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Abstract
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Keywords
statutory derivative action, (SDA)

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THE STATUTORY DERIVATIVE ACTION IN AUSTRALIA: AN EMPIRICAL REVIEW OF ITS USE AND EFFECTIVENESS IN AUSTRALIA IN COMPARISON TO THE UNITED STATES, CANADA AND SINGAPORE.

Melissa Hofmann*

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This article reviews the use of the statutory derivative action (SDA) in Australia and assesses its success in Australia compared to its impact in the United States, Canada, Japan, Germany, France, New Zealand, Malaysia, India and Singapore. Each jurisdiction's standing, leave and notice requirements, together with the costs issue are covered. The article also addresses criticisms by commentators that the statutory derivative remedy has little practical use and that there are other remedies already available to address corporate wrongs.

INTRODUCTION

Once a company is incorporated, it acquires a separate legal identity, with the ability to sue and to be sued. However, a company cannot act on its own and relies on its representatives in order to function as a legal personality. Accordingly, the management is bestowed with exorbitant powers of control, subject to duties and responsibilities. Shareholders, who are the 'owners' of the company, are left with residual powers of oversight and control, which includes the power to sue for personal and corporate wrongdoings committed by the management.

The Statutory Derivative Action ('SDA'), also referred to as the *representative action*,[1] was enacted by various legislatures around the world to unveil

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1 Although the phrase 'statutory derivative action' is widely used in Australia to refer to the action available to shareholders in Part 2F.1A of the Corporations Act 2001 the Act does not refer to the action as being a 'statutory derivative action' (though the term was used by Heenan J in *Westgold Resources NL v Precious Metals Australia Ltd* [2002] WASC 221. The phrase has been contrasted with 'statutory representative action' by academics, with the suggestion that use of the word 'derivative' is a colloquial misnomer. Bruce Welling at page 544 of *Corporate Law in Canada - the Governing Principles* (2nd ed, Scribblers Publishing 1991) said, 'The term "derivative action", in its modern corporate use, seems to be American in origin. It is used in America to describe a common law (not statutory) action brought, usually by a shareholder, on behalf of a corporation to redress a wrong done to the corporation.' Whilst the term is properly used in the American common law action

corporate mismanagement and to alleviate the imbalance of power created by the separation of ownership and control. It empowers shareholders by enabling them to bring an action on behalf of the company against company insiders for wrongs suffered by the company in circumstances where the company is either unable or unwilling to bring the action. Whilst the SDA was only introduced into Australian company law less than five years ago, this form of action is relatively well established in countries including Canada,[2] the United States,[3] France,[4] Israel,[5] Japan,[6] Singapore,[7] New Zealand[8] and South Africa.[9]

This article reviews the use of the SDA in Australia since its introduction and analyses the success and effectiveness of the SDA in Australia compared to its use in the United States, Canada, Japan, Germany, France, New Zealand, Malaysia, India and Singapore. This article looks at each jurisdiction's standing, leave and notice requirements, together with the costs issue before concluding as to the popularity and success (or lack) of the derivative suit in that particular jurisdiction. Neither the personal action nor the statutory oppression remedy will be addressed in detail. The article concludes by addressing criticisms by various commentators that the statutory derivative

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context it may be being misused in Australia, Canada, United Kingdom and other common law jurisdictions. Welling adds that, 'There is a danger that colloquial terms in the courtroom may bring with them the technical limitations inherent in those terms in other jurisdictions.' (546).

2 *Canada Business Corporations Act 1975*. The statutory derivative action was introduced into Canadian company law in the 1970s following reform as early as 1967: Lang Thai, 'How Popular are Statutory Derivative Actions in Australia? Comparisons with United States, Canada and New Zealand' (2002) 30 *Australian Business Law Review* 118, 124.

3 The derivative action can be traced back to the 1855 decision in *Dodge v Woolsey* 59 US 331, 341 (1855). Provision for statutory derivative action is at both Federal (Rule 23.1 of the Federal Rules of Civil Procedure, and state level (individual state company legislation): Stephen Bottomley, 'The Relative Importance of the Statutory Derivative Action in Australia' (2002) 2 *International Corporate Law Annual* 141, 142.

4 *Commercial Code* (Legislative Part) Book 2 Title II Article L225-252 to L225-257 (Law No 2001 – 420 of 15 May 2001, Article 107(8) Official Gazette of 16 May 2001) <http://www.legifrance.gouv.fr/html/codes_traduits/commercetextA.htm#Section%208:%20Civil%20liability>

5 Arad Reisberg, 'Promoting the use of derivative actions' (2003) 24(8) *The Company Lawyer* 250 with reference to s 1194A of the *Companies Act 1999* at 250. Reisberg also commented that prior to the introduction of the statutory derivative action that Israeli Courts, unlike English courts have 'shown an inclination to effectively "brush aside" the procedural barriers of *Foss v Harbottle* where they stand in the way of justice being served.'

