

“LEGAL STANDING” AND “THE DEMAND” IN SECTION 165 OF THE COMPANIES ACT 71 OF 2008: A COMPARATIVE DISCUSSION*

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SUMMARY

Section 165 of the Companies Act 71 of 2008 provides that applicants with *locus standi* who are aware of a wrong perpetrated against the company and who wish to pursue a derivative action against the company must have served a demand on the company requiring it to commence or continue legal proceedings to protect its own legal interests. Thereafter, the company must have filed a notice indicating that the company refuses to comply with the demand, or alternatively, the company must have failed to comply at all or failed to comply properly with its obligations relating to the investigation of the demand and its response to the demand. This article explores the concepts of legal standing and the demand that must be served on the company requiring it to commence or continue legal proceedings to protect its own legal interests as contemplated in section 165(2) of the 2008 Act, with the aim of identifying the commendable aspects of these concepts as well as the possible shortfalls.

1 INTRODUCTION

Section 165 of the Companies Act 71 of 2008 (2008 Act) abolished the rule in *Foss v Harbottle*¹ (the common-law derivative action) that a person other than the company can in certain limited cases bring legal proceedings on behalf of the company, and replaces that rule with the statutory provisions that are contained in section 165 of the 2008 Act.² This approach is similar to the provisions in Canadian company law legislation that revoked the common-law derivative action and introduced the statutory derivative action.³

* This article is based on sections of the author's PhD thesis.

¹ (1843) 2 Hare 461.

² S 165(1) of the Companies Act 71 of 2008.

³ Griggs "The Statutory Derivative Action: Lessons That May Be Learnt from the Past!" 2002 4 *University of Western Sydney Law Review* par 1.2; Coetzee "A Comparative Analysis of the Derivative Litigation Proceedings Under the Companies Act 61 of 1973 and the

Section 165 therefore provides for a statutory derivative action to enforce the rights of the company on its behalf because, although it is the proper plaintiff, the wrongdoers are in control of the company and therefore will not seek to enforce the rights of the company against themselves.⁴

The statutory derivative action that was contained in section 266 of the Companies Act 61 of 1973 (1973 Act) was not limited to so-called “unratifiable wrongs” and could be used even if the wrong complained of was capable of ratification or could have been condoned by the company.⁵ Section 266 of the 1973 Act was limited in that it could only be used where the company suffered a loss as a result of a wrong, breach of trust or breach of faith committed by a director or officer of the company.⁶ The common-law derivative action was not abolished by section 266 of the 1973 Act while section 165 of the 2008 Act abolishes any common-law right of a person other than a company to bring or prosecute any legal proceedings on behalf of that company.

This article discusses the concepts and principles relating to legal standing and the demand that must be served on a company requiring it to commence or continue legal proceedings to protect its own legal interests as contemplated in section 165(2) of the 2008 Act.

The United Kingdom (UK) is used as a comparator. The main reason to compare the relevant provisions in the UK Companies 2006 Act (2006 Act) is that investigating a foreign legal system that has heavily influenced South African (SA) company law (such as the UK) provides a greater understanding of section 165 in the 2008 Act. Investigating the comparable provisions in the 2006 Act may be useful in providing solutions, guidelines and warnings to supplement any gaps or defects in our own statutory regime. Therefore, the relevant provisions in the 2006 Act are discussed to identify lessons that SA can learn from the UK derivative action system while finding ways for effective use of the derivative action system in SA. The article concludes with a series of recommendations in the form of proposed amendments with the aim of providing further clarity and effectiveness to section 165 of the 2008 Act.

Companies Act 71 of 2008” 2010 *Acta Juridica* 298.

⁴ Delpont *Henochsberg on the Companies Act 2008* (2018) 593; *Mbethe v United Manganese of Kalahari (Pty) Ltd* [2016] JOL 35242 (GJ), 2016 (5) SA 414 (GJ) (High Court judgment) par 64 ff; confirmed on appeal: *Mbethe v United Manganese of Kalahari (Pty) Ltd* 2017 (6) SA 409 (SCA) (SCA judgment) expressly abolishes any right at common law of a person other than a company to bring or prosecute any legal proceedings on behalf of the company, as it existed under the rule in *Foss v Harbottle*; *Remgro Limited v Unilever South Africa Holdings (Pty) Limited* [2015] ZAKZPHC 54 par 26.

⁵ Coetzee 2010 *Acta Juridica* 298; Cilliers, Benade, Henning and Du Plessis *Corporate Law* 3ed (2000) 307; s 266(1) of the Companies Act 61 of 1973.

⁶ S 266(1) of the 1973 Act.

2 THE APPROACH IN SOUTH AFRICA

2.1 Legal standing

Section 266 of the 1973 Act was only available to members of the company whereas section 165 of the 2008 Act extends the right to sue to:⁷

- a) a shareholder or a person entitled to be registered as a shareholder of the company or of a related company;⁸
- b) a director or prescribed officer;⁹
- c) a representative trade union of the employees of the company or any other representative of employees of the company;¹⁰ and
- d) a person who has been granted leave by a court to initiate proceedings.¹¹

It is not only registered shareholders that have legal standing but also persons who are entitled to be registered as shareholders.¹² Section 1 of the 2008 Act defines a shareholder as the “holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register as the case may be”. Cassim opines that, on the basis of this definition, it appears that a registered shareholder will qualify under the 2008 Act as a shareholder as will those persons entitled to be registered shareholders and persons to whom shares have been transferred without the share transfer having been entered in the securities register.¹³ According to Cassim, this includes persons to whom shares have been transferred or transmitted by operation of the law – for instance, where the applicant has inherited shares but has not registered the shares formally, or where the shares have been transferred to the applicant by insolvency.¹⁴

Locus standi or legal standing is granted to shareholders, directors and prescribed officers of the company in question as well as to “related companies”. The term “related companies” includes holding and subsidiary company relationships as well as the direct or indirect control by one company over the other or the business of the other.¹⁵ This extension to the shareholder, directors and prescribed officers of related companies is a commendable addition. The inclusion recognises the reality that shareholders or directors of a holding company may, in certain circumstances, have a legitimate interest in initiating a derivative action to

⁷ S 165(2) of the 2008 Act.

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ *Ibid.*

¹¹ *Ibid.*

¹² A “shareholder” refers to a person to whom the rights attached to a share have been transferred, without the registration of the transfer necessarily being completed; included is the executor of a deceased estate (*New Heights Developers (Pty) Ltd v Bogatsu* [2017] ZAGPJHC 353).

¹³ Cassim *The New Derivative Action under the Companies Act* (2016) 14; see also Cassim “Shareholder Remedies and Minority Protection” in FHI Cassim, MF Cassim, R Cassim, Jooste, Shev and Yeats *Contemporary Company Law* 2ed (2012) 779.

¹⁴ Cassim *The New Derivative Action under the Companies Act* 14.

¹⁵ Cassim *The New Derivative Action under the Companies Act* 15.

prevent harm to a subsidiary company by those in control of the company.¹⁶ Section 165 is unique in that it also grants legal standing to a third category of applicant – namely, trade unions representing employees of the company and other employee representatives.¹⁷ The remedy is thus available to a much wider audience than in section 266 of the 1973 Act. According to Coetzee, the broadening of the categories of possible litigant is in line with the principles of good corporate governance.¹⁸

As stated above, the category of person that can apply to court for leave to bring the proceedings in the name of the company is significantly wider under section 165 of the 2008 Act than it was under section 266 of the 1973 Act.

2.2 The demand

Section 165(2) states that a person “may serve a demand on the company to commence or continue legal proceedings, or take related steps, to protect the legal interests of the company”.¹⁹

The use of the word “may” when referring to the service of the demand could be criticised for its lack of clarity and certainty. The uncertainty arises as to whether the service of the demand is compulsory or discretionary. However, the use of the word “may” in the section is nonetheless considered to indicate a mandatory precondition of service of the demand as a precondition for a derivative action.²⁰ This was confirmed by the court in *Mouritzen v Greystone Enterprises (Pty) Ltd (Mouritzen)*.²¹

In *Mouritzen*, Ndlovu J handed down the first judgment in South Africa in relation to the new statutory derivative action. The matter was brought in terms of section 165(5) of the 2008 Act. In *Mouritzen*, K Mouritzen and D Mouritzen were brothers and were the only directors of Greystone Enterprises (Pty) Ltd (the Company). The Mouritzen Family Trust (the beneficiaries of which are the families of both K and D Mouritzen) held 98 shares in the capital of the Company and D Mouritzen and his wife held 49 shares each. K and D Mouritzen were paid equal monthly salaries by the Company and were issued with credit cards in their names, on the basis that transactions on those credit cards were debited to and paid by the Company.²² K Mouritzen alleged that D Mouritzen was abusing his credit card to the detriment of the Company and the shareholders.²³ On 23 May 2011, K Mouritzen, through his attorneys, sent a letter (which constituted a s 165(2) demand) to the Company’s postal address, the Company’s attorneys (by email) and to D Mouritzen (by email) in terms of which he

¹⁶ *Ibid.*

¹⁷ *Ibid.*

¹⁸ Coetzee 2010 *Acta Juridica* 299.

