THE DERIVATIVE ACTION AS A MEANS TO PROMOTE THE OBJECTIVES OF SECTION 7(j) OF THE COMPANIES ACT 71 OF 2008

By

POTLAKI EMMANUEL MOHLABI

Student number: 1501052

SUPERVISOR: JUDITH KATZEW

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DECLARATION

I, 1501052 declare that this Research Report is my own unaided work. It is submitted in partial fulfilment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

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ABSTRACT

The Companies Act 71 of 2008 seeks to enhance corporate governance in South Africa by promoting transparency, accountability, and efficiency in the management of companies. Section 7(j) of the Companies Act underpins these principles, aiming to ensure responsible management of companies and the protection of stakeholder interests. One of the mechanisms designed to achieve these objectives is the derivative action under s165 of the Companies Act, 71 of 2008. It is one of the provisions of the Companies Act that facilitates the efficient and responsible management of a company by holding directors accountable to the company and its stakeholders. This is achieved through making the derivative process more accessible, with fewer impediments placed on the applicant and importantly, by the expansion of the legal standing of potential applicants to include not only the shareholders but also the directors, employees' representatives. Further, the Companies Act confers discretion on the courts to authorise any other person to bring the litigation on behalf of the company where the legal interests of such company suffer. This research considers whether these mechanisms of the derivative action as prescribed by s165 of the Companies Act,71 of 2008 do sufficiently bolster and promote the objectives of s7(j) of the Companies Act, 71 of 2008. It is argued that the courts have the overarching responsibility that this remedy is used to further the legal interest of the company and not further ulterior motives. The paper concludes that whilst there are some deficiencies in s165 of the Companies Act, including, the issue of costs such as the provision relating to security for costs, access to information and an overly complex mechanism that may hamper the effectiveness of the remedy, overall, s165 of the Act promotes the objectives of s7(j) of the Act.

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TABLE OF CONTENTS

I. INTRODUCTION

In 2004, the then Minister of Trade and Industry Mandisi Mpahlwa emphasized that companies are the bedrock of the economy of the country and its prosperity and social renewal.[1] To achieve these ends, the Companies Act, 71 of 2008 ('the Act') introduced significant reforms aimed at improving corporate governance in South Africa. Amongst its key objectives is the promotion of transparency, accountability, and efficiency within the corporate structures, as encapsulated in s7(j) of the Act.[2] Whilst the objective of promoting efficient and responsible management of the company is an important ingredient for sound corporate governance, there has not been much focus on this aspect of s7(j).[3] Efficient and responsible management of the company is important to safeguard the interests of stakeholders, and the economy at large. One of the mechanisms provided in the Act to uphold these principles, is the derivative action outlined under s165 of the Act.[4] The widened *locus standi* is one amongst other ways that are intended to promote the accountability in s165(2).[5] This mechanism ensures that directors are answerable not only to shareholders but also to a broader group of stakeholders who are impacted by the company's operations, promoting responsible and efficient management.[6] It also addresses the issue of reluctance by directors or majority shareholders to pursue legal action, especially when they themselves may have been responsible for the harm or they may have personal stakes in avoiding litigation by affording a broader number person a *locus standi*.[7]Derivative actions not only enforce accountability but also deter misconduct and promote good governance practices.[8] Notwithstanding the benefits that this action can potentially achieve, its practical application is not without challenges. Whilst s165 has excised the common law derivative action, the company remains a 'proper plaintiff'[9] in the event the

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[1] South African company for the 21st century guidelines for corporate law reform, May 2004.
[2] FH Cassim & MF Cassim *Contemporary Company Law* 3rd ed (2021) 4. Also see ibid.
[3] M Gwangwana 'The South African Companies Act and the realization of Corporate Human Right Responsibilities' (2015) 18 *PELJ* 3108 -3102. Katzew J 'Crossing the Divide Between the Business of the Corporation and the Imperatives of Human Rights: The Impact of Section 7 of the Companies Act 71 of 2008' 2011 *SALJ* 686-687.
[4] Section 7(J) of the Companies 71 of 2008.The section provides that "7 The purposes of the Act are to- …. encourage the efficient and responsible management of companies;"
[5] Section 165(2)(d).
[6] M F Cassim 'Cost orders, obstacles, and barriers to the derivative action under section 165 of the Companies Act 71 of 2008' (2014) 26 *South African Mercantile Law Journal* 1-2
[7] ibid
[8] Ibid
[9] (1843) 2 Hare 461, 67 ER 189

injury is inflicted on it. However, in instances where the harm is perpetrated by those who clothed with power to authorise the company to sue and they will not institute proceedings against themselves, the law makes an exception to general rule.[10]

In this research report, I examine to what extent does the derivative action under s165 advance and buttress the objectives of s7(j) of the Act by balancing the interests of the minority shareholders and other stakeholders who may have standing, with the need to protect the companies' legal right to manage and conduct its own affairs.[11] In establishing the answer to the question posited above, I trace the following roadmap for coherence and completeness purposes. First, I set out an overview and briefly trace the historical development of the derivative action. This will 'set the scene' for the exploration of this mechanism as a complement to s7(j). Second, I deal with the derivative action under s165 – what the statutory derivative action entails, including a close consideration of the procedural aspects involved. Third, I explore what s 7(j) entails and how and to what extent does the derivative action support it. In other words, I consider how the derivative action promotes (or fails to promote effectively) the objectives of s7(j) of the Act, which is aimed at promoting efficient and responsible management of the companies in light of the competing interests of all pertinent stakeholders and the overarching need for a company to manage its own affairs. Next, I set out the intersection between the s165 derivative action and s7(j) of the Act including some identified shortcomings of s165, the derivative action. This will include the question of who bears the burden of costs, access to information in the hands of people perpetrating harm on the company and the need to put up security for costs in certain instances. Lastly, I conclude that a purposive and progressive approach by the courts regarding leave to sue in derivative application will give teeth and enhance the effectiveness of the remedy as opposed to a restrictive and conservative approach. This is reinforced by the fact that s165 enhances accountability, deters misconduct, and thus fosters efficient management within companies. The outcome of this research suggests that while derivative actions are important in supporting corporate governance principles, certain legislative and practical reforms may maximize their potential in achieving the objectives of s7(j).

II. OVERVIEW AND HISTORICAL DEVELOPMENT OF THE DERIVATIVE ACTION

[10] Mbethe v United Manganese of Kalahari (Pty)Ltd 2016(5) SA 414, 64-66
[11] See section 66 of the Companies Act 71 of 2008

From the outset I restate that the purpose of this paper is to look at the extent the derivative action under s165 of the Act promotes the objectives of s7(j). However, before I grapple with the essence of this paper, for a proper foundation it is important to consider the derivative action's historical development. The derivative action is a world-wide phenomenon, originating in common law jurisdictions,[12] that has become a crucial tool for enforcing directors' duties and ensuring corporate accountability.[13] According to Cassim, effective corporate governance requires an effective derivative action.[14] It enables people who would not ordinarily have capacity to act on behalf of the company to sue or defend proceedings in the instances where those who are at the helm of the company would not authorise to sue or defend the company because they are perpetrators of the harm inflicted on the company. Thus, the remedy makes the directors invariably answerable for their conduct.

