court to appoint a *curator ad litem* upfront, the demand requirement eliminates the involvement of courts in the preliminary stages of the proceedings<sup>65</sup> and speeds up the leave application process.

Thirdly, section 165 does not prescribe causes of action on which a derivative action could be based, but provides a wide description allowing the action to protect broad legal interests of the company.<sup>66</sup> It is submitted that this permits the protection of legal interests through any expedient legal means relevant to the circumstances,<sup>67</sup> such as the case in *Trinity Asset*

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<sup>58</sup> MF Cassim op cit note 4 at 10; Lindi Coetzee 'A Comparative Analysis of the Derivative Litigation Proceedings under the Companies Act 71 of 1973 and the Companies Act 71 of 2008' (2010) *Acta Juridica* 290 at 298.

<sup>59</sup> Section 165 (1).

<sup>60</sup> Kathy Idensohn 'The Fate of Foss under the Companies Act 71 of 2008' (2012) (2) *South African Mercantile Law Journal* 355 at 359.

<sup>61</sup> MF Cassim op cit note 4 at 10; Idensohn *ibid*.

<sup>62</sup> MF Cassim op cit note 4 at 9.

<sup>63</sup> See *Mbethe* supra note 28 and 58, emphasizing that the reason for the intended action must be the protection of legal interests of the company.

<sup>64</sup> MF Cassim op cit note 22 at 7.

<sup>65</sup> MF Cassim op cit note 4 at 19-20.

<sup>66</sup> Coetzee op cit note 58 at 298; MF Cassim op cit note 4 at 10.

<sup>67</sup> Stoop op cit note 40 at 536.

*Management (Pty) Ltd v Investec Bank*.<sup>68</sup> There the court gave standing to shareholders to approach the court for a declaratory order regarding the validity of a loan agreement that was part of a circular, even though they were not party to the agreement.<sup>69</sup>

Fourthly, there is no prescription of persons against whom a derivative action may be brought. This enables derivative actions where wrongs were committed by individuals who owe no fiduciary duty to the company, and against those whom the majority may not be willing to proceed against.<sup>70</sup> Fifthly, standing is widened to include broader stakeholders of the company.<sup>71</sup> The Act also introduced changes to legal costs and access to information which brings hope of elimination of these barriers to the derivative action.

With wider scope of application comes larger room for abuse. The procedural aspects of the new statutory derivative action incorporate provisions requiring the authentication of the claim and prevention of abuse of the remedy and courts by applicants. Among others the Act entitles the company to set aside the demand on the basis that it is frivolous, vexatious and without merit;<sup>72</sup> leave would be granted if the court is satisfied that the applicant is acting in good faith, that the proposed proceedings involve a trial of a serious question of material consequence to the company, and that it is in the best interest of the company;<sup>73</sup> and that once leave has been granted, derivative action proceedings may not be discontinued, compromised or settled without leave of the court.<sup>74</sup>

## **2.3 Comparison with foreign jurisdiction**

### ***Canada and Australia***

The Canadian and Australian derivative actions were similarly founded on English law, and based on the rule in *Foss v Harbottle* and its exceptions. Flaws of the respective common law derivative actions in these jurisdictions manifested themselves differently: for example in Australia, leading challenges to the common law derivative action related to stringent

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<sup>68</sup> 2009 (4) SA 89 (SCA) quoted by Stoop Ibid.

<sup>69</sup> Stoop ibid fn 60.

<sup>70</sup> MF Cassim op cit note 4 at 101.

<sup>71</sup> Section 165 (2); see ch 3 infra.

<sup>72</sup> Section 165 (3).

<sup>73</sup> Section 165 (5) (b).

<sup>74</sup> Section 165 (15).

requirements for establishing standing, inconsistent requirements relating to ratification, and the issue of costs of the action.<sup>75</sup>

In Australia, the Corporate Law Economic Reform Program Act 1999 introduced the statutory derivative action contained in Part 2F.1A of the Corporations Act of 2001 (the Corporations Act) action.<sup>76</sup> The common law derivative action is similarly abolished,<sup>77</sup> and the grounds for the statutory derivative action are not limited. Previous and present members and officers respectively, and any person granted leave by the court have *locus standi*.<sup>78</sup>

In Canada, recommendations of the Dickerson Committee<sup>79</sup> culminated in the enactment of the federal statute, the Canada Business Corporations Act, R.S.C 1985 (CBCA). Most of the Canadian provinces followed recommendations of the Dickinson report<sup>80</sup> and their corporations' statutes are similar to the CBCA. The CBCA does not limit grounds or the substance of the underlying cause of action on which the statutory derivative action may be brought, nor does it prescribe persons against whom the substantive action may be initiated.

## USA

Whilst the American legal system is also based on the common law with rich English law roots, its corporate law bears no resemblance to the rule in *Foss v Harbottle*.<sup>81</sup> The US equivalent of the rule in *Foss v Harbottle* was formulated in the landmark case of *Hawes v City of Oakland*<sup>82</sup> which set procedural requirements for bringing a derivative action.<sup>83</sup> These were that the complainant shareholder must first make a demand to all the shareholders requesting that they resolve the matter,<sup>84</sup> and to the directors requesting that the grievance be pursued;<sup>85</sup> the complainant must specify facts that justify the complaint;<sup>86</sup> and to have standing the

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<sup>75</sup> Kenny Yang 'The Evolution of the Australian Derivative Action: Floodgates to Shareholder Activism?' (2013) 16 *International Law and Business Law Review* 419 at 424-426.

<sup>76</sup> PR Austin & IM Ramsay *Ford's Principles of Corporations Law* 15 ed (2013) at 669.

<sup>77</sup> Section 236 (3) of the Corporations Act of 2001.

<sup>78</sup> Section 236 (1).

<sup>79</sup> For the report see Robert W.V. Dickerson, John L. Howard & Leon Getz, *Proposals for a New Business Corporations Law for Canada: Commentary*, vol. 1 (Ottawa: Information Canada, 1971) [Dickerson Report].

<sup>80</sup> William Kaplan, Q.C & Bruce Elwood 'The Derivative Action: A Shareholder's "Bleak House"?' (2003) 36 *443* at 353-454.

<sup>81</sup> Lynden Griggs 'The Statutory Derivative Action: Lessons that may be Learnt from its Past' (2002) 6 *UW Sydney Law Review* 63 at 79.

<sup>82</sup> 104 U.S. 450 (1882).

<sup>83</sup> Griggs op cit note 81 at 80-81.

<sup>84</sup> Ibid at 81.

<sup>85</sup> Ibid, unless such demand would be futile.

<sup>86</sup> Griggs op cit note 81 at 81.

complainant must own shares in the company at the time of the alleged wrong.<sup>87</sup> The abovementioned decision led to the formulation of the content of Rule 23.1 of the Federal Rules of Civil Procedure, 1966<sup>88</sup> that lay down additional requirements for standing for derivative suits.

The US judicial approach on derivative actions is therefore different from that of commonwealth countries founded on the rule in *Foss v Harbottle* in the sense that the latter can be said to be one of denying derivative action unless it is within strict guidelines.<sup>89</sup> The former, based on the principles of *Hawes v City of Oakland*, capacitates derivative actions by formulating procedural requirements for eligibility.<sup>90</sup>

## 2.4 Conclusion

The statutory derivative action in terms of the Companies Act is an improvement from previous versions of the actions. The abolition of the common law derivative action and repeal of the 1973 Act and their replacement with section 165 of the Act brings clarity regarding to the nature, scope and procedure for the derivative action without losing the benefit of the body of case law already built around previous versions of the actions,<sup>91</sup> which would continue to be of force wherever applicable.

The derivative action in terms of section 165 is augmented in scope of application in line with the statutory provisions of the Canadian and Australian actions in the sense, among others, that causes of action are no longer restricted to breaches of directors' duties as was the case with the action under section 266 of the 1973 Act; directors are no longer the only persons against whom derivative actions may be brought; categories of persons with *locus standi* have been substantially widened to include significant stakeholders of the company. The remedy has also been streamlined in the Act through the reduction of the involvement of the courts in the preliminary stages of the proceedings. Advancements in the above areas, which potentially make the remedy more accessible for invocation, are balanced by the various quality measures meant at curbing abuse by applicants.

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<sup>87</sup> Ibid.

<sup>88</sup> Ibid.

<sup>89</sup> Griggs op cit note 81 at 80.

<sup>90</sup> Ibid at 93.

<sup>91</sup> MF Cassim op cit note 4 at 7.

Significantly, and more relevantly for this study is the statutory expansion of categories of persons with *locus standi* to representatively pursue redress for the company to the point of giving the courts the discretion to allow other non-specified persons that meet other requirements to pursue the company's cause. This is consistent with the paradigm shift away from viewing the board as serving the interests of the company, or rather those of its shareholders<sup>92</sup> as has been the construct, and may very well be an affirmation that reference to the best interests of the company which directors are required to act in when discharging their duties, extends those of its stakeholders.<sup>93</sup>

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<sup>92</sup> Esser & Delpont op cit note 6 at 100.

<sup>93</sup> Lombard & Joubert op cit note 10 at 215.

## CHAPTER 3: DERIVATIVE ACTION STANDING

### 3.1 Introduction

The derivative action under common law and in terms of section 266 of the 1973 Act allowed minority shareholders under certain circumstances to pursue redress for harm suffered by the company as a result of directors' wrongdoing. This tool is labelled a minority shareholders remedy due to the fact that it allowed them to seek redress for wrongs done to the company in approved<sup>94</sup> defiance of the contrary decision of the majority, by which they (minority) are otherwise bound.

The Companies Act expands *locus standi* for the derivative action to include persons entitled to be registered as shareholders, directors and prescribed officers of the company or related company, trade unions or employee representatives, and any other person who has been granted leave by the court.<sup>95</sup> These empowered stakeholders stand in relation to the company,<sup>96</sup> and therefore standing in terms of section 165 of the Act may not be imputed to similar stakeholders of entities that are not companies<sup>97</sup> in the manner that the courts had allowed under common law.<sup>98</sup>

### 3.2 *Locus standi* defined

The term *locus standi*, or standing, refers to the right to bring legal action in a court of law.<sup>99</sup> Per Cameron J in *Sandton Civic Precinct (Pty) Ltd v City of Johannesburg & Another*,<sup>100</sup> legal standing is the 'sufficiency and directness of a litigant's interest in proceedings which warrants his or her title to prosecute the claim asserted.' Such interest gives the litigant 'a right to be heard in his own cause'.<sup>101</sup>

Standing capacitates the enforcement of rights and invocation of remedies applicable to the relevant person for the given cause of action and, in the context of the derivative action, it

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<sup>94</sup> By the court through granting the applicant leave.

<sup>95</sup> Section 165 (2) of the Companies Act of 2008.

<sup>96</sup> 'Company' as defined in section 1.

<sup>97</sup> Ibid.

<sup>98</sup> As was the case in *Petersen and Another v Amalgamated Union of Building Trade Workers of SA* 1973 (2) SA 140 (ECD) and *TWK Agriculture Ltd v NCT Forestry Co-operative Ltd and Others* 2006 (6) SA 20 (N) where the respective courts allowed common law derivative actions brought in relation to a trade union and a co-operative respectively.

<sup>99</sup> <https://dictionary.cambridge.org/dictionary/english/locus-standi> accessed on 25 January 2018.

<sup>100</sup> (458/2007) [2008] ZASCA 104 para 19.

<sup>101</sup> *Rescue Committee DRC v Martheze* 1926 CPD 300.

enables those that have it to hold directors accountable for their decisions or actions *vis-a-vis* the company.<sup>102</sup> The expansion of *locus standi* for the derivative action indicates the legislature's determination that such persons have a legitimate interest in or connection to matters relating to decisions of the company by which they are most likely impacted.<sup>103</sup>

### 3.3 Shareholder standing

The derivative action has been widely considered a minority shareholders' remedy even though it is equally available to majority shareholders.<sup>104</sup> The remedy does not require a derivative shareholder applicant to hold a specified minimum shareholding in the company, unlike with some European countries' statutes that do.<sup>105</sup> The result is that shareholders, regardless of the number of shares they have in the company, qualify to bring a derivative action.

A shareholder is defined as the holder of a share issued by a company and who is entered in the certificated or uncertificated securities register.<sup>106</sup> A share is one of the units into which the proprietary interest in a profit company is divided,<sup>107</sup> whilst 'securities' includes shares, debentures or other instruments irrespective of their form or title.<sup>108</sup>

Holders of securities which are not shares, such as debenture holders and bondholders, do not therefore have standing under this category. The holder of a beneficial interest similarly lacks standing,<sup>109</sup> not because he does not have a sufficiently direct interest, but because the Act bestowed such direct interest upon persons against whose names shares in the company are registered. This was confirmed in the recent decision of *Smyth v Investec Bank Ltd*<sup>110</sup> where the court had to determine whether the appellants, who were beneficial holders of shares registered in their nominees' names, had standing to seek relief in terms of section 252 of the 1973 Act. One of the appellants' arguments was that as beneficial owners they stand to suffer

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<sup>102</sup> Richard Croucher and Lilian Miles 'Corporate Governance and Employees in South Africa' (2010) 10 *Journal for Corporate Law Studies* 367 at 372-373.

<sup>103</sup> *Lewis Group Limited v Woollam and Others* (9900/2016) [2016] ZAWCHC 130 para 33.