6 *Commercial Code of Japan*, Articles 267-268: Stephen Bottomley, 'The Relative Importance of the Statutory Derivative Action in Australia' (2002) 2 *International Corporate Law Annual* 141, 142.

7 Introduced into the *Companies Act* Cap 50 (Singapore) in 1993.

8 Above n 5, 142; *Companies Act 1993* (New Zealand) ss 165-8.

9 Above n 5, 142; *Companies Act 1973* (South Africa) ss 266-8.

remedy has little practical use and that there are other remedies already available under the Act to address corporate wrongs, thereby rendering the SDA ineffective and unnecessary.

The second part will then empirically review Australian reported cases on the SDA in Australia between 28 June 2000 and 30 March 2005[10] in an attempt to understand: -

- which courts and jurisdictions give more favourable treatment to the SDA;
- the number of SDAs dismissed and the reasons why, and
- the number of SDAs to which leave is granted.
- the type of companies which are the subject of the action
- the grounds of complaint to support the SDA.

Part 1

The United States

1 Introduction

The derivative action has been available in the US since 1855.[11] The present day SDA is based on the common law derivative action, which was established in *Hawes v City of Oakland*[12] and reproduced today in Rule 23.1 of the *Federal Rules of Civil Procedure*[13] and the *Model Business Corporations Act*. Most states have civil procedure and corporations laws that mirror these federal laws.[14]

Whilst there appears to be conflicting opinions as to the popularity of the SDA,[15] the American SDA is regarded as one of the 'primary mechanisms for holding corporate

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[10] The search was conducted on the www.austlii.edu.au website on 1 November 2003.

[11] *Dodge v Woolsey* 59 US 331, 341 (1855), as referred to in Michael A Collora and David M Osbourne, 'Class-Action Reforms Spur Derivative Claims: Shareholders are taking a fresh look at derivative suits to pursue investor fraud cases' (15 February 1999) *National Law Journal* at 2 http://dwyercollora.com/articles/mc_class.asp (accessed 4 November 2003).

[12] 104 US 450 (1882) (US Supreme Court).

[13] Lynden Griggs, 'The Statutory Derivative Action: Lessons That May Be Learnt From The Past!' (2002) 6 UWSLR 63, 81 <http://80-search.informit.com.au.ezproxy.bond.edu.au:8080/fullText;res=AGISPT;dn=20032652>

[14] For example, the *Delaware Corporations Code*.

[15] 'Such litigation is relatively rare in the case of public companies': Ian M Ramsay, 'Enforcement of Corporate Rights and Duties by Shareholders and the Australian Securities Commission: Evidence and Analysis' (1995) 23 *Australian Business Law Review* 174, 179.

[15] Above n 5, 162: 'Shareholder litigation is "an infrequent experience".'

fiduciaries accountable'[16] and is based on a managerial system of corporate governance. Regardless of outcome, the American SDA is used with far greater frequency than the SDA available in Canada, Australia, New Zealand and Singapore.[17]

1.1 Civil Procedure

The American SDA (both at Federal and state level) differs quite dramatically to the common law SDAs examined here in that:

1. There is no leave requirement (unlike Australia, New Zealand, Canada and Singapore).[18]
2. The notice of demand requirement is very strict: the plaintiff is required to plead every cause of action in the written notice.
3. The standing requirement is more restrictive than the Australian, Canadian and New Zealand standing requirement in that in order to bring a SDA the plaintiff must be a current member or 'have been a shareholder or member of the corporation or the association at the time of the transaction of which complaint is made or that the share or membership, if acquired thereafter, devoid by operation of law'.[19]
4. The costs associated with running a SDA can be funded on a contingency basis until settlement of the action.
5. A special litigation committee may be appointed by the company's board of directors to determine whether it is in the best interests of the company (the business judgment rule) for the SDA to be pursued.
6. Pursuant to s 23.1 of the Federal Court Rules of Civil Procedure, once a SDA is commenced the action cannot be settled, discontinued or compromised without the court's approval (collusion).[20]

Notice of demand requirements

The notice of demand requirements are strict. The content of the notice must be adequate for its purpose - identify the wrongdoers; plead every cause of action; outline the nature of the injury suffered by the company; and state the

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16 'When Should Courts Allow the Settlement of Duty-of-Loyalty Derivative Suits?' (1996) 109 *Harvard Law Review* 1084, 1085.

17 Lang Thai, 'How Popular are Statutory Derivative Actions in Australia? Comparisons with United States, Canada and New Zealand' (2002) 30 *Australian Business Law Review* 118, 124.

