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An analysis of the statutory derivative actions in South Africa and selected jurisdictions

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by

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Chapter 1: Introduction

1.1 Background

Upon incorporation, a company ensues its separate legal personality and immediately acquires legal rights and obligations.[1] The consequence of separate legal personality is that the directors[2] and shareholders[3] of the company are neither liable for the liabilities of the company nor are they beneficiaries of the assets of the company.[4] As a separate legal entity, only the company can institute legal proceedings for any wrongdoings committed against it.[5] This would be done through its directors as persons responsible for the business and the affairs of the company.[6] The role of the directors is to manage the affairs of the company for the best interests of the company. [7] They have the authority to exercise all the powers and perform all the functions of the company, unless the Memorandum of Incorporation of the company provides otherwise.[8] The directors thus owe a fiduciary duty to the company and are liable for loss, damages or costs sustained by the company as a consequence of any breach by the director of the duties.

Derivative action is an action brought in the name of the person[9] who seeks relief for the company against those suspected of having performed wrongs against the company for the relief to be granted to the company.[10] This happens in the event where the persons who are meant to be the protectors of the company are the alleged wrongdoers and will not bring action against themselves, in such instances, a derivative action may be brought.[11] Under the Companies Act 61 of 1973[12] derivative actions were confined to the wrongdoings committed by the directors of the company or its past directors.[13] Under the Companies Act 71 of 2008[14] derivative action is

[1] *Salomon v Salomon & Co* [1897] AC 22 (HL); *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 at 550, s8(4) of the Constitution of the Republic of South Africa, 1996.
[2] With the exception of personal liability, companies wherein the directors and past directors are severally liable with the company for the liabilities of the company during their term in office: s19(3) of the Companies Act, 2008.
[3] With the exception of the right to the remaining assets of the company upon liquidation.
[4] *Macaura v Northern Assurance Co Ltd* [1925] AC 619.
[5] The proper plaintiff rule developed in *Foss v Harbottle* (1843) Hare 461, 67 ER 189 at para 490-491.
[6] The decision in the case of *Foss v Harbottle* (Ibid) cemented these principles. See also s66(1) of the Companies, 2008.
[7] S76 of the Companies Act, 2008.
[8] S66 of the Companies Act, 2008.
[9] As defined in s165 (2) of the Companies Act 71 of 2008.
[10] Delport et *al Henochsberg on the Companies Act 61 of 1973* Lexis Nexis.
[11] *Foss v Harbottle* supra note 5; *Moir v Wallersteiner and Others (No 2*) [1975 1 All ER 849 (CA) at 857 d-f; *Francis George Hill Family Trust v South African Reserve Bank and Others* 1992 (3) SA 91 (A) at 97 B-G;
[12] Hereinafter, Companies Act, 1973.
[13] S266 of the Companies Act, 1973.
[14] Hereinafter, Companies Act, 2008.

brought to protect the legal interests[15] of the company, consequently asserting the rights of the company in instances where the controllers of the company refuse to.[16] In as much as the term 'legal interest' is not defined by the Companies Act, 2008, it can be said to be wider than the concept of 'legal rights', it could be said to mean 'a mere concern, involvement or investment, which could be of a financial, legal, employment or even environmental nature.'[17] This is a tool to prevent the directors from exploiting the company and to ensure a proper functioning and governance of the company.[18] This is further used in instances where the wrongdoers happen to be the directors themselves who will not institute action on behalf of the company against themselves.[19]

The minority shareholders were bound by the decisions of the majority and found themselves without recourse in instances where they were aggrieved by the decisions of the majority shareholders. Even with the statutory remedy of protecting the minority shareholder, at first the minority was placed in a difficult position of having to prove the conduct of its oppressors was unfairly prejudicial, unjust of inequitable.[20] Even when the minority shareholder has proved that it was treated unfairly prejudicially, unjustly or inequitable, the best remedy the court would do was to order the company to buy back the shares of the minority shareholder.[21] Derivative action is not a new concept in South Africa, it goes as far back as 1843 when the exception of the majority rule was established in the case of *Foss v Harbottle*.[22] The derivative action have evolved from common law[23] to statutory derivative action.[24] Another principle for which an exception was created was the principle of proper plaintiff. The proper plaintiff in matters involving the company is the company itself. Derivative action is seen as a form of protecting the minority shareholder as it is an exception to the majority rule and proper plaintiff rule.[25]

[15] However, ss 1 and 165 of the Companies Act, 1965 do not define "legal interests" in respect of the provision of derivative actions; Delport *The Companies Act Manual* 2ed (2011) 161.

[16] Cassim 'Shareholder Remedies and Minority Protection' Cassim FHI *et al* Contemporary Company Law 2ed (2012).

[17] Stein C *et al The New Companies Act Unlocked* (2011) Siber Ink South Africa 371

[18] Corporate Governance is defined as "The exercise of ethical and effective leadership by the governing body towards the achievement of the following governance outcomes: Ethical culture; Good performance; Effective control and Legitimacy." King IV Report: Fundamental Concepts, 20.

[19] Cassim MF 'Shareholder Remedies and Minority Protection', supra note 16, 776.

[20] S252 (1) of the Companies Act, 1973.

[21] *Bayly v Knowles* 2010 (4) SA 548 (SCA) para 24.

[22] *Foss v Harbottle* supra note 5.

[23] The exceptions to the proper plaintiff and majority rule principles.

[24] S165 of the Companies Act, 71 of 2008.

[25] The rule was created in *Foss v Harbottle* supra note 5.

In attempting to use this protection, the derivative action applicant faces uncertainties. The derivative action as envisioned in the Companies Act, 2008 has loopholes and uncertainties for the derivative action applicant. The company interests that the derivative action applicant is seeking to protect are not defined. This lacuna is left at the court's discretion. This has a potential of being a burden to the court and also of causing confusion to the derivative action applicant. The derivative action applicant does not have access to information as the legislature has removed the provisions of the curator ad litem in section 165 of the Companies Act, 2008, making it difficult to put together a case for the alleged wrongdoers to answer to. The curator ad litem played a vital role in that it was ensured that the information reaches the court without it landing in the wrong hands.

1.2 Problem Statement

According to the Companies Act, 1973, the derivative action application could only be brought in respect of a delict or a breach of trust or faith by its directors which resulted in the company having suffered damages as a result of the wrongdoing of its directors.[26] This helped the derivative action applicant to know exactly what was required to convince the court that there were grounds for derivative action. This has changed drastically with the grounds in the Companies Act, 2008. This paper will take a look at what is it that the derivative action is protecting when bring derivative action.

Derivative action forms part of the effort by the legislator to protect the minority shareholder. However, when it comes to its implementation, the protection of the minority shareholder seems to not be a priority. This is because, the derivative action applicant under section 165 of the Companies' Act, 2008, faces a number of uncertainties, such as lack of access to information, costs, rebuttable presumption[27] that could render the derivative action process redundant and unused.

For any litigation to have a chance to make it to a court roll, the applicant needs to prove, on whichever standard applicable, that there is *prima facie* proof of the alleged wrongdoing. In order to prove that, the applicant will need to have information. Since the derivative action applicants are not always directors of the company, they will not necessarily be in a position that grants

[26] S266 of the Companies Act, 1973; Benade C *et al Corporate Law* (2000) Butterworths: Durban 307; Coetzee L *'A* comparative analysis of the derivative litigation proceedings under the Companies Act 61 of 1973 and the Companies Act 71 of 2008' (2010) 290 *Acta Juridica* 298.

[27] S165 (7) of the Companies Act, 2008.

them access to company information needed to attempt to prove the allegation. The removal of the process of the *curator ad litem* coupled with the expansion of the derivative action applicant has highlighted that the derivative action is not affording the derivative action applicant the protection it needs.[28]

The lack of access to information combined with the element of costs, threaten the use of this type of protection on to the minority shareholder simply because, the applicant will need to determine if she/he will have the information she/he requires and if there is enough money to sustain the application. This seems to put the issue of costs before that of the interest of the company. [29]

The Companies Act, 2008, has expanded the grounds upon which to bring derivative action to be "to protect the legal interests of the company."[30] The failure of the legislature to define the term "legal interests" could cause a problem for the derivative action applicant due to the legislature's failure to define the term "legal interests". The derivative action applicant is at the mercy of the court's interpretations and those of the academics.[31]

1.3 Research Questions

The dissertation aims to answer to answer the following questions and thus the primary research that follows can be put as follows:

What is the legal interest that is protected by the derivative action?

With the expansion of derivative action applicant and the grounds upon which a derivative action can be brought, it would be prudent if the legislature had defined what could be considered legal interests. The failure by the legislator to define legal interests makes it the responsibility of the court to interpret it. [32] This is a burden that will take the courts time, further it is not assisting the derivative action applicant in determining what they need to consider to be in the best interest of the company as different persons[33] relate to the company differently and will consider the best interest of the company differently.

[28] Cassim MF "Obstacles and barriers to the derivative action: Costs orders under s165 of the Companies Act of 2008 (Part 2) (2014) 26 SA MERC LJ 242-243.
[29] Cassim MF *Ibid*, 241; Coetzee L supra note 26, 303.
[30] S165 (2) of the Companies Act, 2008.
[31] Stein C *et al* supra note 17.
[32] Coetzee L, supra note 26, 298.
[33] Shareholder, trade union, director etc.

How will the courts interpret the interests of the company and the interests of the broader derivative action applicants?

The persons who could bring derivative application under the Companies Act, 1973, were restricted to members only.[34] Section 165[35] has broadened the category of the derivative action applicants. It now includes a person who is entitled to being a shareholder.[36] This means that the person starts exercising the rights they are entitled to as shareholders, before they are actually shareholders as defined in section 1 of the Companies Act, 2008. The inclusion of directors is a welcomed change as the directors are the custodians of the company and have all the information that the derivative action applicant would want to have at the institution of the derivative action, thus they are in a better position to know when abuse is happening against the company. [37] The broader categories of applicants also include prescribed officers, trade union representatives and any person that the court has a discretion in granting them access when it believes it's necessary and expedient. This means that the creditors and debtors of the company may also be granted leave to bring derivative action. It will be interesting to see if the broader category of derivative action applicant will utilise the provisions of section 165 in protecting their interesting, taking into account the cost and access to information obstacles that shareholders have always faced.

How can the legislature's failure to explicitly list the powers of the independent investigator or committee affect the derivative action and the quality of investigation?