<sup>104</sup> Ramsay & Saunders op cit note 33 at 418-419. Their empirical research show that more than 80 per cent of derivative actions brought in Australia between the years 2000 and 2005 were initiated by shareholders; and that 6.5 per cent of overall applicants were majority shareholders. See also Bruce Welling *Corporate Law in Canada: The Governing Principles* 3 ed (2006) at 505.

<sup>105</sup> MF Cassim op cit note 15 at 108-109.

<sup>106</sup> Section 1.

<sup>107</sup> Section 1.

<sup>108</sup> Section 1.

<sup>109</sup> *Remgro Limited and Another v Unilever South Africa Holdings (Pty) Ltd* (8835/2015) [2015] ZAKZPHC 54 para 1.

<sup>110</sup> *Smyth v Investec Bank Ltd* (674/2016) [2017] ZASCA 147.

prejudice in connection with their ownership of shares.<sup>111</sup> They also argued that to deny them statutory relief under section 252 would be contrary to the principle that an agent (in this regard their nominees) may not sue in his own name on behalf of the principal.<sup>112</sup> In dismissing the appeal Petse JA remarked that the statutory remedy sought by the applicants is available to those that meet the statutory requirements for standing.<sup>113</sup> The court held that the common law principle of agency relied upon by the appellants has been overridden by the 1973 Act.<sup>114</sup> It is submitted that whilst this decision related to standing for the oppression remedy under the 1973 Act, its principle on shareholder standing applies to shareholder standing for the derivative action, and that despite having been decided in terms of the 1973 Act, it would continue to be force and effect under the Act.

It seems that affording standing to persons who are registered as shareholders of the company is backed by the policy of law that the company must concern itself only with registered holders (and not beneficial owners) of the shares.<sup>115</sup> In slight deviation from the foregoing the Act recognises interests of beneficial holders and seeks to protect some of them: such as section 56 (1) which permits a person to hold any of the company's issued securities for the benefit of another, section 56 (8) which allows the holder of a beneficial interest to vote on a matter where he has been recorded as beneficial owner, and section 56 (10) which compels the registered holder to deliver notice of a shareholders' meeting to the beneficial holder, and give him a proxy appointment should the beneficial owner so demand. The Act's partial acknowledgement of beneficial owners' interests with regard to the internal affairs of the company may be viewed as signifying an acceptance of their interests in the company.

Section 165 (2) introduced two major changes to the *locus standi* of shareholders. First, the standing of persons entitled to be registered as shareholders, which empowers persons to whom rights attached to shares have been transferred without the registration of the transfer having been concluded.<sup>116</sup> Persons to whom shares were transmitted by operation of the law such as transmission on death or insolvency of the shareholder,<sup>117</sup> and those whom the company

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<sup>111</sup> *Smyth* supra note 110 para 25.

<sup>112</sup> *Ibid* para 26.

<sup>113</sup> *Ibid* para 45.

<sup>114</sup> *Ibid* para 27.

<sup>115</sup> *Standard Bank of South Africa Ltd v Ocean Commodities Inc* 1983 (1) SA 276 (A) at 289.

<sup>116</sup> PM Meskin, P Delpont (ed), & Q Vorster, Contributors: D Burdette, I Esser, & S Lombard *Henochsberg on the Companies Act 71 of 2008* (Service Issue 15 updated October 2017) at 590(2).

<sup>117</sup> MF Cassim in *FHI Cassim et al op cit* note 16 at 779.

neglects or unduly refuses to register despite all requisite essentials having been complied with, may thus bring a derivative action.<sup>118</sup>

The second invention is the standing of shareholders (and directors and prescribed officers) of related companies;<sup>119</sup> thus enabling these stakeholders of a holding company to bring a derivative action on behalf of a subsidiary company.<sup>120</sup> This widens the net of corporate governance to related companies in that directors become accountable to stakeholders of companies in which the company holds a controlling<sup>121</sup> interest or of those that control it. Section 2 (2) extensively defines the notion of control to include holding and subsidiary relationships, the direct or indirect control by a company of the other or of each of them by another person,<sup>122</sup> and control of the business of the company in situations where such control may not be apparent.<sup>123</sup>

It is submitted that the standing of qualified stakeholders of related companies is subject to the operation of section 2 (3) of the Companies Act in terms of which a company may be exempted from the application of a provision in the Act based on a relationship contemplated in section 2 (1). To obtain the exemption, the company concerned<sup>124</sup> must show the court, the Companies and Intellectual Property Commission<sup>125</sup> or the Takeover Regulation Panel<sup>126</sup> that it acts or has acted independently of any related person.<sup>127</sup> The rationale for the provision, being not to broadly impute dependency or joint decision-making between related companies where it may not be the case, is sound and protects companies not influenced by decisions and activities of their related companies or persons. The granting of the exemption however, which would specifically be in relation to the matter at hand, in this regard derivative proceedings initiated,

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<sup>118</sup> Ibid; and *Barnard v Carl Greaves Brokers (Pty) Ltd & others, Carl Greaves Brokers (Pty) Ltd & others v Barnard, Barnard v Bredenhann & others* (821/2016, 8263/2016, 10622/2016) [2007] ZAWCHC 2 para 41 read with paras 7-10.

<sup>119</sup> 'Related company' has the meaning ascribed in section 2 (1) (c) read with section 2 (2) of the Companies Act.

<sup>120</sup> MF Cassim op cit note 4 at 15.

<sup>121</sup> Control has the meaning ascribed in section 2 (2) of the Act.

<sup>122</sup> MF Cassim op cit note 4 at 15.

<sup>123</sup> Delpont et al op cit note 116 at 30(5).

<sup>124</sup> At worst this could be directors (of a related company) seeking to uphold their decision not to seek redress for harm done to that related company, or through this mechanism seeking to evade accountability for corporate wrongs that they themselves committed against that related company. It may also be directors of the holding company in which the applicant is a qualified stakeholder in circumstances where the harm suffered by the company relates to actions or decisions of the holding company's board.

<sup>125</sup> Established in terms of section 185 of the Act.

<sup>126</sup> Established in terms of section 196 of the Act

<sup>127</sup> Section 2 (3) of the Act.

would result in statutorily qualified stakeholders of a company unsuited to bring a derivative action on behalf of a related company.

### **3.4 Director and prescribed officer standing**

A director is an individual who has been appointed as director, and one who may not be so appointed but nonetheless occupies the position or fulfils the role of a director.<sup>128</sup> The definition of a prescribed officer is drawn-out but culminates to an individual in a senior position with executive control or influence over the whole or a part of the business of the company.<sup>129</sup> Significant in these definitions is that notwithstanding the title each may hold, their role and what they do in relation to the company determines if they are directors or prescribed officers as the case may be.

The Act seeks to balance rights and obligations of shareholders and directors within companies.<sup>130</sup> It is submitted that affording directors standing for the derivative action could create such balance. This is because directors' lack of standing under common law and section 266 of the 1973 Act had meant that they could invoke the derivative action only where they were also shareholders of the company.

Lawful decisions taken through the exercise of the majority vote are, in terms of the principle of majority rule, binding on the minority.<sup>131</sup> By operation of this principle a director would be 'compelled' to implement or act upon a decision that may not be in the best interests of the company, and one that he may have voted against. It is considered in this regard that directors' standing capacitates a director<sup>132</sup> who voted in favour of the company seeking relief against those that have harmed it, but whose vote did not obtain the support of the majority, to exercise his fiduciary duty of acting in the best interests of the company.

A submission could therefore be made that the scope of exercise of directors' duties has been widened beyond merely voting against what would not be in the best interests of the company, and that such duty could entail taking steps, such as initiating a derivative action, to protect the interests of the company. Such submission ought to be qualified by the meaning of what is in

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<sup>128</sup> Section 1.

<sup>129</sup> Section 1 read with regulation 38 of the Companies Regulations, 2011.

<sup>130</sup> Section 7 (i).

<sup>131</sup> *Mbethe* supra note 28 para 59.

<sup>132</sup> As was the applicant in *Mouritzen v Greystone Enterprises (Pty) Ltd & Another* (10442/2011) [2012] ZAKZDHC 34.

the best interests of the company. In *Re Smith & Farewell Ltd*<sup>133</sup> the court laid down the legal principle that directors are bound to exercise the powers conferred upon them in what they themselves consider is in the best interests of the company. Where the individual director considers that it would be in the best interests of the company to initiate a derivative action in order to protect the company's interests, the consideration should be weighed against the means to achieve the desired result. In the context of the barrier of legal costs to the derivative action outlined in chapter 5 *infra*, it is submitted that the duty to act in the best interests of the company must be balanced against what is practically attainable by the relevant director and the means required to discharge such a duty. It is further submitted that to the extent that no upfront indemnification for costs is availed to those who hold fiduciary duties, their duty to act in the best interests of the company would not necessarily entail initiating the derivative action even though that it would be in the company's best interests to do so.

Codified directors' duties also apply to prescribed officers.<sup>134</sup> *Locus standi* of directors and prescribed officers is therefore in perfect harmony with their statutory duties, particularly the duty to act in the best interests of the company in terms of section 76 (3) (a). Directors and prescribed officers are capacitated to hold each other accountable for breaches of the same duty in having been perpetrators of wrongdoing to the company, or having voted against redressing wrong done to the company where such decision was not in the company's best interests. A major advantage of standing of directors and prescribed officers for the derivative action is that they have a vested interest in the affairs and welfare of the company,<sup>135</sup> especially from an accountability perspective in line with their statutory duties. These stakeholders' closer engagement with the operations of the company naturally brings corporate wrongdoing onto their radar, unlike in the case of shareholders in major companies or other external stakeholders.

### **3.5 Trade unions standing**

*Locus standi* of trade unions and employee representatives<sup>136</sup> is a significant advancement in the board's accountability to key stakeholders as employees, whom trade unions represent, are the very engines through which most companies are able to generate income.<sup>137</sup> It also

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<sup>133</sup> [1942] Ch 304 at 306 referenced by Farouk HI Cassim 'The Duties and the Liabilities of Directors' in FHI Cassim et al op cit note 16 at 524.

<sup>134</sup> Section 76.

<sup>135</sup> MF Cassim in FHI Cassim et al op cit note 16 at 780.

<sup>136</sup> Section 165 (2) (c).

<sup>137</sup> HC Schoeman 'The Rights Grated to Trade Unions under the Companies Act 71 of 2008' (2013) 16 (3) *Potchefstroom Electronic Law Journal* 236 at 241.

acknowledges that employees have an interest in the good governance and the financial well-being of the company that is worthy of creating some measure of accountability for.<sup>138</sup> Employees' direct interest in the company would be its sustainability as they are vulnerable to job losses resulting in loss of income. This could be a result of the company's decision to unduly write-off a significant debt which if otherwise recovered, could improve the company's financial standing. Significantly, individual employees do not, in their own right and name, have standing for the derivative action in terms of section 165 (2) (c).

Unlike most derivative action stakeholders, trade unions possess a track record of being bold and bullish to approach the courts to protect the interests of their members. It is anticipated that where harm to the company leads to the impediment to employees' interests, trade unions would not be hesitant to seek redress for the company through the derivative action.

It is submitted however that section 165 (1) (c) may be faced with interpretation hurdles in its application. First, whilst the terms 'shareholder', 'director' and 'prescribed officer' have been extensively defined in the Act, what constitutes 'representatives of employees' has not. It is envisaged that '(registered) trade union' would follow the definition in section 213 of the Labour Relations Act 66 of 1995 (Labour Relations Act) and related provisions. Employee representatives are typically persons appointed by the company or employees to represent employees in engagements with the company. Furthermore, the Act does not set out representation thresholds for employees. It is however submitted that the imprecision of what would constitute employee representatives may result in the courts liberally defining it, thereby ring-fencing the direct standing of those that represent employees regardless of their form, composition or substance, and would ensure their near unrestricted access to the remedy.

Secondly, the extent of representation of employees in trade unions is unclear. The words '*that represents employees of the company*' in section 165 (2) (c) seem to denote singlehood and unanimity in the representation of employees by such representative. It is therefore unclear whether a minority trade union in a company with more than one trade union representing its employees, or a private trade union representing one or a very small fraction of employees would be regarded as 'representing employees of the company' for the purposes of standing

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<sup>138</sup> Ibid at 242; see also *Woollam* supra note 103 para 33.

for the derivative action. It is hoped that none of above uncertainties would frustrate potential derivative actions initiated by those representing employees.

### **3.6 Discretionary standing**

The Companies Act grants unspecified persons standing for the derivative action through the exercise of the court's discretion in terms of section 165 (2) (d) (paragraph (d)). To obtain leave in terms of paragraph (d) applicants must satisfy the court that it is necessary or expedient to grant leave in order to protect their legal right. Thus, a stakeholder such as a director who has been removed from the board supposedly owing to the derivative action he was contemplating to institute, and thus lacking standing on all other categories, and who does not have personal legal rights also sought to be protected, would not qualify for leave in terms of paragraph (d) even though the redress he seeks through the derivative action is not for the protection of his personal interests, but for those of the company.<sup>139</sup>

This expediency and necessity to protect the applicant's rights requirement may have been intended to curb abuse of the court by applicants who have no relationship with the company or its affairs; it is rather onerous to satisfy. Furthermore, there is no clarity on what the criteria for determining if it is necessary or expedient to protect the applicant's legal rights should be.<sup>140</sup> This does not eliminate the requirement that the criteria for determining harm to the applicant's interests complies with the premise on which the derivative action is founded, as the action remains a derivative one.<sup>141</sup>

A secondary role of discretionary standing under paragraph (d) is the protection of the applicant's legal rights. It has been submitted that the court should not grant leave where alternative measures to the derivative action that can address the applicant's grievance would produce substantially the same redress.<sup>142</sup> It is submitted that the existence of an alternative remedy for the protection of the applicant's rights, which is a suitable alternative<sup>143</sup> to obtaining personal relief through the derivative action and one in which the applicant has a real prospect of success,<sup>144</sup> and which is accessible independently of the derivative action, may be an

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<sup>139</sup> MF Cassim op cit note 15 at 117.

