SECTION 165 OF THE COMPANIES ACT 71 OF 2008: A COMPARATIVE DISCUSSION OF THE CONCEPTS OF RATIFICATION, ACCESS TO INFORMATION AND ALTERNATIVE REMEDIES*

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SUMMARY

The lack of access to company files, company information and other company documents has historically been an obstacle to applicants attempting to institute derivative proceedings on behalf of a company. The information contained in these documents is critical in order to prove wrongful conduct. Section 165(14) of the Companies Act 71 of 2008 provides that the court is the final authority on whether to grant leave to institute proceedings: ratification is merely a factor for the court to consider. The subsection does away with the common-law rule that illegal acts or frauds on the minority (previously commonly known as the exceptions to the rule in *Foss v Harbottle*) are not ratifiable by the company. The availability of an alternative remedy is an important factor to consider when determining whether the derivative action will be in the best interests of the company, especially if the proposed derivative action may result in lengthy and time-consuming litigation. However, the availability of another remedy should not be a deterrent to applicants who wish to institute derivative proceedings.

1 INTRODUCTION

A lack of access to information has proved to be an obstacle for applicants wishing to institute derivative proceedings in terms of section 165 of the Companies Act 71 of 2008 (the 2008 Act). Information is needed to prove alleged wrongful conduct by wrongdoers. A lack of access to information has the potential to disincentivise derivative proceedings in section 165 of the 2008 Act. This article discusses the effect of ratification or approval of the alleged wrong by the shareholders, as provided for in section 165 of the

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2008 Act, and whether this provision prevents a person from making a demand or applying for leave in terms of the section. The article also explores whether the alternative remedies contained in Chapter 7 of the 2008 Act act as an inhibiting factor to the institution of derivative proceedings and thereby prevent applicants from instituting successful actions based on section 165 of the 2008 Act.

The United Kingdom (UK) was chosen as comparator because company law in the UK has historically had a heavy influence on South African company law. This article discusses comparable provisions of the law in the UK (more specifically the Companies Act 2006 (the 2006 Act)) with the aim of determining whether the UK law may be useful in providing clarity and guidance on the lacunae or defects in our own arrangement. This article concludes with recommendations in the form of proposed amendments to section 165 of the 2008 Act with the aim of ensuring that South Africa provides a more effective and efficient system to protect applicants who seek to institute derivative proceedings.

2 THE SOUTH AFRICAN APPROACH TO ACCESSING INFORMATION, RATIFICATION AND ALTERNATIVE REMEDIES IN RELATION TO DERIVATIVE PROCEEDINGS IN SECTION 165 OF THE 2008 ACT

2 1 Access to information in derivative proceedings

One of the major obstacles for an aggrieved shareholder is difficulty in accessing the information needed to prepare an application to court for the granting of leave to bring proceedings in the name and on behalf of the company. This obstacle is aggravated if the perpetrators of the conduct complained of are in control and have a monopoly over the relevant information. Section 165(9)(*e*) of the 2008 Act permits an applicant shareholder to inspect the company's books but this is only once leave to bring derivative proceedings has been granted by the court.[1] In order for an applicant to present a convincing application, it is submitted that it is imperative that they have full access to the company records. The right to inspect company records under section 165(9)(*e*) of the 2008 Act is not enough. It would be more prudent and legally sound to allow applicants the right of full access to the books to prepare a detailed and comprehensive application. This would be in line with the requirements of section 165(5)(*b*) of the 2008 Act and in the best interests of the company. However, it may be possible in certain circumstances for the applicant to make an application in terms of the Promotion of Access to Information Act.[2]

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1 Cassim "Shareholder Remedies and Minority Protection" in FHI Cassim, MF Cassim, R Cassim, Jooste, Shev and Yeats *Contemporary Company Law* 2ed (2012) 784–785.

2 2 of 2000. See *Davis v Clutchco (Pty) Ltd* 2004 (1) SA 75 (C).

Section 165(4) of the 2008 Act permits an independent and impartial person or committee to investigate the alleged wrongdoing. The glaring shortcoming of this provision is that the independent or impartial person or committee is not equipped with wide investigative powers. The 2008 Act is silent on the extent of the investigative powers, and furthermore there is the real possibility that the independent and impartial person or committee may be appointed by the wrongdoers themselves, which could result in an inadequate and biased report or investigation into the alleged wrongdoing.[3] Under section 266 of the Companies Act 61 of 1973 (the 1973 Act), a more balanced and impartial approach was adopted: the provisional curator was given extensive investigatory powers by the Minister and had to report directly to the court, which prevented any collusion and possible bias.[4]

However, an applicant shareholder may find relief from the obstacle of lack of access to information and possible bias on the part of the independent and impartial person or committee by filing a complaint with the Companies and Intellectual Property Commission (CIPC). The CIPC is empowered in terms of section 168(1) to conduct an investigation and appoint an inspector or investigator.[5] The inspector or investigator has the power, through the CIPC, to access information relevant to the alleged complaint, summon documents, interview relevant individuals, search premises and to make copies of any documents and even to attach and remove items that are relevant to the investigation.[6] The shareholder who made the complaint to the CIPC has a right to view the report provided by the CIPC.[7] The CIPC then has the right to decide whether to pursue derivative proceedings and if it does, this will relieve the applicant of the burden of costs.[8] However, although the CIPC does play this important role, it is imperative that this does not then place an extra burden on the CIPC to monitor the activities of the directors of the company or have its time consumed by dealing with frivolous complaints.[9]

2 2 Ratification in derivative proceedings

Section 66(1) of the 2008 Act provides that the business and affairs of the company must be managed by the board of directors. The board of directors is vested with the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that the Act or the

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3 Cassim "Cost Order, Obstacles and Barriers to the Derivative Action Under Section 165 of the Companies Act 71 of 2008 (Part 2)" 2014 26 *South African Mercantile Law Journal* 243.