For the derivative action applicant, access to information has always been a stumbling block as this information[38] is ultimately in the hands of the controllers of the company who also happen to be the alleged wrongdoers,[39] unless the minority shareholder also happens to be a director in the self-managed companies.[40] Minority shareholder don't always happen to be directors in big corporates where the line between the controller and owner of the company is boldly drawn.[41]

[34] S 266(1), only members could bring an application to the courts for derivative action.
[35] Companies Act, 2008.
[36] S165 (2) (a) of the Companies Act, 2008; Cassim FHI *et al* supra note 16, 780.
[37] Cassim *et al* supra note 16, 780.
[38] Benade C *et al* supra note 26, 306.
[39] Cassim *The New Derivative Action under the Companies Act, Guidelines for Judicial Discretion* (2016) 65.
[40] Ibid.
[41] Ibid.

The provisional *curator ad litem* in the Companies Act, 1973 had certain powers[42] and reported directly to the court. The independent investigator or committee[43] in the Companies Act, 2008, reports to the very same persons that are alleged not to have protected the legal interest of the company. The change from the *curator ad litem* procedure[44] to the introduction of the independent investigator or committee[45] would automatically have an effect on the information that reaches the court. This would have a direct effect on the decision that the court makes.

What are the uncertainty caused by rebuttable presumption?

Currently, directors of the company are seen as not related parties to the company. This means that the people that could directly be responsible for the derivative application are "protected" by the law, adding yet another burden to the derivative action applicant to prove to the court that it is in the interest of the company to proceed with the derivative action wherein a director is alleged to have done wrong. The irony in this rebuttable presumption is that fraud on the minorities by those in control of the company was part of the exception to the majority rules and proper plaintiff rules in *Foss v Harbottle*.[46]

1.4 Comparison to Foreign Jurisdictions

The Companies Act, 2008, states that the South African Courts may consider foreign jurisdictions when interpreting the provisions of the Act.[47] The South African derivative action in section 165 of the Companies Act, 2008, as highlighted in the Van Wyk de Vries Commission, is based on stakeholder activism.[48]

Stakeholder activism could be said to have commenced with the improvement in recognizing the shareholders rights in the Companies Act, 1973 by giving the shareholder, no matter the shareholding, the right to approach the court whenever they felt aggrieved.[49] This could be said to have been strengthened by King Report II Report [50] as a result of non-compliance of corporate governance by the directors of the company.[51] It flourished when the King Report III[52]

[42] S267 of the Companies Act, 1973.
[43] S165(4) (a) of the Companies Act, 2008.
[44] S266(3).
[45] S165(4) (a).
[46] *Foss v Harbottle* supra note *5*.
[47] S5 (2) of the Companies Act, 2008
[48] The van Wyk de Vries Commission of Enquiry into the Companies Act, Main Report 1970 para 42.15.
[49] Ss 252, 258 and 266 of the Companies Act, 2008; Lekhesa MW "Shareholder activism: the birth of a new phenomenon in South African corporate law" Masters of Law dissertation, University of Free State (2009) 23
[50] The King Code of Governance for South Africa, 2002.
[51] Lekhesa MW supra note 52, 25.
[52] The King Code of Governance for South Africa, 2009.

acknowledged that there are other participants in the running of the company and whose interests needs to be taken into account when companies make decision. The act of the legislature in codifying the recognition of other role players in the Companies Act, 2008, solidified the importance of stakeholder activism. Such activism had already been adopted in countries such as the United Kingdom and Australia.[53] The current South African derivative action procedure draws from the legislation of the Australia. The United Kingdom Canada, Australia, New Zealand, and the USA influenced the development of the current South African derivative action.[54] These jurisdiction will be looked upon for assistance with the potential problems seen in section 165.[55]

1.5 Literature Overview

The principle of majority rule[56] is the spine for the smooth operation of these duties of the directors.[57] With that principle in mind, the shareholders still have roles to play in the running of the business of the company, especially in instances where the shareholder resolutions are required.[58] Again, in these instances, the principle of majority rules is the only way in which resolutions can be passed, by majority. In *Sammel v President Brand Gold Mining Co Ltd*[59] explained this principle in perspective "*...by becoming a shareholder in a company a person undertakes ... to be bound by the decisions of the prescribed majority of the shareholders, if those decisions of the affairs of the company are arrived at in accordance with the law even where they adversely affect his own rights as a shareholder.*"[60] In the current form, the statement in *Sammel v President Brand Gold Mining Co Ltd* [61] would take into account the role the majority shareholder now plays in influencing the company to steer good corporate governance and sustainability of the company.[62] Monetary benefit is no longer the main driving force of majority influence.[63]

[53] Lekhesa MW supra note 52.
[54] Cassim MF 'The statutory derivative action under the Companies Act of 2008: Guidelines for the exercise of the judicial discretion' Doctor of Philosophy thesis, University of Cape Town, (2014) 9.
[55] Such as the rebuttable presumption and access to information.
[56] Wherein the required number of votes are acquired in the passing of a resolution, depending on the Memorandum of Incorporation of the company.
[57] Cassim MF supra note 42, 1.
[58] Wherein the decision of financial assistance is deliberated in terms of s45 of the Companies Act, 2008.
[59] *Sammel v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A).
[60] Ibid at 678; *Garden Province Investment v Aleph (Pty) Ltd* 1979 (2) 525 (D) at 534A-535C. See also Cassim FHI *et al* supra note 16, 771-772.
[61] *Sammel v President Brand Gold Mining Co Ltd* supra note 62.
[62] Code for Responsible Investing in SA (CRISA) 8.
[63] Ibid.

The proper plaintiff and the rule of majority can give rise to abuse where those that committed the wrongdoings against the company happen to have majority votes and are the controllers of the same company.[64] These wrongdoings by the controllers were the exceptions that birthed the common law derivative action.[65] The derivative action developed as an exception to the rules in *Foss v Harbottle* to provide protection to minority shareholders in certain instances where the majority mismanaged the company.[66] Should the decision of the majority shareholders be unlawful, the minority shareholder could approach the courts. The burden of proof that the minority shareholder faced was cumbersome, not only did the minority shareholder have to prove that the decision of the majority was *contra bonis mores*, but, the minority shareholder had a further burden of proving that he/she had legal standing to approach the court, that there was no other remedy and that it was urgent before the court could hear the merits.[67] These exceptions were not much of a relief to the minority shareholders who wanted to bring derivative action due to them being too stringent and burdensome, this resulted in this provision being sparingly used.[68]

The Van Wyk de Vries Commission, in recognising that the shareholders' right to interfere in the legal interests of the company was limited, recommended the introduction of the statutory derivative action.[69] This introduction of statutory derivative action[70] was a supplement to the common law of derivative actions.[71] The implementation of section 266 of the Companies Act, 1973, meant that the member of the company can bring an action to enforce the company's rights,[72] even if the decision was ratified by the majority.[73] This was a welcomed change as it meant that the courts could now interfere with the boardroom decisions of the company, which was one of the reasons the courts were reluctant to hear matters of derivative actions, as decided in *Foss v Harbottle*.

Section 266 was not without its own restrictions. The statutory derivative litigation could only be brought by the member of the company,[74] on the grounds that the company had suffered

[64] Cassim MF supra note 42, 7.
[65] *Foss v Harbottle* supra note 5.
[66] Coetzee L supra note 26, 292.
[67] Ibid.
[68] Benade C *et al* supra note 26, 306
[69] The van Wyk de Vries Commission of Enquiry into the Companies Act, supra note 51.
[70] S266 of Companies Act, 1973; Coetzee L supra note 26.
[71] The van Wyk de Vries Commission of Enquiry into the Companies Act, supra note 51. The recognition that the shareholders right to interfere in the legal interest of the company were limited.
[72] *TWK Agriculture Ltd v NCT Forestry Co-Operative Ltd* 2006 (6) SA 20 (N).
[73] S266(1) of the Companies Act, 1973.
[74] Delport P *et al* supra note 8, 512.

damages as a result of the wrong doing of its directors (past or current).[75] Should the applicant wish to bring derivative action for any other reason than the ground listed in section 26, the minority shareholder had to bring the derivative action through common law,[76] which brought the same cumbersome burden of proof on the plaintiff.

The birth of section 165 of the Companies Act, 2008 comes from the changes that had to be effected in company law to bring it in line with the country's democratic dispensation and the changes in the global economy.[77] Institutional Investors have created a code in which to operate by as majority shareholders, in most instances. Like the King Code of Governance for South Africa is a voluntary, it has influenced the amendments of the Companies Act and the JSE rules, the same hope is pinned on CRISA to influence the majority institutional shareholders to not only focus on the monetary benefits, but to also pay attention to and steer the company with their influence towards sound governance principles and practices including engagement on Environmental, Social sustainability.[78] The Companies Act, 2008 had to incorporate stakeholder activism as stakeholders, like shareholders, were considered as investors. [79] Section 165 brought about the expansion of the derivative litigant,[80] the change in how the investigation is being conducted[81] and who appoints the independent investigator/committee.[82] Section 165 does not come without its own obstacles, the rebuttable presumptions and the lack of access to information could have a potential of stifling the derivative actions.[83]

1.6 Methodology

This dissertation will take the desktop approach. In so doing, the provisions of the Companies Act, 1973 and the Companies Act, 2008 will be looked at to gain an understanding of the changes that were introduced by the Companies Act, 2008. Over and above, the relevant provisions of the English Law's Companies Act, 2006 and Australian Law's Corporations Act, 2001 will be compared with the provisions of the Companies Act 2008, to appreciate whether the changes

[75] Benade C *et al* supra note 26, 307.
[76] Stoop HH 'The derivative action provisions in the Companies Act 71 of 2008' (2012) 129 *SALJ* 527.
[77] Corporate Law Reform Policy (Government Notice 1183 GG 26493 of 23 June 2004) 34.
[78] Code for Responsible Investing in SA (CRISA) 6.
[79] Corporate Law Reform Policy supra note 80; Coetzee L supra note 26.
[80] S65(2) of the Companies Act, 2008.
[81] The appointment of the independent investigator is now conducted by the company at its discretion and the investigator reports directly to the company. Unlike the appointment of the curator ad litem, which was mandatory and the curator reported to the court directly.
[82] S165 (4) of the Companies Act, 2008.
[83] Cassim MF supra note 42, 126.

took into account the South African fragile economy as compared to the stabilised economies of the English and Australian.