<sup>140</sup> Delpont et al op cit note 116 at 590 (2) - (2A).

<sup>141</sup> Ibid at 590 (2A).

<sup>142</sup> Maleka Femida Cassim 'Judicial Discretion in Derivative Actions under the Companies Act of 2008' (2013) 130 *SALJ* 778 at 802.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

indication that it is neither necessary nor expedient for the court to grant leave. However wanting of principles and judicial precedents to guide the application of the paragraph (d) qualification, the basis for the court's discretion would probably be directed by the context of the relevant case.

### **3.7 Comparison with foreign jurisdiction**

#### ***Canada and Australia***

The CBCA and most provincial statutes in Canada have a minimum of three categories of persons granted standing for the Canadian statutory derivative action. First is the security holders' category in terms of which previous and present holders of securities, as well as holders of beneficial interests have standing.<sup>145</sup> This is wider than 165 (2) (a) of the Companies Act as it includes beneficial owners, of whom the beneficiary of the trustee who is a registered shareholder is one,<sup>146</sup> and holders of other securities such as debenture holders and bondholders.<sup>147</sup>

Previous and present shareholders (and directors)<sup>148</sup> of the company's affiliates also have standing. In *Moriarty v Slater*<sup>149</sup> the minority shareholders of an American body corporate that held one hundred per cent of shares of an Ontario corporation were granted standing on the basis that the definition of 'claimant' was broad enough to include the plaintiffs.

Claimants may also obtain standing with leave of the court through the exercise of the court's discretion.<sup>150</sup> However, unlike section 165 (2) (d) which lays down onerous conditions to be satisfied for granting leave, the court under section 238 (d) of the CBCA looks at whether the applicant is a 'proper person'. Section 165 (2) (d) could therefore be viewed as restricting discretionary standing whilst the CBCA adopted a milder form of pre-qualification that requires the claimant to satisfy the court that he is a proper person.

The CBCA gives standing to the Director, a public servant appointed by the minister in terms of section 260, who is entrusted with the administration of the CBCA.<sup>151</sup> A similar provision

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<sup>145</sup> Section 238 (a) of the CBCA.

<sup>146</sup> *Ibid.*

<sup>147</sup> *Welling op cit note 104 at 504.*

<sup>148</sup> Section 238 (b) of the CBCA.

<sup>149</sup> 1989 67 OR 2d 758, 42 BLR 42 (Ont) as cited by *Welling op cit note 104 at 504 fn 26.*

<sup>150</sup> Section 238 (d) of the CBCA.

<sup>151</sup> Section 238 (c).

in the Companies Act is section 165 (16), which allows the Companies and Intellectual Property Commission or the Takeover Regulation Panel to serve the demand or to apply for leave.

In Australia, the Corporations Act of 2001 largely followed CBCA provisions on the standing of shareholders, officers, and in the discretionary category. Standing for the shareholders category is similar to section 165 (2) (a) of the Companies Act in that it is limited to shareholders and persons entitled to be registered as shareholders of the company or related company, and beneficial owners also do not have standing.<sup>152</sup> The Australian discretionary category does not have any qualifications akin to section 165 (2) (d) of the Companies Act or section 238 (d) of the CBCA; this magnifies the realm of judicial discretion regarding persons to whom to grant standing and circumstances that inform the exercise of such discretion. The CBCA,<sup>153</sup> Corporations Act<sup>154</sup> and the Companies Act confer standing to shareholders of related companies, whilst the CBCA and the Companies Act extend standing to directors, and to prescribed officers in respect of related companies.

Even though both the Canadian and Australian statutes confer standing on previous shareholders, directors and officers, previous shareholders and directors in Canada were denied standing based on their lack sufficient interest in the outcome of the derivative action.<sup>155</sup> Canadian courts have held that they have residual discretion to deny standing where the complainant did not have status at the time of the alleged oppression;<sup>156</sup> and in *Jacobs Farms Ltd v Jacobs*<sup>157</sup> the court remarked that it was not the legislature's intention to allow all former shareholders and directors to bring a derivative action. Previous stakeholders have no standing under the Companies Act.<sup>158</sup> The court's refusal to grant qualified stakeholders leave would be based on the applicant's failure to satisfy the court of his fulfilment of the three prerequisites laid down in section 165 (5) (b).<sup>159</sup> It is submitted that aside from the exercise of the court's discretion in terms of section 165 (5) (b) and the demand not having been set aside in terms of section 165 (3), there appears to be no basis for the court un-suiting persons with explicit

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<sup>152</sup> Section 236 (1) (a) (i) of the Australian Corporations Act.

<sup>153</sup> Section 238 (a).

<sup>154</sup> Section 236 (1) (a) (i); see also Austin & Ramsay op cit note 76 at 671.

<sup>155</sup> Pearlie Koh Ming Choo 'The Statutory Derivative Action in Singapore – A Critical and Comparative Examination' (2001) 13 *Bond Law Review* 64 at 72.

<sup>156</sup> J. Anthony VanDuzer 'Who May Claim Relief from Oppression: The Complainant in Canadian Corporate Law' (1993) 25 *Ottawa Law Review* 463 at 482.

<sup>157</sup> (1992) OJ NO 813 (Ont Gen Div) quoted in Choo op cit note 155 at 72.

<sup>158</sup> See paragraph 3.8.1 infra.

<sup>159</sup> Section 165 (5) (b); MF Cassim op cit note 4 at 37 and 51.

statutory standing in terms of section 165 (2) (a), (b), and (c). Moreover South African courts do not have powers to override unambiguous statutory provisions.<sup>160</sup>

## USA

Standing for the derivative action in the US is governed by applicable state law and the Federal Rules of Civil Procedure,<sup>161</sup> which require the plaintiff to be a shareholder at the time of instituting the derivative claim, and at the time of the infringing transaction.<sup>162</sup> The second requirement is referred to as contemporaneous ownership, and is intended at curtailing potential plaintiffs from buying the derivative claim by purchasing shares after the alleged wrong had occurred.<sup>163</sup>

Under the contemporaneous ownership rule, the plaintiff must have been a shareholder at the time of the alleged wrong<sup>164</sup> and at the time of bringing the derivative suit, and must maintain shareholding throughout the derivative litigation.<sup>165</sup> A plaintiff who ceases to be a shareholder for any reason also loses standing,<sup>166</sup> but should he sell his shares pending the derivative action, another qualifying shareholder may intervene to maintain the action.<sup>167</sup>

The restriction of standing to current title holders under the Companies Act of 2008 is in line with the US requirement under Rule 23 (1), *albeit* falling short to the contemporaneous ownership requirement. This is logical as the contemporaneous ownership principle in South Africa would lack the policy relevance that necessitated it in the US.<sup>168</sup>

With regard to the standing of beneficial owners, the court in *Daly v. Yessne* 131 Cal. App. 4th 52, 60-61 (2005) established that the plaintiff had no investment in the company when most of the challenged events occurred, and therefore her interest before she acquired her shares was held to be a mere contractual arrangement that permitted her to buy stock in the company, but which deprived her of standing. US directors do not have standing for the derivative action,

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<sup>160</sup> *Smyth* supra note 110 para 54, and *Mbethe* supra note 28 para 190. For a contrary view see MF Cassim op cit note 15 at 104.

<sup>161</sup> Federal Rules of Civil Procedure, 1996.

<sup>162</sup> Seth Aronson, Sharon L. Tomkins, Ted Hassi, Andrew R. Escobar ‘*Shareholder Derivative Actions: From Cradle to Grave*’ <https://www.mondaq.com/pdf/clients/87654.pdf> (accessed on 21 December 2017) at 10.

<sup>163</sup> *Ibid*. The USA is a highly litigious nation with lawyers taking work on a contingency basis.

<sup>164</sup> *Ibid* at 13.

<sup>165</sup> *Brambles USA, Inc. v. Blocker*, 731 F. Supp. 643 (D. Del. 1990).

<sup>166</sup> Aronson et al op cit note 162 at 13 quoting *Lewis v. Anderson*, 477 A.2d 1040, 1049 (Del. 1984).

<sup>167</sup> Aronson et al *ibid* at 14.

<sup>168</sup> MF Cassim op cit note 15 at 107.

and in *Schoon v Smith*<sup>169</sup> the court dismissed a derivative action that was brought by a director who was not a shareholder for lack of standing.

### 3.8 Other facets of standing

#### 3.8.1 Currency of standing

Past shareholders, directors, prescribed officers and those who previously represented employees or those representing previous employees do not have standing.<sup>170</sup> It has been argued that the standing of past officers of the company is superfluous in that because they are no longer directly associated with the company, they would be acting in their own interests rather than the company's when they bring a derivative action.<sup>171</sup> In Canada, previous shareholders and directors were viewed as lacking sufficient interest in the outcome of the action despite having the requisite statutory standing.<sup>172</sup> Furthermore, the wordings of paragraphs (a), (b) and (c) of section 165 (2) are couched in the present, signifying that applicants must hold their standing-qualification positions at the time that they make the demand. The case of *Brown and Others v Nanco (Pty) Ltd*<sup>173</sup> related to the applicants' *locus standi* under section 266 of the 1973 Act where the court had to determine whether the applicants, who had sold their shares before the provisional order was granted, retained *locus standi* to move the court for confirmation of that order. In dismissing the case Philips AJ remarked:-

‘I agree with applicants' counsel that the word "member" in sec. 266 (1) and (2) must mean that the requisite of membership must be present until application has been made to Court for the appointment of a provisional curator ad litem, which was on 20 August 1975. I derive this conclusion from the words "any member of the company may initiate proceedings" in sub-sec. (1), the words "any such member shall serve a written notice" in sub-sec. (2) (a), and the words "the member may make application to the Court" in sub-sec. (2) (b).<sup>174</sup>

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<sup>169</sup> 953 A.2d 196, 200 (Del. 2008).

<sup>170</sup> Section 165 (2).

<sup>171</sup> Choo op cit note 155 at 71.

<sup>172</sup> *Jacobs Farms Ltd* supra note 157.

<sup>173</sup> 1977 (3) SA 761 (W).

<sup>174</sup> At 764 H-765 A.

Likewise a person bringing an application for leave in terms of section 165 (6)<sup>175</sup> must have standing at the time of making that application.

The implied exclusion of previous stakeholders has the effect of ‘forcing’ current qualified stakeholders to diligently serve the company whilst in office. There is a hypothetical yet probable scenario of a director being forced out of an impending derivative action and out of the company by the adoption of an ordinary resolution at the shareholders’ meeting<sup>176</sup> through which he also loses standing in terms of section 165 (2) (b); or of a shareholder’s removal following a merger in which he was forced to relinquish his shares where such merger was unlawful or intended to exterminate the shareholder and the derivative action planned or initiated by him.<sup>177</sup> In this regard it has been submitted that an exception could be made for the continuing of standing of the released stakeholder.<sup>178</sup>

Related to the currency of a shareholder’s standing is the question of the applicability of the contemporaneous ownership requirement in South Africa. In the English case of *Smith v Croft (No2)*<sup>179</sup> the court held that in a common law derivative action the shareholder is able to assert a claim for a cause of action that arose before he became shareholder. There is no contemporaneous ownership requirement under section 165 of the Act, and whilst the common law derivative action has been abolished, it has been submitted that the rationale in the *Smith v Croft* decision has relevance to the statutory derivative action.<sup>180</sup>

### 3.8.2 Specificity of standing

The cause of action in a derivative action relates to wrong done to the company for which the company is the proper plaintiff to seek redress. A derivative action may accordingly only be brought with leave of the court<sup>181</sup> as the only means of legitimizing the exception. The wording of section 165 (5): ‘A person who has made a demand in terms of subsection 2’ describes the applicant as at the time of making the demand. It is submitted that apart from circumstances contemplated in section 165 (6), the right to apply for leave in terms of section 165 (5) rests on

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<sup>175</sup> Section 165 (6) allows persons with standing to apply for leave without having served a demand in terms of section 165 (2).

<sup>176</sup> In terms of section 71 (1).

<sup>177</sup> MF Cassim op cit note 15 at 110.

<sup>178</sup> Ibid.

<sup>179</sup> [1987] 3 ALL ER 909 referenced in MF Cassim op cit note 15 at 106.

<sup>180</sup> MF Cassim op cit note 15 at 106.

<sup>181</sup> Austin & Ramsay op cit note 76 at 668.

the shoulders of the person that served a demand on the company.<sup>182</sup> It is further submitted that the person that made a demand is the one capacitated by the Act to proceed with leave application.