4 S 267 and s 260 of the 1973 Act; Cassim "Cost Order, Obstacles and Barriers to the Derivative Action Under Section 165 of the Companies Act 71 of 2008 (Part 1)" 2014 26 *South African Mercantile Law Journal* 243.

5 S 169(1)(*c*) of the 2008 Act.

6 As set out in Part E of Chapter 7 of the Act; see s 169(3) and 176–179 of the 2008 Act.

7 S 170(2)(*b*) of the 2008 Act.

8 S 165(16) of the 2008 Act; see also s 170(1)(*e*); Cassim 2014 *South African Mercantile Law Journal* 244–245.

9 S 169(1)(*a*) of the 2008 Act, which provides that the Companies Commission may refuse to investigate a complaint if it appears to be frivolous or vexatious; Cassim 2014 *South African Mercantile Law Journal* 245.

company's Memorandum of Incorporation (MOI) provides otherwise.[10] The board of directors now has the ultimate power to manage the affairs of the company. The shareholders of the company can ratify the decisions of the board.[11] This was the position under the common law and section 266 of the 1973 Act. The ratification or approval by the shareholders provided for in section 165(14) of the 2008 Act does not prevent a person from making a demand or from applying for leave. In addition, the ratification or approval does not prejudice the outcome of any application for leave, but the court may take that ratification or approval into account in making any judgment or order.

Cassim opines that the court in exercising its discretion should consider the following factors:[12]

a) whether the votes were made by shareholders who were independent and disinterested;
b) whether the shareholder had access to information so as to make an informed decision; and
c) whether the act in question was one that could be ratified (an illegal act or a fraud on the minority is never ratifiable).

It is submitted that the factors provided by Cassim are useful. However, the fact that the court will be the final arbiter in deciding whether to grant leave, and that ratification is merely a factor for the court to consider, ensures greater accountability and confidence in the proceedings. It is further submitted that the role of the court here also ensures that the process is not influenced or undermined by collusion and bias by members or directors who could previously vote to ratify wrongdoing and therefore effectively bring the derivative proceedings to a standstill.

According to Delport, it is possible to formulate an interpretation that the power to ratify still vests with the shareholders, and that section 165(14) merely indicates the effect (or not) of such a ratification. It is submitted that this may have been a persuasive argument but for the fact that this subsection is also found in section 266 of the 1973 Act, under which the shareholders had the ultimate power.[13]

A flaw in the wording of section 165(14) of the 2008 Act is that it refers to shareholder ratification or approval of "any particular conduct of the company". The basis of derivative proceedings is that the wrongful acts are perpetrated against the company and that the applicant institutes derivative proceedings on behalf of the company. This being the case, any approval by

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10 Delport *Henochsberg on the Companies Act 2008* (2018) 596; Cassim "When Companies Are Harmed by Their Own Directors: The Defects in the Statutory Derivative Action and the Courts" (Part 2) 2013 25 *South African Mercantile Law Journal* 318; "When Companies Are Harmed by Their Own Directors: The Defects in The Statutory Derivative Action and the Cures" (Part 1) 2013 25 *South African Mercantile Law Journal* 168–183.

11 S 165(14) of the 2008 Act.

12 Cassim (Part 1) 2013 *South African Mercantile Law Journal* 170 and (Part 2) 2013 *South African Mercantile Law Journal* 318; Cassim in FHI Cassim *et al Contemporary Company Law* 795.

13 Delport *Henochsberg on the Companies Act 2008* 596.

the shareholders must relate to wrongful actions of the perpetrator and not the company's conduct.[14] Furthermore, it is submitted that the Act does not take into consideration a situation where the wrongdoers are the shareholders. Practically, the provisions could result in the wrongdoers ratifying their own wrongful conduct.

The power given to the court to ratify or grant approval is a welcome addition to the 2008 Act as it prevents decisions being influenced by majority rule and allows for unbiased judicial discretion in the dismissal or continuance of the action.[15] However, a court may still be left in the unenviable situation of trying to decide which wrongs are ratifiable and which are not.

2 3 Alternative remedies to derivative proceedings

Chapter 7 of the 2008 Act contains the remedies and enforcement provisions. Part A commences with general principles that are applicable to remedies and enforcement. An alternative method for addressing complaints or preserving rights is set out in section 156 of the 2008 Act. Part C of Chapter 7 deals specifically with alternative dispute resolution (ADR). The 2008 Act also provides for a Companies Tribunal to deal specifically with company law matters.[16] The Companies Tribunal comprises a chairperson, and no more than 10 members, appointed by the Minister. Part F of Chapter 7 sets out the procedures for dispute resolution through the Companies Tribunal.[17]

The 2008 Act also provides for other forms of dispute resolution – namely High Court proceedings, complaints to the Takeover Regulation Panel[18] and, in terms of section 185 of the Act, to the CIPC.[19]

Section 158 of the 2008 Act provides that the remedies in the Act must be used to promote the purpose of the Act. Section 158 states:

> "When determining a matter brought before it in terms of this Act, or making an order contemplated in this Act–
> a) a court must develop the common law as necessary to improve the realization and enjoyment of rights established by this Act; and
> b) the Commission, the Panel, the Companies Tribunal or a court–
> (i) must promote the spirit, purpose and objects of this Act; and
> (ii) if any provision of this Act, or other document in terms of this Act, read in its context, can be reasonably construed to have more than one meaning, must prefer the meaning that best promotes the spirit and purpose of this Act, and will best improve the realization and enjoyment of rights."