In certain instances, the remedy functions as a tool designed to ensure that the shareholders or other stakeholders are able to enforce the company's rights or to recover compensation on behalf of the company when the board of directors' refuse to do so[15]. I submit that this is a reminder and restatement to those who are in control of the company that, much as they have been conferred with power to authorise the company to act in certain instances, that power is not unfettered, and that in exceptional circumstances as it shall be shown below that the company can still act though not through the ordinary means of being authorised by the company i.e minority may apply for a leave to sue derivatively. In this instance, the derivative action remedy serves as a deterrent tool.[16] It thwarts the management abuse and ensures that there is control over the board of directors by allowing litigation to be brought by minority shareholders or other interested parties, against the errant directors who have committed a breach to the company.[17] The ability of any person who has a standing to sue on behalf of the company keeps the directors in check and forces them to act for the best interest of the company. In *Teo Gek Luang v Ng Ai Tiong and Ors,*[18] the court held that derivative action is meant to improve the standards of corporate governance because the directors are

[12] H Baum & D W. Puchniack *The derivative action: an economic, historical and practice- oriented approach* (2012) Cambridge University Press & Assessment: Cambridge 1.
[13] Ibid.
[14] M F Cassim 'Cost orders, obstacles, and barriers to the derivative action under section 165 of the Companies Act 71 of 2008' (2014) 26 *South African Mercantile Law Journal* 1
[15] Ibid
[16] Ibid
[17] *Greenshields of Canada Ltd V Kalma Coff* (1995) 18 BLR (2d) 197 (CA) 205.
[18] (1999) 1 SCR 434. at 438.

made to account for the breach of their fiduciary duties to the company. This is ad idem with South African law jurisprudence. The net effect of holding the miscreant directors to be accountable is that they are forced to act thoroughly and responsibly.

The derivative action can also be used as an ex-post check on corporate behaviour of directors in that it acts as a break, or a warning or disincentive to directors who may be considering committing some corporate misconduct.[19] If parties with the necessary standing to act derivatively can or do bring a successful claim , it can deter improper behaviour of directors who might be in the similar position who want to avoid the rigorous and expensive process of going to court and reputational damage associated with being sued.[20] Once the matter lands in court, it becomes public knowledge and therefore, secrecy, privacy and internal dealing cease to exist. Certain information which according to the company's policies would ordinary be known by the company becomes public knowledge. This result, therefore, further encourages directors to act for proper motives and efficiently. In *Diamond v Oreamuno,*[21] the United States' decision, the court stated that the purpose of the derivative action is both 'compensatory' and 'deterrent'. It was further considered to promote accountability by directors and managers.[22] Overall, and most importantly, this derivative action, as shown in this research report, does serve as a corporate governance tool by ensuring that directors are held accountable for their action.[23] It ensures that justice is served in instances where directors act for personal gain and for ulterior motives.[24] The underlying rationale for this remedy, and its processes and procedures have not remained static over the years. There has been a significant development from the time this remedy was development at common law to the

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[19] MF Cassim 'Costs Orders, Obstacles and Barriers to the derivative actions under section 165 of the Companies Act of 2008(Part 1) (2014) 26 SA Merc LJ 3.

[20] *Seinfeld v Coker A* 2d 330, 333 (delich. 2000). Also see MF Cassim 'The New Derivative Action under the Companies Act: Guidelines for judicial discretion' (2016) *JUTA* at 13-14

[21](2002/ 9 NZCLC 262, 966 at 262.

[22] Supra note 19.

[23] H Baum & D W. Puchniack *The derivative action: an economic, historical and practice- oriented approach* (2012) Cambridge University Press & Assessment: Cambridge 1. See invariable features of derivate action: -

(a) Injury is inflicted on the company,
(b) The injury is usually committed by someone who has a duty to the company,
(c) The body of the company that is vested with power to correct the harm instituting the action for the relief in the company's name will not fulfil its relevant duties, largely because such person vested with those powers are the perpetrator himself.
(d) The company's power to enforce its right is conferred on another person to enforce the rights of the company through a derivative action,
(e) The costs of the derivative action are on the face value borne by plaintiff shareholder- whatever case it may be,
(f) The relief from a successful derivative action flows directly to the company.

[24] M F Cassim 'Judicial discretion in the derivative action under the Companies Act 71 of 2008' (2013) 130 *South African Law Journal, 779-784*

statutory derivative action under s165. Whilst s165(1) of the Act has excised the existence of common law derivative action and s266 of the Companies Act of 1973, the history of this remedy is not without significance. It assists in painting a picture of the beginning of this remedy and how it has evolved over time.

(a) Common law

At its basic purpose, the derivative action serves as an exception to the general rule that only the company itself can sue for harm done to it. In *Burland v Earle,*[25] the court held that where the wrong has been inflicted on the company, the action should *prima facie* be instituted by the company itself. This is known as the 'proper plaintiff rule'.[26] The management of the affairs and business of the company vests with the board of directors.[27]This includes the decisions whether the company should sue or defend litigation brought against it.

The proper plaintiff rule as discussed in the case of *Foss* case[28]and *Prudential Assurance Co Ltd v Newman Industries Ltd,*[29] echoes that an individual shareholder is prevented from instituting proceedings in the courts to complain about the irregularity of the internal affairs of the company which can cured by a vote of majority in the general meeting.[30] The rule emphasis that in instances where the wrong is done to the company, the company is the *prima facie* the party who must sue.[31] 'The proper plaintiff rule underpins the principle that it is only the company that can sue for the loss caused on it in respect of breach of duty owed to it. No shareholder can institute claim in respect of the company in this instance in his or her capacity as a shareholder'.[32] The derivative action is an exception to the general rule.

In *Carlen v Drury,*[33] it was held that under the common law, the courts will not be required to interfere with the management of companies if it is done within acceptable bounds. This rule was better explained by Dowling J in the case of *Yende v Orlando Coal Distributor (Pty) Ltd,*[34] that, in general, the courts have adopted the policy that where the company ought

[25] 1902 AC 83, 93.
[26] (1843) 2 461;67 ER 189. Also see FH Cassim & MF Cassim 'Contemporary Company Law' 3rd ed (2021) 1053
[27] Section 66(1) of the Companies Act 71 of 2008
[28] (1843) 2 Hare 461, 67 ER 189.
[29] (No 2): CA 1982.
[30] RC Williams 'Concise Corporate Law' (1994) 154
[31] Stephen Griffin 'Company law fundamental principles' (1994),155
[32] *Hlumisa Investment Holdings (RF) Ltd and Another v Kirkinis and Others* [2020] JOL 47567 (SCA), 2020 (5) SA 419 (SCA) paras 33
[33] (1812) 1 V 7 B 154.
[34] 1961 (3) SA 314 (W)103

to regulate its affairs by a suitable resolution of the majority of the shareholders, the court should not interfere in the domestic affairs of the company. This is sound policy as it is in keeping with sacrosanct concept of the separate legal personality of the company.[35]It also allows the management of the company to further the interests of the company with minimal or no interference at all from either minority shareholders or any person with a *locus standi*[36].

While the obvious advantage of this rule is that it prevents multiplicity of action and potential harassment to be suffered by the company owing to multiplicity of lawsuits, but this also meant that 'the tyrannical conduct of the majority towards minority will go unchallenged'.[37]The mischief arises when those who are in control of the company are responsible for the harm inflicted on the company.[38] A strict application of the *Foss* rule inevitably led to undesirable results that where directors have inflicted harm on the company, such misconduct will never see its day in court[39]. The concentration of powers in the hands of the directors made it hard, if not impossible, for the directors of the companies to be held responsible in the instances where they themselves have committed an offence against the company.[40]Certainly, they will not authorise the company to act against themselves. The inflexible application of the *Foss* rule inadvertently hampered the efficiency and accountability of the management of the company.