One may ask whether a possible derivative action perishes with the subsequent loss of standing of the person that made the demand or was granted leave. Section 165 (12) of the Act allows another person with standing to apply to court for the replacement of the person granted leave.<sup>183</sup> It is submitted that the specificity and personal nature of leave granted to the applicant necessitates that any substitution also be sanctioned by the court.<sup>184</sup> Significantly, substitutions in terms of the Australian statute are allowable only to previous and present shareholders and persons entitled to be registered as shareholders, and to previous and present officers of the company.<sup>185</sup> Thus a person without outright standing in terms of section 236 (1) (a) of the Corporations Act is ineligible to be another's substitute. Conversely, section 165 (12) of the Act does not distinguish who may be a substitute. This makes a paragraph (d) applicant eligible for substitution subject, however, to also satisfying the prevailing requirements of section 165 (2) (d).

Section 165 (12) of the Act does not address substitutions of applicants prior to granting leave, such as where a prescribed officer resigns after having served a demand on the company. In this regard it is submitted that another person with standing must rehash the process by serving a demand in order to apply for leave in his name. It is further submitted that the repetition of some aspects of the procedure, such as the appointment of an investigator in terms of section 165 (4) (a) where the substance of the wrong against the company and the demand are the same, may not be necessary where such requirement has already been complied with in terms of the initial demand, unless the person making the demand is the main subject of the investigation where there could be a frivolous claim made.

### **3.8.3 Representative actions**

A person's right to serve a demand or apply for leave in terms of section 165 may be exercised by the relevant persons directly, the Commission or Panel or another person on behalf of

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<sup>182</sup> See MF Cassim op cit note 15 at 110, stating that the shareholder is not explicitly required to remain a shareholder until he makes an application for leave.

<sup>183</sup> MF Cassim in FHI Cassim et al op cit note 16 at 794.

<sup>184</sup> MF Cassim op cit note 22 at 8.

<sup>185</sup> Section 238 (1) of the Corporations Act.

qualified persons as allowed by section 157.<sup>186</sup> Section 157 provides that the right to bring a matter to court in terms of the Act may be exercised by the person contemplated in the relevant section or by someone acting on behalf of the entitled person who cannot act on his own behalf. It is therefore only where a person with standing cannot act on his own due to lack of legal capacity, such as a minor child or mentally incapacitated person, that someone else may do so on his behalf. This is qualified by the limitation imposed by section 157 (3) that in so far as derivative actions are concerned, the representative action would be on behalf of the person entitled to make a demand in terms of section 165 (2). The effect of section 157 is therefore not to confer standing on persons acting for those that cannot bring a derivative action due to lack of standing, but rather to allow representation on behalf of those that do but are somehow not capacitated to do so themselves.

Section 165 (16) is distinguishable from section 262 (2) of the 1973 Act, in that the latter had allowed the Minister of Trade and Industry to institute legal proceedings on behalf of the company if it was in the public interest to do so to recover damages that arose from fraud, delict or misconduct relating to the mismanagement of the company's affairs, or the recovery of the company's property. In this regard the Minister was empowered to institute proceedings under section 262 in respect of causes action that were not covered by section 266 of the 1973 Act, and those that were but the derivative action might never have been brought in terms thereof because of a grievously burdensome order regarding security for costs under section 268 of the 1973 Act.<sup>187</sup> The Companies Act's equivalent of the section 262 action is contained in section 157 (1) (d) which permits an action in the public interest with leave of the court.

### **3.9 Conclusion**

Legislators have gone to greater lengths to making the derivative action available to broader stakeholders in line with statutes of comparable jurisdictions, particularly those of Canada and Australia, whilst largely shying away from adopting US rules of standing which avails the remedy only to shareholders under stringent conditions, particularly the one of contemporaneous ownership.<sup>188</sup>

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<sup>186</sup> Section 165 (16).

<sup>187</sup> Meskin et al op cit note 54 at 505.

<sup>188</sup> MF Cassim op cit note 15 at 104.

The broadening of shareholders' standing to include those entitled to be registered as shareholders is in line with section 236 (1) (a) (i) of the Australian statute. However the lack of direct standing of beneficial owners relegates these stakeholders to the discretionary category where they must satisfy the formidable requirements of section 165 (2) (d) to obtain leave, which, given their financial interests in the company and statutory rights,<sup>189</sup> they could satisfy.

Standing of (executive) directors and prescribed officers may have a more deterrent effect on corporate wrongdoing as, given their operational involvement, they may be privy to restricted information on questionable transactions that may be the basis for derivative claims.<sup>190</sup> *Locus standi* of persons that represent employees of the company is a unique invention<sup>191</sup> that fits naturally into the employee-centric labour environment in which South African companies operate.

Standing with leave of the court is a major development of *locus standi* for the South African derivative action, however circumstances under which the court may grant discretionary leave are restrictive in comparison to corresponding provisions of the Canadian and Australian statutes.

The expansion of categories of persons that can access the derivative action to protect the interests of the company is viewed as a parallel expansion of interests required to be protected under the auspices of interests of the company.<sup>192</sup> The overall effect of extended standing is that the Act gives the company's stakeholders ammunition with which to hold its board accountable for harm done to the company where the board refuses to seek its redress.<sup>193</sup> It is laudable that the legislature ring-fenced *locus standi* of current internal stakeholders of the company, who perceptively represent the different layers of a company's chain of command. These are shareholders at the ownership level, directors at decision making level and prescribed officers at senior management and operations level, and the entire body of employees through their representatives.

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<sup>189</sup> Such as contained in section 56 of the Act.

<sup>190</sup> MF Cassim op cit note 15 at 116; *Mouritzen* supra note 132.

<sup>191</sup> MF Cassim op cit note 4 at 15.

<sup>192</sup> Lombard & Joubert op cit note 10 at 224 and at fn 71.

<sup>193</sup> MF Cassim op cit note 15 at 112.

## CHAPTER 4: OPPRESSION REMEDY

### 4.1 Introduction

The body of company law provides remedies to individual shareholders and other permitted persons whose rights or interests were encumbered by the company or by instruments or persons in relation to it. Where the shareholder's rights or interests have been impeded, the said shareholder is the proper plaintiff to seek personal relief.<sup>194</sup> This is in stark contrast with the derivative action where the applicant steps into the shoes of the proper plaintiff, the company, to seek redress for wrongs committed against the company<sup>195</sup>– the relief sought therefore belonging to the company. In *Lewis Group Limited v Woollam*,<sup>196</sup> a person entitled to be registered as shareholder served a demand in terms of section 165 (2) of the Act, calling upon the company to protect its legal interests by commencing proceedings for the declaration of four of its directors delinquent in terms of section 162 of the Act. In setting aside the demand Binns-Ward J remarked that the 'right of the shareholder that is afforded protection in terms of section 162 is not a right of the company; it is the separate and personal right that each and every shareholder enjoys individually...'<sup>197</sup>

Proceedings for the protection of shareholders' rights or interests *vis-à-vis* the company may be brought in terms of, among others, sections 163 (the oppression remedy), 161, and 218, and at common law.<sup>198</sup> The oppression remedy has been available to minority shareholders who sought relief from oppressive, abusive, or prejudicial action or omission perpetuated traditionally by the majority shareholders of the company, which impacted on them personally as shareholders.<sup>199</sup>

The statutory remedy historically operated parallel the common law personal action. This remains unchanged in section 163 given that the Act does not abolish the right to seek relief from oppressive conduct under common law in circumstances that are similar to those contemplated in section 163.<sup>200</sup>

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<sup>194</sup> MF Cassim op cit note 4 at 179.

<sup>195</sup> Delpont et al op cit note 116 at 589.

<sup>196</sup> *Woollam* supra note 103.

<sup>197</sup> *Ibid* para 43.

<sup>198</sup> Section 161 (2). See also MF Cassim op cit note 4 at 207.

<sup>199</sup> MF Cassim op cit note 4 at 179 and 181.

<sup>200</sup> Delpont et al op cit note 116 at 570, contrasting this from section 165(1) which abolishes the common law derivative action.

## 4.2 Evolution and nature of the remedy

The statutory oppression remedy was imported into the South African corporate legal system from English law by the adoption of section 111*bis* of the Companies Act of 1926<sup>201</sup> in 1952.<sup>202</sup> The inaugural statutory remedy was introduced and applied as an alternative remedy to winding up the company where a member complained of oppression.<sup>203</sup> The remedy was carried forward into the 1973 Act in the form of section 252. Under the Companies Act of 2008 section 163 grants the remedy wider scope of application than its predecessors<sup>204</sup> ranging from widened *locus standi*, broader prejudice causing conduct that can be challenged under it, and comprehensive remedial orders that the court may grant.<sup>205</sup>

The oppression remedy under section 163 is available in circumstances where any act or omission of the company or related person has had a result that is oppressive or unfairly prejudicial to or unfairly disregards the interests of the applicant; the business of the company or related person is being carried out in a manner that is oppressive or unfairly prejudicial to or disregards the interests of the applicant; or the powers of a director or prescribed officer have been exercised in a manner that is oppressive or unfairly prejudicial to or disregards the interests of the applicant.<sup>206</sup> The Act introduces the notion of interests which, although not defined, has been construed to be wider than rights.<sup>207</sup> Furthermore, the scope of the oppression remedy is wider in that it is not fault based and does not intrinsically require that the conduct be unlawful in the sense of infringing legal rights.<sup>208</sup>

## 4.3 Standing

Only shareholders<sup>209</sup> had *locus standi* for the oppression remedy in terms of both the 1926 Act and the 1973 Act. The wording imputing standing in the 1973 Act<sup>210</sup> has in effect been retained

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<sup>201</sup> Act 46 of 1926 (the 1926 Act).

<sup>202</sup> JS (Schoeman) Oosthuizen and PA Delpont ‘Rectification of the Securities Register of a Company and the Oppression Remedy’ (2017) 80 *THRHR* 228 at 240.

<sup>203</sup> *Ibid.*

<sup>204</sup> Section 111*bis* of the Companies Act 46 of 1926 and section 252 of the 1973 Act.

<sup>205</sup> Aubrey Sibanda ‘Advancing the Statutory Remedy for Unfair Prejudice in South African Company Law: Perspectives from International Jurisprudence’ (2015) *SA Mercantile Law Journal* 401 at 402.

<sup>206</sup> Section 163 (1).

<sup>207</sup> MF Cassim in FHI Cassim et al op cit note 16 at 770 quoting *Utopia Vakansie-Oorde Bpk v Du Plessis* 1974 (3) SA 148 A at 170H-171D.

<sup>208</sup> MF Cassim op cit note 4 at 180.

<sup>209</sup> Registered members.

<sup>210</sup> Section 245 read with section 106.

in the Companies Act, and it is anticipated that the courts would continue to use principles that underpinned interpretations of the previous provision in their application of section 163.

A shareholder is the holder of a share and who is registered in the securities register,<sup>211</sup> and therefore persons entitled to be registered as shareholders and beneficial owners lack standing in terms of section 163. In *Lourenco v Ferela (Pty) Ltd (no1)*<sup>212</sup> the applicants, who were intestate heirs of shares not yet registered in their names, were held not to have *locus standi* to bring an application in terms of section 252 of the 1973 Act. The case of *Kalil v Decotex (Pty) Ltd*<sup>213</sup> had contrary facts. It was alleged that whilst the applicant was a registered member, he had ceded his shares to a third party and therefore lacked standing in a winding up application. The court asserted that it is entitled to go behind the register in order to ascertain the true owner of the shares.<sup>214</sup> These two cases are however distinguishable in that although in *Kalil* the applicant was actually a registered member with *prima facie* standing, the application related to the liquidation of the respondent company.<sup>215</sup> In *Lourenco* the applicants did not satisfy a fundamental statutory requirement for standing to obtain relief in terms of section 252 of the 1973 Act.

The *Smyth* case was decided under section 252 of the 1973 Act on the dawn of the section 163 remedy, and affirms the well-established position that only persons qualified in the statute have *locus standi* for the statutory remedy. The effect of this decision is that despite beneficial owners likely to be at the fore of prejudice arising from oppressive or unfair conduct, they lack statutory standing to obtain statutory relief.<sup>216</sup> Meanwhile the standing of nominees as registered holders enables them to protect the interests of beneficial owners on whose behalf they hold the shares.<sup>217</sup>

Even though the oppression remedy was invoked by minority shareholders, it was available to shareholders as a whole, regardless of the extent of their shareholding.<sup>218</sup> South African courts have endorsed this view and granted relief to shareholders who could cast fifty per cent of votes

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<sup>211</sup> Section 1; refer to paragraph 3.3 of this document for a discussion on shareholder standing.

<sup>212</sup> 1998 (3) SA 281 (T) referenced by Oosthuizen & Delpont op cit note 202 at 242-243.

<sup>213</sup> 1988 (1) SA 943 (A).

<sup>214</sup> At 980 H-J

<sup>215</sup> Oosthuizen & Delpont op cit note 202 at 242-243 fn 92.

<sup>216</sup> *Smyth* supra note 110 para 56 read with para 27.

<sup>217</sup> MF Cassim op cit note 4 page 182.

<sup>218</sup> See Blackman et al op cit note 49 at 9-6 fn 3 citing *Re Legal Costs Negotiators Ltd* [1999] 2 BCLC 171.

at the company's general meeting.<sup>219</sup> It has been held with regard to majority shareholders that they would be refused the remedy where they are able to use their voting power to eliminate the oppression complained of.<sup>220</sup>

Section 163 extends standing for the remedy to include directors of company.<sup>221</sup> This is a logical advancement as it recognises the frustration and prejudice arising from oppressive conduct that directors often endure in the discharge of their duties to the company. In *Motale v Abahlobo Transport Services (Pty) Limited and Others*<sup>222</sup> it was held that the refusal of directors to allow a fellow director to access the company's financial records amounted to oppressive or unfairly prejudicial conduct to the interests of that co-director.