¹⁹ S 165(2) of the 2008 Act.

²⁰ Cassim *The New Derivative Action under the Companies Act 16*; Cassim in FHI Cassim *et al Contemporary Company Law* 779.

²¹ *Mouritzen v Greystone Enterprises (Pty) Ltd* 2012 (5) SA 74 (KZD) par 24.

²² *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 2.

²³ *Ibid.*

demanded that the Company institute legal action against D Mouritzen to compel him to produce records of his credit card transactions and necessary supporting documents to enable the Company to determine whether or not those expenses were properly charged against the Company. In response, D Mouritzen sent an email to K Mouritzen's attorneys disputing the allegations against him.²⁴ K Mouritzen then approached the court for an order granting him leave to institute a derivative action in the name of the Company against D Mouritzen for delivery by D Mouritzen to K Mouritzen of the full account of his credit card expenditure, the assessment of expenses in the said account and payment to K Mouritzen (as a representative of the Company) of any amount that appears to be due to K Mouritzen (as a representative of the Company).²⁵ D Mouritzen argued that (i) the letter sent to the Company's postal address (the section 165(2) demand) was improperly served and (ii) K Mouritzen's derivative action was in bad faith and that K Mouritzen was driven by personal animosity that existed between the Mouritzen brothers. Ndlovu J observed that the use of the word "may" in relation to the service of a section 165(2) demand may obscure the legislative intent that the service of a section 65(2) demand is a prerequisite for the institution of a section 165(5) derivative action.²⁶

As far as the issue as to whether the demand was properly served, Ndlovu J stated:²⁷

"[I] observe that the service of the demand on the company is an essential prerequisite for the institution of an application under section 165(5) and without which such person is obviously barred from launching the application. Given this observation, it is imperative and compulsory that a prospective applicant must comply with the service requirement before proceeding in terms of section 165(5). On this basis, the section ought, in my view, to be understood in the context that an applicant 'must' serve the demand on the company. It is a peremptory provision."

Ndlovu J noted that there was nothing in section 165(2) of the 2008 Act to suggest that a section 165(2) demand must be served by delivering it to the registered office of a company. Ndlovu J stated further:

"I find that the purposive interpretation of section 165(2) does not require that a demand referred to in that section must necessarily be served on a company by delivering it at its registered office or its principal place of business".²⁸

In the author's view, any legally recognisable manner of service of any court process or document initiating application proceedings shall be adequate, provided that the court considering the matter, in the exercise of its discretion, is satisfied that the demand was duly served on the company for which it was intended.²⁹ In *Mouritzen's* case, the court held that the postage of a letter by ordinary mail to the company's postal address and the emailing of a copy of the letter to the company's attorneys had constituted a proper

²⁴ *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 9.

²⁵ *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 3.

²⁶ *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 13–16.

²⁷ *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 24.

²⁸ *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 33.

²⁹ *Ibid.*

and valid service of the demand.

The demand can be served by a shareholder, or by a person entitled to be registered as a shareholder of the company.³⁰ The demand may also be served by a director or prescribed officer of the company or a related company.³¹ Cassim submits that a person serving a demand should have been a shareholder when the “wrong” was committed and that there is no requirement as to the extent of the shareholding of the relevant shareholder.³² In terms of section 165, a registered trade union representing employees or another representative body that has been appointed to represent employees of the company may also serve the demand upon the company.³³ Furthermore, any person who has been granted leave by the court may serve a demand on the company if the court is satisfied that it is necessary or expedient to protect the legal interest or rights of a person.³⁴

It is not clear what would qualify as necessary and expedient or what criteria a court would use in this regard to protect the legal right of a person. However, what must be borne in mind is that section 165 is not a personal action but a derivative one. Delpont submits that this would involve a person who, owing to their relationship with the company, has an interest in initiating the action.³⁵ The demand may provide for the commencement or the continuation of legal proceedings or related steps to protect the company’s legal interests.³⁶ The demand may call upon the company to initiate or defend derivative proceedings on behalf of the company in the event that the company has failed to do so, or it may permit a person to intervene in proceedings in which the company is a party and continue with the proceedings on behalf of the company. Section 165(2) also permits a person to take related steps to protect the company’s legal interests, which may involve the settling or compromising of legal proceedings on behalf of the company.³⁷

According to Delpont, the courts should not take too legalistic an approach to the terms of the demand and the test should be based on the evidence available and whether the company might conceivably succeed on the envisaged action.³⁸ In *Amdocs SA Joint Enterprise (Pty) Ltd v Kwezi Technologies*,³⁹ the court concluded that the threshold that the applicant has to overcome is a low one compared to the onus that the company bears for relief in terms of section 165(3).⁴⁰ Subsection 3 provides that when a

³⁰ S 165(2)(a) of the 2008 Act.

³¹ S 165(2)(b) of the 2008 Act.

³² See generally, Cassim “The Doctrine of Contemporaneous Share Ownership and Aspects of *Locus Standi* in the New Derivative Action” 2018 135 *South African Law Journal* 101–120; Delpont *Henochsberg on the Companies Act 2008* 594.

³³ S 165(2)(c) of the 2008 Act.

³⁴ S 165(2)(d) of the 2008 Act.

³⁵ Delpont *Henochsberg on the Companies Act 2008* 595.

³⁶ S 165(2) of the 2008 Act.

³⁷ Cassim *The New Derivative Action under the Companies Act* 17.

³⁸ Delpont *Henochsberg on the Companies Act 2008* 593.

³⁹ *Amdocs SA Joint Enterprise (Pty) Ltd v Kwezi Technologies (Pty) Ltd* 2014 (5) SA 532 (GJ) par 17.

⁴⁰ See also *Mbethe v United Manganese of Kalahari (Pty) Ltd* (High Court judgment) *supra* par

demand is served on the company, the company has 15 business days to apply to court to have the demand set aside on the basis that the demand is frivolous, vexatious or without merit.

In *Lewis Group Ltd v Woollam*,⁴¹ the court indicated that the nature of the onus should be what ordinarily applies in civil litigation and there is no “heaviness” in the equation. The court stated that⁴²

“there is no presumption in favour of the complainant that its demand is not frivolous, vexatious or without merit, any more than there is one in favour of the company that it is. The statutory provisions do not give rise to any inherent probability one way or the other. ... Similarly, there is no special dispensation in favour of complainants as the reference to ‘a low threshold’ might suggest when it comes to considering the cogency of a demand in terms of section 165(2).”

This has now been confirmed by the Supreme Court of Appeal (SCA) in *Mbethe v United Manganese of Kalahari (Pty) Ltd (Mbethe)*.⁴³

Section 165 does provide guidelines on the content of the mandatory demand. The Companies Regulations⁴⁴ require a standard prescribed form to be used for these purposes. The form in question requires the person making the demand to “attach a statement of particulars, setting out the legal action [he/she] require[s] the company to take”.⁴⁵ The court will have to determine whether the applicant has complied with section 165.

Section 6(8) of the 2008 Act provides:

“If a form of document, record, statement or notice is prescribed in terms of this Act for any purpose – (a) it is sufficient if the person required to prepare or complete such a document, record, statement or notice does so in a form that satisfies all of the substantive requirements of the prescribed form.”

Section 266 of the 1973 Act did not specifically require the amount to be claimed or to give a precise description of the circumstances giving rise to the loss in a derivative claim. However, the notice under section 266 did have to be specific enough to enable the company to know what proceedings it was being called upon to institute. According to Stoop, this principle could be applied to the demand under the 2008 Act.⁴⁶

It is important to note that the notice in terms of the 1973 Act gave rise to a different consequence and purpose. Once the notice was served on the company, the company was called upon to institute proceedings. Whether

162; confirmed on appeal in the SCA judgment.

⁴¹ [2017] 1 All SA 192 (WCC).

⁴² *Lewis Group Ltd v Woollam* [2017] 1 All SA 192 (WCC) par 55–56.