It was held in the case of *TWK Agriculture Ltd V NCT Forestry Co-operative Ltd and Others,*[41] that the rule in *Foss* case is subject to the exception that a shareholder should be allowed to bring the proceedings on behalf of the company where the persons in charge of the company benefit themselves wrongfully or in breach of their duty and will use their majority power to prevent the company from claiming against them. To persuade the court that it is in the interest of justice that the wrong be corrected, the minority shareholder must demonstrate that those who are in control refused or failed to act in the company's best interests.[42] However, the courts were not able to adjudicate on derivative action proceedings in instances where there was a ratification of irregularity or impugned action by majority shareholders.[43]

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[35] ibid
[36] Ibid
[37] RC Williams 'Concise Corporate Law' (1994) 157.
[38] *Lewis Group Ltd v Woolman* (9900/2016) 2017 (2) SA 547
[39]*Atwool v Merryweather* (1867) LR 5 Eq 464, 37 LJ.
[40] Tshepo Mongalo and Tshepiso Scott (eds) *Corporate Law & Corporate Governance* (2003) 265
[41] 2006(6) SA (N), 9
[42] Stephen Griffin 'Company law fundamental principles' (1994),154
[43] *Communicare and Others v Khan and Another* 2013 (4) SA 482 (SCA)5-8

In the case of *Edwards v Halliwell,*[44] Jenkins LJ set out instances where the *Foss* rule will not find application. The rule will not be applicable where (a) the minority shareholder seeks to restrain a conduct that is ultra vires or illegal[45] (b) where minority shareholders want to declare the resolution that was passed at the general meeting to be void on the ground that it could only be passed by special resolution,[46] (c) instances where the wrong inflicted on the company is also an infringement of minority's own individual right,[47] lastly, (d) cases that involves fraud on the minority shareholders. [48]The balance brought about by the derivative action is desirable, and it is in tandem with the submissions[49] that 'no civilized and workable system would permit majority to act arbitrarily and unreasonably towards the minority'.[50]

Whilst the exception to the *Foss* rule was commendable, the common-law application was not without challenges, which limited the efficacy of the remedy. Firstly, at common law, only shareholders could apply for leave to sue derivatively.[51] This obviously disregarded people whose interests are affected by the running of the company such as employees. Things like liquidation, and retrenchment affect the livelihood of the employees and when decisions are taken/ not taken that can harm the company- the employees should have a say.[52] Secondly, it was not clear which cause of actions were not ratifiable in general meetings.[53] Thirdly, there was no recognizable procedure to access information in the hands of miscreant majority.[54]This inevitably hampered the success of the remedy. The s165 derivative action, as it shall be seen later in the body of this paper, has ameliorated, to a large degree, these hurdles. Lastly, the burden of costs disincentivized the minority shareholders from applying for derivative action. In the event that the leave to sue derivatively is refused, the minority shareholders would be mulcted with legal costs. [55] The effectiveness of the derivative action fraught with these obstacles, was significantly undermined and its contribution to the efficient and responsible management was made almost redundant. Aiming to address these inefficacies and pitfalls of

[44] [1950] 2 All ER 1064.
[45] Ibid
[46] Ibid. also read *Grancy Property Limited v Manala* [2013] 3 All SA 111 (SCA) 32
[47] Ibid
[48] Ibid
[49] R C William 'Concise Corporate Law' Butterworth, (1994) 157
[50] Ibid
[51] Tshepo Mongalo and Tshepiso Scott (eds) *Corporate Law & Corporate Governance* (2003) 266
[52] Ibid
[53] ibid
[54] Ibid
[55] Ibid

the common derivative action, a statutory derivative action was introduced in section 266 of the 1973 Companies Act.[56]

(b) The derivative action in terms of s 266 of 1973 Act

Owing to the impediments and difficulties of the common law derivative action, the Van Wyk De Vries Commission ('the Commission') was appointed to investigate how, amongst other issues, the derivative action could be improved.[57] The Commission found that the common law derivative action was 'rigid' and 'riddled with impediments' and that its significance of affording the minority shareholders protection was inefficient.[58] The recommendation of the Commission paved a way to the introduction of the statutory derivative action under Section 266 of the Act of 1973.

Under the Companies Act of 1973,[59] a provision was introduced that allowed shareholders to bring a derivative action on behalf of the company when a director breached their duty of good faith or of care , skill and diligence resulting in harm or loss of benefit to the company.[60] As a significant departure from the common law, this provision enabled a shareholder to bring proceedings on behalf of the company, even if the breach complained of had been condoned or ratified.[61] It is not useful to deal with whole procedure for derivative action under the Act of 1973 except to remark that the company did not have many options in terms of how it could deal with the actions of the majority when these were unlawful through a derivative action. Areas of concern that undermined the efficacy of this statutory procedure included the complexity of the notice to institute proceedings, especially in instances where the directors felt it was not necessary to do so, and also, amongst other issues, the issue that the derivative action could only be brought where the harm has already taken place. It could not be brought where harm was anticipated imminently. With these obstacles highlighted, it was clear that the provision of s266 of the 1973 Act, did not make using a derivative action an effective way to have some oversight to ensure that companies were managed efficiently and responsibly.

[56] Section 266 of Companies Act 61 of 1973.
[57] Main Report of the Commission of Enquiry into the Companies Act (R.P. 45/1970 of 15 April 1970).
[58] Mongalo op cit note 24.
[58] [1896] UKHL 1(1897) AC 22
[59] Section 266(1) of Act 61 of 1973.
[60] Ibid
[61] Section 266(1) of Act 61 of 1973.

Finally, the Companies Act 71 of 2008 was promulgated which included a completely revised derivative action in s165 that attempts to address and improve on the issues identified in its predecessor as set out above.

Now that I have given the background and the main research question as to whether the derivative action under s165 works to promote the objectives of s7(j) of the Act and to effectively overcome the obstacles in previous iterations, as set out above, will be considered.

III. THE DERIVATIVE ACTION IN TERMS OF S165 OF THE COMPANIES 71 OF 2008

(a) Overview of section 165 derivative action

In an attempt to address the shortcomings and inadequacies of the previous company law derivative action, the Companies Act 71 of 2008 has excised the derivative action in terms of the common law and Act of 1973[62] and introduced a streamlined derivative action housed in s165 of the Act.[63] The s165 derivative action is a paradigm shift from the past regime and reflects the contemporary needs for efficient and responsible management of companies. Generally, the prerogative to run the company has been conferred on the board.[64] *Foss v Harbottle*[65] and the derivative action are concerned with majority of shareholders, that is considered the company[66]. But s165 makes an exception to this rule.

Section 165(2) of the derivative action allows persons with a requisite legal standing to seek permission from the court to sue derivatively in order to protect the legal interest of the company where the company's legal interest has suffered and those vested with managerial, and control will not authorise the proceedings. The provision that allows the persons with a locus standi to bring application for leave if it can be shown that legal interest of the company suffers and those who are clothed the necessary powers to protect the companies' interests are failing take to action, discards all procedural hurdles, impediments and problematic concepts such as fraud on minority, wrongdoer control and ratifiability principle which constituted hostile deterrents to the protection of minority shareholders.[67] The basis for the existence of

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62 Section 165(1) Companies Act of 2008.
63 Tshepo H Mongalo 'The unlamented demise of the common-law derivative action: A note remembering Michael Larkin" (20210 138 *SALJ* 508
64 Section 66(1) of Act 71 of 2008.
65 *Foss* supra note 26
66 *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd and Others* 2014 (5) SA 179 (WCC) 55.
67 Cassim op cit note 19

the derivative action as a relaxation of the 'proper plaintiff' rule , remains intact, which is to provide relief when aggrieved minority shareholders are unable to bring an action on behalf of the company due to those in control refusing to authorize such legal action.[68]

The requirement to serve a demand as stipulated in section 165(2) serves two significant functions; that is to reinforce the proper plaintiff rule and to give the company an opportunity to manage its internal affairs without the interference of the courts.[69] It allows the shareholders, directors, registered trade unions or employees representatives or any person who has been granted leave to institute or continue proceedings or take related steps to protect legal interests of the company.[70] Unlike under common law and Act 61 of 1973,[71] where shareholders could bring the derivative proceedings, section 165(2)[72] extended the category of persons to bring a derivative action.