Secondary sources such as academic journal articles, textbooks and published seminars will be studied to gain an understanding, analyse and compare the interpretations of the different courts and how they differ or share similarities.

1.7 Outline

This dissertation will be structured as follows:

Chapter1: Introduction

Chapter 2: The Common Law Derivative Action

Chapter 3: The Statutory Derivative Action

Chapter 4: Developments regarding the derivative action in the United Kingdom and Australia

Chapter 5: Conclusions and Recommendations

The discussions in the above chapters will highlight the loopholes in the South African statutory derivative action and how the lacunas can be rectified. In the meantime, what are the ways, if any, the derivative action applicants can use to get what their need in bringing the derivative action and how the courts can interpret the derivative action provisions of the Companies Act, 2008.

Chapter 2: The Common Law Derivative Action

2.1 Introduction

Previously, the courts refused to interfere in matters of partnership, unless if it was for the purposes of dissolution.[84] The shareholders had to use the internal conflict management as the courts would not interfere in internal matters. This was confirmed in the case of *Foss v Harbottle*[85] when the court stated that that it would not deal with matters that could be ratified by the majority shareholders and, further, that the company was the proper plaintiff in matters relating to it. The case also established exceptions to the two elements, thus establishing common law derivative action.

2.2 The Foss v Harbottle rules

The case of *Foss v Harbottle*[86] established rules that gave rise to the principles of, the internal management, majority rules and proper plaintiff rules. When a wrong is committed against a company, only the company, as the aggrieved party, could decide whether to redress that wrong or not. This became known as the proper plaintiff rule. In the event the company decided not to redress it, the shareholders could, by majority vote, ratify the decision of the company. This resulted in the minority shareholder having to accept the decision of the majority, even if the decision adversely affected her/his rights as a shareholder. This rule was known as the majority rule. Closely linked to these two rules was also the rule of internal management, wherein the courts refused to interfere in the internal affairs of the company because of complaints by the minority shareholders. The rules in *Foss v Harbottle* had led to the belief that these rules promoted the interests of the company to the detriment of the minority shareholder[87] and that the rights of minority shareholders were not a priority to the courts. This could have been based on the fact that *Foss v Harbottle* rule barred a minority action whenever the alleged misconduct was in law capable of ratification, the independent majority need not be given a real opportunity to consider the matter.[88]

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[84] Boyle A J *Minority Shareholders' Remedies* (2002) 2.
[85] *Foss v Harbottle* supra note 5.
[86] Ibid.
[87] Griggs L 'The Statutory Derivative Action: Lessons that may be learnt from the Past' (2002) 4 University of Western Sydney Law Review para 1.2.
[88] Boyle A J supra note 87, 4.

There were three possible reasons for the rules in *Foss v Harbottle*. The first one was that the rules were necessary to avoid double jeopardy, to avoid multiple actions against the defendant.[89] The second reason was, because majority shareholders could ratify the decisions of the company, there was no logic in litigating on matters that were ratified by the majority shareholder.[90] Finally, it would jeopardize the creditors in that when the litigation was successful in the name of the company, the assets of the company will be returned to the company without first paying the creditors.[91]

A company, as the proper plaintiff, was the only one that could bring action of wrongdoing against the wrongdoer. The exception was if the company refused to bring such action. The shareholder did not have an automatic right to bring the action on behalf of the company, this was an exception. The courts were not interested in interfering with internal matters of the company, especially if the shareholder opt to ratify the decision of the directors.[92]

2.3 The exceptions to the *Foss v Harbottle* rules

Sir James Wigram V.C[93] accepted that if these rules are rigidly applied, it could have a consequence of having the minority shareholder rights considered as inconsequential. A compromise was recognised by having exceptions to the rules. For purposes of derivative action, the following were the exceptions to the general rules:

(i) Illegal acts and acts *ultra vires* to the company [94]

Although the company was the proper party to bring action for damages suffered by the company, the court recognised that because the board of directors were the ones that decided when a company would sue, the directors were not likely to bring a lawsuit against themselves.[95]

[89] The court held, in the case of *McLelland v Hullet and Others* 1992 (1) SA 456 D that the existence of the rules in *Foss v Harbottle* (supra note 5) was backseat a company is a separate legal entity if a shareholder was permitted to sue, it could result in double jeopardy against the defendant for the same wrong.

[90] *Foss v Harbottle* supra note 5; JT Pretorius *et al Hahlo's South African Company Law through the Cases* 6 ed, (1999) 380

[91] Ibid; Coetzee L supra note 26, 292.

[92] *Sammel v President Brand Gold Mining Co Ltd* supra note 62, 1.

[93] The presiding officer in the case of *Foss v Harbottle (*supra note 5).

[94] These are acts that fall outside the scope of the duties of the directors and are contrary to the Memorandum of Incorporation.

[95] Scarlett AM 'Shareholder Derivative Litigation's Historical and Normative Foundations Legal Studies' Research Paper Series 61 Buffalo L. Rev. 837 (2013).

(ii) Transactions unratifiable by a bare majority

Ratification could not be invoked by a simple majority if the act required a special resolution.[96] If the requirements of special resolution were not fulfilled, any shareholder could restrain the company from acting on resolutions. In instances where the company needed a special resolution[97] but the shareholders simply passed a majority vote,[98] the shareholder could have grounds to bring derivative action.[99]

(iii) Fraud on a minority by those in control

Where the persons in control of the company wrongfully act against the company and because they are in control of the company, they use their controlling power to prevent the company from instituting action against themselves. In such instances, a shareholder would be accepted for the minority shareholder to act on behalf of the company.[100] This type of fraud was considered by the courts as a more serious type of fraud as compared to the common law crime of fraud.[101] This term is in actual fact in accurate because the fraud in question is the fraud against the company and the minority shareholders are the ones is seeking a right to recover on behalf of the company.

In as much as these are known as exceptions, the *Foss v Harbottle* rule had no role to play in situations where the perpetrators committed illegal acts and/or the acts committed were *ultra vires* to the company and transactions that require special majority to be ratified. What was a true exception to the *Foss v Harbottle* rule was the fraud on the minority as it constituted abuse of power by the directors/controllers of the company and a breach of common law fiduciary duty of doing what was in the best interest of the company.

2.4 The Application of Common Law Derivative Action

There were some decisions, even if ratified by the majority could not be protected, these became known as unratifiable wrongs.[102] The unratifiable wrongs became the exceptions to the rules established in *Foss v Harbottle* and they gave rise to common law derivative action. Derivative Action was a unique remedy as it allows a person to bring action that is rightfully someone

[96] These are resolution wherein the required votes for it to be passed is higher than the ordinary resolution. Depending on the companies, these may vary in percentage, it is however default at 75% of the votes.
[97] With a requirement of 75% of votes in favour in order for the resolution to be passed.
[98] This voting required an above 50% votes.
[99] Provided that all the other requirements are met.
[100] Coetzee L supra note 26, 292.
[101] *TWK Agriculture Ltd v NCT Forestry Co-Operative Ltd and Others* 2006 (6) SA20 (N) para 15; Benade C *et al* supra note 26, 306.
[102] Benade C *et al* supra note 26, 297.

else's.[103] It was introduced as a result of actions that arose from the abuses of management in companies.[104] A minority shareholder could bring derivative action against the perpetrators in cases where:

1. The company refused to bring the action;
2. The action concerned fell within the exceptions; [105] and
3. The shareholder was bringing the action on behalf of all the shareholders.[106]

Over and above proving the above, the minority shareholder had to prove that:

(i) He or she had *locus standi*;

(ii) There was no other remedy available; and

(iii) That it was urgent.[107]

As the company refused to take action, the minority shareholder, when instituting the derivative action would cite the minority shareholder as a nominal defendant in order for the ruling of the court to be applicable to the company. Any damages awarded by the courts, were for the benefit of the company and not the shareholder.

2.5 Problems with common law derivative action

Common law derivative action has been criticised for being impractical and inadequate in protecting minority shareholders.[108] Common law derivative action was detrimental to the rights of the shareholder.[109] The company, during the application of common law derivative action, had more protection than the minority shareholder.[110]

The shareholder in bringing derivative action needed to prove that the action in question fell within the exceptions. Over and above that, the shareholder had to establish and prove *locus standi,* that this was the last resort and that it was urgent. Even after establishing the above, the minority shareholder still faced other obstacles.

[103] Griggs L supra note 90, 12.
[104]Griggs L supra note 90, 3.
[105] Foss v Harbottle supra note 5 203, 207-08.
[106] Benade C *et al* Supra note 26, 303; JT Pretorious *et al* supra note 63, 382.
[107] *Foss v Harbottle* supra note 5, 492.
[108] Ngwalana VR 'Majority rule and minority protection in South African company law: a reddish herring' (1996) 113 South African Law Journal 527.
[109] Griggs L supra note 90 para 2.1.
[110] Griggs L supra note 90 para 1.2.

The first problem that the minority shareholder would face in bring derivative action would be access to the information that was required in establishing and proving the allegation of wrongdoing. The wrongdoers were the ones that were in control of the information needed to pursue a derivative action.[111] The directors of the company would not volunteer the information required to pursue derivative action, especially because doing so would mean have meant that they would need to answer the allegation and they initially had refused to institute proceedings against themselves. The minority shareholder found themselves in what would be considered an impossible position.

Secondly, it did not matter in what way the derivative would go, the derivative action applicant had nothing to benefit from this application. The derivative action applicant had to finance the application even though the benefit was for the company. If the derivative action applicant was unsuccessful, the derivative action applicant would have to pay the costs of the application.[112] Similarly, if the derivative action applicant was successful, the beneficiary of the favourable judgment would be the company.

Thirdly, there was uncertainty as which conduct could not be ratified by the majority. Besides the actions that required special majority to be ratifiable, which actions could be ratified and which could not be ratified. The derivative action applicant is left in an uncertain situation.

2.6 Conclusion

Common law derivative action was very restrictive and was not shareholder friendly. Besides the fact that the courts never wanted to interfere in the internal management of a company, the courts never wanted to deviate from the plaintiff rule, in cases were the wrong was done to the company. This left the derivate applicant with an enormous task of convincing courts that the exceptions exist and that the application was in the best interest of the company.

The courts took the majority rule concept very seriously and believed that anything can be fixed by the majority shareholders ratification. The minority shareholder, besides having to prove the enormous requirements, had to further fund the derivative action that the derivative action applicant would never benefit from personally. All the uncertainty and the courts resistance led to this remedy seldom being used as a protection of the right of the minority shareholder. Common law derivative action had to evolve, to be more inclusive of protecting the rights of minority shareholders.