18 Ibid, 119.

19 Ibid, with reference to Rule 23.1 of the *Federal Court Rules of Civil Procedure*.

20 Ibid, 122.

remedy requested.[21] But the company's directors must also be given at least 90 days to respond to the content of the notice, unless the plaintiff can show that a shorter timeframe is required as the company would otherwise suffer irreparable injury.[22]

The notice of demand requirement can only be excused at the Chancery Court's discretion in deciding whether, on application of the test in *Aronson's* case:

> under the [alleged] facts, a reasonable doubt is created that: (1) the directors are disinterested and independent; and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.[23]

The Litigation Committee

The Litigation Committee (the Committee) is a unique concept to the American SDA. It is a function instigated by the directors of the allegedly injured company at the time the plaintiff commences the SDA, as it stays the proceedings until such time as the Committee determines whether it is in the best interests of the company to litigate the SDA. The Committee is perhaps the main obstacle that needs to be overcome by the potential plaintiff in bringing a SDA. The Committee is purportedly made up of company directors independent of the allegedly injured company. In reality, however, bias surely exists as the directors of the allegedly injured company appoint the Committee.

1.2 Litigation costs

Reasons for the SDA being popular in America include:

1. Lawyers are being encouraged by the courts to take on SDAs on either a contingency or 'lodestar' basis because they use several methods of calculating solicitors' fees in a SDA depending on the success of the action.[24] Using the 'common fund' method, the solicitor's fee percentage is calculated based on the amount awarded by the court before any distributions are made. The solicitor's fees (of between 20% and 30%) are to be paid first using the percentage rule:[25] *Trustees v Greenough*[26] and *Central RR & Banking Co v Pettus*.[27]

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[21] Ibid, 120, with reference to rule 23.1 of the *Federal Court Rules of Civil Procedure*.
[22] Ibid.
[23] Ibid, 120 with reference to *Aronson v Lewis* 473 A 2d 805, 814 (Del 1984).
[24] Ibid, 123.
[25] Ibid.
[26] 105 US 527 (1881).
[27] 113 US 116 (1885).

2. Because potential complainants can take advantage of contingency fee arrangements with lawyers, thereby avoiding the prohibitive cost issue suffered by complainants in Australia, Canada, and Singapore and to a lesser extent, New Zealand.

1.3 How popular is the derivative suit?

Between 1995 and 2003 there appear to have been 144 reported SDA cases in Delaware alone.[28] Of this figure, the majority of the cases have occurred within the last four years. This figure suggests that the SDA is used quite regularly, despite suggestions that use of the SDA in America is quite rare.

In contrast to Australia, the American SDA is also used by potential plaintiffs in class actions and securities fraud cases. In fact, due to litigious shareholders and the apparent abuse of the SDA to litigate securities-fraud, investor fraud and misappropriation of corporate opportunities (by way of example), US Congress enacted the Private Securities Litigation Reform Act 1995 in an attempt to, amongst other things, end the 'routine filing of lawsuits against issuers of securities and others whenever there is a significant negative change in value in the value of the issuer's stock' and to end 'the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimised party to settle'.[29]

However, due to dysfunctions in the *Private Securities Litigation Reform Act 1995*, Congress enacted the *Securities Litigation Uniform Standards Act of 1998* to address these problems. This Act specifically excludes SDAs.[30] Such moves by Congress to limit the use of the SDA suggests that the broad use of the SDA may actually be more common that otherwise thought.

Canada

2.1 Introduction

The Canadian SDA was introduced in the 1970s following the recommendations of the *Dickerson Committee* in 1971 on company law reform with respect to the rights of shareholders. In contrast to the American SDA, which is based on more general

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[28] This figure is based on a search on the Lexisone website on 3 November 2003, submitting the phrase 'derivative action': <www.lexisone.com/caselaw/freecaselaw?action=FCLSearchCaseByTerm&pageLimit=10&format=CITE&sourceID=325&pageNumber=1&sourceType=State&sourceCandidate=325&sourceCandidate=se;ectSource&searchTerm=derivative+action&dateType=relative&relativeDate=5-Y&fromDate>

[29] Michael A Collora and David M Osbourne, 'Class-Action Reforms Spur Derivative Claims: Shareholders are taking a fresh look at derivative suits to pursue investor fraud cases' (15 February 1999) *National Law Journal* 1.

[30] Ibid.

standards of fiduciary duties as defined by case law, the Canadian SDA is heavily regulated by regulatory agencies such as the Ontario Securities Commission.[31]

The Canadian SDA, considered by many jurisdictions as the ideal model of SDAs, has been borrowed and adapted to a great degree by New Zealand, Australia and Singapore.

The Canadian SDA is referred to throughout other sections of this article. To avoid duplication, this section briefly overviews the Canadian SDA.

2.2 Civil Procedure

With respect to standing, Canada's approach is quite strict. Pearlie Koh Ming Choo notes:

> In practice, most of the applications reviewed in one study were brought by current shareholders. But where the applications were made by former shareholders or former directors, these were denied primarily because the judges felt that such applicants lacked 'sufficient interest' in the outcome of the derivative action.[32]

Canada's leave and notice requirements are not dissimilar to Australia's. When determining whether leave should be granted to the complainant, 'it should be borne in mind that a derivative action brought by an individual shareholder on behalf of a corporation serves a dual purpose. First, it ensures that a shareholder has a right to recover property or enforce rights for the corporation if the directors refuse to do so. Second, and more important for our present purposes, it helps to guarantee that some degree of accountability and to ensure that control exists over the board of directors by allowing shareholders the right to bring an action against directors if they have breached their duty to the company'. [33]

2.3 How popular is the derivative suit?

There have been approximately 199 reported SDAs throughout the whole of Canada for the period 29 January 1987 and 23 October 2003.[34] Authoritative

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[31] Deborah DeMott, 'Oppressed But Not Betrayed: A Comparative Assessment of Canadian Remedies for Minority Shareholders and Other Corporate Constituents' (1993) *Law and Contemporary Problems* 181, 182 <www.law.duke.edu/globalmark/research/oppresse.html>.