#### 4.4 Standing capacity

The common law position has been that a shareholder could obtain relief under the oppression remedy if he was prejudiced in his capacity as shareholder.<sup>223</sup> It is anticipated that on application that this would imply the same for directors who have standing. A member or shareholder who was oppressed in that capacity was however not denied the remedy because he also suffered prejudice in another capacity; he had to prove that the oppression affected his rights as a shareholder.<sup>224</sup> This principle was imposed as a limiting factor to the oppression remedy by the courts, but has since been relaxed.<sup>225</sup> Cassim opines that the inclusion of the concept of interests in section 163 enables the court to avoid a too strict approach to the principle, and allows the court to take into account wider interests of the applicant.<sup>226</sup> Moreover no explicit requirement exists in section 163 for the interests to be affected or disregarded in any capacity.<sup>227</sup>

It is submitted, on the strength of the foregoing, that a director could invoke the remedy where his interests as creditor or employee of the company were unfairly disregarded. It was held in

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<sup>219</sup> MF Cassim op cit note 4 at 183 citing *Benjamin v Elysium Investment (Pty) Ltd* 1960 (3) SA 467 (E) and *Livanos v Swartzberg* 1962 (4) SA 395 (W).

<sup>220</sup> MF Cassim op cit note 4 at 183 citing *Re Baltic Real Estate (No 2)* [1993] BCLC 503 & *Re Legal Costs Negotiators Ltd* supra note 218.

<sup>221</sup> Section 163 (1).

<sup>222</sup> (2015) JOL 34696 (WCC) at 17, as referenced by Delpont et al op cit note 116 at 574(4).

<sup>223</sup> MF Cassim in FHI Cassim et al op cit note 16 at 761.

<sup>224</sup> Blackman et al op cit note 49 at 9-16 referencing *Aspec Pipe Co (Pty) Ltd v Mauerberger* 1968 (1) SA 517 (C) at 525.

<sup>225</sup> MF Cassim op cit note 4 at 185.

<sup>226</sup> Ibid.

<sup>227</sup> Delpont et al op cit note 116 at 571.

*Aspec Pipe Co (Pty) Ltd v Mauerberger* supra that where the applicants suffered prejudice in another capacity than as shareholders it could be relevant for the purposes of the oppression remedy if it was part of a scheme intended to prejudice them as shareholders;<sup>228</sup> and the court in *Nanef v Con-Crete Holding Ltd*<sup>229</sup> held that whilst the wrongful dismissal would not be a basis for invoking the oppression remedy (on which the dismissal formed part), the facts of the case indicated a pattern of oppression which brought the conduct within the scope of the oppression remedy.

There is sufficient English authority to support oppression suffered in other capacities, such as employee or creditor.<sup>230</sup> In *Re Alchemia Ltd*<sup>231</sup> the court noted that the remedy for a dismissed employee who is also a member would be unfair dismissal unless it could be shown that the dismissal affected the person's interests as a member; in *Gamlestaden Fastigheter AB v Baltic Partners Ltd*<sup>232</sup> it was held that the interests of members that claim to be unfairly prejudiced, do not need to be interests in their capacities as shareholders.

In light of Cassim's submissions that the above principle of capacity should not be too strictly construed,<sup>233</sup> it is hoped that the courts would adopt the principles of standing capacity endorsed in the above decisions. It is however submitted that the standing of shareholders and directors, to the implicit exclusion of other persons, could be a gateway to obtain relief for prejudice they suffered in capacities in which they lack statutory standing. This would be particularly true for the South African oppression remedy as the court does not hold discretionary power to confer standing on any other person, nor does the Act empower it to do so. It is further submitted that this could be the basis of inequity where the capacity or role in which a shareholder or director suffered prejudice lacks a statutory avenue to obtaining relief, whilst those that do not have outright standing in terms of section 163 (1), such as prescribed officers, have no access to the same relief from the same prejudicial or oppressive conduct.

#### **4.5 Comparison with other jurisdictions**

##### ***Canada***

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<sup>228</sup> Ibid at 525.

<sup>229</sup> [1993] OJ No 1756 at 71 (QL) (Gen Div) quoted in Delpont et al op cit note 116 at 574(4).

<sup>230</sup> Austin & Ramsay op cit note 76 at 736-737.

<sup>231</sup> [1998] BCC 964 (Ch D).

<sup>232</sup> [2008] 1 BCLC 468 in MF Cassim op cit note 4 at 185.

<sup>233</sup> MF Cassim op cit note 4 at 185.

The Canadian oppression remedy was dubbed the most comprehensive among commonwealth jurisdictions.<sup>234</sup> Under the CBCA the remedy is accessible to wider categories of stakeholders, including previous and present security holders, and beneficial owners of both the company and related companies.<sup>235</sup> Previous and present directors also have standing.<sup>236</sup> The remedy is also available to any person who, in the discretion of a court, is a proper person to make the application.<sup>237</sup> It has been held that the corporation may itself be a complainant for the oppression remedy.<sup>238</sup>

Standing of previous shareholders and previous directors in terms of the CBCA is however not absolute as it may be overridden by the court through the exercise of its residual discretion.<sup>239</sup> Standing by leave of the court accommodates persons who do not have explicit standing, such as creditors, employees, lessors, licensors, and widows of former shareholders,<sup>240</sup> and empirical research on the Canadian oppression remedy found that eight per cent of the applications were instituted by creditors.<sup>241</sup> Conversely, section 163 of the Act allows standing only to shareholders and directors of the company.

The question regarding whether the person claiming a right to be a shareholder could be a complainant for the purposes of the Canadian oppression remedy is moot. In *Lee v International Consort Industries*<sup>242</sup> Lee, who had no shares in the company, commenced oppression proceedings in which *inter alia*, he claimed that shares be transferred to him. The court, in unsuiting Lee, held that if he is accepted as the proper person ‘...there is the anomalous situation that he is given the status of a member able to complain about oppressive conduct by those in control of the company when the oppressive conduct he complains of is denial of his status as a member. If indeed he has a right to the shares his claim can be made in another proceeding.’

It is expected in Canada that oppression claims must be brought by a person who was a shareholder at the time the oppressive conduct was committed,<sup>243</sup> and that the claimant’s

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<sup>234</sup> Sibanda op cit note 205 at 402.

<sup>235</sup> Section 238, and had previously included creditors.

<sup>236</sup> Section 238 (a).

<sup>237</sup> Section 238 (d).

<sup>238</sup> VanDuzer op cit note 156 at 476.

<sup>239</sup> Ibid at 469 and 482.

<sup>240</sup> Stephanie Ben-Ishai and Poonam Puri ‘The Canadian Oppression Remedy Judicially Considered: 1995-2001’ (2004) 30 *Queen’s Law Journal* 79 at 104.

<sup>241</sup> Ibid at 103.

<sup>242</sup> 1992 63 BCLR (2d) 119.

<sup>243</sup> VanDuzer op cit note 156 at 470.

interests must presently be oppressed at the time of the application.<sup>244</sup> This was confirmed in *Michalak v. Biotech Electronics Ltd*<sup>245</sup> where the complainants, former shareholders of the company, were denied the remedy because their interests were not oppressed at the time of their application.

### ***Australia***

The Australian oppression remedy is packaged as a boutique remedy linked to the holding of shares in the company. Current members<sup>246</sup> have standing and beneficial owners do not.

Explicit in members' standing is that they could seek relief from prejudice emanating from conduct that occurred prior to their registration as members.<sup>247</sup> There is no corresponding provision in the Companies Act for relief from conduct that occurred prior to the commencement of the standing-giving position. It is submitted in this regard that qualified applicants should have standing provided that they are suffering prejudice in their current standing-giving positions or capacities.

Under the Australian Corporations Act a member can seek relief from prejudice they suffered in a capacity than as member;<sup>248</sup> an improvement from the previous statute which limited relief to members who suffered oppression in their capacity as member.<sup>249</sup> This eliminates the uncertainty that exists under the section 163 remedy where standing in respect of prejudice suffered in other capacities would be subject to the court's discretion based on the circumstances of the case, and the common law. Invocation of the remedy in respect of prejudice suffered by another person<sup>250</sup> is allowable only if the prejudice was suffered by the latter in his capacity a member.<sup>251</sup>

Standing of previous members under the Corporations Act is limited to those who were removed from the register due to selective reduction, or those who ceased to be members and where the application relates to circumstances in which they ceased to be members.<sup>252</sup> The

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<sup>244</sup> Ibid.

<sup>245</sup> [1986] R.J.Q. 2661, 35, B.L.R. 1 (Sup.Ct.) referenced by VanDuzer *ibid*.

<sup>246</sup> In terms of section 231 (b) a member is one whose name is entered in the register of members.

<sup>247</sup> Per *Re Spargos Mining NL* (1990) 3 ACSR 1 referenced in Austin & Ramsay *op cit* note 76 at 715.

<sup>248</sup> Section 234 (a) (i).

<sup>249</sup> Austin & Ramsay *op cit* note 76 at 736.

<sup>250</sup> Per section 234 (a) (ii).

<sup>251</sup> Austin & Ramsay *op cit* note 76 at 715.

<sup>252</sup> Section 234 (b) and (c).

aforegoing sensibly limits *locus standi* of previous members by narrowing the cause of action for invoking the remedy, as compared to the CBCA that allows unfiltered access of the remedy by past shareholders, save as may be limited through the exercise of the court's residual discretion.<sup>253</sup> Former shareholders and directors have no *locus standi* for the oppression remedy under the Companies Act.

Persons to whom shares were transmitted by operation of the law have standing under the Australian remedy.<sup>254</sup> Even though the Companies Act recognises the transfer of shares by operation of the law,<sup>255</sup> it is silent on whether representatives of shareholders who assume beneficial interest in such shares qualify to invoke the oppression remedy.<sup>256</sup> However persons who act on behalf shareholders (that cannot act in their own name) can invoke the oppression remedy by virtue of the operation of section 157 (1) (b) of the Companies Act.

Finally any person whom the Australian Securities and Investment Commission (ASIC) regards as appropriate based on its investigation into the affairs of the company has standing under section 234 of the Australian Corporations Act. The ASIC is the agency responsible for the administration of companies in Australia – and has powers that include conducting investigations into the affairs of the company on the basis of which it is capacitated to give standing for the oppression remedy.<sup>257</sup> The South African equivalent of the ASIC, the Companies and Intellectual Property Commission, is not empowered to confer standing.

## **USA**

The nature of the US oppression remedy, its basis, circumstances in which it is available, and the nature of relief to be obtained differ from state to state, and is generally inconsistent with the broad principles underpinning the remedy in most common-wealth jurisdictions.

Similar to the oppression remedy under section 111*bis* of the 1926 Act, the oppression remedy in terms of the MBCA is one of the grounds for the shareholder seeking the dissolution of the company.<sup>258</sup> State statutes and the courts allowed milder forms of relief as a remedy for oppressive conduct, such as the appraisal-type remedy where the affected shareholder

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<sup>253</sup> VanDuzer op cit note 156 at 469 and 482.

<sup>254</sup> Section 234 (d).

<sup>255</sup> Section 51 (6) (b).

<sup>256</sup> Sibanda op cit note 205 at 412.

<sup>257</sup> Section 234 (e).

<sup>258</sup> Section 14.30 (2) (ii).

withdraws from the company and compels it to purchase his shares at a fair value,<sup>259</sup> and the appointment of a provisional director.<sup>260</sup>

Under the MBCA shareholders have standing for the oppression remedy in respect of past, present and imminent oppression perpetrated or to be perpetrated by directors or those in control of the company.<sup>261</sup> The Australian Corporations Act similarly allows the remedy in respect of actual or proposed actions or resolutions.<sup>262</sup> Conversely, section 163 of the Act allows the remedy only in respect of past and present conduct in line with section 241 (2) (b) and (c) of the CBCA. With regard to state statutes, the Delaware Code<sup>263</sup> does not have a remedy for shareholder oppression or unfair conduct; and it was affirmed in *Nixon v Blackwell*<sup>264</sup> that the court should not provide relief to shareholders outside of their contracted terms.

The Louisiana and Michigan statutes have striking attributes with which to compare section 163 of the Act. The Louisiana Business Corporation Act<sup>265</sup> (LBCA) acknowledges oppression by the company specifically,<sup>266</sup> contrary to the MBCA where the conduct concerned is that of ‘the directors or those in control of the corporation’.<sup>267</sup> The specificity of the perpetrator as the company in the LBCA arguably denies a shareholder relief from oppressive conduct perpetrated by individuals in circumstances where the said act or omission may only be committed by or attributed to a natural person, such as with fraud.<sup>268</sup> Circumstances in which an applicant has *locus standi* to seek relief are comparably widely worded in section 163 when compared with the LBCA, and enable holding the company and those whom it put in its charge accountable for oppressive conduct.

The Michigan remedy in terms of the Michigan Company Laws Ann section 450.1489 (West 2012), is unavailable where the oppressive conduct or actions complained of are permitted in terms of the constitution or rules of the company, or agreement. Conversely section 163(1) of the Act, and the corresponding provisions of the Canadian and Australian statutes, do not have this detail. It is submitted that section 163 (1) (b) is broad enough to allow the remedy where

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<sup>259</sup> Douglas K. Moll ‘Shareholder Oppression and the New Louisiana Business Corporation Act’ (2014) 60 *Loyola Law Review* 461 at 475.

<sup>260</sup> *Ibid* at 469.