[111] Ngwalana supra note 111, 531.
[112] Benade C *et al* supra note 26.

Chapter 3: Statutory Derivative Action

3.1 Introduction

The common law derivative action had a lot of barriers and hurdles for the derivate applicant.[113] It could be said it is the reason why there was no record of any derivative action applications that were brought under the common law.[114] With the practical challenges that common law applicants faced, there was a need to evolve this remedy to help the minority shareholder. This led to the Van Wyk de Vries Commission's recommendation that common law derivative action[115] was not friendly to the minority shareholders and that an amendment to the common law derivative action was required[116] It recommended that the derivative action be evolved.[117] The evolved derivative action had to, *inter alia*, overcome the notion of having the minority as an outsider of the company and find a remedy to have the derivative action applicant have access to information. Further, it had to have a mannerism to filter frivolous and vexatious claims.[118] Section 266 of the Companies Act, 1973 was wider in application as it applied to past directors and officers of the company.[119]

The Companies Act, 2008, did not only repeal the Companies Act, 1973, derivative action provision, it also abolished the common law derivative action, it could be argued that section 165 in actual fact only abolished the exceptions to the *Foss v Harbottle rule*. [120] This is because the other principles that were applicable during the application of common law derivative action still apply.[121] The proper plaintiff rule is the essence of derivative action, the derivative action applicant is protecting the legal interest of the company, the proper plaintiff. The Companies Act, 2008 extended the application of derivative action as a right of recourse.[122] It has extended the derivative action applicant to include different stakeholders, grounds and it can now be

[113] Cassim MF supra note 42, 9.
[114] Benade C *et al* supra note 26, 305.
[115] Common law derivative which was applicable at the time.
[116] The Van Wyk de Vries Commission of Enquiry into the Companies Act, supra note 51, 42.19-42.18; Coetzee L supra note 26, 294; Benade C *et al* supra note 26, 306.
[117] The van Wyk de Vries Commission of Enquiry into the Companies Act, supra note 51, 42.15; Benade C *et al* supra note 26, 306.
[118] The van Wyk de Vries Commission of Enquiry into the Companies Act, supra note 51, 42.15.
[119] Chokuda CT 'The Protection of Shareholders' Rights versus Flexibility in the Management of Companies: A Critical Analysis of the Implications of Corporate Law Reform on Corporate governance in South Africa with specific reference to protection of shareholders' Doctor of Philosophy thesis, University of Cape Town, 2017
[120] Cassim MF, supra note 42.
[121] Ibid.
[122] Stylianou A 'Evolution of the derivative action as an enforcement of rights mechanism under the Companies Act 71 of 2008' Masters in Law dissertation, University of Pretoria, 2016 17.

brought against third parties wherein the directors refuse to act against them for whatever reason.[123]

3.2 Section 266 of the Companies Act, 1973

The first statutory derivative action co-existed with the common law derivative action in a form of section 266 of the Companies Act, 1973. This allowed the member of the company[124] to bring derivative action on behalf of the company against the directors and/or officers. From common law, the directors were known to have been the only controllers of the company, however, the statutory derivative action introduced officers.[125] The inclusion of the word officer, meant that any person who held managerial position in the company and exercised control over activities of the company could be held liable.[126] The company secretary was not exempted from the wrongdoings.[127] It was a relief that the statutory derivative action included wrongs that could be ratifiable, the derivative action applicant no longer had to first find out if the act was ratifiable or not before bringing the action.[128] According to Blackman, the purpose of the statutory derivative action was to overcome the disadvantages of the common law derivative action and to prevent frivolous and vexatious claims.[129] Balancing the common law derivative action and the statutory derivative action was not easy for the derivative action applicant. If the derivate applicant did not meet the requirements of section 266 of the Companies Act, 1973, the common law derivate action would apply. The derivative action applicant had to endure the tedious common law requirements.

3.2.1 The application of section 266 of the Companies Act, 1973

Section 266 permitted a member[130] to bring derivative action in instances where the company has suffered damages resulting from the wrong, breach of trust or breach of faith committed by any director or officer of the company. [131] Section 266 ensured that former directors and officers of the company were accountable for their time in office, by extending the application of

[123] Cassim MF 'When the companies are harmed by their own directors: the defects in the statutory derivative action and the cures (part 1)'2013 SA MERC LJ 170.
[124] S266 (1) of the Companies Act, 1973.
[125] S266 (1) of the Companies Act, 1973; Officers as defined in s1 of the Companies Act, 1973.
[126] JT Pretorius *et al* supra note 93, 264.
[127] Coetzee L supra note 26, 295.
[128] S266 (4) of the Companies Act, 1973.
[129] MS Blackman 'Companies' in WA Joubert (ed) LAWSA vol 4(2) (1996) para 210 fn2.
[130] Registered as such in accordance with the Companies Act, 1973.
[131] S266 (1) of the Companies Act, 1973.

derivative action to erstwhile directors and officers,[132] furthermore, company has not instituted proceedings for the recovery of such damages, loss or benefit.[133] These grounds were gladly welcomed as they eliminated the burden previously placed on the applicant to distinguish between ratifiable and non-ratifiable wrongs.[134]

The applicant[135] had to first serve a written notice on the company requesting the company to institute action against the wrongdoers within a month. In as much as the Companies Act, 1973 did not specify what should've been in the notice, the contents of the notice must be sufficient enough for the company to know what proceedings it was called to institute.[136] If the company failed to heed to the request of the derivative action applicant, the applicant could approach the court for an appointment of a provisional *curator ad litem* to investigate the allegations against the wrongdoers.[137] Some may say that serving the written notice to the company was a waste of time because the provisional *curator ad litem* would be appointed by the court to investigate the allegations against the company and the courts would decide if it was in the best interest of the company to institute the proceedings.[138] Serving the notice was a welcomed step as it could've been a step to avoid the cost of litigation,[139] in the event the directors of the company do what is stated in the letter thereby saving the derivative action applicant the cost of providing security[140] which at the court's discretion could've included the costs of the provisional *curator ad litem.*[141] The courts would only approve the appointment of a provisional *curator ad litem* if the applicant was able to prove the following-

1. The company failed to institute the proceedings. The Companies Act, 1973 did not state when the proceedings in question would have been instituted, one would conclude that it would be in instances where the company had failed to institute the proceedings against the wrongdoers when the matter arose and/or when a month expired after the service of the notice from the applicant.[142]

[132] S266 (1) of the Companies Act, 1973.
[133] S266 (1) of the Companies Act, 1973; Benade C *et al* supra note 26, 306; Henochsberg *et al* supra note 10, 511.
[134] Benade C *et al* supra note 26, 306; S266 (4) of the Companies Act, 1973.
[135] The applicant had to be a registered member of the company. The said director or shareholder would lack *locus standi* if not registered as a member of the company, *Thurgood v Dirk Kruger Traders (Pty) Ltd* 1990 (2) SA 44 (E) 46.
[136] JT Pretorious *et al* supra note 63, 402.
[137] S266 (2) (a) of the Companies Act, 1973.
[138] Coetzee L supra note 26, 296.
[139] Depending on whether the directors of the company heed to the contents of the notice.
[140] S268 of the Companies Act, 1973.
[141] Benade C *et al* supra note 26, 310, Schreiner OC 'The Shareholder's Derivative Action–A Comparative Study of Procedures' (1979) 96 SALJ 203.
[142] S266 (3) (a) of the Companies Act, 1973.

2. There were prima facie grounds for the proceedings.[143] The Companies Act, 1973 was not clear as to what was it that the court had to look out for in order to be satisfied of this ground. It was established in case law that the court would not look at whether the company would succeed in the application. However, there must be prima facie grounds for the investigation as vague allegation and the derivative action applicant's desire to have the investigation conducted would not be sufficient grounds. The investigation must satisfy the court that if the investigation was conducted, it wound uncover some irregularities.[144]
3. The investigation into the allegations was justified.[145] The investigation into the allegations include not only the relief sort in the notice, but it could also include all the grounds that resulted in the relief sort.[146]

3.2.2 The powers of the provisional *curator ad litem*

In keeping to the three principles established in The Van Wyk de Vries Commission,[147] the statutory derivative action was structured in a way as to make sure that the court received the information it needed to make an informed decision without having the applicant personally involved. To achieve this, a provisional *curator ad litem* would be appointed, provided that the derivative action applicant satisfied the court of the three grounds.[148]

The purpose of the provisional *curator ad litem* was to investigate if the alleged wrong had been conducted and if it was in the best interest of the company to institute the proceedings against the wrongdoers.[149] In investigating, the provisional *curator ad litem* could call upon any person to produce any books, records and documents related to the company that they have in their possession or control.[150] The provisional *curator ad litem* also had the powers to issue summons and summon any person for interrogation which was conducted under oath.[151] The consequence

[143] S266 (3) (b) of the Companies Act, 1973.
[144] *Thurgood v Dirk Kruger Traders (Pty) Ltd* 1990 (2) SA 44 (E), Benade C *et al* supra note 26 at 308.
[145] S266 (3) (c) of the Companies Act, 1973.
[146] *Thurgood v Dirk Kruger Traders (Pty) Ltd* 1990 (2) SA 44 (E).
[147] The Van Wyk de Vries Commission of Enquiry into the Companies Act, supra note 51, 42.15: Shareholders being considered outsiders of the company with no access to the records of the company, the defendants being the controllers of the company, and deterrent to frivolous and vexatious claims.
[148] S266 (3) (a)-(c).
[149] Benade C *et al* supra note 26 at 309, Oosthuizen TSAR 328; *Brown v Nanco (Pty) Ltd* 1976 (3) SA 832 (W); The provisional *curator ad litem* is obliged to take into the account the wishes of the shareholders, however, the interests of the company must still be given some attention.
[150] S260 (1) of the Companies Act, 1973.
[151] S260 (2) and (3) of the Companies Act, 1973. The provisional *curator ad litem* had the authority to administer an oath.

of failing to corporate with the investigation of the provisional *curator ad litem* led to a person being found guilty of an offence.[152]