A key consideration in the determination of whether a proposed derivative

14 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 320–321.
15 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 318.
16 S 193 of the 2008 Act, which is part of Chapter 8, Part B.
17 S 193(4) of the 2008 Act.
18 S 156(*d*) of the 2008 Act; see also s 187(2) of the 2008 Act.
19 See ss 168–175 and ss 117–120 of the 2008 Act.

action is in the best interests of the company is the availability of an alternative remedy. Cassim opines that the court should refuse to grant leave to institute derivative proceedings if there are alternative measures to address the grievance of an applicant and if these would produce substantially the same result.[20] According to Cassim, this route would prevent the company from entering into litigation proceedings.[21] The availability of internal remedies such as those listed in sections 20(4) and 163 of the 2008 Act (provided the circumstances do not compel the company to litigate against its wishes) would be an important consideration to determine whether it is in the best interests of the company to grant leave to an applicant in terms of section 165 of the 2008 Act.

In *Mbethe v United Manganese of Kalahari (Pty) Ltd*,[22] the court stated that, in addition, section 165(5)(*b*)(iii) of the 2008 Act requires that it be "[i]n the best interests of the company that the applicant be granted leave to commence the proposed proceedings". The court stated that if there were alternative means to obtain the same relief that did not involve the company being compelled to litigate against its wishes, this would be an important consideration in determining whether to grant leave to an applicant.[23] The provisions of sections 20(4) and 163 of the 2008 Act provide an alternative avenue for the relief sought.[24] It is respectfully submitted that if the alternative proposed remedies are not useful or do not provide adequate redress, the applicant should not be prevented from pursuing the derivative action.

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20 Cassim in FHI Cassim *et al Contemporary Company Law* 802.

21 *Ibid*.

22 2017 (6) SA 409 (SCA).

23 *Mbethe v United Manganese of Kalahari supra* 33; *Swansson v Pratt* [2002] NSWSC 583 (3 July 2002) 60.

24 *Mbethe v United Manganese of Kalahari supra* 33–34.
S 163(1) of the 2008 Act provides:
"(1) A shareholder or a director of a company may apply to a court for relief if–
(a) any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant;
(b) the business of the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant; or
(c) the powers of a director or prescribed officer of the company, or a person related to the company, are being or have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant."
In terms of s 163(2) of the Act, the court is entitled to make any interim or final order it considers fit, including an order restraining the conduct in question.
S 20(4) of the Act provides:
"One or more shareholders, directors or prescribed officers of a company, or a trade union representing employees of the company, may apply to the High Court for an appropriate order to restrain the company from doing anything inconsistent with this Act."

3 THE UK APPROACH TO ACCESSING INFORMATION, RATIFICATION AND ALTERNATIVE REMEDIES IN RELATION TO DERIVATIVE PROCEEDINGS

3 1 Access to information in derivative proceedings

Limited access to information within the structures of the company makes it difficult for applicant shareholders in derivative proceedings to provide evidence, documents and information to establish either a *prima facie* case or the alleged wrongful conduct of directors. In the UK, section 261(3) of the 2006 Act provides that the court may require the company to provide the evidence if the applicant succeeds in establishing a *prima facie* case for the granting of permission. It is submitted that the inclusion of this provision does not extend far enough to assist applicants in gaining access to important and relevant information as it pertains to the derivative claim.[25]

3 2 Ratification in derivative proceedings

Ratification continues to be an important factor under the statutory derivative procedure.[26] Section 239(7) of the 2006 Act retains the common-law rules on acts that are not ratifiable by the company, such as illegal acts or fraud on the minority – previously commonly known as the exceptions to the rule in *Foss v Harbottle*.[27] Section 261(3) and (4) of the 2006 Act provides that permission to continue derivative proceedings will be refused if the act or omission has in fact been ratified or authorised by the company. The practical effect of these provisions is that ratification will prevent the derivative claim from proceeding any further.

In instances where no ratification or authorisation has taken place, the court is still required to consider whether to grant leave for the derivative proceedings based on the act or omission.[28] It is submitted that this approach is problematic because it leaves the courts to grapple with the confusion and the predicament that existed in the common law in determining which wrongs are ratifiable and which are unratifiable.[29] This could lead to a situation where a significant amount of time in leave hearings is devoted to whether or not certain wrongs are ratifiable.[30]

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25 S 261(3) provides that a court:
(a) may give directions as to the evidence to be provided by the company, and
(b) may adjourn the proceedings to enable the evidence to be obtained.

26 See Fridman "Ratification of Directors' Breaches" 1992 10 *Company and Securities Law Journal* 252 in relation to how ratification affected derivative actions at common law. His view was that "the mere possibility of ratification was sufficient to deprive a shareholder of the ability to bring a derivative action."

27 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 320.

28 *Ibid*; *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch).