In *Lewis Group Limited v David Farring Woolman,* Binns-Ward J stated that the provisions that affords standing for directors and employee representatives clearly reflect the modern recognition that persons other than shareholders have a genuine and cognisable concerns in the assertion or defence of company's legal interests at its best.[73] The widened *locus standi* is quite revolutionary and laudable in that it will come in handy in instances where the majority of shareholders are prepared to overlook the harm suffered by the company owing to breach of duty by directors, the employees faced with resultant retrenchment or wage cuts may be in a position to persuade the court that it would be in the best interests of the company objectively, to seek redress against the errant directors.[74] Furthermore, 'the introduction of the section has created an open-ended cause of action, allowing derivative actions to be initiated within the boundaries of what is deemed as the legal interests of the company'.[75] I submit that

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[68] Ibid, also see HGJ Beukes & WJC Swart 'blurring the dividing line between oppression remedy and derivativ e action: Kudumane Investment Holding Ltd v Northern Cape Manganese Company (Pty) ltd and others (2012) 2 4 *Merc LJ 13*

[69] Ntsako Sharon Msomi *An analysis of extended locus standi for the derivative action and the oppression remedy under the Companies Act 71 of 2008* (unpublished LLM dissertation, University of Pretoria, 2019) 10.

[70] Section 165(2) of Act 71 of 2008.

[71] Section 266 of the Companies Act 61 of 1973.

[72] Section 165(1) Companies Act of 2008.

[73] *Lewis Group Ltd v Woolman* (9900/2016) 2017 (2) SA 547.

[74] Ibid.

[75] Maleka Femida Cassim 'judicial discretion in the derivative action under the Companies Act 71 of 2008' (2013) 130 SALJ 778

what constitutes legal interests of a company is open to interpretation by the court. [76] Lastly, there is no closed list of people against whom a derivative may be brought.[77]

The Act provides sufficient flexibility to allow derivative actions to be pursued, even in instances where the harm suffered by the company is caused by individuals who do not owe fiduciary obligations to the company.[78] Such actions can be taken against those who cause the harm, even if the majority of shareholders or directors resist taking any legal action against.[79] With regards to granting leave to sue derivatively, the Act places increased responsibility on the courts. This is accomplished by applying three open-textured criteria[80] as outlined in section 165(5)(b). The court is afforded discretion in granting permission to applicants to institute or continue proceedings on behalf of the company.[81] The court considers whether the application for leave was brought in 'good faith', if the proposed or ongoing proceedings involve a 'trial of serious questions of material consequence to the company', and whether it is in the' best interests of the company' that the applicant be granted leave to commence or continue the proceedings, as the case may be.[82]

In this regard 'the courts act as gatekeepers and play an overarching role in the exercise of their discretion to allow or refuse leave to a minority shareholder (or other applicant) to commence derivative litigation on behalf of a company'.[83] Contrary to the common law, the Act no longer allows the ratification of shareholders to prevent a person with *locus standi* from making a demand for the company to initiate or continue legal proceedings on its behalf, or from seeking leave to sue derivatively. Even if the shareholders of the company approve or ratify the conduct in question, it will not serve as a barrier to those seeking to take legal action on behalf of the company.[84] It is also noteworthy that such ratification will not prejudice the outcome of the application brought for leave or intervention in terms of section.[85] The court

[76] *Marib Holdings (pty)ltd v Patrick Albert Parring* N.O and 4 others, reportable case no:22058/2019,18.
[77] ibid
[78] MF Cassim 'When companies are harmed by their own directors: defects in statutory derivative action and cures (2013) 25 *SA MERC LJ* 168-170.
[79] Supra note 39.
[80] Maleka Femida Cassim 'judicial discretion in the derivative action under the Companies Act 71 of 2008' (2013) 130 SALJ 778,779.
[81] Ibid. also see TH Mongalo '*Corporate Actions and The Empowerment of Non shareholders Constituencies* (unpublished Doctor of Philosophy in law (PhD)).

[82] ibid
[83] Maleka Femida Cassim 'judicial discretion in the derivative action under the Companies Act 71 of 2008' (2013) 130 SALJ 778-779.
[84] Section 165 (14)(a) of the Companies Act 71 of 2008.
[85] Section 165(14).

will only take into account or note the ratification or approval before making any judgment or order.[86]

In other words, the court will be required to adjudicate on the application brought before it for leave notwithstanding the fact that the conduct complaint of has been ratified. The court must deal with the application before it on its merits as if there has not been ratification or approval by the shareholders. The court may decide to consider the ratification or approval when making its judgment, but the application cannot be refused merely because the conduct complained of has been approved or ratified.[87] I submit the introduction of the s165 remedy provides a better means to the promote the objective s7(j) of the Act as the remedy is now available to a broader range of people and the court has an overarching role to ensure that the remedy is given teeth while at same time ensuring that it is not used to achieve ulterior ends. The remedy ensures that the board of directors are always up to standard with duties. I now proceed to look the procedure under s165 to consider whether it promotes the objective s7(j) of the Act.

(b) Procedure in terms of section 165 of the Companies Act 2008

(i) Locus Standi.

Unlike Section 266 of the 1973 Act as discussed above, section 165 of the new Act extends *locus standi* to include shareholders, directors, and employee representatives.[88] This bears restating as it is fundamental to the premise of this research report.

Locus standi is granted to shareholders, directors, prescribed officers of the company, and 'related companies. Regarding the shareholders, legal standing is not only limited to registered shareholders, but also extends to those who have the right to be registered as shareholders.[89] The term 'related companies' encompasses both holding and subsidiary company relationships, as well as situations where one company has direct or indirect control over another or its operations.[90] This extension of standing is a development that significantly contributes to support the purpose of the Companies Act as set out in s7(j).

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[86] Section 165 (14)(b).
[87] Ibid at section 165(4).
[88] Section 165(2) of the Companies Act 71 of 2008.
[89] *New Heights Developers (Pty) Ltd v Bogatsu* (2017) ZAGPJHC 355. Also read 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.
[90] Section 1 of the Companies Act 71 of 2008.

Section 165 stands out by also granting legal standing to a third category of applicants—trade unions representing the company's employees and other employee representatives. This makes the remedy accessible to a broader range of individuals compared to Section 266 of the 1973 Act. According to Coetzee,[91] this expansion of eligible litigants aligns with the principles of good corporate governance. The widened locus standi ensures that the multiple people who have an interest in the affairs of the company can hold the directors accountable where such directors would not correct their wrongdoings by allowing the company to institute proceedings against them. This illustrate that the board of directors being aware that it is more than just shareholders who can hold them to account and potentially bringing the proceedings on behalf of the company where the board fails to do in situation where the harm is inflicted, the board is forced to be act with more efficiency and more responsibly.[92]The broadened locus standi will invariably make the derivative remedy more accessible and make it easier for board to held more accountable by a variety of people. I submit that the widened locus standi will act as an impetus for an efficient and responsible management of the company by the directors.