[32] Pearlie Koh Ming Choo, 'The Statutory Derivative Action in Singapore – A Critical and Comparative Examination' (2001) 13 *Bond Law Review* 64, 72.

[33] Robins JA in *Richardson Greenshields of Canada Limited v Russell J Kalmacoff, David M Cockfield, Joseph O'Brien, Darold H Parken, Edward H Wernick, John L Lee, Dino Bottero and Security Home Mortgage Investments Corporation* (1995-04-07) ONCA c19193 with reference to MA Maloney, 'Whither The Statutory Derivative Action?' (1986) 64 *Can Bar Rev* 309 <http://www.canlii.org/on/cas/onca/1995/1995oncal10110.html> .

[34] This figure is based on doing a search on the Canlii website on 3 November 2003, submitting the phrase 'derivative action':

views suggest that the SDA is used infrequently and has 'not made the impact on Canadian corporate law which might have been expected'.[35]

Singapore

3.1 Introduction

Due to the well-developed oppression remedy[36] available in Singapore, use of the SDA is very rare.[37] Since the introduction of the SDA in 1993, there have been two reported SDA cases,[38] one unreported SDA case,[39] and 7 reported cases in which the company has sued its directors for breach of duty.[40]

The Singaporean SDA is not dissimilar to the English, Canadian, Australian and New Zealand SDAs and is modelled on the Canadian SDA contained in the *Canada Business Corporations Act.* The Singaporean SDA is contained at ss 216A and 216B of the *Companies Act* Cap 50.

However, unlike the Canadian SDA, the Singaporean SDA applies only to companies *not* listed on the Singapore Stock Exchange[41] as companies that are listed on the stock exchange are already subject to heavy regulation and disgruntled shareholders have the option of selling their shares on the open market.[42]

3.2 Standing and leave requirements

To bring a SDA, pursuant to s 216A the person bringing the action (the

'complainant') must be either a member of the company;[43] the Minister (in the case of a declared company under Part IX)[44] or any other person who, in the discretion of the Court, is a proper person to make an application under this section.[45]

<www.canliii.org/sino/srch.pl?method=phrase;query=derivative%20action;bouton.x=7;bouton.y=9;context=full;firsthit=1;lang=en;database=en>

35 Above n 5, 162 with reference to Cheffins (n 98).

36 Section 216 of the Companies Act Cap 50.

37 Kanaga Dharmananda, 'Singapore – The Oppression Action in the Tropics' (2001) 22(6) *The Company Lawyer* 194, 194.

38 Above n 33, 64.

39 Ibid, 75.

40 Ibid, 70 at n 37.

41 Ibid, 81. At n 93 the author further states that, 'Although it is recognised by the Select Committee members that if the company was listed on stock exchanges other than the Singapore Stock Exchange, it may apply for leave to bring a statutory derivative action under section 216A'.

42 Ibid, 81 with reference to the Report of the Select Committee on the Companies (Amendment) Bill, para 45.

43 Section 216A(1)(a) of the *Companies Act* Cap 50.

44 Section 216A(1)(b) of the *Companies Act* Cap 50.

45 Section 216A(1)(c) of the *Companies Act* Cap 50

Neither former shareholders nor directors are expressed as potential complainants as is the case in Australia. Yet the scope of potential claimants is broader than the Australian provision. Provided one can satisfy the court that there is a proper person to make the SDA, leave will be granted at the court's discretion.

On satisfying standing requirements, the complainant will only be granted leave if he has satisfied the court that the SDA is not brought without merit as:

1. 14 days notice has been given to the company's directors of the proposed SDA if the company's directors fail to bring, diligently prosecute or defend or discontinue the action;[46]
2. The complainant is acting in good faith;[47]
3. The action is *prima facie* in the company's interest. [48]

Unlike Australia, there is no obligation bestowed upon the court to grant leave as it is in the 'best interests'[49] of the company to do so, and there is a 'serious question to be tried'.[50]

However, there is no requirement in Australia that the SDA be, *prima facie*, in the company's interest. In the Companies & Securities Advisory Committee's *Report on a Statutory Derivative Action*, the view of the Committee that the 'serious question to be tried' test was more favourable to the *prima facie* test was accepted.[51] It appears that a problem with the requirement that the complainant establish a *prima facie* case at the time of applying for leave from the court to bring a SDA may lead to a trial of the issues as opposed to "demonstrating that he has an arguable, or a reasonable, case."[52]