29 Confirmed in *Franbar Holdings Ltd v Patel supra.*

30 Boyle "The New Derivative Action' 1997 18 *Company Lawyer* 258; see Poole and Roberts "Shareholder Remedies: Corporate Wrongs and the Derivative Action" 1999 *Journal of*

The applicant shareholder would still be prevented from instituting a derivative claim in instances where there has been no formal ratification if the act or omission complained of was capable of being ratified or authorised by the majority of shareholders.[31] In *Singh v Singh*,[32] the court refused to grant the applicant permission to continue a derivative action because he could only receive a remedy for the wrong if he brought a personal action for an unfairly prejudicial act, as the alleged wrong of excessive remuneration had already been ratified by the company. This prevented the possibility of the applicant pursuing a derivative action.[33]

The directors of the company in certain instances may be required to convene a meeting to assess whether the independent shareholders would ratify or approve the act or omission.[34] There has been criticism that convening such a meeting could lead to extensive and prolonged consideration of detailed factors. However, it is submitted that if a time limit were imposed upon such a meeting, this would prevent prolonged meetings and prevent the detailed analysis of irrelevant factors.[35]

The 2006 Act does provide for a significant change to ratification. Section 239 of the 2006 Act now provides that the votes of wrongdoing directors and connected shareholders are to be disregarded when ratifying allegedly wrongful conduct. This addition to the section is important as it creates more confidence in the proceedings by preventing wrongdoers from voting and ratifying wrongful actions in which they participated, as their decision would be tainted by bias and impropriety.[36] It is submitted that the approach adopted in the 2008 Act is a far better one.[37] Section 165(14) provides for shareholder ratification or approval of "any particular conduct of the company". The approval by the shareholders must relate to wrongful actions of the perpetrator and not the company's conduct.[38] The ratification or approval by the shareholders provided for in the subsection does not prevent a person from making a demand or from applying for leave and is not an obstacle to a derivative action. In addition, the ratification or approval does not prejudice the outcome of any application for leave, but the court may take that ratification or approval into account in making any judgment or order. The section also provides the court with the power to ratify or grant

Business Law 109; Keay "Assessing and Rethinking the Statutory Scheme for Derivative Actions Under the Companies Act 2006" 2016 16 *Journal of Corporate Law Studies* 19.

31 Joffe, Drake, Richardson, Collingwood and Lightman *Minority Shareholders: Law, Practice & Procedure* 3ed (2008) 6; see also *Edwards v Halliwell* [1950] 2 All ER 1064; *Burland v Earle* [1902] AC 83 93; Sykes "The Continuing Paradox: A Critique of Minority Shareholder and Derivative Claims Under the Companies Act 2006" 2010 2 *Civil Justice Quarterly* 221.

32 [2014] EWCA Civ. 103.

33 See Akinyera *A Comparison of the UK and US Legal Approaches to Derivative Action* (LLM, University of West London) 2016 37.

34 See generally Sykes 2010 *Civil Justice Quarterly* 221.

35 Ramsay and Saunders "Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action" 2006 6 *Journal of Corporate Law Studies* 397, 427, 442–433; Sykes 2010 *Civil Justice Quarterly* 221.

36 Tang "Shareholder Remedies: Demise of the Derivative Claim?" 2015 1 *UCL Journal of Law and Jurisprudence* 198.

37 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 318–320.

38 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 320–321.

approval of the ratification to prevent any biased decisions by the shareholders.[39]

3 3 Alternative remedies to derivative proceedings

The consideration as to whether there is an alternative remedy available was an important consideration under the common law.[40] The common law was broad and allowed the court to consider all available remedies including those remedies that could be used by the company to seek redress.[41] The 2006 Act provides that the court must also consider whether there is an alternative remedy or cause of action that the applicant could pursue instead of a derivative claim.[42]

Historically, section 495 of the Companies Act 1985 was the favoured remedy for aggrieved shareholders as opposed to the common-law derivative action.[43] There is the possibility that aggrieved shareholders may continue to use a personal remedy that is now found in section 994 of the 2006 Act rather than the statutory procedure. The courts perhaps will now direct all shareholders who complain of a breach by directors of their fiduciary duties or where action is pursued on behalf of the company to bring their claims under section 994 rather than use the statutory derivative action under section 263. There is also the possibility that the courts will guard against the abuse of the statutory derivative action and instead encourage applicants to institute claims under section 994. In *Mumbray v Lapper*,[44] the applicant shareholder was directly involved in the wrongdoing and the court refused the applicant permission to pursue the derivative action and preferred winding-up on just and equitable grounds[45] or a remedy under section 459 in the 1985 Act. According to Keay, the courts are more likely to prefer alternative remedies where the applicant acts without good faith.[46]

In *Jafari-Fini v Skillglass Ltd*, [47] the court refused permission for a derivative action because the applicant shareholder had a personal action arising out of the same facts as the derivative claim. If the shareholder succeeded in the personal claim, the result would be that the shareholder would be able to regain control of the company and then cause the company

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39 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 318.

40 *Konamaneni v Rolls-Royce Industrial Power (India) Ltd* [2004] EWHC 2071 (Ch); [2005] BCC 216 [2002] 1 WLR 1269 29; 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* 495.

41 *Barret v Duckett* [1995] BCC 362 [1995] BCC [372]; Keay and Loughrey 2008 *Law Quarterly Review* 495.

42 S 263(3)(*f*) of the 2006 Act.

43 Li *A Comparative Study of Shareholders' Derivative Action* (2007) 35; Boyle *Minority Shareholders' Remedies* (2002) 94.

44 [2005] EWHC 1152 (Ch); [2005] BCC 990.