The Companies Act, 1973, bestowed onto the provisional *curator ad litem*, the same powers as the inspector,[153] with a limited scope. In as much as the powers were limited, they were also comprehensive.[154] The powers of the provisional curator ad litem were limited to the grounds set out in the application.[155] The provisional *curator ad litem* could not investigate anything outside the application, unless the court has granted the extension.[156] The courts could also expressly grant the provisional *curator ad litem* powers. In as much as the powers of the provisional *curator ad litem* were limited to the grounds set out in the application, the courts have held that the provisional *curator ad litem*'s investigations must not be restricted to the relief sought in the written notice to the company if the grounds relied on could justify other related relief.[157]
The provisional *curator ad litem* would then investigate the allegations and also the desirability to bring the proposed derivative action and compile a report for the court. The court, upon receipt of the report by the provisional *curator ad litem* rule could:

1. Discharge the provisional order. This would be in instances where the court concludes that that there were no grounds to institute the proceedings. The court may also rule to discharge the provisional order, where instituting the proceedings was not justified; or
2. Confirm the appointment of the *curator ad litem* and issue the necessary directions as it may deem fit.[158]

3.2.3 An assessment of section 266

In as much as section 266 of the Companies Act, 1973, did not abolish the common derivative action, it did provide some relief to the applicants. The information, which was the most important thing, was readily available as the appointment of the provisional *curator ad litem* ensured that the information reaches the court. The applicant no longer had the burden to determine if the wrong was ratifiable or not. The company was also protected against vexatious and frivolous claims as the provisional *curator ad litem* prepared a report to the court and the court decides if the proceedings should proceed or not. The derivative action applicant, unlike in

[152] This was not applicable in instances where privilege was a cause for failure to comply. This had its own set of problems. Coetzee L supra note 26, 297; S260 (4) of the Companies Act, 1973.
[153] S260 of the Companies Act, 1973.
[154] Stoop HH supra note 79, 531.
[155] *Loeve v Loeve Building and Civil Engineering Contractors (Pty) Ltd* 1987 (2) SA 92 (D) 101.
[156] S267 (1) of the Companies Act, 1973.
[157] *Thurgood v Dirk Kruger Traders (Pty) Ltd* 1990 (2) SA 44 (E) 53B.
[158] S266 (4) of the Companies Act, 1973.

common law, only had to prove that the company had suffered loss and did not have to prove that the wrongdoers profited at the company's expense.[159]

There were instances where the provisions of section 266 were limiting as compared to the common law derivative action application. The derivative action applicant could not rely on the statutory derivative action, if the general meeting could not be held. It further limited the application of derivative action to directors and officers[160] and did not include the application to the shareholders, unlike in common law application.[161] Section 266 of the Companies Act, 1973, still had some problems for the derivative action applicant. The grounds upon which the derivative action applicant could bring the action were limited. Further to this, the costs on the derivative action applicant were great. If the derivative action was successful, the damages were awarded to the company. The derivative action applicant, as a minority shareholder would only benefit indirectly.[162] If the derivative action was not successful, all costs of the application were borne by the unsuccessful party, being the derivative action applicant.[163] There was still room for improving the protection of the minority shareholders through derivative action. This led to the amendment of the Companies Act.

3.3 Section 165 of the Companies Act, 2008

Derivative action under section 266 of the Companies Act, 1973, was limited in who could be the derivative action applicant and the grounds upon which to bring derivative action. [164] The Companies Act, 1973, became outdated. It was out of sync with the South African political dispensation and the global economy. This led to its amendment[165] The Companies Act, 2008, brought major changes to derivative action in that it introduced more categories of derivative action applicant, to include, not only a shareholder[166], but also the stakeholders.[167] It further expanded on the grounds upon which to bring a derivative action.[168] It is notable that section 165 of the Companies Act, 2008, expressly abolished the common law derivative action,[169] unlike its predecessor.

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[159] Chokuda CT supra note 122.
[160] Past and present.
[161] S266 (1) of the Companies Act, 1973; Chokuda CT supra note 122.
[162] Coetzee L supra note 26, 296.
[163] *Brown and Others v Nanco (Pty) Ltd* 1985 (2) SA 682 (NC) 765.
[164] Coetzee L supra note 26, 29; S266 (1) of the Companies Act, 1973.
[165] Corporate Law Reform Policy supra note 80, 34.
[166] A shareholder registered as such as defined in s1 of the Companies Act, 2008.
[167] The Companies Act, 2008, increased stakeholder participation.
[168] This has expanded to the legal interests of the company, s165 (2) of the Companies Act, 2008.
[169] S165 (1) of the Companies Act, 2008.

These additions can be hailed as great steps to stakeholder participation. However, the derivative action under section 165 of the Companies Act, 2008 has some loopholes. For the purposes of this dissertation, the loopholes that will be focused on are:

1. The failure of the legislature to define "legal interests";
2. The consequences of expanding the derivative action applicant taking into account that there was no longer a provisional *curator ad litem*;
3. The failure by the legislature to give the investigator express powers; and
4. The uncertainty caused by the rebuttable presumption.

3.3.1 The applicant

The discussion into the loopholes highlighted above will only make sense by including the derivative action applicant and the demand.[170] Under Section 266 of the Companies Act, 1973, only a member[171] could approach the court for derivative action. The class of derivative action applicant has expanded to include not just a shareholder, but also persons entitled to be registered as shareholders, directors or prescribed officers,[172] trade union representatives and any person who 'has been granted leave of the court to do so'.[173] A shareholder is defined as a holder of the shares issued in the company and whose name is entered into the register.[174] It is notable that the protection of minority shareholder has gone as far as to include persons that are entitled to be registered as a shareholder.[175] This would be a person to whom shares have been transferred, but for some reasons they names have not been entered into the register.[176]

Trade union and employee representatives have always had an enormous role to play in labour law and it seems that the trade unions will be playing an important role in company law as well. It is laudable to see the inclusion of registered trade union and employee representatives as derivative action applicant which seems to be exclusive in South Africa.[177] Employee have been playing an important role in company law as far back as the inception of the first King Report.[178] Common law derivative action and the Companies Act, 1973, did not afford trade unions to bring

[170] Discussed hereunder.
[171] S103 of the Companies Act 61 of 1973: A member was a subscriber of the memorandum of a company and any other person who agrees to be a member and whose name is entered into the members' register.
[172] Inclusive of directors of prescribed officers of related companies.
[173] S165 (2) of the Companies Act, 2008.
[174] S1 of the Companies Act, 2008.
[175] S165 (2) (a) of the Companies Act, 2008.
[176] Cassim FHI *et al* supra note 16, 702; Stoop HH supra note 79, 536.
[177] Cassim MF supra note 42, 15.
[178] Joubert EP 'A comparative study of the effects of liquidation or business rescue proceedings on the rights of the employees of a company' Doctor of Laws thesis, University of South Africa (2018) 11.

derivative action application on behalf of the company as only member could bring derivative actions.[179] The failure of the Companies Act, 2008, to differentiate between the registered trade union, and majority trade union results in employee representatives that do not to certain rights in the Labour Relations Act (Act 66 of 1995) having the same right as those exclusive to the majority trade union.[180] The importance of the employees' role in companies cannot be over exaggerated. The King IV Report in its definition of stakeholder differentiates internal stakeholders to include employees and that internal stature always material, unlike external stakeholders, who may or may not be material.[181]

Including directors and offers of the company and related company is laudable as the directors and officers have first-hand information on the operations of the company. These categories of persons also have fiduciary duties to act in the best interest of the company, amongst others.[182] It also includes relationships between the subsidiary companies and its Holding company and the groups of subsidiary companies. This puts a limitation on the abuse that carries on where group companies are concerned wherein the Holding company is domineering over the subsidiaries. This is why it is perplexing that the rebuttable provisions include directors.[183]

The legislature seems to have been intentional when expanding the categories of derivative action.[184] This is seen in including employees and further in including a category wherein the court has a discretion to grant standing to any other persons provided the court is satisfied that it is necessary or expedient to protect that person's legal right.[185] This right however must be in direct correlation with the legal interests of the company.[186] This serves as an opportunity for stakeholders such as creditors who would not ordinarily have *locus standi* in internal company matters.

3.3.2 Demand and Grounds

A derivative action applicant must serve a demand on the company to commence or continue legal proceedings or take related steps to protect the interests of the company.[187] The use of the

[179] S266 (1) of the Companies Act, 1973; Schoeman HC "The rights granted to trade unions under the Companies Act 71 of 2008" (2013) 237 PER 249.
[180] Schoeman HC supra note 182.
[181] Joubert EP supra note181, 6; The King Code of Governance for South Africa, 2016.
[182] S76 of the Companies Act, 2008.
[183] S165 (7) of the Companies Act, 2008. The effect of the rebuttable presumption and the category of directors as wrongdoers is discussed hereunder.
[184] Taking into account the objection of the Corporate Law Reform Policy to have stakeholders play an active role in company law.
[185] S165 of the Companies Act, 2008; Cassim MF supra note 42, 15; *Mouritzen v Greystone Enterprise (Pty) Ltd* 2012 (5) SA 74 KZD; Cassim MF supra note 42, 16.
[186] Cassim MF supra note 42, 15.
[187] S165 (2) of the Companies Act, 2008.

word "may"[188] is misleading as the derivative action applicant does not have an option of not serving a demand, unless exempted by the court.[189] This is supported by the fact that only a person who has made the demand may apply to the court for leave to bring or continue proceedings in the name and on behalf of the company.[190] Further, a derivative action applicant may approach the court, in exceptional circumstances, to bring the derivative action application in the name of the company without first serving a demand.[191] The exception circumstances may include reasoning that the service of the demand may result in irreparable harm to the company or substantial prejudice to the interests of the applicant or that eh company may not act on the demand to prevent the harm or prejudice.[192]

The reasoning behind the service of the demand may be said to be the proper plaintiff rule, in that since it is the company that has suffered harm, it must be the company itself to bring the action, through its board of directors.[193] This can be seen as a tool to balance the role of the board of directors in manning the affairs of the company with the interference of the shareholders.[194] The demand to be served on the company must be in relation to the protection of the legal interests of the company. [195] In as much as the Companies Act, 2008, is silent on the form the demand must take and how much information must be on the demand, it can be said that there should be enough information and the demand must be construed in such a manner that it will afford the company the opportunity to consider the conduct complained of and the opportunity to take remedial action and protect the legal interests of the company.[196]

There is a concern that the service of a demand is a waste of time, resources and money for both the company[197] and the derivative action applicant.[198] This may also result in the negative publicity on the company and destabilise the company.[199] This process adds another layer thereby making the derivative action procedure more cumbersome on the applicant.[200]