Notice

With respect to the Singaporean notice requirements, whilst it is compulsory to give notice, the legislation is silent as to whether the notice is to be in writing and if so, the content of the notice. This is identical to the position in Canada[53] but unlike the position in Australia, which has written notice requirements.[54]

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46 Section 216A(3)(a) of the *Companies Act* Cap 50.
47 Section 216A(3)(b) of the *Companies Act* Cap 50.
48 Section 216A(3)(c) of the *Companies Act* Cap 50.
49 Section 237(2)(c) of the *Corporations Act* 2001 (Cth).
50 Section 237(2)(d) of the *Corporations Act* 2001 (Cth).
51 Companies & Securities Advisory Committee, *Report on a Statutory Derivative Action*, July 1993 page 17.
52 Ibid at 17 with reference to J Corkery, *Directors' Powers and Duties* (1987) at 170-171.
53 Section 239(2)(a) of the Canada Business Corporations Act
54 Section 237(2)(e)(i) of the Corporations Act 2001 (Cth)

Not unlike the position in Australia, Canada, New Zealand and the United States, the mandatory notice requirements can be dispensed with provided the complainant can establish to the court's satisfaction that it is not expedient to give such notice. In such circumstances the court can make any such interim order as it sees fit.[55]

Good faith and in the interests of the company

Similar to the United States, the business judgment rule plays a significant role for the judge in determining whether the SDA (if it is brought with the purpose of instituting litigation on behalf of the company) is in the interests of the company. The court is required to take account of the directors' views on commercial matters when considering whether the SDA is in the interest of the company[56] and whether the decisions made by the company's directors leading up to the SDA were made in good faith. Unlike Australia, there is no rebuttable presumption.[57]

Singapore's approach to the SDA's good faith requirement is based on the view that if the SDA is in the interests of the company, is with merit[58] and the facts surrounding the bringing of the SDA do not constitute bad faith,[59] that that application for the SDA is one brought in good faith. Provided these requirements are satisfied, the court does not appear to be overly concerned if the action is brought with an element of self-interest.

3.3 Litigation costs

Singapore's position with respect to legal costs is similar to Australia's: unless otherwise ordered by the court;[60] the complainant is responsible for costs of bringing the SDA. Furthermore, if the complainant is unsuccessful, he is also responsible for the respondent's legal costs. Pursuant to section 216A(5)(c), the court may make an order that the company pay the reasonable fees and disbursements incurred by the complainant in bring the SDA.

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55 Section 216A(4) of the Companies Act Cap 50

56 N 33 at 78.

57 Section 237(3) of the Corporations Act 2001 (Cth).

58 The unreported SDA case of *Poh Kim Chwee v Lim Swee Long* (OS No 376 of 1997) and the reported SDA case of *Seow Tiong Siew v Kwok, Fung & Winpac Paper Products Pte Ltd* [2000] 4 SLR 768, as referred to by Pearlie Koh Ming Choo, 'The Statutory Derivative Action in Singapore – A Critical and Comparative Examination' (2001) 13 Bond Law Review 64 at page 75 are the only other two SDA cases. They were dismissed as they were not in the interests of the respective companies and completely lacked merit.

59 N 33 at 74: *Teo Gek Luang v Ng Ai Tong* [1999] 1 SLR 434 is the only successful SDA.

60 Section 216A(5)(c) of the Companies Act Cap 50: an order requiring the company to pay reasonable legal fees and disbursements incurred by the complainant in connection with the action.

3.4 Conclusion

As already stated, the SDA is rarely used in Singapore and is viewed as a deterrent to potential corporate wrongdoing rather than as a mere remedy. It is viewed as a necessary mechanism available to shareholders in order to protect their interests in the company and in exercising good corporate governance. Whilst the Singaporean SDA is modelled on the Canadian SDA, the former has borrowed views on correlation of the SDA with the Business Judgment Rule from the English Law Commission and the United States, both of which require the court to take into consideration the views of the company's directors in determining whether the potential SDA is in the best interests of the company.[61] Not unlike Australia and Canada, the responsibility for costs of the SDA is a major obstacle to a potential complainant in bringing a SDA. Furthermore, there is no personal reward for bringing a SDA in Singapore: the damages (if any) are awarded to the company and in any event, the complainant may also be responsible for the legal costs regardless of outcome.

Australia

4.1 Introduction

On 13 March 2000 the SDA commenced operation following introduction into the Corporations Law (as it was then known) by the Corporate Law Economic Reform Program Act 1999.This form of SDA is based on the Ontario Business Corporations Act, 1982.[62]

4.2 Civil Procedure

Before the Court will grant leave to the applicant to proceed with a statutory derivative action, the applicant must satisfy the court that: -

1. It is unlikely that the company will commence the necessary proceedings, or properly take responsibility for the proceedings or for the steps in the proceedings: s 237(2)(a);
2. The applicant is acting in good faith: s237 (2)(b);[63]
3. It is in the best interests of the company that the applicant be granted leave: s 237(2)(c);[64]
4. It is applying for leave to bring proceedings because there is a serious issue to be tried: s 237(2)(d); and

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[61] N 33 at 78-79.