45 S 122(1)(*g*) of the Insolvency Act 1986.

46 *Barret v Duckett supra*; *Re Portfolios of Distinction Ltd* [2006] EWHC 782 (Ch); [2006] 2 BCLC 261; Keay and Loughrey 2008 *Law Quarterly Review* 495-496.

47 [2005] EWCA Civ 356; [2005] BCC 842.

to institute derivative proceedings.[48] The court noted that if the applicant's personal claim ceased to exist, that would also have terminated the company's right to bring a derivative claim.[49]

In *Airey v Cordell*,[50] the court provided a broad interpretation of an alternative remedy. The court concluded that an alternative remedy included a settlement that also protected the applicant shareholders' interests. The court reached this conclusion based on the fact that the company was a viable concern and that the interests of the company were vested in the interests of the conflicting shareholders. Furthermore, the applicant shareholder desired to remain in the company and therefore it was in his interest that the company be preserved and protected.[51]

In *Hook v Sumner*,[52] the court held that a decision by the applicant to pursue a personal action does not act as a bar to instituting a derivative claim. A member may want to remain a shareholder of the company rather than seek a remedy under the unfair prejudice section of the 2006 Act, which could result in the applicant's share being bought out and the applicant could thereby be forced to exit the company.[53]

In instances where the board of directors can demonstrate that the alleged wrong can be remedied by a personal action brought by the applicant against the wrongdoer, the court can refuse to grant permission.[54] This may occur in cases where a personal action is more appropriate than a derivative action.[55]

It is important to note that the existence of an alternative remedy, such as a personal action by the applicants, will not inevitably rule out the possibility of a derivative action in instances where the claim may be pursued both derivatively and personally.[56] This was evident in *Cullen Investment Ltd v Brown*,[57] where the applicant shareholder initially instituted a personal action against the director for breach of duty when the director deprived the company of an investment opportunity and took the opportunity for his own interest.[58] The director objected to the personal action, claiming the duty was owed to the company and not to the applicant. The applicant then initiated

48 *Jafari-Fini v Skillglass Ltd supra*; [2005] BCC 842 47 and 52.

49 *Jafari-Fini v Skillglass Ltd supra*; Keay and Loughrey 2008 *Law Quarterly Review* 484.

50 [2006] EWHC 2728 (Ch) BusLR 391.

51 *Airey v Cordell supra* 48 and 84; Keay and Loughrey 2008 *Law Quarterly Review* 497.

52 [2015] EWHC 3820 (Ch).

53 See *Clarke v Cutland* [2003] EWCA Civ 810, [2004] 1 WLR 783; *Gamlestaden FastigheterAB v Baltic Partners Ltd* [2007] UKPC 26, [2007] Bus LR 1521; *Montgold Capital LLP v Agnieszka Ilska Ilska* [2018] EWHC 2982 (Ch) 40.

54 Ss 263(3)(*f*) and 268(2)(*f*) of the 2006 Act.

55 *Mission Capital Plc. v Sinclair* (2008) EWHC 1339 (Ch); *Singh v Singh supra*; Akinyera *A Comparison of the UK and US Legal Approaches to Derivative Action* 37.

56 *Barrett v Duckett* [1995] 1 BCLC 243; *Mumbray v Lapper supra*; Akinyera *A Comparison of the UK and US Legal Approaches to Derivative Action* 38.

57 [2015] EWHC 473.

58 *Kiani v Cooper* [2010] EWHC 577 (Ch); [2010] BCC 463; *Ritchie v Union of Construction, Allied Trades and Technicians* [2011] EWHC 3613 (Ch); Keay 2016 *Journal of Corporate Law Studies* 31.

derivative proceedings. The court granted permission.[59] If the court in this case had refused permission to grant a derivative action, then the company would not have been able to recover any damages and there would have been no repercussions for the perpetrator's wrongful actions. Akinyere opines that this illustrates that the court may be willing to grant permission for derivative proceedings where there is the possibility that the company will benefit from the derivative action despite the availability of a personal action.[60]

In the UK, the court is required to consider alternative remedies, but the existence of an alternative remedy does not prevent the institution of derivative proceedings.[61] The alternative remedy, however, must be based on the same cause of action that gave rise to the derivative claim.[62] The courts in the UK must, in terms of section 263(*f*) of the 2006 Act, in permission hearings, consider whether the action that is the subject of the derivative claim could be pursued by the shareholder in his or her own right. This has often led courts to consider whether a shareholder could present a petition under section 994 of the Act based on unfair prejudice and, as a result, this has deprived the applicant of instituting a derivative claim.[63]

According to Cassim, it often occurs that both a derivative action and an unfairly prejudicial petition are founded on breaches of directors' duties.[64] The UK legislation may limit and exclude the availability of the derivative action in these situations. Section 165 does not limit the availability of derivative actions in this manner and the Act provides for a wide range of remedies. In *Mbethe*,[65] the court stated that, in addition, section 165(5)(*b*)(iii) of the Act requires that it be "[i]n the best interests of the company that the applicant be granted leave to commence the proposed proceedings". If there are alternative means to obtain the same relief that do not involve the company being compelled to litigate against its wishes, this would be an important consideration in determining whether to grant leave to an applicant.[66] The alternative remedies are available under the provisions of sections 20(4), 163 and section 185 of the Act.[67]

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59 *Cullen Investment Ltd v Brown supra* 473.

60 Akinyera *A Comparison of the UK and US Legal Approaches to Derivative Action* 38; *Barrett v Duckett supra*; *Mumbray v Lapper supra*; *Parry v Bartlett* (2011) EWHC 3146; [2012] EWHC 2363 (Ch) LTL 28/9/2012.