<sup>261</sup> *Ibid*.

<sup>262</sup> Section 232 (b) & (c).

<sup>263</sup> Delaware General Corporation Law – Title 8 Corporations.

<sup>264</sup> 626 A.2d 1366 (Del. 1993).

<sup>265</sup> Act No. 328 (May 30, 2014), which became effective on 1 January 2015.

<sup>266</sup> Per section 1-1435 (A).

<sup>267</sup> Section 14.30. (2) (ii).

<sup>268</sup> Moll *op cit* note 259 at 489.

the conduct complained of emanates from the application of the MOI or rules of the company in the running of its business as indicated. Like section 234 (a) (i) of the Australian Corporations Act, the Michigan remedy allows standing where the plaintiff was oppressed in a capacity than as shareholder.<sup>269</sup> Oppression emanating from termination of employment or limitation of employment benefit would therefore be remediable. In *Berger v Katz*, 291663, 20112309217 (Mich. Ct. App. July 28, 2011)<sup>270</sup> the court endorsed the statutory provisions and found that the defendants engaged in willfully unfair and oppressive conduct by amongst others, limiting the plaintiff's salary whilst providing raises for themselves; and in terminating payments to the plaintiff that were normally made to all of them as shareholders.<sup>271</sup>

#### 4.6 Conclusion

The statutory oppression remedy under section 163 of the Act was influenced largely by the provisions of the CBCA. Widened standing to include directors, and shareholders and directors where their interests were disregarded or prejudiced by the conduct of a related company has the potential to improve the scope of application of the South African oppression remedy from the perspective of invocation of the remedy. It is however anticipated that these factors would assist companies to run their businesses efficiently with regard to the interests of their stakeholders, comprising those that have *locus standi* for the remedy, and those that may suffer prejudice in other capacities.

The continued lack of standing of unregistered holders of shares in the company<sup>272</sup> for the oppression remedy is unfortunate, as they have proprietary interests that are worthy of creating some measure of protection for. The continued existence of the common law oppression remedy and actions in terms of section 161 and 218 of the Act do provide some solace *albeit* without the benefit of the expansive remedies available in terms of section 163.

The court's order for the entry of the applicant's name into the company's securities register alongside the granting of the relief from oppressive conduct in the *Barnard*<sup>273</sup> case is revolutionary. The decision does not however give unregistered shareholder applicants the right to bring an application for relief whilst not being so registered. To obtain relief, a person

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<sup>269</sup> Section 450.1489 (West 2012).

<sup>270</sup> Cited in Peter J. Horne 'Suppressing Minority Shareholders Oppression' (2013) 16 *Duquesne Business Law Journal* 199 at 228.

<sup>271</sup> *Ibid.*

<sup>272</sup> Persons entitled to be registered as shareholders and beneficial owners.

<sup>273</sup> *Supra* note 118.

entitled to be registered as shareholder has to seek such an order with the application for relief from oppression, even where the oppressive conduct complained of is the undue denial of his registration as shareholder.<sup>274</sup> Standing of beneficial owners would be a necessary advancement, one that needs a company policy shift towards better recognition and protection of interests of beneficial owners.

Unlike the derivative action, the interests of employees of the company<sup>275</sup> are conspicuously not represented in the oppression remedy through *locus standi*. This may however be justified by the ample legislation in South Africa that are aimed at protecting the interests of employees. It is submitted that the Labour Relations Act and related labour legislation have adequate measures to contend with infringed employees' interests, and that to give employees or those that represent them standing for the oppression remedy would amount to a duplication of procedures and remedies. Section 163 does not provide for discretionary standing, which if in place, would solve the anomaly where the remedy is sought by a qualified applicant for prejudice suffered in a capacity in which he lacks standing. It is submitted that there is room for the creation of discretionary standing with leave of the court within reasonable perimeters.

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<sup>274</sup> *Lee v International Consort Industries* supra note 242.

<sup>275</sup> As prescribed officers or through employee representatives.

## CHAPTER 5: PERSISTING BARRIERS

### 5.1 Background

*Locus standi* is a person's right to be heard by a court on a matter, informed by his proximity to a cause of action, rights, or interests sought to be enforced or protected.<sup>276</sup> The judicial assertion of such a right by the *dominis litis* in legal proceedings however, is complemented by aspects relating to legal costs and access to information: the litigant is responsible for legal costs to be incurred to assert his rights, and as the master of the suit, he is required to prove his case through providing relevant evidentiary documents.

The derivative action is hailed as a device with which to enforce corporate governance through directors' accountability, to protect the interests of the company, and to obtain redress for harm done to the company.<sup>277</sup> This tool's ability to efficiently realize its objectives has been under scrutiny on the basis that it is embedded in barriers<sup>278</sup> that transcend *locus standi* to invoke it. These barriers relate to legal costs of the derivative action, and access to information required to substantiate the action. It can thus be said that the extent to which the derivative action is able to meet its objectives, even with the boost of extended *locus standi*, ought to be assessed by determining if, and how, section 165 of the Companies Act could eliminate or lessen the impact of the abovementioned barriers.

### 5.2 Legal costs

#### 5.2.1 Foundational

A shareholder<sup>279</sup> aggrieved by corporate misconduct where the board refuses to seek redress for the company is faced with an array of unpalatable options. He may sell his shares,<sup>280</sup> however this may not be ideal if he intends to stay invested in the company. Alternatively the shareholder could accept the board's decision not to seek redress. The ultimate non-recovery of what is due to the company could lead to the diminution of the share value in his and other individual shareholders' hands, and may be a driving force behind seeking to obtain some form

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<sup>276</sup> See paragraph 3.2 supra.

<sup>277</sup> MF Cassim op cit note 4 at 8.

<sup>278</sup> Ibid at 149-150.

<sup>279</sup> In the case where the stakeholder is a shareholder.

<sup>280</sup> A Reisberg 'Funding Derivative Actions: A Re-examination of Costs and Fees as Incentives to Commence Litigation' (2004) 4 *Journal of Corporate Law Studies* 345 at 345.

of redress despite the board's contrary decision. Per Lord Bingham in *Johnson v Gore Wood & Co (a firm)*<sup>281</sup>

'Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss suffered by the company. A claim will not lie by a shareholder to make good a loss which would be made good if the company's assets were replenished through action against the party responsible for the loss, even if the company, acting through its constitutional organs, has declined or failed to make good that loss.'

Thus only the company directly or through a derivative action may bring proceedings for its redress, and a shareholder has no personal claim to be asserted in that regard.<sup>282</sup> Another option would be for the stakeholder to force the company's hand to seek its redress by bringing a derivative action. However whether the stakeholder desirous of bringing a derivative action can proceed with such action depends on whether he can fund legal fees for relief that inherently belongs to the company.<sup>283</sup> It is thus imperative to explore the issue of costs as a barrier to the derivative action.

Fundamentally, the judicial framework for litigation costs in South Africa indicates that the unsuccessful party pays the legal costs of suit.<sup>284</sup> These costs comprise the unsuccessful party's own costs and the bulk the successful party's. The successful party would however not recover all of his costs from the unsuccessful party because the costs are subject to taxation in accordance with tariffs of applicable rules of the relevant court, thus leaving the successful party to his own devices to fund the difference.<sup>285</sup>

Owing to the recovery of legal costs not being an automatic right, the court must make an order to that effect, usually on finalization of a matter.<sup>286</sup> A litigant ought therefore to have a financial base from which to pay his legal fees as they accrue during the subsistence of legal proceedings. The issue of legal costs is therefore a major factor for a person who contemplates bringing legal

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<sup>281</sup> [2001] 1 All ER 481 (HL) at 502.

<sup>282</sup> MF Cassim op cit note 142 at 803.

<sup>283</sup> MF Cassim op cit note 22 at 12.

<sup>284</sup> Ibid.

<sup>285</sup> Ibid.

<sup>286</sup> Interim costs may also be ordered.

action.<sup>287</sup> Legal costs for the derivative action are distinct in that although derivative proceedings are prosecuted through or under the instructions of the person with *locus standi*, the real litigant, to whom the relief sought or any benefit of the action legally accrues, is the company.<sup>288</sup> A derivative action is one brought by a stakeholder through the operation of the exception to the proper plaintiff rule. It is thus reasonable to expect the exception to be extended to apply to the manner in which the (applicant's) costs of the derivative action are handled. It would also be reasonable to expect a derivative action system to require that legal costs relating to derivative proceedings be borne by the company.<sup>289</sup>

Findings of an empirical study of the Australian statutory derivative action in the first six years following its introduction paint a picture on pertinent aspects of the Australian statutory action that may be telling of the South African version of the remedy. In respect of derivative actions where leave was granted, the study found that costs of the leave application were awarded in 15.8 per cent of the cases, against 21 per cent where the applicant was denied costs, and 31 per cent where costs were reserved.<sup>290</sup> They also found that in none of the cases was the company ordered to fund the application in respect of the substantive action.<sup>291</sup>

### 5.2.2 Statutory provisions

The 1973 Act did not make provision for the recovery of the applicant's legal costs relating to the derivative action from the company. Under section 268 of that Act the court could require the applicant to provide security for the costs of the provisional *curator ad litem* and the respondent where it was of the view that the applicant will be unable to pay the respondent's costs should the respondent successfully oppose the application.<sup>292</sup>

The Companies Act deals with costs for the derivative action in section 165 (10) and (11). Under section 165 (10) the court has the discretion to make orders it deems appropriate for the costs of the person that applied for or was granted leave, or of the company or any other party to the proceedings. The court's general discretion on costs orders is therefore preserved.<sup>293</sup> In

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<sup>287</sup> Albert Monichino 'Costs in Statutory Derivative Actions: The Lingering Ghost of Wallersteiner' (2015) 33 *Company & Securities Law Journal* 104 at 104.

<sup>288</sup> Cassim op cit note 4 at 148.

<sup>289</sup> *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA) referenced in MF Cassim op cit note 4 at 152.

<sup>290</sup> Ramsay & Saunders op cit note 33 at 428.

<sup>291</sup> *Ibid.*

<sup>292</sup> Meskin et al op cit note 54 at 515.

<sup>293</sup> MF Cassim op cit note 4 at 151 citing *Foyster v Foyster Holdings Pty Ltd (prov lipptd)* (2003) 47 ACSR 705 at 708.

the *Mouritzen* case where the applicant was granted leave to bring the derivative action, the court exercised its discretion on the issue of costs for the leave application by not making an award for costs, and instead reserving it for determination by the court hearing the substantive application.<sup>294</sup> This is despite the fact that costs orders may be made at any time<sup>295</sup> during derivative proceedings, thereby creating the possibility for provisional costs.<sup>296</sup> It has been submitted that in determining the issue of costs for the derivative action, the courts should exercise their discretion in a balanced manner: they should not be too generous lest they open floodgates of claims, and should not adopt a too restrictive approach as that may discourage legitimate claims sought to be asserted derivatively.<sup>297</sup>

Section 165 (11) empowers the court to order the applicant to provide security for costs. This may have been intended to protect the company and the defendant directors in the event that the applicant is unable to pay the costs following an unsuccessful derivative action,<sup>298</sup> and may be viewed as preserving the provisions of section 268 of the 1973 Act.

### 5.2.3 Comparison with other jurisdictions

The landmark English case of *Wallersteiner v Moir (No 2)* laid guidelines for liability for legal costs under the common law derivative action. The court held that the decision to initiate a derivative action ought to have been made in the interests of the company,<sup>299</sup> and that it is normal for the company to be liable for costs if the action was brought in good faith and on reasonable grounds.<sup>300</sup> It was further held that in a successful derivative action the wrongdoer, or failing him, the company, must pay legal costs and that if the action is unsuccessful, the company must bear the costs as the applicant acted for the company.<sup>301</sup>

Indemnification right laid out in *Wallersteiner* was statutorily adopted in New Zealand<sup>302</sup> and in the United Kingdom (UK)<sup>303</sup> with discretionary power, even as the principle was widely

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<sup>294</sup> *Mouritzen* supra note 132 para 67. This accords with Ramsay & Saunders' findings that in the majority of derivative actions where leave was granted (31 per cent) costs were reserved.

<sup>295</sup> Section 165 (10).

<sup>296</sup> MF Cassim in FHI Cassim et al op cit note 16 at 792.

<sup>297</sup> Julia Tang 'Shareholder Remedies: Demise of the Derivative Claim?' (2012) *UCL Journal of Law and Jurisprudence* 178 at 203.

<sup>298</sup> MF Cassim op cit note 4 at 155.

<sup>299</sup> *Wallersteiner* supra note 289 at 392 as referenced by MF Cassim op cit note 4 at 152.

<sup>300</sup> *Ibid* at 403-404.

<sup>301</sup> *Ibid* 391-392.

<sup>302</sup> Section 166 of the New Zealand Companies Act 105 of 1993.