(ii) The demand and the application to set aside the demand.

To initiate a derivative action, s165(2) requires persons who have *locus standi* to serve a demand upon the company before they can approach the court for leave, demanding the company to commence or continue legal proceedings.[93] The section provides that a person 'may serve a demand on the company to commence or continue legal proccedings…' Accordingly, the word may could be criticised for lack of clarity and certainty.[94] The court has held in *Mouritzen v Greystone Enterprises (Pty) ltd,*[95] that although the language of section 165(2) of the Act appears to be discretionary in that, it says persons with a necessary legal standing, may serve a demand on a company to commence or continue legal proceedings, the demand is peremptory.[96]The court went on to state that it is not necessary that the service of the demand be effected on the registered address of the company or principal place of the business.[97] In its concluding remarks, the court pointed that it is adequate for one to employ

[91] Coetzee 2010 Acta Juridica299.
[92] FH Cassim & MF Cassim *et el* Contemporary Company Law 3rded (2021) 1061
[93] Section 165(2) of the Companies Act 71 of 2008.
[94] D Subramanien 'Legal Standing' And 'The Demand' In Section 165 of The Companies Act 71 Of 2008: A Comparative Discussion". *Obiter* (1682-5853), 43 (2).
[95] 2012(5) SA 74 (KZD) 34
[96] Ibid.
[97] Ibid.

any legally recognizable manner of service that is used in court process or document initiating proceedings.[98] The approach by the court above is a commendable one because does not strictly prescribe a specific ways on which services can be effected, so long service is done in a legally recognizable manner will suffice. This does not stifle the effectiveness of the remedy by imposing stringent requirements for service. The Act does not prescribe what should be contained in the demand but requires that it should lay a basis for a cognisable claim.[99]The company that has been served with a demand may within 15 days of the service of the demand approach the court to set aside the demand if it is of the opinion that is frivolous, vexatious or without merit.[100]

The court held in the case of *Amdocs SA Joint Enterprise (Pty) v Kwezi Technologies (Pty) ltd,*[101] that the applicant for the relief as envisaged in terms of section 165(3) is entitled to succeed if he is able to show that the demand is 'meritless', 'frivolous' or 'vexatious'. Frivolous proceedings have been defined as 'proccedings where a litigant has adopted contemptuous attitude and uses intemperate language during the proceedings, whilst vexatious simply means proccedings aimed at harassing and frustrating the defendant.[102] In an application to set aside the demand on the basis of lack of merits, the court does not pre-empt the determination of the claim that the demander is intending to prosecute derivatively nor is it concerned with the prospects of success of that claim.[103] In the event that the company does not make an application in terms of sub-section (3), or the court does not set aside the demand in terms sub-section(3), the company is enjoined to: (a) appoint an independent and impartial person or committee to investigate the demand.[104] The appointed independent and impartial person or committee has the following duties,[105] (a) to investigate the demand, and report to the board on,[106] (i) any facts or circumstances that may rise to the cause of action as envisaged in the demand or that may relate to any proceedings contemplated in the demand,[107] and also (b) investigate into the probable costs that would be incurred in pursuing the proposed cause of action or such continued proceedings.[108] The company may within 60 business days after

[98] 2012(5) SA 74 (KZD) 34
[99] *Marib Holdings (pty)ltd v Patrick Albert Parring* N.O and 4 others, reportable case no:22058/2019 at page 20.
[100] Section 165(3) of the Companies Act 71 of 2008.
[101] 2014 (5) SA 532 (GJ). 15
[102] *Caluza v Minister of Justice* 1969 1 SA 251 (N), also read *Van Eck Bros v Van der Merwe* 1940 CPD 357
[103] *Lewis Group Ltd v Woolman and others* (2) [2017] 1 All SA 231 (WCC). Also read Marib Holdings (pty)ltd v Patrick Albert Parring N.O and 4 others reportable case no:22058/2019 at page 20
[104] Section 165.
[105] Section 165(4).
[106] Section 165(4)(a).
[107] Section 165(4)(a)(i).
[108] Section 165(4)(b).

the demand has been served or any longer time as a court, on the application, the company, may allow, either: start or continue proceedings or even take necessary to protect the interests of the company as envisaged in the demand[109] or simply decline to comply with the demand by serving a notice on the person who issued the demand.[110] I submit that the provision that allows the company to ask for extension of 60 day period to respond to the demand either by conducting an investigation, or taking necessary steps to protect interests of the company or simply declining to institute or continue proceedings allows the company the handle their internal affairs before the court can intervene.

The person with a *locus standi* and who has made a demand in terms of subsection (2) may then apply to court for the leave to initiate or continue the derivative action proceedings on behalf of the company. The court may if is if satisfied that the company has (i) failed to take any particular step required by subsection(4)[111];or (ii) where the independent investigator lacked impartiality and independence;[112] (iii) or where he has accepted a report that was inadequate in its preparation, or was irrational or unreasonable in its conclusions or recommendations[113] or (iv) acted in a manner that was inconsistent with the reasonable report of the independent and impartial investigator or committee,[114]or (v) has served a notice refusing to comply with the demand, in terms of subsection(4)(b)(ii).[115] The court may grant leave to sue derivatively to the applicant if it is satisfied that the applicant is acting in good faith,[116] that the proposed or continuing proceedings involves a trial of serious question of material consequence to the company;[117] and it is in the best interests of the company that the applicant be granted leave to commence the proposed proceedings or continue the proceedings as the case may be.[118] The individual requirements of section 165 of the Act should not be considered in isolation but conjunctively.[119] To the extent that the company can apply to the court to set aside the demand affirms that with the board of directors has the prerogative to manage the affairs of company. An endeavor to set aside a demand is part of managing the affairs of the company. Furthermore, the provision requiring the company to appoint an independent and

[109] Section 165(4)(b)(i).
[110] Section 165(4)(b)(ii).
[111] Section 165(5)(a)(i).
[112] Section 165(5)(a)(ii).
[113] Section 165(5)(a)(iii).
[114] Section 165(5)(a)(iv).
[115] Section 165(5)(a)(v).
[116] Section 165(5)(b)(i). For a discussion on this requirement see: MF Cassim 'The statutory derivative action under the Companies Act of 2008: the role of good faith' (2013) 130 *South African Law Journal 496-508*
[117] Section 165(5)(b)(ii).
[118] Section 165(b)(iii).
[119] *Mbethe v United Manganese of Kalahari (Pty) Ltd* (2017) (5) SA 409(SCA) 60-67.

impartial investigator to investigate the demand, the circumstances that gave rise to the cause of action, and the probable costs if the company is to continue or stop proceedings is another means of reinforcing accountability and efficiency of the board of directors.[120] The decision to continue or institute proceedings on behalf of the company might always be the best for company for different reasons including but not limited to; it might be more costly for the company to pursue litigation or litigation might unnecessarily strain relationship between the company and the defendant instances where mediation may suffice.