[188] S165 (2) of the Companies Act, 2008.
[189] S165 (6) of the Companies Act, 2008; Coetzee L supra note 26, 300.
[190] S165 (5) of the Companies Act, 2008.
[191] S165 (6) of the Companies Act, 2008.
[192] Chokuda CT supra note 122, 120.
[193] Chokuda CT supra note 122, 121.
[194] Stoop HH supra note 79, 535.
[195] Cassim MF supra note 42, 16.
[196] *Ibid.*
[197] Stein C supra note 17, 373
[198]Chokuda CT supra note 122, 120.
[199] Ibid.
[200] Chokuda CT supra note 122, 121; Goehre KA 'Is the demand requirement obsolete? How the United Kingdom modernised its shareholder derivative procedure and what the United States can learn from it' (2010) 28 *Wisconsin International LJ* 140, 146

The derivative action applicant may apply to the court to continue with the action or bring an action in the name of the company wherein the court may only grant such application if it is satisfied that the derivative action applicant is acting:

i. in good faith;
ii. the proposed or continuing proceedings involve the trial of a serious question of material consequence to the company; and
iii. it is in the best interest of the company that the applicant be granted leave to commence the proceedings as the case may be.[201]

The court may grant the derivative action leave if it is satisfied that it is in the interests of the company[202] to do so, amongst other requirements.[203] The term "legal interests" is not defined in the Companies Act, 2008, and the very few guidelines are offered in this regard.[204] It can be said that the term "legal interests" is wider than the rights of the company and wide enough not to restrict the ground upon which a derivative action could be brought.[205] Some authors believe that the term legal interest could also include potential rights.[206] This includes the grounds wherein the company suffered damages resulting from the wrong, breach of trust or breach of faith committed by any director or officer of the company to anything that could damage the legal interests of the company. This is a welcomed addition as during the reign of section 266 of the Companies Act, 1973, if the grounds upon which the derivative action applicant wanted to bring, they would have to revert to the common law which is now expressly abolished by the Companies Act, 2008.[207] However, the legislature's failure to define or give guidance as to what could be considered "legal interests" of the company could have unintended consequences for the company in that the company might find itself entertaining the frivolous demands in the same manner as it would a valid demands. This has an effect of wasting time for the company and the courts.

[201] S165 (5) (b) (i)-(iii) of the Companies Act, 2008.
[202] S165 (5) (b) (iii) of the companies Act, 2008.
[203] See footnote 196.
[204] Stoop HH supra note 79, 537; see footnote 17 above.
[205] Cassim MF supra note 42, 16.
[206] Delport P *et al* supra note 8, 592.
[207] S165 (1) of the Companies Act, 2008.

3.3.3 Investigating the demand

The company may, 15 days after receiving the demand apply to the court to have it set aside on the grounds that it's frivolous, vexatious and without merit.[208] The company may also serve a notice of refusal on the derivative action applicant.[209]

If the company does not apply to the court for the setting aside of the demand or serves the derivative action applicant with the notice of refusal or if the court does not set aside the demand, the company is obligated to appoint an independent investigator/committee to investigate the contents of the demand.[210] In so requesting, the legislature is of the view that persons will act in good faith in appointing the independent and impartial person or committee as the process does not involve the courts. This seems to be counterproductive because the court is giving the decision to appoint an independent person to the very same persons who are alleged to have not acted in the best interest of the company. The legislature in this instance changed a working formula for no reason. There was no reason for changing the process of appointing the provisional *curator ad litem* as it was also independent, impartial, appointed to investigate, but report to the court. The whole investigation process under section 266 of the Companies Act was somewhat error proof, unlike the investigating process under section 165 which could be manipulated.

Further, the Companies Act, 2008 does not afford the investigator with any powers under which to perform his/her/their duties. It is humbly submitted that the legislature erred in changing the investigating process under section.

3.3.4 Access to information

Access to information has always been a hindrance for derivative action applicants, from as far back as common law applications. This seemed to have been resolved under the provisions of section 266 of the Companies Act, 1973 with the appointment of the provisional *curator ad litem*.

Access to information is the backbone of derivative action litigation. It seems like the legislature in drafting section 165 of the Companies Act, 2008, forgot about the importance of the correct information reaching the courts. Derivative action applicants, under section 165 of the

[208] S165 (3) of the Companies Act, 2008; Lewis Group Limited v David Farring Woollam and Others 2017 (2) SA 547 (WCC).
[209] S165 (4) (a) of the Companies Act, 2008.
[210] S165 (4) (a) of the Companies Act, 2008.

Companies Act, 2008, find themselves in a problematic position of not having access to information and also with no solution.[211]

As this information is in the hands of the controllers of the company who also happen to be the wrongdoers, this can be an obstacle to the derivative action applicant.[212] This affects the effectiveness of the derivative action as the derivative action applicant, not only faces the possibility of costs of the derivative action, but they also find themselves responsible for costs of different applications for access to information.

One would argue that the appointment of an investigator should relieve the derivative action applicant from having to get the information themselves. However, there is something fundamentally wrong about how the investigator is appointed. Firstly, the investigator is appointed by the very same persons against whom the allegations are made. Secondly, the investigator reports back to the company. There are no guidelines on how to investigate the allegations on the demand and what powers the investigator/committee has in investigating, what the investigator has access to or not, which could hinder the purpose of derivative action. This is of outmost importance with the expansion of derivative action applicant. Granted, commercial information is important to the company and one would not want a situation where such information ends up in the wrong hands, however, the legal interest of the company and in relation to the interest of the derivative action, are also important enough to be investigated in a proper manner.

The applicant does not have the right to any information of the company prior to the court granting leave to bring the derivative action. [213] Section 165 does not give the applicant the right to any information during the preliminary status of derivative action. The derivative action applicant finds would have to rely on the Promotion of Access to Information Act (PAIA)[214] for any hope in accessing information. In as much as a shareholder is treated as an outsider that does not stop them from using the provisions available to the public to obtain the information from the company.[215] The applicant in applying for the information in accordance with PAIA will have to prove that the information sought is for protection of a legal right[216] and that it will not

[211] For all intents and purposes, a shareholder is an outsider to the company. "…the disadvantages of the shareholder being 'outside' the company, in the sense that he has no access to the records of the company, the disadvantage of the defendants being in control of the company (the real plaintiff) and also the question of adequate deterrents to inhibit frivolous and vexatious proceedings." Van Wyk de Vries Commission Report, para 42.15.
[212] Cassim MF supra note 42, 167.
[213] Coetzee L supra note 26, 303.
[214] Act 2 of 2000. PAIA gives effect to section 32 of the Constitution.
[215] *Davis v Clutcho (Pty) Ltd* 2004 (1) SA 75 (C).
[216] S32 (1) (b) of PAIA.

be able to do so without the information required.[217] This is a cost that the derivative action applicant should not be liable for, had the legislature not amended the manner in which the demand is investigated.

The access to information in section 26[218] does not provide much relief to the derivative action applicant.[219] The most important information[220] is not accessible to the applicant as the information in relation to the application under section 26[221] is what every public person is entitled to. The right to peruse the company books[222] only comes after the court has granted the application to institute the derivative action. This means that at the preliminary stages, the derivative action applicant would have to trust that the investigator/committee in question is truly independent and believe the information provided.

The derivative action applicant under section 266 of the Companies Act, 1973 was in a better position in that the provisional curator ad litem was appointed by the court, had the powers afforded to it by the legislature and the directions by the court in some other instances.

3.3.5 Rebuttable presumption and the effect it has on derivative action

The expansion of the derivative action applicant also came with the expansion of the cause for the grounds to being derivative action. Derivative action is no longer based on the acts/omission of the directors and/or majority shareholders, but also third parties. A third party is defined as someone that is not related or inter-related to the company.[223] The courts are probable to grant leave for derivative action in cases where the parties are related or inter-related.[224] That is not the case in derivative action proceedings involving third parties due to the rebuttable presumption provision. [225] The rebuttable presumption provision provides that granting leave for derivative action is not in the best interest of the company where the derivative action applicant is the third party or where the derivative action proceedings relate to the action of the third party.

At face value, the rebuttable presumption is great. It is the court's way of not interfering with the internal matters of the company. It also limits the possible interference of the shareholders when

[217] Coetzee L supra note 26, 297.
[218] Companies Act, 2008.
[219] Section 26 is only applicable to shareholders and it's only applicable to some information and not all information that a minority's shareholder may need.
[220] The company accounts, resolutions, Board Meeting Minutes.
[221] Companies Act, 2008.
[222] S165 (9) (e) of the Companies Act, 2008.
[223] S165 (8) of the Companies Act, 2008; Stoop HH supra note 79, 548.
[224] Cassim FHI *et al* supra note 16, 789.
[225] S165 (7) of the Companies Act, 2008.

the directors are executive their duties in manning the affairs of the company.[226] The court in making a decision not to grant leave for derivative action places a greater weight on the directors' decision not to initiate or continue with the proceedings against the third party.[227] It could be said that the directors are expected, in performance of their duties, to make informed decision. The business judgment rule is a protective tool to for the directors against civil liability, but only if the directors could prove that in making the decision, they acted in good faith, reasonably informed and reasonably believed their decision was in the best interest of the company.[228] It is also expected that the director in making the decision also take into account commercial and business pros and cons of proceeding with the legal action.[229]

In as much as it is logical to include the rebuttable presumption, there is a loophole that could be detrimental to the application of derivative action.[230] The definition of third party is wide enough to include directors.[231] The directors may benefit from the rebuttable presumption provision,[232] unless the director is in control of the company. If a derivative action applicant seeks leave to bring derivative action against the company directors, the provision of rebuttable presumption will automatically apply because the directors are considered as third parties.[233] The decision of the company directors to protect their colleagues who are not, for the purposes of the definitions provided, controllers of the company, but have an influence on the board, is protected by this provision. This is contrary to the very reason how the derivative action started in the first place. The biggest causes of derivative actions are the directors. The legislature, in not excluding directors in the definition of third parties erred, with respect, especially when section 266 of the Companies Act, 1973, was solely focused on the misconduct of the directors. Section 165 of the Companies Act was meant to extend that provision, but it seems that it has inadvisably protected the directors from their misconduct.