[62] Companies & Securities Advisory Committee, *Report on a Statutory Derivative Action*, July 1993 page 13.

[63] *Swansson v Pratt* [2002] NSWSC 583.

[64] Id.

5. The applicant gave written notice to the company at least fourteen days prior to making the application notifying the company of its intention to apply for leave and the reasons for same (unless the court finds that it is appropriate to grant leave even though notice was not given to the company).[65]

Each of these criteria must be satisfied for the court to grant leave to the applicant to proceed with the derivative action.[66] Compared to New Zealand's requirement that the applicant establish for the court that *either*:

1. The company does not intend to bring, diligently continue or defend, or discontinue;[67] or
2. It is in the interest of the company that the conduct of the proceedings should not be left to the directors or to the determination of the shareholders as a whole.[68]

need be satisfied before the court will grant leave to the applicant to proceed with the SDA,[69] Australia's leave requirements are quite restrictive.

4.3 Litigation Costs

Similar to other common law jurisdictions, and unlike America, contingency fee arrangements are prohibited in Australia,[70] yet the cost of bringing a SDA is prohibitive and regarded by many[71] as the reason why the SDA is infrequently used.

> The costs issue appears to be a major hurdle in bringing an SDA. By way of example, Mitchell in *'Has the Tyranny of the Majority Become Further Entrenched?'* refers to the exorbitant costs incurred in *Prudential Assurance Co Ltd v Newman Industries (No 2)*[72], where a full hearing of 70 days was held, and $1.5 million in costs run up, in order to decide the question of standing to bring a case.[73]

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65 Corporations Act s 237(2)(i)(ii).

66 *Goozee v Graphic World Group Holdings Pty Ltd* (2002) 42 ACSR at 541.

67 N 18 at 127: S165(3)(a) of the Companies Act 1993 (New Zealand).

68 S 165(3)(b) Companies Act 1993 (New Zealand).

69 Section 165(3) of the Companies Act 1993 (New Zealand).

70 N 5 at 161.

71 For example: Ian M Ramsay, 'Enforcement of Corporate Rights and Duties by Shareholders and the Australian Securities Commission: Evidence and Analysis' (1995) 23 *Australian Business Law Review* 174 at 178; Pearlie Koh Ming Choo, 'The Statutory Derivative Action in Singapore – A Critical and Comparative Examination' (2001) 13 Bond Law Review 64 at pages 89-90; Stephen Bottomley, 'The Relative Importance of the Statutory Derivative Action in Australia' (2002) 2 *International Corporate Law Annual* 141 at 162.

72 [1982] Ch 204.

73 Vanessa Mitchell, 'Has the Tyranny of the Majority Become Further Entrenched?' (2002) 20 *Company and Securities Law Journal* 75 at page 81.

Mrs Brightwell, the third and fourth defendant in *Brightwell v RFB Holdings*,[74] raised the prohibitive nature of costs in defending a SDA.

On the facts of this case, Mrs Brightwell was the widow of a director of family company RFB Holdings who died in 1995 leaving personal debts owing to the company (which through the alleged fraudulent accounting practices of the company's accountant been forgiven: the liquidator's report "indicates that the Deceased received a "dividend and capital repayment" of $416,720 in respect of his single share, whereas the other shareholders each received $2 per share").[75]

The majority of the shares in RFB Holdings were held by the deceased's children and ex-wife, with Mrs Brightwell holding 10 shares and the deceased's estate holding 1 share. Proceedings were commenced by the plaintiffs in 1998.

With respect to legal costs, which would amount to approximately $125,000.00 by the time the SDA was heard, Austin J was quite sympathetic over Mrs Brightwell's expenses burden. Even though the plaintiffs were successful in their application for leave to bring the SDA action, the plaintiffs were ordered to pay the costs of Mrs Brightwell up to leave being granted to proceed with the SDA, because the earlier costs incurred by Mrs Brightwell arose out of failure on the plaintiffs' side to make proper and appropriate claims in the original statement of claim.[76] Austin J took a similarly flexible approach on costs in *Shum Yip Properties v Chatswood Investment & Development*,[77] awarding costs and interest (in addition to damages) to the plaintiff.

In comparison to Australia, New Zealand has taken a more flexible approach on costs arising from the SDA. Once the court has granted leave to the complainant to bring the SDA, unless the court finds that it is unjust or inequitable for the company, the court is required to make an order that the company be responsible for the reasonable costs incurred by the complainant in bringing the action.[78] Whilst this may be the case, there have only been approximately 10 SDAs since 1994,[79] which suggests that the costs associated with bringing a SDA may not actually be a major deterrent.

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[74] [2003] NSWSC 7.

[75] [2003] NSWSC 7 At 8.

[76] [2003] NSWSC 7, 70.

[77] [2002] NSWSC 13.

[78] Above n 18, 128 with reference to s 166 of the *Companies Act 1993* (New Zealand).