⁴³ See *Lewis Group Ltd v Woollam supra* par 56; *Mbethe v United Manganese of Kalahari (Pty) Ltd* (SCA judgment) *supra* par 12 and 16; see also Du Plessis “The South African Statutory Derivative Action: Background, Comparisons and Application” in Hugo and Kelly-Brown (eds) *Essays on the Law of Banking, Companies and Suretyship* (2017) 276.

⁴⁴ GN R351 in GG 34239 of 26 April 2011.

⁴⁵ Regulation 36(1) requires a Form CoR 36.1 to be used for this purpose. This is a standard form used to notify the company of matters in terms of other sections of the Act as well – namely, ss 37, 39 and 115 of the 2008 Act.

⁴⁶ Stoop “The Derivative Provisions in the Companies Act 2008” 2012 129 *South African Law Journal* 537–538.

there were grounds to institute proceedings was only determined once the curator had been appointed and only if there were *prima facie* grounds to institute a derivative action. Under section 165(4)(a) of the 2008 Act, an individual or committee must be appointed to investigate the merits of instituting derivative proceedings.⁴⁷

Serving a demand on the company thus sets the framework for a potentially costly independent investigation. The purpose of the investigation is not intended to ascertain whether a case might be found but it is to investigate the merits of the case and the viability of the company pursuing that case and not possible incidental bases for other claims.⁴⁸

It is submitted that section 165(2) of the 2008 Act must always be read with section 165(6). Section 165(6) provides that a person contemplated in section 165(2) of the 2008 Act (such as a shareholder, director or prescribed officer) may, in exceptional circumstances, apply to court for leave to bring a derivative action without serving a section 165(2) demand. In terms of section 165(2), in order to commence with a derivative action, a person would need to serve a demand on the company to bring or continue legal proceedings to protect the legal interests of the company.

2 3 Prescription

In terms of the principles laid down in *Foss v Harbottle*, when a wrong has been committed against a company, it is the company that has to initiate the action. In terms of section 165, action may be initiated by the shareholders or other persons listed above. In this instance, the ordinary principles of prescription would apply. However, section 13(1) of the Prescription Act⁴⁹ provides:

“If ... (e) the creditor is a juristic person and the debtor is a member of the governing body of such juristic person; ... the period of prescription shall not be completed before a year has elapsed after the day referred to in paragraph (i).”

Section 13(1)(i) refers to the situation where:

“the relevant period of prescription would, but for the provisions of this subsection, be completed before or on, or within one year after, the day on which the relevant impediment referred to in paragraph ... (e) ... has ceased to exist.”

Therefore, an action in terms of section 165 can be brought after such time. In instances where the wrongdoer is in control of the company, it will not be possible to institute action against the wrongdoer, as the latter may frustrate the commencement of the action. If the debt has prescribed in terms of section 13 of the Prescription Act, this will in effect, terminate the right to bring an action in terms of section 165, not because the latter has prescribed

⁴⁷ *Ibid.*

⁴⁸ *Lewis Group Ltd v Woollam supra* par 56; Delpont *Henochsberg on the Companies Act 2008* 594.

⁴⁹ 68 of 1969.

as section 165 on its own does not create a “liability” in respect of the wrongdoer, but because the liability that formed the basis of the section 165 claim has prescribed.⁵⁰

In cases where a section 165 action is initiated and section 13(1)(e) of the Prescription Act is not applicable and if a curator is appointed, the prescription period will commence on the date of the appointment of the curator, as liability in respect of the wrongdoer is then created by the appointment by the court.⁵¹ Delport states that the dictum expressed by Maja ADJ in *OffBeat Holiday Club v Sanbonani Holiday Spa Share Block Ltd* may not be correct. According to the author, if the action belongs to the company, and a shareholder merely executes it for the company, the appointment of, and institution of, the action by the shareholder cannot be the “inception” of the debt/obligation.⁵²

In *OffBeat Holiday Club v Sanbonani Holiday Spa Share Block Ltd*,⁵³ Cachalia AJ stated that a shareholder’s entitlement or right to use section 266 to protect the company, and indirectly itself, from delinquent directors and officers cannot prescribe where the “debt” to the company itself has not prescribed as this entitlement (to act for the company) does not have a correlative debt, whereas the right of a company does.⁵⁴ The shareholder’s “right” to bring an action therefore remains intact and alive so long as the company is capable of enforcing its rights. The company will always remain the creditor and section 266 of the 1973 Act, or section 165 of the 2008 Act, merely allows the shareholder to bring the claim on behalf of the company. Either the shareholder (under section 266 of the 1973 Act or section 165 of the 2008 Act) or the company may enforce the claim as long as the claim exists and therefore it is not necessary to determine if prescription only commences when a curator is appointed.⁵⁵

2 4 Setting aside the demand

A company that has been served with a demand may within 15 business days apply to court to set aside the demand only on the grounds that the demand is frivolous, vexatious and without merit.⁵⁶ In *S v Cooper*,⁵⁷ the court stated that the word “frivolous” in its ordinary and natural meaning connotes an action or legal proceeding characterised by lack of seriousness because it is manifestly insufficient. In *Argus Printing & Publishing Co Ltd v*

⁵⁰ Delport *Henochsberg on the Companies Act 2008* 595; see also *OffBeat Holiday Club v Sanbonani Holiday Spa Share Block Ltd* [2016] 2 All SA 704 (SCA) par 57.

⁵¹ Delport *Henochsberg on the Companies Act 2008* 596; see also *OffBeat Holiday Club v Sanbonani Holiday Spa Share Block Ltd supra* par 41.

⁵² *Offbeat Holiday Club v Sanbonani Holiday Spa Share Block Ltd supra*; Delport *Henochsberg on the Companies Act 2008* 595.

⁵³ *Supra*.

⁵⁴ Delport *Henochsberg on the Companies Act 2008* 595; *OffBeat Holiday Club v Sanbonani Holiday Spa supra* par 52.

⁵⁵ Delport *Henochsberg on the Companies Act 2008* 595; *OffBeat Holiday Club v Sanbonani Holiday Spa supra* par 58 and 61.

⁵⁶ S 165(3) of the 2008 Act.

⁵⁷ 1977(3) SA 475 (T) 476D.

Anastassiades,⁵⁸ the court stated that an action would be “frivolous” or “vexatious” if it was so unfounded that it could not possibly be sustained. “Vexatious” would mean that the action is obviously unsustainable as a matter of certainty.⁵⁹ An application brought in terms of section 165 will not be sustained if it can be demonstrated that it is brought without merit in the sense that it cannot succeed.⁶⁰ The onus rests on the company to prove that the demand was misdirected. This can be achieved by demonstrating that the demand was misdirected because it was either bad in law or not in keeping with the facts. Although an application that is vexatious or frivolous would demonstrate the absence of good faith (or existence of bad faith), there is no onus on the respondent to disprove good faith.⁶¹

In *Lewis Group Ltd v Woollam*, the court stated that a complainant who is unable to put forth a cogent and competent demand, albeit not necessarily with the precision required for pleading it, regardless of the outcome of a derivative action, would be acting vexatiously.⁶²

In *Lewis Group Ltd v Woollam*, the court said that the provisions of subsection 3, which expressly and emphatically limit the bases upon which a company can have a demand set aside, appear to have been inspired by the jurisprudence in respect of section 266(3) of the 1973 Act. The court then held that an application for the appointment of a provisional curator *ad litem* to investigate a demand made in terms of section 266(2) would be refused if the company showed that the demand was without merit, or frivolous and vexatious.⁶³

Section 165 does not indicate how detailed the demand should be or the extent of the information it should contain. Cassim submits that because the demand is to afford the company the opportunity to reconsider the conduct complained of and the opportunity to take proper remedial action, the demand should be specific enough to enlighten the company of the legal proceedings contemplated against it and the grounds for such proceedings. This will enable the company properly to consider the conduct complained of and what action to take.⁶⁴ It is submitted that this is the correct approach as it would be too onerous to expect the complainant to draft a demand in detail and with many technicalities as such persons are often already faced with the prospect of lack of information, resources and evidence. It must also be

⁵⁸ 1954 (1) SA 72 (W) 74.

⁵⁹ See *Bisset v Boland Bank Ltd* 1991 (4) SA 603 (D); *LD v Technology Corporate Management (Pty) Ltd*; *SD v LD* [2018] ZAGPJHC 69 par 29 (in respect of s 163); *S v Cooper supra*; *Argus Printing & Publishing Co Ltd v Anastassiades* 1954 (1) SA 72 (W) 74.