<sup>303</sup> Rule 19.9E of the Civil Procedure Rules 2000.

adopted in other commonwealth jurisdictions' court decisions.<sup>304</sup> Conflicting decisions regarding costs prevail in the UK with some decisions requiring the applicant to show the need for seeking an order for indemnification of costs,<sup>305</sup> and some rejecting this on the basis that indemnification is a principle and should not have regard to a petitioner's financial position.<sup>306</sup>

Aspects of the *Wallersteiner* principles were incorporated in the Companies Act as part of the qualification criteria for granting leave.<sup>307</sup> These are that the applicant must be acting in good faith, and that it is in the interests of the company in terms of section 165 (5) (b) (i) and (iii). Whilst these principles are not overtly part of the costs provisions in the Companies Act, it has been submitted on the strength of their application as part of the leave qualification that once leave has been granted, the applicant would have satisfied the requirements and fitting of obtaining indemnification order for costs from then on.<sup>308</sup>

In Canada section 240 (d) of the CBCA allows a court to order the company to compensate the applicant's reasonable legal fees connected to the derivative action. The court may also order that any amount declared payable by the defendant be paid in whole or in part to previous or present security holders instead of the company.<sup>309</sup> It is submitted that such a provision is in accord with the protection of shareholders as investors in the company, and in South Africa it would be in alignment with the objective of promoting development of the South African economy and promoting investment in the South African markets.<sup>310</sup> The CBCA similarly provides for the company to be ordered to pay the complainant's interim costs of the action.<sup>311</sup> In sharp contrast with section 165 (11) of the Act, a Canadian complainant is not required to furnish security for costs.<sup>312</sup>

The wording of section 165 (10) is sourced directly from section 242 of the Australian Corporations Act, save that under the Corporations Act an order may require an indemnification for costs.<sup>313</sup> From the outset it seems not to have been the intention of the Australian legislature that the successful applicant for leave should be entitled to his costs of

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<sup>304</sup> MF Cassim op cit note 4 at 157-158.

<sup>305</sup> *Smith v Croft (No1)* [1986] 1 WLR 580 at 597.

<sup>306</sup> *Jaybird Group Limited v Wood* [1986] BCLC 319 at 327.

<sup>307</sup> MF Cassim op cit note 4 at 152.

<sup>308</sup> *Ibid.*

<sup>309</sup> Section 240 (c) of the CBCA.

<sup>310</sup> Section 7 (b) and (c) of the Companies Act.

<sup>311</sup> Section 242 (4) of the CBCA.

<sup>312</sup> Section 242 (3) of the CBCA.

<sup>313</sup> Austin & Ramsay op cit note 76 at 681 citing *Fiduciary Ltd v Morningstar Research Pty Ltd* (2005) 53 ACSR 732 at 744.

bringing the derivative action,<sup>314</sup> and they decided to statutorily move away from *Wallersteiner* model of costs for the derivative action in favour of the court's discretion.<sup>315</sup>

Judicial decisions in Australia are however shaping the form of discretion to be exercised by the courts. In *Wood v Links Golf Tasmania Pty Ltd*<sup>316</sup> the court held that in a derivative action where the requirements of section 237<sup>317</sup> have been met, it is appropriate that the company be ordered to pay the costs of the applicant; as with in *Foyster v Foyster Holdings Pty Ltd*<sup>318</sup> where the court held, *albeit* without making such an order, that a derivative applicant should be protected against the costs of a derivative action that he had to bring. The court in *Swansson v RA Pratt Properties Pty Ltd*<sup>319</sup> stated that it must be shown at the time of requesting leave to bring a derivative action that the company is able to pay the costs of the envisaged derivative action – ensuring that the company is not driven into liquidation through a costs order that it simply cannot afford to honor.

These decisions are in no way definitive as the court may still exercise its discretion and not make a costs order against the company. It is worth drawing comparison to the costs provisions of section 166 of the New Zealand Companies Act. There the court may, on application by a derivative applicant to whom leave has been granted, order that the whole or part of reasonable costs of bringing the derivative action be paid by the company.<sup>320</sup> The court is thus *required*<sup>321</sup> upon application, to make a favourable costs order to a derivative applicant unless it is demonstrated that it would be unjust or inequitable for the company to bear such costs.<sup>322</sup> This requirement directs the basis for the exercise of the court's discretion for costs orders, and may filter abuse of the remedy.

The issue of costs of the derivative action in the US is different from commonwealth jurisdictions. This may be attributable to the favourable costs regime in the US which includes that all parties pay their respective legal costs regardless of the outcome of the litigation, except

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<sup>314</sup> Monichino op cit note 287 at 108.

<sup>315</sup> Ibid 108-109.

<sup>316</sup> [2010] FCA 570 referenced in MF Cassim op cit note 22 at 14.

<sup>317</sup> Section 237 of the Australian Corporations Act deals with leave application and circumstances under which leave may be granted by the court.

<sup>318</sup> *Foyster* supra note 293 para 13 under citation [2003] NSWSC 135.

<sup>319</sup> (2002) 42 ACSR 313 at 326.

<sup>320</sup> MF Cassim op cit note 22 at 13.

<sup>321</sup> My emphasis.

<sup>322</sup> Section 166 of the New Zealand Companies Act.

in the instance of abuse;<sup>323</sup> that US plaintiffs who succeed in their action are not limited by the cap on judicially recoverable fees based on tariffs akin to South Africa; and the contingency fee system where attorneys' fees are agreed to and paid as a percentage of the sum to be recovered from the defendant.<sup>324</sup> In South Africa, contingency fees based work is regulated by the Contingency Fee Act,<sup>325</sup> which was founded to encourage legal practitioners to undertake speculative actions on behalf of their clients.<sup>326</sup> Contingency fees were prohibited under common law,<sup>327</sup> and unlike in the US where they are commonly used, they remain rare in South Africa except in the case of complex and specialist litigation involving an untested area of law, and medical and personal injury claims based litigation.

The issue of costs had been a barrier to derivative actions since prior to 2011 when the Companies Act become effective, when only shareholders had *locus standi*. As investors, shareholders could be perceived to have deeper pockets from which to fund a derivative action, especially when also propelled by a personal interest of protecting their investment value. Other stakeholders that have standing in terms of section 165 (2) would, with the exception of trade unions, ordinarily be in no better position to fund costs for the derivative action. Furthermore, to the extent that there are no costs incentives for stakeholders<sup>328</sup> to institute derivative proceedings, the future of derivative actions is a gloomy one given that the current legal costs regime does not encourage them to initiate such proceedings.

Trade unions have a different frame of reference. They provide a service for which they receive payment through monthly fees from their members. For this reason it is submitted that with that funding stream, the costs for a derivative action would not be a barrier to trade unions (to the exclusion of other employee representatives), or at least not to the same extent as the other stakeholders. Therefore under the current statutory regime of costs awarded on a discretionary basis, qualified stakeholders that may bring derivative actions would be those that can afford

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<sup>323</sup> Martin Gelter 'Why do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 *Brook Journal of International Law* 843 at 861.

<sup>324</sup> Ann M. Scarlett 'Imitation or Improvement? The Evolution of Shareholder Derivative Litigation in the United States, United Kingdom, Canada, and Australia' (2011) 28 *Arizona Journal of International & Comparative Law* 569 at 605.

<sup>325</sup> Act 66 of 1997.

<sup>326</sup> Gert Nel 'Decoding s 2(1) (a) and (b) of the Contingency Fees Act' (2018) (June) *De Rebus* DR 14. <http://www.derebus.org.za/decoding-s-21a-and-b-of-the-contingency-fees-act/> (accessed on 5 December 2018).

<sup>327</sup> *Ibid.*

<sup>328</sup> Akin to additional qualification conditions applicable to discretionary stakeholder in terms of section 165 (2) (d) of the Act.

to fund legal costs without the need to be reimbursed, including those that have the means to obtain funds to finance legal fees.

Given the body of statutes of comparable jurisdictions that influenced the form of the South African derivative action and its pertinent elements, one may surmise that the legislature deliberately left the issue of costs to the discretion of the court as a neutral body empowered with details of a particular derivative action. This may be justified by the fact that a derivative action is brought in defiance of the lawful decision of those who are legislatively empowered<sup>329</sup> to decide whether or not to prosecute a matter, and may be seen as a remedy that requires some form of protection by the court, even on aspects relating to costs. However to the extent that an applicant successfully brings a derivative action, and his costs relating to the action are not judicially ordered to be paid by or recovered from company, the company is unjustly enriched by the relief obtained through the efforts and resources of the stakeholder.<sup>330</sup> Furthermore, the company does not bear residual costs that were not allowed during taxation, and which cannot be recovered by the applicant.

### **5.3 Access to information**

#### **5.3.1 Foundational**

Information is an essential commodity for legal proceedings. To succeed, litigants must prove their claims with appropriate evidence. Before the substantive action in derivative proceedings could commence, the applicant must have satisfied the compulsory procedural requirements of making a demand<sup>331</sup> and obtaining leave. Leave may be granted if the court is satisfied that the applicant is acting in good faith, the proceedings involve the trial of a serious question of material consequence to the company, and that it is in the best interests of the company that the applicant be granted leave.<sup>332</sup> It is therefore incumbent on the applicant to articulate details of

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<sup>329</sup> By section 66 (1) of the Act.

<sup>330</sup> Andrew Keay 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 *Journal of Corporate Law Studies* 39 accessed at <http://eprints.whiterose.ac.uk/84073/> on 12 December 2018 at 28 referencing J. Wilson 'Attorney Fees and the Decision to Commence Litigation: Analysis, Comparison and an Application to the Shareholders' Derivative Action' (1985) 5 *Windsor Yearbook of Access to Justice* 142, 177.

<sup>331</sup> Except as allowed in terms of section 165 (6).

<sup>332</sup> Section 165 (5) (b).

corporate wrongdoing with sufficient particularity to show the company's legal interests involved,<sup>333</sup> and must adduce appropriate evidence to prove it.<sup>334</sup>

The epitome of access to information as a barrier to the derivative action lie in the fact that a derivative applicant suspecting wrongdoing against the company must gather information to determine the merits of the envisioned derivative proceedings<sup>335</sup> in circumstances where those who harmed the company are not only in control of the information sought,<sup>336</sup> and thus in a position to hide or discard it, but may be the very directors that are vested with the authority to decide whether or not to pursue redress for wrongs done to the company.<sup>337</sup> Being outside of the company and removed from its operations and management, external stakeholders<sup>338</sup> such as minority shareholders in large companies are not in a position to informally obtain evidence of corporate misconduct and / or to evaluate whether their claims have merit for pursuit.<sup>339</sup> There may also be a timing issue where pertinent information comes to light during leave application<sup>340</sup> through submissions on behalf of the company, which points to the soundness of the board's decision not pursue those that harmed the company or any other factor that would justify the court's refusal of leave.

### 5.3.2 Statutory provisions

The statutory derivative action under the 1973 Act aimed at addressing minority shareholders' lack of access to information due to their being outside of the company by improving its access through the appointment of the *curator ad litem*. The *curator ad litem's* role included conducting an investigation of the grounds described by the applicant in his application<sup>341</sup> and as directed by the court. The Companies Act of 2008 tweaked provisions relating access to information for the derivative action through two provisions.

First is section 165 (4), which requires the board to appoint an investigator to investigate the section 165 (2) demand. The credibility of the outcome of the investigation may however be

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<sup>333</sup> MF Cassim op cit note 4 at 65.

<sup>334</sup> Ibid.

<sup>335</sup> Arad Reisberg 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 *ECFR* 69 at 83.

<sup>336</sup> Ibid at 84.

<sup>337</sup> Blackman et al op cit note 49 at 9-181.

<sup>338</sup> Compared to internal stakeholders such as directors and prescribed officers.

<sup>339</sup> Reisberg op cit note 335 at 84.

<sup>340</sup> Samantha S. Tang 'Corporate Avengers Need Not be Angels: Rethinking Good Faith in the Derivative Action' (2016) 16 *Journal of Corporate Law Studies* 471 at 483.

<sup>341</sup> Meskin et al op cit note 54 at 514.

questionable regard being had to the investigator's purported lack of impartiality<sup>342</sup> – he is appointed by and reports to the board on the findings of his investigation.<sup>343</sup> By comparison, the 1973 Act provided for a *curator ad litem* to be appointed by and reporting to the court on the findings of the investigation.<sup>344</sup> This protected the integrity of the investigation and report from an objectivity and impartiality perspective, and had ensured that the content of the report was accessible to the court and the applicant.<sup>345</sup>

The statutory change in the person that commissions an investigation into derivative proceedings initiated may have been intended among others, to allow a company driven process that eliminates the court's intervention in the preliminary stages of derivative proceedings. It is apparent from the wording of section 165 (4) that the investigation is commissioned and undertaken to apprise directors of information surrounding the demand made by the stakeholder, and is not intended to aid the applicant to gather information relating to corporate wrongdoing or prepare for leave application.

Secondly, section 165 (9) (e) allows the inspection of books by the person granted leave to adequately prepare for the substantive action. This does not go far for a stakeholder who is investigating the merits of his suspicion of wrongdoing and seeking to apply for leave, as he would still lack information and documents required to prove that the proposed proceedings involve a trial of serious question of material fact and that it is in the best interests of the company that the applicant be granted leave as required by section 165 (5) (b) (ii) and (iii).<sup>346</sup>

Notwithstanding the above provisions and the noble cause they seek to meet, before applying for leave, a stakeholder, particularly an external one, has no formal channel through which to obtain information relating to corporate wrongdoing, because the kind of information that the company is compelled to provide in terms of section 26 of the Companies Act<sup>347</sup> is generic in nature and would mostly be unrelated to the corporate wrongdoing under consideration by the stakeholder. The lack of an explicit statutory obligation for the investigator to avail his findings to the court or the applicant (before leave application)<sup>348</sup> is a setback for the provision and what is thought it was intended to address, and points the applicant to the direction of requesting

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<sup>342</sup> MF Cassim op cit note 4 at 169.

<sup>343</sup> Ibid.

<sup>344</sup> Section 266 (3).