61 *Lesini v Westrip Holdings Ltd* [2009] EWHC 2526; Cassim "Judicial Discretion in Derivative Actions Under the Companies Act 2008" 2013 4 *South African Law Journal* 805.

62 *Franbar Holdings Ltd v Patel supra*; Cassim 2013 *SALJ* 805.

63 Keay 2016 *Journal of Corporate Law Studies* 39.

64 Cassim 2013 *SALJ* 805.

65 *Supra.*

66 *Swansson v Pratt supra* 60.

67 *Mbethe v United Manganese of Kalahari supra* 33–34.
Section 163(1) of the Act provides:
"(1) A shareholder or a director of a company may apply to a court for relief if–
(a) any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant;
(b) the business of the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant; or

4 CONCLUSION AND RECOMMENDATIONS

It is submitted that free and unhindered access to information by the applicant shareholder at the outset of the derivative proceedings is vital to enable the applicant adequately to prepare a demand to institute derivative proceedings. It is submitted that a lack of access to information and documents such as receipts, invoices, financial records, minutes of meetings and contractual papers is a major obstacle to an aggrieved applicant who wishes to prepare an application to court for the granting of leave to institute such proceedings and may prove to be detrimental to having their demand granted by the court. This situation is further exacerbated if the perpetrators of the wrongful conduct are in control of the required information. Section 165(9)(*e*) of the 2008 Act permits an applicant shareholder to inspect the company's books but this, it is submitted, is insufficient as this is permitted only once leave for the derivative proceedings is granted by the court.[68] Applicants may require access to information and company records at an earlier stage, such as when drafting the demand. Information is needed at an earlier stage to satisfy the court of the veracity of the alleged conduct and is needed by the applicant to determine whether the alleged wrongful conduct is worth pursuing through a derivative action, especially because the applicant runs the risk of having to use their own financial resources to institute the derivative action. It is submitted that early access to company information will assist an applicant in determining whether it is worthwhile expending their own financial resources and potentially being personally liable for any adverse costs order in an unsuccessful derivative claim. Although it is possible for applicants to make an application in terms of the Promotion of Access to Information Act[69] to gain vital information for the drafting of the demand in the proposed derivative action, it would be in line with the objectives of the 2008 Act of transparency and accountability to permit applicants the right of full access to all relevant information in order to prepare a detailed and comprehensive application.

In the UK, section 261(3) of the 2006 Act provides that the court may require that evidence be provided by the company if the applicant succeeds in establishing a *prima facie* case for the granting of permission.[70] However, it is submitted that this provision, like section 165(9)(*e*) in the 2008 Act, is insufficient as it provides for the right to access information only after the

(c) the powers of a director or prescribed officer of the company, or a person related to the company, are being or have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant."

In terms of s 163(2) of the Act, the court is entitled to make any interim or final order it considers fit, including an order restraining the conduct in question.

Section 20(4) of the Act provides:

"One or more shareholders, directors or prescribed officers of a company, or a trade union representing employees of the company, may apply to the High Court for an appropriate order to restrain the company from doing anything inconsistent with this Act."

68 Cassim 2013 *SALJ* 784.

69 2 of 2000.

70 S 261(3) of the 2006 Act provides that a court:

(a) may give directions as to the evidence to be provided by the company, and

(b) may adjourn the proceedings to enable the evidence to be obtained.

initial stage of the proceedings. Information is needed at the outset of the proceedings and section 165 needs to be amended to provide applicants with such a right.

It is therefore submitted that section 165(2) in the 2008 Act should be amended further to read as follows:

> "(2) 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.
>
> (2A) The demand contemplated in subsection (2) should set out the following–
>
> (*a*) who the alleged wrongdoers are;
>
> (*b*) the facts that gave rise to the wrongdoing;
>
> (*c*) the potential harm that the company could suffer if the demand is not granted; and
>
> (*d*) the potential costs in the derivative litigation proceedings.
>
> (2B) The court in contemplation of subsection (2) may make an order requiring the company or the directors to provide information or assistance in relation to the proceedings or in the drafting of the demand as contemplated in subsection (2A) and may adjourn the proceedings to enable the evidence to be obtained."

In section 266 of the 1973 Act, the statutory derivative action was not limited to so-called "unratifiable wrongs"[71] and could be used even if the wrong complained of was capable of ratification or condonation by the company. In terms of the section, a member was able to initiate proceedings, notwithstanding that the company had in any way ratified or condoned any wrong, breach of trust or breach of faith of any act or omission committed by a director or officer of the company. The remedy in section 266 was limited, however, 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.[72] In the UK, it would not be possible to pursue a derivative claim if the cause of action arose from an act or omission that had been ratified or authorised by the company.[73] Section 263(2)(*c*) of the 2006 Act provides that the court is obliged to refuse permission to grant a derivative action if the cause of action has been ratified by the company. The UK Act, in section 239(7), retains the common-law rules that illegal acts or a fraud on the minority (previously commonly known as the exceptions to the rule in

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71 S 266(1) of the 1973 Act; Blackman "Majority Rule and the New Statutory Derivative Action" 1976 39 *Tydskrif vir Hedensdaagse Romeins-Hollandse Reg* 27.