⁶⁰ S 165(3) of the 2008 Act.

⁶¹ *Amdocs SA Joint Enterprise (Pty) Ltd v Kwezi Technologies supra* par 14 and 15; *Mbethe v United Manganese of Kalahari (Pty) Ltd* (High Court judgment) *supra* par 161; confirmed on appeal: *Mbethe v United Manganese of Kalahari (Pty)* (SCA judgment) *supra*.

⁶² *Lewis Group Ltd v Woollam supra* par 47–52; *Delpont Henochsberg on the Companies Act 2008* 595.

⁶³ *Lewis Group Ltd v Woollam supra* par 92; see also *Van Zyl v Loucol (Pty) Ltd* [1985] 1 All SA 263 (T), 1985 (2) SA 680 (NC) 685GI and *Thurgood v Dirk Kruger Traders (Pty) Ltd* [1990] 3 All SA 668 (E), 1990 (2) SA 44 (E) 49–50; *Delpont Henochsberg on the Companies Act 2008* 595.

⁶⁴ Cassim *The New Derivative Action under the Companies Act 17*.

borne in mind that information relating to the affairs of the company may be within the control of the wrongdoers of the company and may not be accessible by the complainant.

2.5 The company's response/reaction to the demand

The relevant section provides that if the company does not make an application to set aside the demand or if the court itself does not set aside the demand, or if the demand is not subsequently withdrawn, the company is obliged to appoint an independent and impartial person or committee to investigate the demand.⁶⁵ The investigator is obliged to report to the board of directors on any facts or circumstances that may lead to a cause of action as contemplated in the demand or that may relate to proceedings contemplated in the demand.⁶⁶

The position was different under section 266 of the 1973 Act, in terms of which the complainant would serve a notice on the company to initiate proceedings⁶⁷ and if the company did not do so within a month, the complainant would bring an application for the appointment of a (provisional) curator *ad litem* to institute proceedings on behalf of the company. The court, in terms of section 266 and subject to certain requirements, was able to authorise an investigation into the grounds of the application and the desirability of the institution of proceedings. The court was empowered to appoint a curator *ad litem* to investigate the grounds of the application and report to the court on the return date. The investigation that the provisional curator *ad litem* may be called upon to undertake is an investigation solely of the grounds described by the applicant in its application, not those in the notice under section 266(2)(a).⁶⁸

The powers given to a curator under section 266 were advanced in the application itself that set out the basis for a *prima facie* case for the appointment of a curator and therefore the ambit of the mandate given to the curator by the court was confined to those grounds. The investigation by the curator was not a general investigation of the company's affairs but an enquiry to assist an aggrieved shareholder by means that supplement the shareholder's common-law rights.⁶⁹

In *Ghersi v Tiber Developments (Pty) Ltd*, the court held that although the order appointing the provisional curator must be interpreted as being limited to this purpose,

“form should not be allowed to defeat the purpose of the section. It is conceivable that a court might be satisfied that the company would not

⁶⁵ S 165(4)(a) of the 2008 Act; see *Caxton and CTP Publishers and Printers Limited v Novus Holdings Limited* (Case no 219/2021) [2022] ZASCA 24 (09 March 2022) par 60.

⁶⁶ S 165(4)(a)(i) of the 2008 Act.

⁶⁷ S 266(2)(a) of the 1973 Act.

⁶⁸ *Ghersi v Tiber Developments (Pty) Ltd* [2007] 4 All SA 847 (SCA), 2007 (4) SA 536 (SCA) par 4.

⁶⁹ *Loeve v Loeve Building and Civil Engineering Contractors (Pty) Ltd* 1987 (2) SA 92 (D) 102 per Booysen J; see also *Brown v Nanco (Pty) Ltd* [1976] 1 All SA 548 (W), 1976 (3) SA 832 (W) 834; *Thurgood v Dirk Kruger Traders (Pty) Ltd supra* 52–53; *Delpont Henochsberg on the Companies Act 2008* 595.

institute proceedings even if given the statutory notice, that the new grounds not specified in the order appointing the provisional curator had been adequately investigated and that the institution of proceedings on those grounds would be desirable. In such a case a court could, at the instance of a shareholder, legitimately confirm the appointment of the provisional curator to enable the latter to institute action based on such grounds. The alternative would be for the court to require formal compliance with the requirements of section 266 (2) and (3) – a hollow exercise if the resultant confirmation would be a foregone conclusion.”⁷⁰

Delpoit in *Henochsberg* submits that based on these principles, if an investigator or committee’s investigation reveals other instances where the company’s legal interests must be protected, this must also be addressed in the report to the board of directors and should not be limited to those contemplated in the demand.⁷¹ It is respectfully submitted that this is the correct position; the most important aspect is to protect the company’s interests and, if there are grounds that exist where the company has suffered wrongful actions, then this must be investigated and pursued. Simply limiting the report to issues raised in the demand, if it is submitted, is not in keeping with the overriding purpose of the provision.

It is the responsibility of the impartial person or committee to report to the board on the probable costs⁷² involved and whether it appears in the company’s best interests to bring or to continue any action or proceedings.⁷³ The inclusion of the word “appears” in the section seems to convey that the impartial person or committee need only put forward a *prima facie* case and that a definitive or concrete finding on whether the initiation or continuation of the proceedings will be in the best interests of the company is not necessary. The major difference between section 165 and its predecessor is that under section 266 the court becomes involved at an earlier stage in terms of the provision for an application to be made for the court to appoint a provisional curator *ad litem* to conduct the investigation. The provisional curator was appointed by the court, and therefore was obliged to report back to the court. Under section 266, it was the curator who had the responsibility for conducting the derivative proceedings on behalf of the company, whereas, under section 165, there is an effort to ease the burden on the courts. The involvement by a court occurs at a later stage, only after the investigation of the demand. Under section 165, the investigator is appointed by the company and his or her report is presented to the board of directors. Presenting the report to the board of directors and not to the court is problematic and is addressed at a later stage in this article. The derivative proceedings under section 165 are conducted by the minority shareholder or other applicants who have been granted permission by the court to do so.⁷⁴

⁷⁰ *Ghersi v Tiber Developments (Pty) Ltd supra* par 4.

⁷¹ S 165(4)(a)(i) of the 2008 Act.

⁷² S 165(4) (a)(ii) of the 2008 Act.

⁷³ S 165(4) (a)(iii) of the 2008 Act.

⁷⁴ Cassim *The New Derivative Action under the Companies Act 20*; see Coetzee 2010 *Acta Juridica* 299; Mongalo (ed) *Modern Company Law Reform for a Competitive South African Economy* (2010) 290, 303. See generally Du Plessis “Revisiting the Judge-Made Rule of Non-Interference in Internal Company Matters” 2010 127 *South African Law Journal* 304, especially 319ff; Du Plessis “Open Sea or Safe Harbour? American, Australian and South

2 6 Application to court to bring or continue proceedings

Within 60 business days after being served with the demand, or within a longer time as the court (on application by the company) may allow, the company must either initiate or continue legal proceedings⁷⁵ or take related legal steps to protect the legal interests of the company, or serve a notice on the person who made the demand, refusing to comply with it – a so-called “refusal notice”.⁷⁶ According to Delport, the issuing of the “refusal notice” could have the effect that subsection 4(b) can be bypassed by this action, thereby also making subsection 3 superfluous.⁷⁷ But it is respectfully submitted that the use of the conjunctive “and” between subsections 4(a) and 4(b), and both prefaced by “must”, would tend to indicate the opposite.⁷⁸ In *Mouritzen*, an email by a director in a representative capacity for the company was also found, *inter alia* owing to the context and tone of the response, to be a notice of refusal by the company to comply with the demand in terms of subsection 4(b)(ii).⁷⁹

The demand may also be withdrawn by the person who initially served the demand. The effect of the withdrawal of a demand would render the institution or continuance of proceedings unnecessary, thereby saving the company unnecessary costs, and would render the procurement or continuance of an independent investigation in terms of subsection 4 unnecessary.⁸⁰

The person who has made a demand may apply to the court for leave to bring or continue proceedings in the name and on behalf of the company if the company has failed to take any particular step required⁸¹ – for example: if it has appointed an investigator or committee who was not independent and impartial; if the company accepted a report that was clearly inadequate in its preparation; if the report was irrational or unreasonable in its conclusions or recommendations; if the company acted in a manner that was wholly inconsistent with the reasonable report of an independent, impartial investigator or committee; or if the company has served a refusal notice.⁸²

These procedural requirements are disjunctive, and failure to comply with any of them will give the person who made the demand the right to apply to court.⁸³ Binns-Ward J stated in *Lewis Group Ltd v Woollam* that the anomaly

African Business Judgment Rules Compared” Part 1 2011 32 *Company Lawyer* 347–352; and Part 2 2011 32 *Company Lawyer* 377–383.