[79] Ibid.

Part two:

How popular is the derivative suit in Australia?

Compared to the statutory oppression remedy, the SDA is not frequently used in most jurisdictions. This is considered an advantage by some authorities, because the SDA works best when used infrequently[80] and is necessary in the overall scheme for good corporate governance.

Shareholder litigation in Australia has a reputation of being rare. While there were 900 decisions reported in the *Australian Corporations and Securities Reports* between September 1989 and March 1994, of these only 93 decisions involved shareholder litigation.[81]

Results of search

Based on a search conducted on *Austlii* of cases containing the phrase *'statutory derivative action'*, there have been 21 reported statutory derivative action cases between 28 June 2000 and 27 August 2003.[82] The result of this search is contained in Table 1 below.

Put into perspective, prior to the introduction of the SDA, the only way an applicant could bring a common law derivative action was under one of the exceptions to the rule in *Foss v Harbottle*.[83] Consequently, there were very few common law derivative actions prior to the introduction of the SDA.

Compared with Ramsay's[84] empirical study into the use of the oppression remedy - which revealed that only 88 oppression cases occurred over a span of 13 years[85] - the fact that there appear to have been 21 applications involving SDAs within the last 3 years suggests that this type of remedy may prove more popular in Australia (especially given the fact that the courts appear to be less restrictive in interpreting the leave requirements under s 237) than it has in Singapore (of which there have been two reported cases) and New Zealand (of which there have been approximately 10 SDA since 1994).[86]

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80 Above n 5, 143.

81 Ian M Ramsay, 'Enforcement of Corporate Rights and Duties by Shareholders and the Australian Securities Commission: Evidence and Analysis' (1995) 23 *Australian Business Law Review* 174, 175.

82 The search was conducted on the www.austlii.edu.au website on 1 November 2003.

83 (1843) 2 Hare 461.

84 Ian M Ramsay, 'An Empirical Study of the Use of the Oppression Remedy' (1999) 27 *Australian Business Law Review* 23, 25-6.

85 Ian M Ramsay, 'An Empirical Study of the Use of the Oppression Remedy' (1999) 27 *Australian Business Law Review* 23, 26. The study is based on reported and unreported decisions handed down by High Court, Federal Court and State Supreme Courts between January 1984 and December 1997.

86 Above n 18, 128.

Based on this search, it appears that the majority of these cases were commenced in the Supreme Court of New South Wales, followed by Victoria, Queensland and Western Australia. There were no reported derivative actions in Australia's remaining State or Territories and there has only been 1 reported Federal Court case.

Of these, 12 of the applications to bring a SDA were successful,[87] with the remaining 8 cases dismissed.[88] Of these 8 cases, two cases were dismissed because the complainant did not have standing,[89] and 6 cases were dismissed because they did not satisfy s 237(2)'s leave requirements.[90] 3 of the cases involved a SDA made on behalf of a company in liquidation, 3 of the applications were made for discovery purposes or access to the company register, one case was with respect to the winding up a company the subject of a deceased estate and one case was with respect to the winding up of a joint venture. Several of the cases were with respect to damages suffered by the company.

Perhaps a reason for the lack of use of the statutory derivative action is the fact that there is 'scant judicial consideration in Australia of the requirements which must be satisfied before leave is granted to bring a derivative action in the name of the company'.[91] In *Swansson v Pratt*, Palmer J commented that

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87 *Roach v Winnote P/L (in Liq)* [2001] NSWSC 822; *Karam v ANZ Banking Group Limited* [2000] NSWSC 596; *Keyrate P/L v Hamarc P/L* [2001] NSWSC 491; *Brightwell v RFB Holdings* [2003] NSWSC 7; *Westgold Resources NL v Precious Metals Australia Ltd* [2002] WASC 221; *Charlton v Baber* [2003] NSWSC 745; *Shum Yip Properties v Chatswood Investment & Development* [2002] NSWSC 13 (at 17-19); *Isak Constructions v Faress* [2003] NSWSC 784; *BL&GY International Co.Ltd v Hypec Electronics Pty Ltd; Colin Anthony Mead v David Patrick Watson* [2001] NSWSC 705; *Carre v Owners Corporation* – SP 53020 [2003] NSWSC 397; *Metyor Inc v Qld Electronic Switching P/L* [2002] QCA 269.

88 *Advent Investors Pty Ltd v Goldhirsch* [2001] VSC 59, *Deangrove Pty Ltd (Rec & Mgrs Aptd) v Commonwealth Bank of Australia* [2001] FCA 173 (this matter was originally stood over for further directions); *Talisman Technologies Inc v Qld Electronic Switching P/L* [2001] QSC 324 (however, this decision was appealed and allowed with costs: see *Metyor Inc v Qld Electronic Switching P/L* [2002] QCA 269); *Jeans v Deangrove P/L* [2001] NSWSC 84; *Goozee v Graphic* [2002] NSWSC 640; *Chapman v E-Sports Club Worldwide Limited* [2000] VSC 403; *Blakeley v Cook* [2001] WASCA 208; *Swansson v Pratt* [2002] NSWSC 583.