72 S 266(1) of the 1973 Act.

73 S 263(2)(c) of the 2006 Act.

Foss v Harbottle) are not ratifiable by the company.[74] Even in instances where no ratification or authorisation has taken place, the court is still required to consider whether to grant leave for the derivative proceedings based on the act or omission.[75] This approach is problematic because it still leaves the court with the unenviable burden that existed in the common law of determining which wrongs are ratifiable and which are unratifiable.[76] This may lead to a large proportion of time in the early stages of the proceedings being devoted to determining whether or not certain wrongs are ratifiable.[77]

A commendable inclusion under section 239 of the UK Act is that it prevents the votes of wrongdoing directors and connected members (shareholders) from being recognised in any vote to ratify the wrongful conduct. This provision is important as it prevents wrongdoers from tainting and undermining the voting process by attempting to ratify their own wrongdoing. [78] By excluding the wrongdoing directors and connected shareholders, the Act restores a degree of impartiality and confidence in the ratification process. This addition to the section is important as it creates greater confidence in the proceedings by preventing wrongdoers from voting and ratifying their wrongful actions, as their decisions will clearly be tainted by bias and impropriety.

In the author's view, the approach to the concept of ratification under the 2008 Act is a better one than under the 1973 Act or the UK Act, but it should be amended to inspire greater confidence.[79] Under the 2008 Act, a decision to ratify the wrongful conduct is not an insurmountable obstacle to the institution of derivative proceedings. Section 165(14) of the 2008 Act provides that ratification, although a factor that the court may take into account, is not decisive and does not automatically result in a stay or dismissal of the action. The fact that the court is the final authority on whether to grant leave, and that ratification is merely a factor for the court to consider, ensures greater accountability and confidence in the proceedings. It also ensures that the process is not influenced or undermined by collusion and bias by members or directors who could previously vote to ratify wrongdoing and therefore halt the derivative proceedings. It is submitted, however, that a flaw in the section is that it fails to indicate what factors the court would consider in deciding whether to confirm the ratification by the shareholders. It is submitted that it would have been prudent for the 2008 Act to have inserted certain guiding criteria, such as those postulated by Cassim, to assist the court in determining whether to confirm a ratification or to grant permission to institute proceedings.[80]

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74 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 320.

75 *Ibid*; *Franbar Holdings Ltd v Patel supra*; *Singh v Singh supra*; Akinyera *A Comparison of the UK and US Legal Approaches to Derivative Action* 37.

76 Confirmed in *Franbar Holdings Ltd v Patel supra*.

77 Boyle 1997 *Company Lawyer* 258; see Poole and Roberts 1999 *Journal of Business Law* 109; Keay 2016 *Journal of Corporate Law Studies* 39.

78 Tang 2015 *UCL Journal of Law and Jurisprudence* 198.

79 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 318–320.

80 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 318. The author opines that the court in exercising its discretion should take into account the following factors:
a) whether the votes were made by shareholders who were independent and

It is submitted that a further flaw in section 165(14) of the 2008 Act is that the section refers to shareholder ratification or approval of "any particular conduct of the company". The wording here is misleading and, it is submitted, incorrect. In derivative proceedings, the company has suffered wrongful conduct owing to acts or omissions that were perpetrated against it, and therefore the company seeks recourse against the alleged wrongdoers. Therefore, it is submitted, any ratification or authorisation must relate to "particular conduct of the wrongdoers" ,who may be either the shareholders or directors.

Although the 2008 Act provides that ratification by the shareholders is merely a factor for the court to consider in whether to grant leave, and that ratification by the shareholders will not prevent the institution of derivative proceedings, the Act fails to prevent the wrongdoers from ratifying their own wrongful actions. The court, as indicated, is not bound by the decision of shareholders to ratify wrongful actions but the fact that ratification by the alleged wrongdoers is a factor to be considered by the court in deciding whether to grant leave constitutes a flaw in the process.[81] It is submitted that it should in no way be within the court's purview to consider the view of shareholders who have participated in alleged wrongdoing. It is submitted that a similar provision to the one adopted under the UK Act that prevents alleged wrongdoers from participating in a decision to ratify alleged wrongdoing be incorporated into the 2008 Act to ensure that the court is guided by the views of honest and *bona fide* individuals. The basis of derivative proceedings is that wrongful acts were perpetrated against the company and that the applicant institutes derivative proceedings on behalf of the company. This being the case, any approval by the shareholders must relate to wrongful actions of the perpetrator and not the company's conduct.[82] Furthermore, it is submitted that the Act does not take into consideration a situation where the shareholders are the wrongdoers. Practically, the provisions could result in the wrongdoers ratifying their own wrongful conduct.

It is therefore the author's submission that section 165(14) of the 2008 Act should be amended to read as follows:

> "If the shareholders of a company have ratified or approved <u>any wrongful conduct that has been perpetrated against the company</u>–
>
> (*a*) the ratification or approval–
>
> (i) does not prevent a person from making a demand, applying for leave, or bringing or intervening in proceedings with leave under this section; and
>
> (ii) does not prejudice the outcome of any application for leave, or proceedings brought or intervened in with leave under this section; and
>
> <u>(iii) shall have no force or effect where the ratification or approval is</u>

disinterested;

b) whether the shareholder had access to information to make an informed decision; and

c) whether the act in question is one that can be ratified (an illegal act or a fraud on the minority is never ratifiable).

81 S 165(14)(*b*) of the 2008 Act.

82 Cassim (Part 2) 2013 *South African Mercantile Law Journal* 320–321.

made by shareholders or related shareholders who were associated with the wrongful conduct.