⁷⁵ S 165(4)(b)(ii) of the 2008 Act.

⁷⁶ *Ibid.*

⁷⁷ *Amdocs SA Joint Enterprise (Pty) Ltd v Kwezi Technologies (Pty) Ltd supra* par 6; see also *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 25.

⁷⁸ Delport *Henochsberg on the Companies Act 2008* 595.

⁷⁹ *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 34.

⁸⁰ In terms of s 165(3) and (4) of the 2008 Act; see also *Lewis Group Ltd v Woollam supra* par 9.

⁸¹ S 165(4) of the 2008 Act.

⁸² S 165(5)(a) of the 2008 Act.

⁸³ See s 165(5) of the 2008 Act; see also *Mbethe v United Manganese of Kalahari (Pty) Ltd* (High Court judgment) *supra* par 45; confirmed on appeal: *Mbethe v United Manganese of*

that a company will often be unable in an application in terms of section 165(3) to see off derivative proceedings on the basis that the complainant will not be able to satisfy the requirements of section 165(5) appears to be the result of an “awkward cobbling together in section 165 of the 2008 Act of various concepts and procedures lifted from quite disparate preceding local and foreign legislation”, and may it be said, from the common law.⁸⁴

According to Cassim, the requirement that no derivative action should be permitted unless the board of directors is made aware of the complaint, and they have either refused to protect the company’s interests or are unlikely to properly and diligently protect the interests of the company, is included to ensure that the power and authority of the board of directors to manage the affairs of the company is not flouted and undermined.⁸⁵

3 THE APPROACH UNDER THE COMPANIES ACT 2006 IN THE UNITED KINGDOM

In the UK, the section dealing with the new statutory derivative action was implemented in October 2007. According to the 2006 Act, the procedure for all derivative claims is regulated in terms of Part 11, Chapter 1 of the Act or in terms of an order of court under section 996(2)(c) of the 2006 Act. Section 996(2)(c) deals specifically with unfair prejudice claims. Although reference is made to section 996(2)(c) and unfair prejudice claims during the discussion that follows, the cases and principles dealing with unfair prejudice claims are beyond the scope of this article.

3.1 Legal standing

Section 260(1) of the 2006 Act provides *locus standi* to initiate derivative proceedings only to members of the company. A former member (shareholder) of the company cannot initiate such an action even if the issue complained of occurred during his or her membership.⁸⁶ A “member” is defined as including a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law⁸⁷ – that is, a personal representative of a deceased member or the trustee of an insolvent member.⁸⁸ According to section 260 of the 2006 Act, a member of the company could bring a derivative action where the alleged wrongdoing

Kalahari (Pty) Ltd (SCA judgment) *supra*; see also *Remgro Limited v Unilever South Africa Holdings (Pty) Limited* *supra* par 30.

⁸⁴ *Lewis Group Ltd v Woollam* *supra* par 92.

⁸⁵ Cassim *The New Derivative Action under the Companies Act* 21.

⁸⁶ S 260 of the 2006 Act; see also Chen *A Comparative Study of Funding Shareholder Litigation* (2017) 32–33.

⁸⁷ S 260(5)(c) of the 2006 Act.

⁸⁸ Kay, Sime and French (eds) *Blackstone’s Civil Practice* 6ed (2017) 269; Safari *Reconsidering the Role of the Derivative Claim in the United Kingdom: A Comparative Study with the United States and New Zealand* (unpublished doctoral thesis, University of London) 2018 <http://openaccess.city.ac.uk/20130/> 77; see also Davies *Gower & Davies, Principles of Modern Company Law* 8ed (2008) 655.

arose before he enters into the company.⁸⁹

Sealy has described the UK courts' approach to minority shareholders' litigation as hostile. Sealy opined that the UK courts were too quick to deny a shareholder legal standing to sue on the basis that the wrong that gave rise to the cause of action was a wrong to the company rather than a wrong to the shareholder personally.⁹⁰ According to Keay, more recent case law does not demonstrate a similar approach to that described by Sealy and Sealy's criticism applies to the courts' approach to shareholders' personal actions rather than derivative claims.⁹¹ According to Boyle, the hostility of UK courts towards shareholder applicants did exist but the attitude of the court depends on the nature and size of the company. Boyle acknowledges that derivative claims are used in private companies but that the courts in the UK are less favourably disposed towards applicants who are shareholders in public companies.⁹²

The 2006 Act limits the institution of a derivative claim only to shareholders of the company. It is submitted that it would have been more appropriate for the 2006 Act to provide for a much broader range of persons who would be able to institute derivative proceedings. Dean opines:

"There seems to be no *a priori* reason why others [besides shareholders] should not enjoy similar access to the courts to protect the company from harm, under a regime of judicial supervision similar to that envisaged to 'manage' shareholder actions."⁹³

Furthermore, the argument that the 2006 Act should provide for a wider range of applicants is enhanced by the fact that shareholders are often regarded as not being the most competent observers of the company's affairs. If this be the case, the Act ought to permit other interested parties to initiate derivative proceedings. Shareholders are more likely to act when a matter involves their own personal interests and are always wary of the potential risks or benefits that may result from their actions. This preservation of self-interest and lack of awareness of company affairs decreases the likelihood of the interests of the company being adequately protected.⁹⁴ A serious effort to protect the interests of the company would entail the 2006 Act permitting any person who has a legitimate interest in the financial affairs of the company to institute derivative proceedings. This would enable a wider range of applicants to institute derivative proceedings to protect the company's interests. Persons other than shareholders may be

⁸⁹ S 260(4) of the 2006 Act.

⁹⁰ Sealy "The Rule in *Foss v Harbottle*: The Australian Experience" 1989 10 *Company Law* 54; Sealy "Problems of Standing, Pleading and Proof in Corporate Litigation" in Pettet (ed) *Company Law in Change, Current Legal Problems* (1987) 12.

⁹¹ Keay and Loughrey "Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006" 2008 124 *Law Quarterly Review* 473.

⁹² Boyle *Minority Shareholders' Remedies* (2002) 24; Keay and Loughrey 2008 *Law Quarterly Review* 474.

⁹³ Dean *Directing Company Law & The Stakeholder Society: Company Law and the Stakeholder Society Public Companies* (2001) 155; Keay "Assessing and Rethinking the Statutory Scheme for Derivative Actions Under the Companies Act 2006" 2016 16 *Journal of Corporate Law Studies* 39.

⁹⁴ Keay 2016 *Journal of Corporate Law Studies* 11.

privity to certain information or conduct that allows the individual or individuals to institute a meaningful derivative claim.⁹⁵ There has been concern that expanding the range of applicants who could institute a derivative claim would result in uncertainty as well as potentially open the floodgates to derivative litigation.⁹⁶ It is respectfully submitted that widening the range of applicants to institute a derivative action does not create uncertainty but rather provides more credibility to the derivative action, as there is a greater emphasis on the protection of company interests. Wrongdoers will be less likely to commit wrongful actions against the company if they are aware that there are a variety of applicants who may be able to step in to protect the company's interests. The possibility of uncertainty does not arise, as all applicants will be subjected to the same requirements and provisions of the Act, which are intended to prevent frivolous or vexatious claims. It is submitted that widening the range of applicants does create the possibility of an increase in derivative claims, but this should be seen in a positive light, as jurisprudence in the area will be enhanced, which allows the court to provide more certainty and clarity in interpreting the provisions in the Act. The experience in other jurisdictions such as Canada⁹⁷ and Singapore⁹⁸ provides for a much broader range of applicants and shows that the floodgates argument has been exaggerated in that the procedure for granting permission to bring proceedings has successfully prevented frivolous claims.⁹⁹

The 2006 Act in its current form does not cater for what has been referred to as “multiple derivative actions” (sometimes referred to as “double derivative actions”).¹⁰⁰ A multiple derivative action is a derivative action that can be brought by minority shareholders of a holding company for a breach of duty or wrongful conduct that has been perpetrated in the subsidiary company.¹⁰¹ Multiple derivative claims have been recognised in the common

⁹⁵ *Ibid.*

⁹⁶ Keay 2016 *Journal of Corporate Law Studies* 10–11.