89 *Advent Investors Pty Ltd v Goldhirsch* [2001] VSC 59: s 236 (3) of the *Law* was intended to apply to events that existed prior to 13 March 2000, that is, to existing common law derivative proceedings. *Blakeley v Cook* [2001] WASCA 208: s 236.

90 *Swansson v Pratt* [2002] NSWSC 583: leave was not granted as the plaintiff failed to satisfy s237(2)(b) and (c). *Goozee v Graphic* [2002] NSWSC 640: leave was not granted as the Plaintiff failed to satisfy s237(2)(b) – (d). *Jeans v Deangrove P/L* [2001] NSWSC 84: leave was not granted as the plaintiff failed to satisfy s 237(2)(a). *Talisman Technologies Inc v Qld Electronic Switching P/L* [2001] QSC 324: leave was not granted as the Plaintiff failed to satisfy s 237(2)(b) and (c). *Chapman v E-Sports Club Worldwide Limited* [2000] VSC 403: leave was not granted as the Plaintiff failed to satisfy s 237(2)(b) – (d).

91 Palmer J in *Swansson v Pratt* [2002] NSWSC 583, [20].

while Part 2.F.1A is said to have been inspired by s 165 of the *New Zealand Companies Act 1993*, which in turn is based on the *Canada Business Corporations Act 1985*, part 2.F.1A is so different to the Canadian and New Zealand counterparts that the case law in these jurisdictions is of little assistance.[92]

Conclusion

Compared with the use of the statutory oppression remedy, which has no leave requirements that need to be satisfied in order to granted standing, and the fact that a complainant bringing a SDA doesn't personally benefit a great deal from a SDA and is likely to be burdened with the costs of running a SDA, the SDA is not as commonly used as the oppression remedy.

Due to the deterrent nature of the SDA,[93] it is questionable whether the SDA can be measured empirically, as observed by Pearlie Koh Ming Choo in 'The Statutory Derivative Action in Singapore – A Critical and Comparative Examination':

> The deterrent effect of the action, because it does not result in positive actions, cannot be measured. It is important to acknowledge this because there have been a number of empirical studies in the United States that show that derivative actions produce little financial benefit, both to the shareholder litigant in the sense that that there is little positive impact on share prices, and to the company.[94]

Some disadvantages of bringing a SDA include:

1. Public knowledge via the media of alleged internal misconduct/mismanagement/negligence;
2. Drop in value of shares, if listed on the stock exchange;
3. Sale of shares;
4. Litigation may ruin the reputation of company – especially when the allegation proves to be unfounded;
5. Unnecessary winding up of the company;
6. It is very costly to commence a SDA in Australia and other common law jurisdictions.

CONCLUSION

'Shareholder derivative suits are a vital support to the free enterprise economy … Derivative suits are the major policemen of managerial

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[92] Ibid.

[93] Above n 5, 162.

[94] Above n 18, 70.

integrity'.[95] Adds Matthew Berkahn, the SDA has the potential to 'add certainty to the law, in the sense that it specifies much more clearly and logically the situations in which an aggrieved shareholder may pursue a remedy for a wrong done to the company'.[96]

Although Australia does not permit SDA actions to be funded on a contingency basis, the fact that there have been 21 reported cases in less than 3 years suggests that, while in its early days, the SDA is more than merely (but importantly) a deterrent. It provides minority shareholders with a mechanism to exercise control on behalf of the company when the directors cannot or will not take action; it serves as a corporate watchdog and bargaining tool in that shareholders can threaten the use of the SDA. Moreover, because of the restrictions on its use and the requirements that need to be satisfied before the complainant is granted leave, it minimises abuse of process and vexatious litigation.

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[95] Companies & Securities Advisory Committee, *Report on a Statutory Derivative Action*, July 1993 page 4 with reference to footnote 12: A.F. Conard, quoted in M.A. Maloney, "Whither the Statutory Derivative Action?" (1986) 64 *Canadian Bar Review* 309 at 315.

[96] Matthew Berkahn, 'The Derivative Action In Australia And New Zealand: Will The Statutory Provisions Improve Shareholders' Enforcement Rights?' (1998) 10 *Bond Law Review* 74, 75.
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Jurisdiction	Total no. of Reported cases	No. of Reported Supreme Court cases	No. of Reported cases on appeal	Year of judgment 2000	2001	2002	2003	No. of Cases whereby leave granted	No. of Cases dismissed
N.S.W.	13	13	-	1	5	3	4	9	4
QLD	2	1	1	-	1	1	-	1(case on Appeal)	1
VIC	3	3	-	1	2	-	-	1	2
W.A.	2	1	1	-	1	1	-	1	1 (appeal dismissed)
Federal	1	-	-	-	1	-	-	-	
Other States & Territories	-	-	-	-	-	-		-	
TOTAL	**21**	**19**	**2**	**2**	**10**	**5**	**4**	**12**	**8**

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