This provision was adopted from the Australian Corporations Act, 2001,[234] however, the interpretation is vastly different. For the first, the Australian definition of related party includes the directors of the companies and their spouses and relatives of the directors and the relatives

[226] Cassim MF supra note 126, 173. Chokuda CT supra note 122, 120; Goehre KAsupra note 203.
[227] Cassim MF supra note 42, 103.
[228] Cassim MF supra note 42, 102 and 105.
[229] Cassim MF supra note 224, 173; Chokuda CT supra note 122, 126.
[230] Cassim MF op supra note 224, 169.
[231] S165 (8) of the Companies Act, 2008; Cassim FHI *et al* supra note 16, 789; Cassim MF Supra note 42, 180-181.
[232] If it is alleged that the director is not related to the company by definition in the Companies Act, 2008.
[233] S165 (8) of the Companies Act, 2008; Cassim MF supra note 42, 109.
[234] S237 (3) read with ss234 and 228 Corporations Act, 2001; *Mouritzen v Greystone Enterprise (Pty) Ltd* supra note 188.

of the director's spouses, their parents and children.[235] With this wide definition, the directors of the company could never be protected, even in error by the provisions of the rebuttable presumptions.[236] This should have been the case in South Africa.

3.4 Conclusion

Derivative action was meant to be better than the common law derivative action, for all its worth, it was. It did though come with limitations. The statutory derivative action under the Companies Act, 1973 limited the derivative action applicant and ground. This meant that any applicant whose cause of action was different from the grounds in section 266, would have to revert to common law.[237]

Section 165 bought with it the much sort after relief, but not without its own limitations. The legislature in section 165 of the Companies Act, respectfully, erred in the manner in which the investigation is conducted. In this instances, the alleged wrongdoers have more power than they need and the derivative action applicant is left out in the cold. Improving the access to information lacuna will create transparency which will prevent groundless derivative action and also play a role in deterring misconduct and mismanagement of directors.[238] Further to this, the provision of the rebuttable presumption, in as much as it can be said that it was added with good intention, if the director is still defines as a third party, then it will have dire consequences.

[235] S228 of the Corporations Act, 2001; Chokuda CT supra note 122, 128.
[236] Chokuda CT supra note 122, 128.
[237] Cassim FHI *et al* supra note 16, 777.
[238] Cassim MF supra note 42, 168.

Chapter 4: Comparative analysis with the foreign jurisdictions

The Companies Act, 2008, stipulates that when interpreting the provisions of the Act, consideration should be given to foreign jurisdictions where appropriate.[239] It further states that the purpose of the Act is to promote the Bill of Right as envisioned in the Constitution[240] and to boost the development of the economy.[241] Both the Companies Act, 2008, and the Constitution are in fact considering foreign law where pertinent. Section 165 of the Companies Act, 2008, is the hybrid of the different jurisdictions, the Australian Corporations Act of 2001, Canada Business Corporations Act of 1985, The United Kingdom's Companies Act of 2006 and an influence of the United States of America.[242] The application of derivative action of the jurisdictions listed above will be compared with the South African provisions to understand where the provisions where adopted from. The United States of America and the Canadian provisions will also be looked at.

4.1 United Kingdom

Derivative action could only be brought in exceptional circumstance. The United Kingdom was also subject to the *Foss v Harbottle*[243] rule and its exceptions. As the times progressed and things changed, this became unreasonable and impractical. The English Law Commission engaged in an enquiry into the protection of shareholders and their remedies available to the shareholders.[244] The common law application of the derivative action fell short of the modern times and this led to the need to amend the Companies Act, 1985 and have an application of derivative action that would be "more modern, flexible and accessible for determining whether a shareholder can pursue the action".[245] The amendment of the Companies Act, 2006, expressly abolished the application of the common law derivative action.[246]

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[239] S5(2) of the Companies Act, 2008.
[240] Act 108 of 1996, Chapter 2. The Constitution stipulates that one must consider international law and may consider foreign law when interpreting the Bill of rights, courts, forums or tribunals, s39 of the Constitution.
[241] S7 of the Companies Act, 2008.
[242] *Mouritzen v Greystone Enterprise (Pty) Ltd* supra note 188.
[243] Supra note 5.
[244] Reisberg A *Derivative Claims under the Companies Act: Much Ado about Nothing* UCL Centre for Law and Economics, published September 2008.
[245] Law Commission *Shareholder Remedies* (Law Com Report No 246, 1997).
[246] S260 (2) of the Companies Act, 2006.

4.1.1 The Procedure

Only a member[247] of the company can bring derivative action and no one else. The grounds upon which the derivative action from an actual or proposed act could be brought are limited to acts of negligence, default, breach of duty or breach of trust by the director of the company or third party.[248] Taking into account that this was the first amendment to the derivative action procedure from the *Foss v Harbottle* rule, one could argue that the grounds have been expanded.

The procedure in bringing the application for leave is stringent on the derivative action applicant and at the same time, it could be said that it is to sift through vexatious and frivolous claims. Unlike the South African procedure, the Companies Act, 2006, does not require the derivative action applicant to serve a demand on the company.[249] The courts in the United Kingdom play plays a major role in derivative action application, prior to the involvement of the alleged wrongdoers.[250] The derivative action applicant must make an application to the court for permission to continue[251] with the derivative action by submitting the claim form and application to the court supported by written evidence.[252] In as much as the derivative action sought is for the company, the company must be cited as a defendant to be bound by the judgment of the court. The derivative action applicant must notify the company.[253] As this is not a formal service of a derivative action, the company is not under an obligation to act. There is also, at this stage, no obligation to notify the directors alleged to have been the cause of the action.

The court will consider if there is *prima facie* case in deciding whether to grant the application or not. The first part of the process is paper based and no viva voce evidence may be considered by the court. The viva voce evidence is only applicable in instances where the court has ruled against the derivative action applicant and it requests the court to reconsider the decision and hear viva voce evidence. The company must be notified of the hearing, and the company can defend their position.

In the event the court decides that there is no *prima facie* case, the action cannot proceed further.[254] If the court decided that there is *prima facie* case, the court will adjourn the application and order the parties to prepare for the full hearing of the derivative action applicant's

[247] This includes a person who is not a member yet, but to whom shares have been transferred by operation of the law; s 260 (5) of the Companies Act, 2006.
[248] S260 (3) of the Companies Act, 2006.
[249] Chokuda CT supra note 122, 124.
[250] Ibid.
[251] S260 (1) of the Companies Act, 2006.
[252] This will be in a form of a sworn affidavit.
[253] At this stage, this is not a formal service of the derivative action.
[254] S261 (2) of the Companies Act, 2006.

application.[255] The company and its directors would have to be served formally with the claim form and the application.

On the return date, both parties will be afforded the opportunity to present their case to the court and the court will, in making a decision, consider a number of factors, inter alia: whether the derivative action applicant is acting in good faith;[256] whether the action in question will be ratified by the shareholders in the future; whether the company has decided not to pursue the action; take into account the views of the shareholders that do not have personal interest in the action;[257] whether the act is likely to be ratified and whether the cause of action could be brought in any other way but derivative action.[258]

The court will make a final decision if the leave for derivative action application should be granted or not.[259] In so doing, it will also consider the issue of cost, the looser compensates the winner.

The Companies Act, 2006, does not grant the derivative action applicant right to the company books to access information to support its application.

4.1.2 Comparative Analysis

The South African way of bringing derivative action is vastly different with the method used under the United Kingdom's Companies Act, 2006 in that

1. The United Kingdom restricts the derivative action applicant to a shareholder only, while in South Africa, the derivative action applicant has been expanded in such a way that stakeholder participation is seen to be done.

2. The grounds upon which to bring the derivative action, under the United Kingdom is restricted to actual or potential acts of negligence, default, breach of duty or breach of trust by the director of the company. In complete contrast, the South African ground for bringing derivative action is to protect the legal interests of the company. There is no limit, so long as the derivative action applicant can prove that it's protecting the interests of the company.

[255] S261 (3) of the Companies Act, 2006.
[256] Barrett v Duckett [1995] 1 BCLC 243.
[257] S263 (4) of the Companies Act, 2006.
[258] S263 of the Companies Act, 2006.
[259] S261 (4) of the Companies Act, 2006.

3. Nothing is clear about what needs to happen before the derivative action applicant approaches the court to continue with the derivative action. It is assumed that as the first step, the derivative action applicant will serve a letter on the company entailing the grievance. There are no clear responsibilities expected from the company upon receiving the supposed letter.

4. It seems that in the United Kingdom, the derivative action applicant is placed in the same position as the South African one. In that the court may give directions as to the kind of evidence to be provided to the derivative action applicant, only after the leave to bring derivative action has been granted. There is no direction as to accessing information prior to that. In South Africa, the derivative action applicant can only rely on the provisions of PAIA, which involves costs and does not guarantee success and trust. Trust that the independent investigator or committee has done proper investigation and is not in the books of the company.

5. South African derivative law has in essence abolished the concept of majority shareholders ratifying the decision of the director. To the point that even if the act that brought about the ground for derivative action was ratified, the court still has jurisdiction over the matter. While in the United Kingdom still endorses the majority shareholder ratification to the point that if the court is of the opinion that the cause of action could ratified in the future, its less likely to grant the application.

4.2 Australia

The Australian common law derivative action was also based on the *Foss v Harbottle*[260] rule and its exceptions. Like in South African and United Kingdom, the common law derivative action became impractical and a barrier for shareholder protection.[261] This impracticality arose a need to introduce the statutory derivative action. The statutory derivative action was introduced under Part 2F.1A of the Corporations Act 2001 (Cth), hereinafter referred to as the Corporations Act 2001.

[260] *Foss v Harbottle* Supra note 5.

[261] Thai L et al Statutory Derivative Actions in Australia and New Zealand: What can we learn from each other New Zealand Universities Law Review Vol 25, 372.

4.2.1 Procedure

Only a member or a former member may apply for leave to bring derivative action.[262] There is an expectation that before the derivative action applicant could bring application for leave to bring derivative action, there must have been some engagement with the company, prior to serving the notice to the company. The applicant must, at least 14 days, before filing for leave must have given notice to the company of its intention to bring leave for derivative action. [263] There would be instances where the court would grant the derivative action even if the notice was not given to the company.[264] There are no reasons quoted in the Corporations Act 2001 as to why would the notice not be served on the company. The Corporations Act 2001 does not specify as to what must be on the notice, but it's submitted that there must be sufficient information for the directors to be in position to decipher the allegations.

If the derivative action applicant satisfies five elements: it must be probable that the company will not be bringing the action itself, the derivative action applicant is acting in good faith, it is in the best interest of the company, there is a serious question to be tried and as discussed above, the applicant has served the notice of the intention to the company, [265] the court must grant leave to bring derivative action.