In the case of *Mbethe v United Manganese of Kalahari (Pty) Ltd,*[121] Swain J held that even where the requirements are met in terms of Section 165(5)(b) of the Act, the court has a residual discretion to refuse to grant the leave. The court in this instance serves as a gatekeeper, sifting out unmerited claims and application brought with ulterior motives and *mala fide*. Only meritorious application for leave will be granted.[122] I submit that the granting of the leave fetters the prerogative of the company's directors to manage its own affair. This is a necessary limitation as balances the decision-making powers of the board of directors and aggrieved stakeholders by offering a recourse in instances where they are unhappy with board's decisions. Subsection (6) provides for a deviation from the procedure by permitting any person with requisite *locus standi* to apply to court for leave without making demand in terms of subsection (2) or without affording the company time to respond to the demand in accordance with subsection (4). I submit that is provision is useful tool in the modern-day corporate governance where certain decisions may have immediate adverse consequences for the company and may require urgent intervention to alleviate or ameliorate the effect of such decision. It takes into cognizance that it will not always be possible to follow the safeguard requirements and anything concomitant thereto. The court in this instance may only grant leave if the court is satisfied that if the period and process envisaged in terms of subsection (3) to (5) are to be completed may result in: - (i) irreparable harm to the company[123], (ii) substantial prejudice to the interest of the applicant or another person.[124] The court must further be satisfied that there is a reasonable possibility that the company may not act to prevent the harm or prejudice or act to protect the company's interests that seeks to protect, and that the requirements of subsection(5)(b)[125] are met. The court in terms of this provisions above, is allowed enough

[120] Cite note 92.
[121] (2017) (5) SA 409(SCA).
[122] M F Cassim 'Judicial discretion in the derivative action under the Companies Act 71 of 2008' (2013) 130 *South African Law Journal, 779-781.*
[123] Section 165(6)(a)(i).
[124] Section 165(6)(a)(ii).
[125] Section 165(6)(b).

flexibility to protect the legal interests of the company where it may not reasonably be feasible to follow the pre-litigation processes of serving a demand on the company and allowing the company to deal with demand. The legal interests of the company are at the forefront of the s165 derivative action.

(iii) 'Open textured discretion of the court'[126]

The court is vested with the discretionary powers to grant the leave to commence or continue proceedings on behalf of the company to the person who has made a demand in terms of subsection(2) if it is satisfied that the applicant is (a) acting in good faith,[127] (b) the proposed or continuing proceedings involve the trial of a serious question of material consequence to the company ,[128] and (c) it is in the best interests of the company that the applicant be granted leave to commence proposed proceedings or continue such proceedings.[129] The court is enjoined to apply discretion in line with the above three vague and general guiding criteria.[130] The criteria envisaged in section 165(5)(b) of the Act is created to serve as check and balance mechanism to limit the abuse of the usage of the derivative action by the minority shareholders and other applicants, and further to filter out the nuisance claims.[131]

In line with the adaptation and an extension of existing common law principles, it is argued that the criterion of good faith has two facets.[132] The first test of good faith relates to the applicant's state of mind.[133] That is subjective. It depends, principally, on honesty exclusively.[134] It was held in the case of the *Chartbridge Corporation Ltd v Lloyds Banks Ltd,*[135] that the test for good faith is whether an intelligent and honest person in the position of the director could in the circumstances, have reasonably believed that he or she was acting in the best interests of the company.[136] The principles governing fiduciary duties as Cassim puts it, should be adopted suitably for the derivative action in terms of section 165 of the Act.[137]

[126]Cite note 122.
[127] Ibid.
[128] Ibid.
[129] Ibid.
[130]M F Cassim 'Judicial discretion in the derivative action under the Companies Act 71 of 2008' (2013) 130 *South African Law Journal*, 780.
[131] M F Cassim note 103.
[132] Ibid.
[133] Ibid.
[134] Ibid.
[135] (1970) Ch. 62 (05 November 1968). Also read MF Cassim 'The statutory derivative action under the Companies Act of 2008: the role of good faith' (2013) 130 *South African Law Journal 496-508*
[136] (1970) Ch 62 74.
[137] Supra note 75.

The last facet of the principle of good faith criterion has to do with the motive or purpose of the applicant in bringing the proposed derivative action.[138] In this instance, the applicant must demonstrate that his actions, to an extent that it relates to the proposed derivative action is based on an honest purpose of protecting legal interests of the company, and not by the ulterior motive of trying to achieve his own personal or private interests for which the derivative action was ill-conceived.[139] The test for serious question to be tried is lower and more lenient to satisfy.[140] The court is not bound to grant leave to the applicant on the basis that the requirements set out in subsection (5)(b) have been met.

It was held in *American Cynamid Co v Ethicon Ltd*,[141] that in order to prove that the action involves a serious question to be tried, the applicant ought to demonstrate that his claim is neither frivolous nor vexatious. I agree with the sentiment by Cassim that the trial of a serious question is in keeping with the policy principle that the application for leave for derivative actions should be relatively simple, short, and inexpensive.[142] This is an appealing incentive and serves as the appropriate impetus for the applicants to bring derivative action without the risk of being exposed to long, cumbersome, and expensive processes. The cases which are likely to be in the best interests of the company are those ones where the directors fail to institute legal proceedings for a breach of legal fiduciary duty, without any legitimate justifications, because they are the perpetrators of the harm to the company.[143] The applicant for leave under section 165 of the Act has a duty to act in the best interests of the company that's akin to that one of directors. This view is reinforced by what is stated in the case of *Mouritzen v Greystone (Pty) Ltd,*[144] that the applicant in terms of s65(5)(b) is required to act in good faith and in the best interests of the company on the standard required of directors. Applicant for leave is required to allege specific averments of wrongdoings and identify rights that are in issue rather than to couch his allegations or suspicions of liability in general terms.[145]

There are no guidelines as how the court should interpret and apply these three requirements, that good faith, the issue involves a trial of a serious question of material consequences to the company and that it must be in best interest of the company for the leave to be granted to commence or continue the proceedings. I submit that when interpreting the

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[138] Supra 75.
[139] *Howard Smith Ltd v Ampol Petroleum Ltd* [1994] AC 821(9C).
[140] *Bechim Group Ltd v B-M Group (Pty) Ltd* 1977 (1) S0 (T).
[141] [1975] AC 396, see also the case of *Chief Nchabeleng v Chief Phasha* 1998 (3) SA 578 (LCC).
[142] Supra note 131.
[143] Ibid.
[144] 2012 (5) SA74 (KZD)para 24.
[145] Ibid para 33.

open-textured criteria in terms of s165(5)(b), the courts should not adopt unnecessarily restrictive approach on the availability of the remedy.[146] I submit, for the courts to give teeth to the s165 derivative action in ensuring that it keeps up to its functions of monitoring and holding board of directors accountable, more liberal, and robust interpretative approach ought to be adopted.[147] The rigid approach will stifle the effectiveness of the remedy. The court should have sight of the purpose of the Act, which amongst others is to encourage high standards of corporate governance,[148]and encouragement of the efficient management of companies.[149] The court has an obligation when determining or making an order in respect of a matter under the Companies Act 71 of 2008 to promote the spirit, purport, and objects of the Act.[150]

(iv) Presumption of not in the best interests of the company

To ensure that the remedy is not abused, and the autonomy of the company is not undermined by requesting court to intervene in the affairs of the company, subsection 165(7) creates a rebuttable presumption that the granting of leave is not in the best interest of the company, it must be established that the proposed or continuing proceedings are by (i) the company against the third party; or a third party against the company. Moreover, the company has decided not to bring the proceedings, not to defend the proceedings ; or to discontinue, settle or compromise the proceedings; and furthermore, all of the directors who participated in that decision acted in good faith for proper purpose, did not have a personal financial interests in the decision, and were not related to a person who had a personal interest in the decision, informed themselves about the subject-matter of the decision to the extent that they reasonably believed to be appropriate; and reasonably believed that the decision was in the best interests of the company. Binns-Ward J stated that the effect of provisions of Section 165(7) amounts to 'nothing more than a restatement of the common law derivative action requirement wherein one was required to show control of the company by wrongdoers, which had to be proved by the shareholder who chose to litigate on behalf of the company'.[151] To the extent that a specific group of stakeholders in terms of s165(2) has been given a locus to apply to sue derivatively, the

[146] MF Cassim 'The statutory derivative action under the Companies Act of 2008: the role of good faith' (2013) 130 *South African Law Journal 496.*
[147] Ibid.
[148] Section 7(b)(ii) of the Companies Act 71 of 2008.
[149] Section 7(j) of the Companies Act 71 of 2008.
[150] Section 158(b)(i) of the Companies Act 71 of 2008.
[151] *Lewis Group Limited v David Farring Woollam* and 4 others case number:9900/2016, 24.

presumption as mentioned above safeguards the ability to manage its business. It is an impervious layer to potential abuse of the remedy.