⁹⁷ S 238 of the Canada Business Corporations Act 1985 includes members, certain creditors, and directors, and also applications may be made by “any other person who, in the discretion of a court, is a proper person to make an application”.

⁹⁸ S 216A(1)(c) of the Singaporean Companies Act provides that the range of persons who can apply for a derivative action includes “any other person who, in the discretion of the Court, is a proper person”.

⁹⁹ Keay 2016 *Journal of Corporate Law Studies* 12; see also Ramsay and Saunders “Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action” 2006 6 *Journal of Corporate Law Studies* 397; Leung “The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime That Recognizes Non-Shareholder Interests” 1997 30 *Columbia Journal of Law and Social Problems* 589 and 625.

¹⁰⁰ Goo “Multiple Derivative Action and Common Law Derivative Action Revisited: A Tale of Two Jurisdictions” 2010 10 *Journal of Corporate Law Studies* 255; Mascarenhas “Multiple Derivative Actions Under English Law” 2013 24 *International Company and Commercial Law Review* 336; Keay *Directors' Duties* (2014) 465–468. See the judgment of Lord Millett in the Hong Kong case of *Waddington Ltd v Chan Chun Hoo Thomas* [2008] HKCFA 63; (2008) 11 HKCFAR 370; [2009] 4 HKC 381; [2009] 2 BCLC 82.

¹⁰¹ Keay 2016 *Journal of Corporate Law Studies* 13; Goo 2010 *Journal of Corporate Law Studies* 255; Mascarenhas 2013 *International Company and Commercial Law Review* 336.

law but are not catered for in the 2006 Act.¹⁰² It is submitted that the 2006 Act should be amended to permit multiple derivative claims under the statutory derivative procedure. This will broaden the range of applicants who are able to institute derivative claims by permitting shareholders in a holding company (who clearly have an interest in the subsidiary) to bring derivative claims to protect the interests of the subsidiary company and *vice versa*.¹⁰³

The UK approach to legal standing is far more limited than the position in South Africa. Besides shareholders, section 165(2) of the 2008 Act allows directors, prescribed officers, trade unions representing employees as well as other employee representatives to institute derivative proceedings on behalf of the company.¹⁰⁴ The section also grants legal standing to shareholders, directors and prescribed officers in “related companies”. The phrase “related companies” includes holding and subsidiary company relationships as well as the direct or indirect control by one company over the other or the business of the other.¹⁰⁵

3 2 Cause of action

The 2006 Act has broadened the cause of action upon which a derivative claim can be instituted.¹⁰⁶ The institution of a derivative claim is no longer limited by a requirement to show that there is proof of fraud on the minority or that the wrongdoers are in control of the company. Currently, under the 2006 Act, a derivative claim may be instituted in response to actions of the directors such as an act or omission that involves negligence, default, breach of duty or breach of trust by a director, former director or shadow director of the company.¹⁰⁷

According to Safari, the intention behind the extension of the derivative claims to include negligence was the protection of investors who, while willingly taking the risk of investing in companies, are not obliged to accept the wrongful conduct of those who manage the affairs of the company – that is, directors failing to act in accordance with their directors’ duties.¹⁰⁸ The cause of action could be the conduct of a director or another person or both,¹⁰⁹ and could have arisen before the claimant became a member of the company.¹¹⁰

¹⁰² *Wilton UK Ltd v Shuttleworth* [2017] EWHC 2195 (Ch) 28; see also *Universal Project Management Services Ltd v Fort Gilkicker Ltd* [2013] EWHC 348 (Ch); [2013] Ch 551; *Abouraya v Sigmund* [2014] EWHC 277 (Ch); [2015] BCC 503.

¹⁰³ Keay 2016 *Journal of Corporate Law Studies* 13.

¹⁰⁴ Cassim *The New Derivative Action Under the Companies Act* 15; s 165(2) of the 2008 Act.

¹⁰⁵ *Ibid.*

¹⁰⁶ At common law an action for negligence could only be brought where the negligence involved bad faith or was self-serving. See *Pavlides v Jensen* [1965] Ch 565; *Daniels v Daniels* [1978] Ch 406.

¹⁰⁷ S 260(3) and (5)(a) and (b); see also *Lesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch); [2010] BCC 420 75; Keay 2016 *Journal of Corporate Law Studies* 14.

¹⁰⁸ S 260(3) and 5(a) and (b) of the 2006 Act; Safari *Reconsidering the Role of the Derivative Claim in the United Kingdom. A Comparative Study with the United States and New Zealand* <http://openaccess.city.ac.uk/20130/77>.

¹⁰⁹ S 260(3) of the 2006 Act.

¹¹⁰ S 260(4) of the 2006 Act.

Despite this broadening of the cause of action for a derivative action, it is submitted that the current regime still leaves much to be desired. The 2006 Act fails to take into account that applicants will not be able to act against wrongful conduct that is independent of the actions of directors. Furthermore, the 2006 Act fails to consider the possibility that any act of negligence on the part of a director may go unpunished because the court will be reluctant to question business decisions taken by directors. There is also the potential for the board of directors to scupper any potential derivative claim from proceeding against a third party in instances where the third party has close ties with the board or any individual director in the company.

South African legislation does not provide any limit and does not specify the causes of action that may be the subject of derivative proceedings. Section 165 provides that the statutory derivative action may be initiated to protect the legal interests of a company. The derivative provisions contained in section 165 are wider than those in the 2006 Act and therefore provide greater scope for applicants to institute a derivative claim.¹¹¹

4 CONCLUSION AND RECOMMENDATIONS

Under the 2008 Act, *locus standi* or legal standing is granted to shareholders, directors and prescribed officers of the company in question as well as to “related companies”.¹¹² Section 165 of the 2008 Act also grants legal standing to a third category of applicants, namely trade unions representing employees of the company and other employee representatives.¹¹³ The derivative action under the 2008 Act is available to a much wider range of applicants when compared to its predecessor, section 266 of the 1973 Act. Under section 266, only shareholders were able to initiate a derivative action. In the UK, the 2006 Act restricts derivative claims in that they may be brought only by members (shareholders) directly concerned. The approach to legal standing under section 266 of the 1973 Act and under the 2006 Act is thus far more limited than under the 2008 Act. Section 165(2) of the 2008 Act, in broadening the scope of legal standing to persons other than shareholders, recognises the reality that a shareholder may not always be the most suitable person to institute derivative proceedings. Shareholders may not have access to all the relevant information that relates to the wrongdoing in question. Furthermore, shareholders often act in their own personal interests and will be reluctant to institute action to protect the interests of the company. The inclusion in the 2008 Act of a wider range of applicants is commendable, not only because it would allow for a greater scope of derivative claims to be brought to the courts, thereby increasing the jurisprudence in the area, but it also recognises that persons other than shareholders may be privy to information that places them in the best position to institute derivative proceedings to protect the interests of the company. The wider range of applicants provided

¹¹¹ Coetzee 2010 *Acta Juridica* 299.

¹¹² S 165(2) of the 2008 Act.

¹¹³ *Ibid.*

for in the 2008 Act allows the courts to provide greater clarity and certainty regarding the provisions in section 165; and it provides more credibility to the derivative proceedings, which are aimed at protecting the interests of the company and simultaneously at ensuring high-quality corporate governance. The 2008 Act, in widening the scope of applicants, also serves as a deterrent factor to potential wrongdoers as there are a number of different applicants in various spheres in the company who are able to institute derivative proceedings.

The term “related company” includes a holding and subsidiary company relationship as well as the direct or indirect control by one company over the other or the business of the other.¹¹⁴ The inclusion of the term “related company” recognises the reality that shareholders or directors of a holding company may, in certain circumstances, have a legitimate interest in initiating a derivative action to prevent harm to the subsidiary company perpetrated by those in control of the subsidiary company.¹¹⁵ The 2006 Act does not grant legal standing to persons in “related companies” and does not provide for multiple derivative actions.¹¹⁶ The failure of the 2006 Act to grant legal standing to shareholders in holding companies for the institution of a derivative action in relation to subsidiary companies is a failure to recognise the financial interests as well as associated reputational interests that shareholders in a holding company have in a subsidiary company or *vice versa*. Under section 165 of the 2008 Act, only current shareholders and directors are included as potential applicants. This is a major shortfall under the 2008 Act. By preventing former shareholders from instituting a derivative action in instances where they were in the company when the wrongful actions were perpetrated fails to recognise the harm that these former shareholders may have suffered indirectly (such as a decrease in the value of their shares) when the wrongful actions were perpetrated against the company. It is submitted that these former shareholders should be able to recover any loss they have suffered. Section 1 of the 2008 Act defines a shareholder as the “holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be”. In light of this definition, a registered shareholder will qualify under the 2008 Act as a shareholder, as will those persons entitled to be registered shareholders and persons to whom shares have been transferred without the share transfer having been entered in the securities register.¹¹⁷ The implication is that new shareholders who were not in the company when the wrongful actions were perpetrated will be able to institute a derivative claim and may therefore benefit indirectly from any award recovered by the company. A similar approach is adopted in the UK. Section 260 of the 2006 Act includes only current shareholders in the pool of potential applicants.