(*b*) the court may take that ratification or approval into account in making any judgment or order. In doing so, the court may have regard to:

(i) whether the shareholders were adequately informed and had proper knowledge of the conduct in question before deciding whether to ratify or approve the conduct; and

(ii) whether the shareholders who ratified or approved the conduct in question were acting in good faith and with proper purposes."

The 2008 Act provides for the use of alternative remedies by an applicant who is seeking redress. Chapter 7 of the Act provides for alternative dispute resolution as a method to resolve disputes that have been instituted in the name of the applicant or for disputes that have arisen within the company. Section 193(4) also provides for the Companies Tribunal to deal with company law matters.[83] There are also other forms of dispute resolution. The 2008 Act provides for dispute resolution through High Court proceedings, complaints lodged with the Takeover Regulation Panel[84] and in terms of section 185 of the Act, with the CIPC.[85]

The possibility of an alternative remedy being available is an important factor to consider when determining whether the derivative action will be in the best interests of the company.[86] This factor becomes even more important if the alternative remedy provides the option of the company not being involved in lengthy and time-consuming litigation.[87] It is submitted that the suitability of an alternative remedy must be based on whether the alternative remedy is able to provide the applicant with the same relief that the applicant would obtain if granted leave to institute derivative proceedings. It is submitted that the alternative remedy must provide the applicant with a realistic chance of seeking the desired redress. It is submitted that the availability of a personal remedy by the applicant under section 163 should not prevent the applicant from being granted leave. It must be borne in mind that a personal action under section 163 and a derivative action under section 165 may overlap in that an applicant may have both a personal action and a derivative action against the wrongdoers. This will often arise where the wrongdoing has infringed the applicant's rights individually as well as in the applicant's capacity as a shareholder, in which case the applicant will institute derivative proceedings on behalf of the company. It is submitted that the availability of a personal remedy under section 163 as described above should not be detrimental to the applicant's chances of being granted leave in derivative proceedings, as a personal action under section 163 is not an alternative remedy to a derivative action. This is so because a successful application under section 163 will yield a reward for a shareholder individually while any award in a successful derivative claim will be paid directly to the company, although a shareholder

83 S 193 is part of Ch 8, Part B of the 2008 Act.

84 S 156(*d*) of the 2008 Act; see also s 187(2) of the 2008 Act.

85 See s 168–175 and s 117–120 of the 2008 Act.

86 Cassim 2013 *SALJ* 802; *Mbethe v United Manganese of Kalahari supra* 33–34.

87 *Swansson v Pratt supra* 60.

may benefit indirectly such as through an increase in share value.[88] It is submitted that our courts, in considering whether there is an alternative remedy available to the applicant, should be cognisant that the availability of a personal action does not qualify as a suitable alternative remedy and a basis for refusing permission to grant leave.[89]

A more limited approach is adopted in the UK. In the UK, the court is required to consider the existence of an alternative remedy such as an unfair prejudice claim under section 994 of the 2006 Act.[90] The existence of an unfair prejudice claim for the applicant does not prevent the court from granting leave.[91] It is submitted that the problem with the position in the UK is that section 260(2)(*b*) of the 2006 Act expressly provides for a derivative action to be brought pursuant to a court order under the unfair prejudice remedy.[92] The implication of this is that the unfair prejudice remedy and the derivative claim are both based on the same cause of action and that they are both founded on a breach of directors' duties. Furthermore, the fact that the court, in permission hearings, must consider whether the action upon which the derivative action is based may be brought under an unfair prejudice claim, greatly undermines the derivative claim as a remedy in its own right; a reading of the section in my view clearly indicates an inherent bias towards the granting of an unfair prejudice claim rather than a derivative action.[93]

In the 2008 Act, the existence of alternative remedies will not limit or undermine the institution of a derivative claim. Section 165 is an individual remedy that is not dependent on the existence or success of an action based on the oppression remedy under section 163 of the 2008 Act. However, it is submitted that the section should clearly indicate that the existence of alternative remedies does not necessarily imply that granting leave for a derivative action will be contrary to the interests of the company.

Therefore, it is the author's submission that section 165(4) of the 2008 Act should be amended to read as follows:

> "(4) If a company does not make an application as contemplated in subsection (3), or the court does not set aside the demand in terms of that subsection, the company must–
>
> (*a*) appoint an independent and impartial person or committee to investigate the demand, and report to the board on-
>
> (i) any facts or circumstances–
>
> (*aa*) that may give rise to a cause of action contemplated in the demand; or

88 Cassim 2013 *SALJ* 802–803.

89 *Ibid*.

90 S 263(3)(f) of the 2006 Act.

91 *Lesini v Westrip Holdings Ltd supra.*

92 Cassim 2013 *SALJ* 805; s 260(2)(*b*) of the 2006 Act provides that a derivative claim may be brought in pursuance of a court order in proceedings under s 994 for the protection of shareholders against unfair prejudice. S 996(2)(c) provides that when a shareholder succeeds in a petition under s 994, one of the orders that may be made by the court is the authorisation of civil proceedings to be brought in the name of and on behalf of the company by such persons as the court may direct.

93 Cassim 2013 *SALJ* 805.

(*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; and, if an alternative remedy is available to the applicant against the proposed defendant, this does not necessarily imply that a derivative action is contrary to the best interests of the company.

(*b*) within 60 business days after being served with the demand, or within a longer time as a court, on application by the company, may allow, either–

(i) initiate or continue legal proceedings, or take related legal steps to protect the legal interests of the company, as contemplated in the demand; or

(ii) serve a notice on the person who made the demand, refusing to comply with it."