(v) Security for costs, and costs of the proceedings

In the application for leave to commence or continue with the proceedings on behalf of the company, the court may require security for costs from the applicant.[152] The section does not set out the grounds under which the security for costs may be sought. It is unclear as to on which basis should the order requiring security for costs be made. It remains to be seen whether it should be brought on application by either of the parties participating in the leave proceedings or whether the court will raise the issue of security for costs out of its own accord.[153] I submit that whichever case it may be, the introduction of security for costs remains an important tool to counter-prevent potential abuse of the remedy. The converse effect is also true, the requirement for security for costs may discourage prospective applicants because the applicants for leave to sue derivatively may not always have money to sponsor the derivative actions or put-up security for costs in the event they are required by the court.[154] This is owing to the reason that the fact the derivative remedy is for the benefit of the company, not directly for the members, people endowed with legal standing will not always have moneys to put up security for costs. Another disincentive is that people who yield power in the company, who are most likely potential respondents (decision makers), may have more financial muscles and appetite to defend their harmful conduct to the company.[155] The court bears a discretion whether or not security for costs should be lodged in any given case,[156] this discretion should be exercised by having regard to all the relevant facts taking into account consideration of equity and fairness to both parties.[157] At any time, a court may make any order it considers appropriate the costs of the following persons in relation to proceedings brought or intervened in with leave under the section 165 or in respect of an application for leave under this section (a) the person who applied for or was granted leave under this section (b) the company or any other party to the proceedings[158]. There is no criteria explicitly set out in section 165 that guides the court in

[152] Section 165(11) of the Companies Act 71 of 2008.
[153] Section 165(10).
[154] M F Cassim 'Cost orders, obstacles, and barriers to the derivative action under section 165 of the Companies Act 71 of 2008' (2014) 26 *South African Mercantile Law Journal*, 14.
[155] Ibid.
[156] Ibid.
[157] *Magida v Minister of Police* 1987 (1) SA 1 (A) at 14 E and 15D.
[158] Section 165(10) of the Companies Act 71 of 2008.

dealing with the issue of costs. In the absence of such guidelines, I agree with *Cassim et el* that the court retains their general judicial discretion in dealing the question of costs.[159] One would have expected the crafters of the Companies Act 2008 would make a radical shift of approach when it comes to the issue of costs as a way of making the derivative action remedy more accessible and enticing. Because in the derivative proceedings, the real plaintiff is the company, the costs burden on the minority shareholder presents a real disincentive for the prospective applicants to litigate on behalf of the company because of the costs follow the cause rule implicit in s165(10). I submit that this conservative approach is archaic and unhelping as it stultifies the effectiveness of the remedy because the prospective applicants for derivative proccedings are left, to a larger extent, at mercy of the court, leaving them as uncertain whether they recover their costs or they will be burden with more costs. The Australian Court held in the case of *Wood v Links Golf Tasmania (Pty) Ltd*[160] that once the leave is granted the costs of derivative action should be on the company. The issue of costs has been a hurdle even during the common law regime and one would have expected that the Companies Act of 2008 would remove this obstacle. It is uncertain as to who should be bear the costs of the derivative litigation particularly where the application was unsuccessful. The success and effectiveness of the derivative remedy depends largely on its accessibility. The burden of costs may disincentivize the applicants who do not have deep pockets to cover the costs on behalf of the company as they do not litigate for their own personal benefit but for the company. Thus far, the question of costs vest in the hands of the court, making it less certain as to who should be bear the costs, particularly in the instances where the application to sue derivatively is unsuccessful. Whilst this may in some instances serves as a safeguard against the abuse of the remedy, I submit that it hinders the accessibility, and undermines the rationale for existence of the remedy.

(vi) Leave of court to discontinue or settle proceedings.

A party that brings proceedings in terms of s165 is barred from discontinuing or entering into compromise or settling the proceedings without the leave of the court.[161] This provision serves as a crucial role in ensuring that the proceedings for leave to sue on behalf of the company is brought for legitimate reasons and not motivated by spitefulness and ulterior motives of the

[159]Ibid.
[160] [2010] FCA 570, 28 ACLC 10–042, 2010 WL 2282333, [2011] ALMD 1152.
[161] Section 165(15) of the Companies Act 71 of 2008.

party.[162]I submit in this way the court is kept abreast with the process of the leave application. This affirms the overarching role the court plays in ensuring the legal interests of the company are upheld and the leave process is not used to achieve ulterior motives. Having looked at provisions of s165, in the next section I consider how the derivative action intersects with the purpose of s7(j) of the Act.

IV. UNDERSTANDING SECTION 7(J) OF THE COMPANIES ACT, 71 OF 2008

The adherence to the section 165 derivative action as discussed above fosters management that is efficient and responsible. The efficient and responsible management is one, amongst other objectives, that s7 of the Act echoes. Whilst some legal scholars have expressed themselves[163] on s7, there is less that has been written about how efficient and responsible management can be achieved within the scheme of the Act. As the backdrop of this understanding, it is important to seek to define the meaning of what "responsible" and "efficient" management is within the context of the Act. The Act does not define what "responsible" and "efficient" management. The above being the position, I resort to the ordinary dictionary meaning of both "responsible" and "efficient'. The ordinary and literal meaning of responsible is – "liable to be called to answer" or "to be called to answer for one's conduct and obligations".[164] By the same token, efficient means "being productive of desired effect especially being capable of producing desired results with little or no waste".[165] s158 of the Act enjoins the court when determining a matter brought before it when making an order to (i) to promote the spirit ,purpose and objects of the Act, and (ii) if any provision of this Act, or other document in terms of this Act, read in terms of its context ,can be reasonably construed to have more than one meaning, must prefer the meaning that best promotes the spirit and purpose of the Act, and will improve the realization and enjoyment of rights.[166] One of the purposes of derivative action as discussed

[162] FH Cassim & MF Cassim cit note 131. For further discussion see MF Cassim 'The derivative action under the Companies Act: Guidelines for judicial discretion' (2016) SALJ 9.9.2

[163] Katzew J 'Crossing the Divide Between the Business of the Corporation and the Imperatives of Human Rights: The Impact of Section 7 of the Companies Act 71 of 2008' 2011 *SALJ* 686-687. Also read Bilchitz D 'Corporate Law and the Constitution: Towards Binding Human Rights Responsibilities for Corporations' 2008 *South African Law Journal Style* 754-789.

[164] Merriam Webster Dictionary, https://www.merriam-webster.com/thesaurus/responsible.

[165] Ibid, https://www.merriam-webster.com/thesaurus/efficient.