It is therefore recommended that section 165(2) of the 2008 Act be

¹¹⁴ Cassim *The New Derivative Action Under the Companies Act* 15; see also Cassim in FHI Cassim *et al Contemporary Company Law* 779.

¹¹⁵ *Ibid.*

¹¹⁶ *Wilton UK Ltd v Shuttleworth supra* 28; see also *Universal Project Management Services Ltd v Fort Gilkicker Ltd supra*; *Abouraya v Sigmund supra*; see also Keay 2016 *Journal of Corporate Law Studies* 12–13.

¹¹⁷ Cassim *The New Derivative Action Under the Companies Act* 14; Cassim in FHI Cassim *et al Contemporary Company Law* 779.

amended such that former shareholders are granted legal standing to institute a derivative action to ensure that these shareholders can recover any indirect benefit that they had lost while they were shareholders in the company. Although any award in a successful derivative action will be made to the company, it is submitted that these former shareholders should be entitled to an amount that constitutes the difference in the value of their shares when the wrongful actions were committed and the value of the shares once an award is made to the company. The current shareholders therefore would be liable to the former shareholders for this amount. The failure of the current shareholders to compensate the former shareholders could make them liable to the former shareholders for a claim of unjustified enrichment.

The amended section 165(2) should read as follows:

“A person must serve a demand upon a company to commence or continue legal proceedings, or take related steps, to protect the legal interests of the company if the person—

- a) is a shareholder, former shareholder or a person entitled to be registered as a shareholder, of the company or of a related company;
- b) is a director, or prescribed officer of the company or of a related company;
- c) is a registered trade union that represents employees of the company, or another representative of employees of the company; or
- d) has been granted leave of the court to do so, which may be granted only if the court is satisfied that it is necessary or expedient to do so to protect a legal right of that other person.”

Section 266 under the 1973 Act was limited in that it could only be used where the company suffered a loss as a result of any wrong, breach of trust or breach of faith committed by a director or officer of the company.¹¹⁸ Section 260 under the 2006 Act in the UK has broadened the grounds upon which a derivative claim may be instituted.¹¹⁹ In the UK, the institution of a derivative claim is no longer limited by the need to prove that fraud on the minority was perpetrated or that the wrongdoers are in control of the company. The 2006 Act provides that a derivative claim may be instituted in response to actions of the directors such as an act or omission that involves negligence, default, breach of duty or breach of trust by a director, former director or shadow director of the company.¹²⁰ However, the 2006 Act fails to take into account that applicants will not be able to take action against wrongful conduct that is independent of the actions of directors. Furthermore, the 2006 Act fails to consider the possibility that any act of negligence on the part of a director may go unpunished because a court

¹¹⁸ S 266(1) of the 1973 Act.

¹¹⁹ At common law, an action for negligence could only be brought where the negligence involved bad faith or was self-serving. See *Pavrides v Jensen supra*; *Daniels v Daniels supra*.

¹²⁰ S 260(3) and (5)(a) and (b) of the 2006 Act; see also *Lesini v Westrip Holdings Ltd supra* 75; see Keay 2008 *Law Quarterly Review* 469.

may be reluctant to question business decisions taken by directors. There is also the possibility that the board of directors may sabotage any potential derivative claim from proceeding against a third party in instances where the third party has a close relationship with the board or any individual director in the company. Section 165 provides that the statutory derivative action may be used to protect the interests of the company. The 2008 Act does not specify the causes of action for which the derivative action is suitable, but provides a wide description that allows use of the action to protect the legal interests of the company.¹²¹ The protection of the company's interests as the ground for instituting a derivative action is a wider ground than was provided for under section 266 of the 1973 Act, which limited the causes of action to instances of delict, breach of trust or breach of faith by a director or officer of the company;¹²² it is also a wider ground than allowed for under section 260 of the UK Act, which is more restrictive in that it only allows breaches of directors' duties to form the basis for an application.¹²³

The protection of the interests of the company as a ground to institute derivative proceedings is commendable and a positive innovation under section 165. The term "legal interest" is not defined in the 2008 Act and therefore the term may be given a wide interpretation and it extends further than the protection of the company's legal rights. Therefore, the institution of derivative proceedings under section 165 is not limited to a specific type of legal interest or any specific cause of action. In this way, the Act has created further scope for the institution of derivative proceedings for wrongdoing perpetrated against the company. Wrongdoers will be less likely to evade responsibility, as the cause of action is not based solely on instances where a wrongdoing, breach of trust or breach of faith is committed by directors or officers in the company.¹²⁴

It is submitted that section 165 under the 2008 Act does not provide clear requirements and guidance as to the content of the mandatory demand. In terms of the Companies Regulations, the demand must comply with a standard prescribed form to be used for the purposes of the derivative action. The form in question requires the person making the demand to "attach a statement of particulars, setting out the legal action [he/she] require[s] the company to take".¹²⁵ The failure of the section to clearly provide what details the applicant is required to set out in the demand could lead to lengthy mini-trials in which the applicant attempts to convince the court that the demand has merit and is not frivolous or vexatious. A lack of adequate details in the prescribed form may lead to the demand being set aside for being vague and lacking in clarity. It is submitted that section 165

¹²¹ Coetzee 2010 *Acta Juridica* 299.

¹²² *Ibid.*

¹²³ S 260(5) of the 2006 Act.

¹²⁴ Cassim in FHI Cassim *et al Contemporary Company Law* 781.

¹²⁵ Regulation 36(1) requires a Form CoR 36.1 to be used for this purpose. This is a standard form used to notify the company of matters in terms of other sections of the Act as well – namely, ss 37, 39 and 115 of the 2008 Act. See also s 6(8) of the 2008 Act, which provides: "If a form of document, record, statement or notice is prescribed in terms of this Act for any purpose, - (a) it is sufficient if the person required to prepare or complete such a document, record, statement or notice does so in a form that satisfies all of the substantive requirements of the prescribed form."

should have set out further guidelines and requirements as to what should be included in the demand.

Section 266 of the 1973 Act did not specifically require the notice to give the amount to be claimed or a precise description of the circumstances giving rise to the loss in a derivative claim. The notice under section 266 did, however, specify enough to enable the company to know what proceedings it was being called upon to institute. It is submitted that a similar principle be applied under section 165 to provide further clarity regarding a description of the alleged wrongdoing, the potential risk facing the company because of the alleged wrongdoing and the potential costs involved in the derivative proceedings.

The UK's 2006 Act does not require a demand to be made by the applicant. Section 261 of the 2006 Act does require the court to apply a *prima facie* test during the first stage of the proceedings to determine whether to grant the applicant permission to institute derivative proceedings.¹²⁶ Only once the court is satisfied that the applicant has made a *prima facie* case in terms of section 261(2) will the company be called upon to provide evidence in terms of section 261(3)(a). However, the application of the *prima facie* test in the UK courts has been less than decisive and has resulted in uncertainty. It is submitted that the lack of clarity and certainty by the courts in the interpretation of the *prima facie* requirement is a serious disadvantage to prospective applicants who wish to institute derivative proceedings. It would therefore be unwise for SA courts to seek guidance from the UK application of the *prima facie* test under section 261 in deciding how an applicant under section 165 should go about drafting the demand and the necessary details therein.

It is submitted that the requirement of a demand coupled with the other substantive procedures under section 165 does have the potential of prolonging the derivative proceedings and thereby increasing costs for the company and the applicant. It is submitted further that the requirement that a demand be made by the applicant also has the potential for an increase in negative publicity for the company and could have the effect of destabilising the business affairs of the company. The UK model may be seen to be a better approach in this respect; although there has been a lack of clarity by the courts in interpreting the *prima facie* case, there is no requirement that a demand be made by the applicant and therefore this reduces the potential for time-consuming and costly derivative proceedings.