In as much as the derivative action applicant can prove the five elements listed above, there is a hurdle of a rebuttable presumption.[266] The granting of leave to bring derivative action will not be in the best interest of the company if the action is by the company against the third party[267] and vice versa. It is also a rebuttable presumption that granting leave for derivative action is not in the best interest of the company if it is established that the director exercised the business judgment rule.[268]

Unlike in South Africa and the United Kingdom, the Australian's Corporations Act 2001 makes provision for the derivative action applicant to have access to information at leave stage. A member of the company may be entitled to company books if authorised by the directors or

[262] This includes a person who is entitled to be registered as a member. S236 (1) of the Corporations Act 2001.
[263] S237 (2) (e) (i) of the Corporations Act 2001.
[264] S237 (2) (e) (ii) of the Corporations Act 2001.
[265] S237 (2) (a) – (e) of the Corporations Act 2001.
[266] S237 (3) of the Corporations Act 2001.
[267] A third party is defined as a person not related to the company, s237 (4) of the Corporations Act 2001. A related party is defined in section 228 of the Corporations Act 2001.
[268] In that every director in making the decision acted in good faith and for proper purpose, did not have material personal interest in the decision, informed themselves of the subject matter and rationally believed (the decision is in the best interest of the company; s237 (3) (c) of the Corporations Act 2001.

shareholders in general meeting.[269] A member also has a right to inspect company minutes provided the request is made in written in advance.[270]

4.2.2 Comparative Analysis

1. The derivative action applicant under the South African Companies Act, 2008 is expanded to not only include the shareholders, but also stakeholders. Unlike the derivative action applicant under the Australian Corporations Act 2011 restricts the applicant to a member.

2. The Corporations Act 2011 does not spell out the grounds upon which the derivative action applicant could bring leave application. While under the South African law, the derivative action is brought to protect the interest of the company.

3. The notice that is served on the company under the Australian law seems to be discretionary on the derivative action applicant. The Corporations Act is drafted in a way that that the derivative action applicant does not need to prove to the court why the notice was not served on the company. In South Africa, the derivative action applicant *must* (emphasis added) serve a demand on the company before he approaches the court. If not, the applicant must prove to the court that it was in the best interest of the company not to serve the demand.

4. In South Africa, the company is given an opportunity to investigate the allegations that are the grounds for the derivative action. The Australian procedure does not have this requirement.

5. Unlike in South Africa, the Australian derivative action applicant has a right to inspect the company books at leave stage which is helpful to the case of the derivative action applicant.

6. The rebuttable presumption in South African company is modelled after the Australian's Corporations Act 2011. The two provisions have similarities,[271] yet vastly different. In South Africa, directors, as the law stands, are considered as third parties while in Australia, the directors are considered as related parties of the company.[272]

[269] Books are defined to include financial records, documents or any other record of information; s9 of the Corporations Act 2001.
[270] S247 of the Corporations Act 2001.
[271] Cassim MF supra note 42, 106.
[272] Cassim FHI *et al* supra note 16, 789.

4.3 Other Jurisdictions

There are some elements of the Canadian law[273] and the United States[274] that influenced the section 165 of the Companies Act, 2008. The expansion of the derivative action applicant under section 165 (2) could be said to have been an influence of the Canadian law.[275]

In the United States, the derivative action applicant is required to make a demand on the company, through its directors, before bringing derivative action.[276] This demand must be specific,[277] articulated in a way that directors are given a fair opportunity to initiate the application requested by the derivative action applicant.[278] This is could be said to have had an influence over the South African's demand provision. In as much as section 165 uses the word "may", case law[279] has determined that there is no discretion. Under the Canadian law, the derivative action applicant must serve a notice to the directors of the company or its subsidiary, not less than fourteen days before bringing the application, of its intention to apply to the court for leave.[280]

4.4 Conclusion

The United Kingdom's inclusion of having the derivative action applicant prove the existence of *prima facie* case at the leave stage is dangerous in the long run as the merits of the action are being considered at the wrong time. The merits of the case are meant to be discussed at the time when derivative action is being brought.

The Australian procedure of derivative action is marked with loopholes. There are no directions as to what is the company obligated in doing prior to application for leave to bring derivative action. It is in favour of the company over the minority shareholder. The Australian provision is the only one that guarantees the derivative action applicant access to information at leave stage.

The United Kingdom and Australian derivative actions are similar to South Africa, but different in material terms. There is no structure in both the United Kingdom and Australian as to the reason behind serving the notice to the company. There is no indication that the company is to

[273] Canada Business Corporations Act (RSC, 1985). Hereinafter referred to the Canadian Act.
[274] Federal Rules of Civil Procedure.
[275] S238 (a) – (d) of the Canadian Act.
[276] Rule 23.1 of the Federal Rules of Civil Procedure.
[277] Halprin v Babbit 3030 F 2d 138 (1st Cir, 1962).
[278] Scott Bender v Steven Scheartz 172 Md App 648 at 669 (2007).
[279] *Mouritzen v Greystone Enterprise (Pty) Ltd* supra note 188.
[280] S239 (2) (a) of the Canadian Act.

act, upon receipt of the notice from the derivative action applicant. In as much as the current South African Companies Act, 2008, needs an amendment in this regard, it directs the company on the steps to take upon receipt of the demand by the derivative action applicant. With this, every party concerned is aware of their rights and responsibilities and in the long run, saves everyone concerned money and time.

The Canadian Act, looking at when it came into operation is the most advanced of the four jurisdictions. It has an expanded applicant when the United Kingdom, South Africa and Australia were still operating under the common law. The United States demand system is well entrenched with the South Africa law.

In comparison to the other jurisdictions,[281] South Africa is more advanced to the application of the derivative action. The derivative action applicant includes stakeholders. There is direction and structure as to what each party must do, when and how. South Africa could be in par with the Australian Corporations Act 2011 when the current Companies Act, 2008, is amended to have the information reach the court during the leave stage. The biggest lacuna South Africa will need to adopt from other jurisdictions is to have directors seen as related parties to the company.

[281] United Kingdom and Australia

Chapter 5: Recommendations and Conclusions

Derivative action in South Africa has gone through different changes as a result of necessityThe common law derivative action as found in the exceptions to the *Foss v Harbottle* rules was too strict on the derivative action applicant in that they found themselves having to prove that they had the right to bring the action and that the grounds in question, amongst others, was not a ratifiable wrong.[282] The common law derivative action was supplemented by the first statutory derivative action in the form of section 266 of the Companies Act, 1973. The statutory derivative action under section 266 introduced new grounds upon which a derivative action could be brought. The derivative action applicant no longer had the burden to prove the existence of the exceptions to the *Foss v Harbottle* rule. It was only if the grounds upon which the derivative action applicant was bringing the derivative action did not fall under the grounds is the Companies Act, 1973, that the derivative action applicant could bring the derivative action under common law.[283]

In as much as the derivative action under the Companies Act, 2008, is greatly welcomed, there are a few flaws that were found with its provision and which could result in the minority shareholders losing confidence and faith in it.[284] The derivative action provisions under the Companies Act, 2008, are broad to include different stakeholder, which is a welcomed change. It also expands the grounds upon which to bring the derivative action application as being "the best interest of the company". However the failure to define what is in the best interest of the company is a lacuna that could be closed, especially taking into account that the derivative action applicant is wide enough to include any person the court has granted leave to.[285] All the stakeholder listed in section 165 consider the interest of the company differently, in line with what is best for them. Confusion could be eliminated and certainty established if the best interest of the company could be defined or direction given to the courts by the legislature.

The second lacuna that could lead to the derivative action provision not being used as much as it should, is the process of investigating the demand.[286] It is common cause that the derivative action applicant does not have access to information during the application for leave stage.[287] With the Companies Act, 1973, the derivative action applicant did not have to worry about access

[282] Boyle A J supra note 87, 4.
[283] Stoop HH supra note 79, 527.
[284] Corporate Law Reform Policy supra note 80.
[285] S165 (2) of the Companies Act, 2008.
[286] S165 (4) of the Companies Act, 2008.
[287] Benade C *et al* supra note 26.

to information or the information reaching the courts due to the appointment, by the court, of the provisional *curator ad litem* who investigated the allegations and reported directly to the court. With the new investigation process, the derivative action applicant is placed in a situation where it is at the mercy of the very same people alleged to have not acted in the best interest of the company. The Independent investigator/committee is appointed by the directors of the company and reports directly to the same board. Challenging the outcome of the independent investigator/committee could be a costly exercise for the derivative action applicant. Having the investigator being appointed by the alleged wrongdoers and over and above that have the investigator report to the same directors is a flawed exercise that leaves great room for manipulation and frustration to the derivative action applicant. Further to this, the legislature in the Companies Act, 2008, unlike in the Companies Act, 1973, does not give the investigator any powers or guidance for the investigation. This could lead to the investigation not being done in a proper manner and what is acceptable in accordance with the rules of evidence. With due respect, the investigation procedure in section 165 (4) would need to be amended to give the minority shareholders the confidence in knowing that their actions will be taken seriously.

Having to face the investigation flaw, the derivative action applicant has to overcome the hurdle of the rebuttable provision.[288] That, if the grounds for the derivative action is related to the actions of the third party, then it would not be in the best interest of the company for the court to grant leave to bring the derivative action. The definition of a third party under section 165 (8) of the Companies Act, 2008, includes directors because directors are not seen as related or inter related to the company, unless the derivative action applicant can prove that the director/s in question are also in control of the company. This provision in essence protects the directors, and not the minority shareholders or the company.

Derivative actions are a form of protection for the minority shareholders and where that protection is needed the most, the legislature, instead provided that protection to the directors leaving the shareholders out in the cold. Majority of the actions in derivative action relate to the allegations of wrongdoings by the directors. It is very important for this section to be amended as soon as reasonably possible as it has great effect in its current form.

The derivative action under the Companies Act, 2008, did not abolish all the provisions of the common law derivative action, the principle of the proper plaintiff is still applicable to date.[289] The derivative action is to protect the legal interests of the proper plaintiff, the company. It is submitted that section 165 of the Companies Act, 2008, did not in fact abolish common law

[288] S165 (7) of the Companies Act, 2008.
[289] Cassim MF supra note 42.

derivative action, but it only abolished the question as to whether section 165 of the Companies Act, 2008, did in actual fact abolish.

Besides the lacunas raised above, the current derivative action is wide enough to recognise stakeholder activism and that is greatly welcomed.

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