[166] Section 158 of the Companies Act 71 of 2008.

above is to forge accountability and protect the financial interests of the company.[167] This specific purpose fit squarely into the objective of s7(j) of the Act, which is to encourage efficient and responsible management. The derivative action reinforces on the board of directors a duty to observe high standards of corporate governance.[168] It ensures that the directors act consistently with their duties, which primarily entails acting in the best interests of the company. When this is achieved, the result is that management becomes more transparent, accountable, and efficient. The objective of s7(j) of the Act is in keeping with the modern-day corporate governance where the need for transparency, accountability and efficiency is the currency of the sound running of the company.

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V. THE INTERSECTION BETWEEN DERIVATIVE ACTION AND SECTION 7(J) OF THE COMPANIES ACT 71 OF 2008 AND SHORTCOMINGS OF S165

Thus far it can already be deduced from what I have canvassed above that when the derivative action remedy is upheld, the miscreant directors are not only held accountable for their breaches but also deters any future encroachments on the company in respect of the similar conduct. The current and future directors become conscientized that they are answerable for the wrongs they have inflicted on the company and their powers to make decisions on behalf of the company is not unfettered. Whilst the derivative action ensures that directors are held accountable, and legal interests of the company are safeguarded, this supports s7(j) of the Act, that encourages responsible and efficient management. The extended locus standi makes the remedy accessible to the variety of people including shareholders, directors and trade union(employees). The net effect of this, is that it becomes easier for the board of directors to be held accountable. In turn, the board of directors are not only encouraged to be efficient but are compelled to be responsible because they would already have been aware that for any dereliction of duty to the company, any person mentioned as having locus standi will approach court to sue derivatively to protect the legal interests of the company. The derivative action ensures that there is accountability and efficiency in the management of the company which when it is achieved the interests of the company becomes protected.

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[167] M Gwangwana 'The South African Companies Act and the realization of Corporate Human Right Responsibilities' (2015)18 *PER*, 3108 -3102.
[168] *Marib Holdings (pty)Ltd v Patrick Albert Parring N.O and 4 others* reportable case no:22058/2019 at page 16.

Whilst I submit that s165 derivative action brought about the desired changes in corporate governance sphere where there is, more than ever before, a need for efficient and responsible management of company as echoed by s7(j) of the Act, it is my submission that certain aspects of s165 can potentially limit the availability and effectiveness of the remedy. The list I provide below is not a *numerus clausus*. On the question of who has the *locus standi* in terms of s165(2), employees of the company can only litigate on behalf of the company to an extent that they are represented by their trade union or any form of representation.[169] It is not clear as to what is the rationale for this limitation. I submit; however, this defeats the logic for expansion of locus standi to include employees because not all employees in the company will belong to a trade union. Indiscriminately, employees, just like directors and shareholders, have vested interest in the proper operations of the company, and equally they must be given full legal standing without further qualifications. So much of success in litigation depends on information available in the hands of the prospective litigants. The Act has not done as much to allow the applicant for leave for derivative action access to information. The chunk of the information which application for leave to sue derivatively hinges on, lies vastly in the hands of those who are in the helm of the company.[170] There is no explicit provision in the entire Act that gives access to information to the group of persons who have locus standi in terms s165(2) of the Act for the purposes of preparing for the derivative action.[171] This will invariably impede on the effectiveness of the remedy. This above limitation not only poses a threat on the viability of the remedy, but it also has a potential of rendering the remedy redundant. As already discussed above, the leave may only be granted in instances where the requirements encapsulated in s165(5)(a) and(b) of the Act are satisfied. From the reading of s165(5) of the Act, it is not peremptory for the court to grant the leave even in instances where the requirements as delineated above are met. It remains to be seen in which instances will the court withhold such leave even when requirements for leave are met. Elsewhere in this paper I have already canvassed the aspect of security for costs, to avoid being prolix, it is not necessary to restate them here. On the balance of issues, I have dealt with in this section, including the issue of costs and security for costs, I submit that they have a potential of limiting the availability and effectiveness of the remedy unnecessarily and these obstacles, if they remain

[169] Section 165(2)
[170] FH Cassim & MF Cassim *et el* cite note 25.
[171]Section 26 of the Companies Act 71 of 2008 gives access to persons who have beneficial interests in the securities of the company, whilst section 31 of the Act deals only with access to financial statement.

unattended, they have an effect of undermining the purpose of s7(j) of the Act. This I submit is not what legislature would have intended as it undermines the rationale of s7(j) of the Act.

VI. CONCLUSION AND RECOMMENDATIONS

The derivative action in term s165 of the Act is consistent with the contemporary needs of the society where there is an obvious consensus that operations of the company, including how the company is managed, affects not only the shareholders but a broader spectrum of stakeholders in the community. The broadened locus standi takes care of the necessary requirement that instances where the directors of company will not authorise for the harm caused on company because they themselves are perpetrators, to allow the individuals listed in s165(2) of the Act to seek to act on behalf of the company. The excise of stringent and unnecessarily rigid causes of action in terms of which a shareholder was entitled to bringing a derivative litigation and the introduction of more widened cause of action in terms of which the leave to sue derivatively is applaudable. The yardstick is now whether the legal interests of the company are being prejudiced and whether those who are clothed with the necessary power are failing to protect the legal interests of the company.[172] The demand on the company by a person with a locus standi as prescribed and procedures concomitant thereto, reaffirm the authority of the board to manage the affairs of the company internally including the decision to litigate or not. The court is an ultimate overseer of whether the derivative remedy ought to be applied. It has been conferred with discretion to exercise this power if it is convinced that the application for leave is brought(a) in good faith (b) there is material issue triable and(c) whether it is brought in the best interests of the company. The court's function is to ensure that the remedy is reasonably accessible but also to ensure that it is not open for abuse by *mala fide* applicants. The effectiveness or otherwise of the remedy lies squarely hands of the courts. Therefore, the court when confronted with s165 derivative action should adopt a purposive approach to give effect to the rationale of the Act. This will ensure that the remedy is given the necessary impetus whilst the abuse of the remedy is guarded. To ensure that the remedy is not stultified, and it promotes the objectives of s7(j) of the Act, a more progressive and robust approach should be adopted by the courts. In the manner delineated above, the object of the remedy, that is to enforce accountability and deter future misconduct of directors will be well served. The directors will be, not only transparent but efficient and responsible because they would

[172] MF Cassim cite note 131.

appreciate that their powers are not unfettered. S165 of the Act strives to protect legal interests of the company by providing a mechanism to hold the directors accountable and minimizing loss or harm on the part of the company by encouraging transparency and high standard of corporate governance.[173] This is consistent with the ideals of the s7(j) of the Act – to encourage efficient and responsible management. To ensure that the remedy is not stultified, and it promotes the objectives of s7(j) of the Act, a more liberal and robust approach should be adopted by the courts. Whilst the remedy at first glance may seem s165 satisfactory, I submit that there are a few things that could be improve by the legislators or even the courts when they are applying the provisions of s165 of the Act, to make the remedy more enticing, available, and more effective for its intended purpose. An amendment to s165(2)(c) may be considered to make a provision for employees who are not represented either by trade union or otherwise. There is a need for a provision for access to information for derivative proceedings. Furthermore, a provision to reimburse the applicant for the necessary expenses incurred in pursuance for derivative action in the event that he or she is successful. The applicant for derivative action should not be mulcted with costs that ordinarily follows in the event a litigant is unsuccessful if the court is satisfied that the applicant is litigating in good faith, and in the best interests of the company. Finally, the court or legislator must define by whom and under what circumstances can the security for costs be requested and ordered. This will ensure that s65 is truly and effectively serves to promote and bolster the important purposes of the Act – the efficient and responsible management of the company.

[173] Section 7(b)(iii) of the Companies Act 71 of 2008

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