<sup>345</sup> MF Cassim op cit note 4 at 169.

<sup>346</sup> Ibid at 65.

<sup>347</sup> Ibid at 168.

<sup>348</sup> Ibid at 169.

information in terms of the Promotion to Access of Information Act 2 of 2000, where applicable.

### 5.3.3 Comparison with other jurisdictions

The Canadian statute contains no direct provisions relating to access to information for the derivative action akin to section 165 (9) (e) or section 165 (4), save for section 240 of the CBCA which provides that ‘the court may at any time make any order it thinks fit including, without limiting the generality of the foregoing...’, which may be read to also include a possible order for the company to provide the claimant with relevant information.

Section 241(1) (d) of the Australian Corporations Act empowers the court to make an order for the appointment of an independent person to investigate and report to the court on the financial position of the company, circumstances which gave rise to the cause of action, the subject matter of the proceedings, or the costs of the proceedings. This is similar to the provisions of section 266 (3) of the 1973 Act in which the *curator ad litem* could be required, on application by the applicant member, to conduct such an investigation for the court.<sup>349</sup> The court’s appointment of and reporting to it by the investigator was however not carried through to section 165 (4) of the Companies Act, thus leaving the provision unperfected.

Section 247A of the Corporations Act allows an application for the inspection of records by a person with *locus standi* for the derivative action, and by one who applied for or was granted leave.<sup>350</sup> This is a wider pool of empowered applicants by virtue of which applications for inspection of records may be granted at different stages of the derivative proceedings. The test applied by the court is good faith of the applicant, and that the inspection of company records must be for a proper purpose.<sup>351</sup> This wording allows those with *locus standi* to inspect records at any time during the derivative proceedings, and it is submitted that the wording is progressive and acknowledges the weak position of potential applicants from an access to information perspective, and may assist to address the anomaly where more pertinent information comes to the applicant’s light once leave application has been launched.

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<sup>349</sup> Section 266 (2) (b).

<sup>350</sup> Section 247A (3).

<sup>351</sup> *Ibid.*

In the US, the MBCA similarly allows access to information for the derivative action to a shareholder whose demand for inspection is in good faith and for a proper purpose,<sup>352</sup> and where the required records are directly connected to the purpose.<sup>353</sup> The demand for the inspection of records where there is suspected wrongdoing against the company or with the view to initiate a derivative action would indicate such proper purpose.<sup>354</sup>

#### 5.4 Conclusion

One of the safeguards of the derivative action is through the preservation of the court's discretion with regard to an order for costs of the derivative action.<sup>355</sup> The manner in which judicial discretion was exercised in the *Mouritzen* case however indicates that courts are more likely to exercise their discretion with great caution, despite being empowered with statutory powers to grant wide orders at any time. Appeals have been made that the court should exercise its discretion in a balanced and flexible manner<sup>356</sup> in order to help the remedy achieve what it has been created and revamped in the Act to achieve.

The likelihood of the court ordering a derivative applicant to furnish security for costs in terms of section 165 (11) remains a deterrent, and necessitates at the very least, the formulation of guiding principles on circumstances in which the court may make such an order. The amendment of section 165 (11) to prohibit courts from ordering applicants to furnish security for costs has also been called for.<sup>357</sup>

With regard to access to information, the investigation contemplated in section 165 (4) is intended to capacitate the company to examine the merits of the demand and ascertain the cause of action, costs, and whether it would be in the company's best interests to pursue or defend the intended action.<sup>358</sup> Section 165 (4) does not enable an applicant to access information required to verify the merits of his suspected wrongdoing against the company. This is because the investigator reports to the board, and there is no requirement for the board to apprise the person that made the demand of the outcome of the investigation.

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<sup>352</sup> Section 16.02 (b) of the MBCA.

<sup>353</sup> Section 16.02 (c).

<sup>354</sup> MF Cassim op cit note 4 at 168.

<sup>355</sup> MF Cassim op cit note 22 at 8-9.

<sup>356</sup> MF Cassim op cit note 4 at 171.

<sup>357</sup> Ibid at 175.

<sup>358</sup> Section 165 (4).

To the company's disadvantage, the continued existence of these barriers has the unfortunate effect of disempowering those empowered through expanded *locus standi* from invoking the remedy.

## CHAPTER 6: CONCLUSION

Widened standing for the derivative action and the oppression remedy places these traditional minority shareholder remedies into the hands of broader stakeholders of the company, resulting in the purported extension of directors' accountability to each of these stakeholders.<sup>359</sup> This development accords with the stakeholder approach of pluralism<sup>360</sup> and is in keeping with recent progressions in the companies' statutes of Canada, Australia and other commonwealth jurisdictions. There is an inherent expectation that extended *locus standi* for these remedies would not only enthrone the responsible discharge of directors' duties and improve corporate governance in companies, but that it would also lead to their increased invocation to redress harm suffered by the company.<sup>361</sup>

For the derivative action, widened standing beyond shareholders empowers other persons in relation to the company to representatively enforce or protect the interests of the company. Consequently, accountability for corporate wrongdoing may no longer be muffled by shareholder apathy that is common among minority shareholders in large and listed companies.<sup>362</sup> It could likewise not be deterred by shareholder complicity in the wrongdoing as is prevalent in small quasi-partnership type of companies where shareholders are also directors or senior employees.<sup>363</sup>

Directors and prescribed officers' standing is apt for the remedy in light of their codified duties under the Act. Unlike shareholders, directors and prescribed officers would have relevant information of wrongdoing; this could be information regarding the occurrence of corporate misconduct, and information that may be required to substantiate a derivative claim as was evident in the *Mouritzen* case where the applicant, a non-shareholder director, learnt of the corporate misconduct through his closer involvement with the operations of the company as an executive director.

Notwithstanding the advancements brought by extended *locus standi* for the derivative action and the oppression remedy, it is submitted that these remedies may be availed to further key stakeholders of the company. These include:

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<sup>359</sup> Lombard & Joubert op cit note 10 at 221.

<sup>360</sup> Esser & Delpont op cit note 6 at 101.

<sup>361</sup> MF Cassim op cit note 15 at 112.

<sup>362</sup> MF Cassim op cit note 22 at 12.

<sup>363</sup> See *Mouritzen* supra note 132.

- (a) Beneficial owners in respect of both the derivative action and the oppression remedy. They have a direct and financial interest in the affairs of the company through their ownership of shares, which ownership is not dependent on their actual registration as shareholders.<sup>364</sup> It is thus necessary that they have direct access to the derivative action without going through section 165 (2) (d) of the Act, and access to the oppression remedy. It is recommended that section 165 (2) (a) and section 163 (1) of the Companies Act be amended to include beneficial owners in line with section 238 (a) of the CBCA.
- (b) Persons entitled to be registered as shareholders in respect of the oppression remedy. The court's order for the entry of the applicant's name into the securities register in the *Barnard v Carl Greaves*<sup>365</sup> case affirms that shareholders' interests come into existence once shareholders have acquired rights or interests as shareholders, and that their registration is an administrative step that provides proof of such ownership.<sup>366</sup> It is recommended that section 163 (1) of the Act be amended to give standing to persons entitled to be registered as shareholders.
- (c) Creditors, inclusive of security holders, of the company or related company. They could suffer financial loss from decisions of the board which unfairly disregard their interests in a manner that may not be remediable through applicable contracts. It is recommended that standing for the oppression remedy be extended to creditors of the company.
- (d) Discretionary standing for the derivative action. It is submitted that the qualification wording contained in section 165 (2) (d) inhibits potential applicants' access to the derivative action. It is recommended that section 165 (2) (d) be amended<sup>367</sup> by the removal of reference to the requirement that it is necessary and expedient to grant leave to protect the applicant's legal right, and replacement with prequalification wording that requires the applicant to show that there is a just cause for the court to grant the applicant leave.
- (e) Discretionary standing for the oppression remedy. There is a need to accommodate other stakeholders, such as directors that lost their directorship through the exercise of oppressive or unfair conduct of shareholders or the board. It is recommended that

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<sup>364</sup> *Smyth* supra note 110 para 23 quoting *Samuel and Others v President Brand Gold Mining Co Ltd* supra.

<sup>365</sup> *Barnard* supra note 118.

<sup>366</sup> *Kalil v Decotex* supra note 213.

<sup>367</sup> MF Cassim op cit note 15 at 117.

standing for the oppression remedy be extended to unanticipated persons (and those that do not have direct standing) with leave of the court.

However given that the oppression remedy is a kind of personal action against the company, it is further proposed that principles guiding the court's discretion to confer standing should include ascertaining whether there are other legal remedies available to the applicant through which relief from oppression may reasonably be obtained. These legal avenues may include valid and binding contracts, legislation and common law remedies where their presence could justify the court's refusal of discretionary standing.

Whilst specified persons have standing for the derivative action and the oppression remedy, other facets of standing could affect their ability to invoke the applicable remedy. For the oppression remedy, there is a large body of case law that supports an applicant's standing for prejudice suffered in a capacity than the one in which they actually have standing. However judicial certainty is yet to be obtained on the availability of the oppression remedy under these circumstances, and it is submitted that such certainty could be attained through the amendment of section 163 to expressly provide for standing in respect of oppression or prejudice suffered in other capacities in line with the Australian statute.<sup>368</sup> Failing statutory amendment, it is submitted that discretionary standing for the oppression remedy recommended above could be applied to further qualify such an applicant.

*Locus standi* for the derivative action gives a qualified stakeholder the right to step into the shoes of the company<sup>369</sup> and beseech the court on a matter involving the company. *Locus standi* however, comes with the obligation for payment of costs, and the discretion of the courts conferred by section 165 (10) to decide on the issue of costs of the derivative action is inadequate as there is no certainty that the applicant will not ultimately be responsible for the costs of pursuing the company's action.

It is recommended that section 165 (10) be amended and replaced with wording akin to section 166 of the New Zealand statute to provide that unless it is shown that the applicant's costs for the derivative action are not reasonable and that under the circumstances it would be unjust for the company to bear them, that the court is required to grant the applicant an order for costs.

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<sup>368</sup> Section 234 (a) (i) and (ii) of the Corporations Act.

<sup>369</sup> *Lewis v Knutson* supra note 41 at 237-238.

The amendment of section 165 (11) to prohibit courts from ordering applicants to furnish security for costs has been called for.<sup>370</sup> It is recommended that principles guiding circumstances in which the court may order an applicant to furnish security in terms of section 165 (11) be statutorily formulated, or that the requirement for furnishing security be removed from the Act.<sup>371</sup>

Access to information provisions in the Act are an improvement from previous versions of companies' legislation in South Africa. Although there is room for their improvement, it is submitted that their shortcomings are counter-balanced by extended *locus standi* to include directors and prescribed officers, and those representing employees (to the extent of employees' awareness of the wrongdoing and access to relevant information); these stakeholders are involved in the day-to-day running of the company and are better placed to obtain and collate information essential to pass the leave application.

The refinement of section 165 (9) (e) however remains relevant particularly for the benefit of stakeholders that are remotely connected to the company's internal affairs, such as minority shareholders of large companies. An amendment of section 165 (9) (e) is necessary to enable a person with standing<sup>372</sup> to access information for the specific purpose of determining the substance of their suspicion before making the section 165 (2) demand, to supporting their leave application and subsequently the substantive action. Furthermore, access to information provisions in the Companies Act could be enhanced by the adoption of US principles that require the applicant to satisfy the court that the required inspection of records is in good faith and for a proper purpose,<sup>373</sup> and that the required records are directly connected to such purpose as the derivative action.<sup>374</sup>

It is submitted that what would ultimately determine whether the empowered stakeholders would be willing and/or have been adequately capacitated to representatively seek redress for wrongs committed against the company would depend on their ability to obtain leave based on information at their disposal, that would be sufficient to prove that the proposed action involves a trial of a serious question of material consequence to the company along with the sufficiency

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<sup>370</sup> MF Cassim op cit note 4 at 175.

<sup>371</sup> Ibid.

<sup>372</sup> Akin to section 274A of the Australian Corporations Act.

<sup>373</sup> Section 16.02 (b).

<sup>374</sup> Section 16.02 (c).

of information availed to them through section 165 (9) (e) to support the substantive action, and their ability to recover costs for the derivative action.

It is submitted that the implementation of recommendations and proposals above would improve the stakeholder's access to the derivative action and, possibly, its invocation. In the absence of any change to the current costs and access to information provisions in the Companies Act, it is submitted that any increase in the invocation of the derivative action<sup>375</sup> could be marginal in relation to the significantly higher number of persons that have *locus standi*, and the improved remedy in terms of unlimited causes of action, and broader defendants against whom derivative proceedings may be initiated. What would remain however, is the conjectural benefit in the anticipated improved discharge of directors' duties, the resultant improvement in corporate governance, and possible redress pursued by<sup>376</sup> or on behalf of the company.

The significance of the derivative action may perhaps not so much be its actual invocation by those so appropriately empowered, as it is its ability to inculcate good corporate governance and encourage the responsible discharge of directors' duties. Through widened standing, the derivative action is likely to have important long-term deterrent gains for the company regardless of the level of its utilisation.<sup>377</sup>

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<sup>375</sup> Linked to broadened standing.

<sup>376</sup> As the company may yield to the applicant's section 165 (2) demand and institute proceedings to directly seek redress for any harm it suffered.

<sup>377</sup> Griggs op cit note 81 at 93; MF Cassim in FHI Cassim et al op cit note 22 at 5.

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