The 2008 Act allows for an applicant to be excused from making a demand in exceptional circumstances.¹²⁷ However, the applicant is required to apply to court to be excused from making the demand. It is submitted that this process also has the potential to increase costs and cause further delays – not only for the company, but for the applicant as well. In order to provide for an effective procedure for applicants to institute derivative proceedings, it is submitted that demand procedures may have to be done away with. But in the absence of such a severe excision, it is submitted that

¹²⁶ Civil Procedure Rules 1998 (SI 1998/3132) R.19.9; s 261 of the 2006 Act.

¹²⁷ S 165(6) of the 2008 Act.

an amendment to the section is necessary in order to provide for an effective derivative action procedure that protects the interests of the company and does not frustrate potential applicants.

It is accordingly submitted that section 165 should prescribe further requirements and guidelines for the wording of a demand. An amendment to the section may be necessary to provide that the applicant sets out fairly and clearly who the wrongdoers are, what the facts are that gave rise to the wrongdoing and what harm the company could potentially suffer. The demand should set the framework for a potentially costly independent investigation. The purpose of the investigation is not to ascertain whether a case might be found, but is to investigate the merits of the case and the viability of the company pursuing that case, and not possible incidental bases for other claims.¹²⁸ Such an amendment will provide further guidance to the potential applicant as to whether the derivative action is worth pursuing and will also provide the court with greater insight into whether there is enough scope to grant leave to institute derivative proceedings. It is submitted that such an amendment will reduce the costs and time involved in the initial stage of the derivative action and may have the effect of preventing frivolous and vexatious claims.

It is submitted further that the use of the word “may” in section 165(2) when referring to the service of the demand creates a lack of certainty as to whether the service of the demand is compulsory or discretionary. The court in *Mouritzen* indicated that the use of the word “may” in the section is considered to indicate a mandatory precondition of service of the demand as a precondition for a derivative action.¹²⁹ This decision, in the author’s view, is correct. However, it is submitted that an amendment to the section indicating that service of the demand is compulsory would provide greater clarity and certainty to potential applicants.

It is therefore recommended that section 165(2) should be amended to ensure that applicants be given further guidance as to what information may be set out in a demand and further that the section should indicate that the service of the demand is compulsory. The amended section 165 should read as follows:

- “(2) Prior to an application in terms of subsection (5), the applicant must have served a demand upon a company to commence or continue legal proceedings, or take related steps, to protect the legal interests of the company provided that a person shall not serve such demand unless the person—
- a) is a shareholder, former shareholder, or a person entitled to be registered as a shareholder, of the company or of a related company;
 - b) is a director or prescribed officer of the company or of a related company;

¹²⁸ *Lewis Group Ltd v Woollam supra* par 56; Delpont *Henochsberg on the Companies Act 2008* 594.

¹²⁹ Cassim *The New Derivative Action Under the Companies Act 156*; see also Cassim in FHI Cassim *et al Contemporary Company Law 779*; *Mouritzen v Greystone Enterprises (Pty) Ltd supra* par 24.

- c) is a registered trade union that represents employees of the company, or another representative of employees of the company; or
- d) has been granted leave of the court to do so, which may be granted only if the court is satisfied that it is necessary or expedient to do so to protect a legal right of that other person.

(2A) The demand contemplated in subsection (2) above should set out the following—

- (i) who the alleged wrongdoers are;
- (ii) the facts that gave rise to the wrongdoing;
- (iii) the potential harm that the company could suffer if the demand is not granted; and
- (iv) the potential costs in the derivative litigation proceedings.”

Section 165(3) of the 2008 Act provides that a company that has been served with a demand may apply to a court within 15 business days to set aside the demand claiming it is frivolous, vexatious or without merit. In cases where the company does not make an application to have the letter of demand set aside or where the court does not set it aside, the company must appoint an independent and impartial person or committee to investigate the demand.¹³⁰ The independent or impartial person is obliged to report to the board of directors on any facts or circumstances that may lead to a cause of action as contemplated in the demand or that may relate to proceedings contemplated in the demand.¹³¹ In addition, the company must within 60 business days after being served with the demand either initiate or continue legal proceedings,¹³² or take related legal steps¹³³ to protect the legal interests of the company, or serve a refusal notice.¹³⁴ The inclusion of these time frames in the 2008 Act is commendable as it prevents unreasonable delays on the part of the company. The company and those in control of the company are forced to take steps either to set aside the demand or to take steps to protect the company. The demand issued by the applicant cannot simply be ignored, as the time frames require a reaction by the company; in this way, the alleged wrongdoing does not go unnoticed.

Under section 266 of the 1973 Act, the complainant was required to serve a notice on the company to initiate proceedings¹³⁵ and if the company did not do so within a month, the complainant would bring an application for the appointment of a (provisional) curator *ad litem* to institute proceedings on behalf of the company.¹³⁶ The court was empowered under section 266 to authorise an investigation into the grounds of the application and the

¹³⁰ S 165(4)(a) of the 2008 Act.

¹³¹ S 165(4)(a)(i) of the 2008 Act.

¹³² S 165(4)(b)(i) of the 2008 Act.

¹³³ *Ibid.*

¹³⁴ S 165(4)(b)(ii) of the 2008 Act.

¹³⁵ S 266(2)(a) of the 1973 Act.

¹³⁶ S 266(2)(a) of the 1973 Act; see also *Loeve v Loeve Building and Civil Engineering Contractors (Pty) Ltd supra* 101; *Thurgood v Dirk Kruger Traders (Pty) Ltd supra* 53B; Beck “The Shareholders’ Derivative Action” 1974 52 *Canadian Bar Review* 159 202–205.

desirability of the institution of proceedings. Under the section, the court was empowered to appoint a curator *ad litem* to investigate the grounds of the application and the curator *ad litem* was required to report back to the court on the return date. A wide discretion was given to the court to appoint a curator if the court was satisfied that the company had not instituted proceedings,¹³⁷ that there were *prima facie* grounds for proceedings to be instituted,¹³⁸ and that an investigation into the grounds and desirability of the institution of proceedings would be justified.¹³⁹

It is submitted that a major flaw in the provisions under section 165(4) is that the independent person or board is not given the same investigatory powers as those afforded the curator under section 266. The investigator appointed under section 165 is appointed by the board of directors and must report back to that board. It is submitted that this creates the possibility that the powers of the investigator will be curtailed or limited, as the terms of reference will be set out by the board of directors. It is unlikely that the board of directors will sanction an investigation into their own wrongdoing and even less likely that action will be taken where there is wrongdoing on the part of the board. It is submitted that the position under section 266 is preferable. The curator in that instance was appointed by the court and was obliged to report back to the court. This ensured a neutral and independent investigation into any alleged wrongdoing. It is submitted that a similar approach under section 165 will provide greater authenticity and credibility to the investigation and subsequent report. Furthermore, section 165(4) creates no obligation for the report it describes to be made available to the applicant. The applicant shareholder has a right under section 165(5)(a)(iii) to challenge the report on the grounds that it may be unreasonable or inadequate, but the section does not provide an automatic right of access to the report. It is submitted that the applicant should have automatic access to the finalised report to ensure that the alleged wrongdoing and infringement of the interests of the company have been adequately investigated and that all related sources and information have been properly ventilated. An effort towards greater transparency in relation to the finalised report will go a long way to restoring confidence in the manner in which the affairs of the company are managed, and issues dealt with. A move towards greater transparency and accessibility is in keeping with good corporate governance and the objectives of the 2008 Act. Considering the above, it is submitted that the provisions in section 165(4) and section 165(5)(a) as they relate to the appointment of the independent investigator require amendment and a new subsection (4A) is proposed to provide for accessibility of the report.

The amended section 165(4)(a) should read as follows:

“(4) If a company does not make an application contemplated in subsection (3), or the court does not set aside the demand in terms of that subsection, the court must intervene to—

- (a) appoint an independent and impartial person or committee to investigate the demand, and report to the court on—

¹³⁷ S 266(3)(a) of the 1973 Act.

¹³⁸ S 266(3)(b) of the 1973 Act.

¹³⁹ S 266(3)(c) of the 1973 Act.

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- (i) any facts or circumstances—
 - (aa) that may give rise to a cause of action contemplated in the demand; or
 - (bb) that may relate to any proceedings contemplated in the demand;
 - (ii) the probable costs that would be incurred if the company pursued any such cause of action or continued any such proceedings; and
 - (iii) whether it appears to be in the best interests of the company to pursue any such cause of action or continue any such proceedings.
- (4A) A person who has made a demand in terms of subsection (2) is entitled, on giving reasonable notice to the court, to inspect the report contemplated in subsection (4)."