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THE EVOLUTION OF THE AUSTRALIAN DERIVATIVE ACTION: FLOODGATES TO SHAREHOLDER ACTIVISM?

KENNY YANG*

Abstract

Corporations Law – Company Management – Shareholder Activism – Statutory Derivative Action – *Corporations Act 2001* (Cth)

This paper will first introduce the notion of a derivative action and examine the evolution of derivative action in Australia, from the general law to its current statutory form. It will highlight the perceived inadequacies of the former and the attempts of the statutory regime in curing its predecessor's defects. It will analyse these distinctions, coming to a conclusion that the statutory approach does little more than encapsulate and lend clarity to the position at general law in Australia and as far as current research suggests, does not lead to shareholder activism.

I INTRODUCTION

One of the primary objectives of an investor as shareholders in businesses is to see a return, and hopefully a high one at that, on their investment. It is however, against the norms of business management to allow its affairs to be dictated by investors. Such a function rests with the directors of the company. Despite this, the astute investor can sometimes influence business management decisions in a number of ways, one such way being the derivative action. Investors may wish to utilize derivative action for their own benefit, the most obvious of which is the maximization of their investment returns, where they feel that company management has been negligent or underperforming. While the derivative action was traditionally a common law one and had its own limitations, Australia enacted the statutory derivative action in 2000. The concern is whether in removing the common law barriers to derivative action, the statutory derivative action has allowed undue shareholder interference and opened the doors to shareholder activism. Has Australia struck the right balance in providing shareholders with the appropriate recourse to corporate mismanagement and in allowing the board sufficient room to appropriately manage the company? For the purposes of this paper, 'shareholder activism' is defined as actions by interested investors designed to influence the

* LLB (Hons, First Class) (Murdoch University), GDLP (Australian National University).

contemporary norms of company management by means of ‘shareholder inspired litigation.’¹ References to section numbers refer to the *Corporations Act 2001* (Cth) unless otherwise stated.

II THE GENERAL LAW OF DERIVATIVE ACTION

Derivative action is an exception to the general principle that a person cannot sue to obtain relief on behalf of another person who has been injured by a wrongdoer.² It is an action that is brought in the name and on behalf of a company. It is ‘derivative’ in that the right to sue does not inherently exist in the name of the party taking the action, but is ‘derived’ from the company.³

A *The Tussle for Control*

It has been established that shareholders do not, in general, control the company and its operations.⁴ Powers of management are generally accorded to the directors of the company, and as Greer LJ stated, ‘if powers of management are vested in the directors, they and they alone can exercise these powers ... They cannot themselves usurp the powers by which the articles are vested in the directors’.⁵ It is however, necessary to strike a balance between holding management accountable and giving them sufficient leeway to run the company effectively.

B *The Case of Foss v Harbottle*

Foss v Harbottle arose as a result of two shareholders commencing action on behalf of themselves and other shareholders on allegations that the directors of the company had fraudulently misappropriated the company’s funds.⁶ Wigram VC held that ‘the corporation should sue in its own name and its corporate character or in the name of someone whom the law has appointed to be its representative’.⁷ The power to initiate proceedings generally rests in the directors of a company, and without their support, no action on behalf of a company can proceed.⁸ This rule comprises two principles:⁹ first, the ‘proper

¹ S Beck, ‘Shareholders’ Derivative Action’ (1974) 52 *Canadian Bar Review* 159, 163.

² H A J Ford, P P Austin, I M Ramsay, *Ford’s Principles of Corporations Law* (LexisNexis, 2002) [11.239].

³ Matthew Berkahn, ‘Derivative Action in Australia and New Zealand: Will the Statutory Provisions Improve Shareholders’ Enforcement Rights?’ (1998) 10 *Bond Law Review* 74.

⁴ P Willcocks, *Shareholders’ Rights and Remedies* (Federation Press, 1991) 1.

⁵ *John Shaw & 875 Sons (Salford) Limited v Shaw* [1935] 2 KB 113,134.

⁶ Berkahn, above n 3, 77–78; *Foss v Harbottle* (1843) 2 Hare 461.

⁷ *Foss v Harbottle* (1843) 2 Hare 461, 491.

⁸ Berkahn, above n 3, 75.

⁹ *Edwards v Halliwell* [1950] 2 All ER 1064, 1066.

plaintiff' rule, based on the principle that a company is a separate legal entity, distinct from its shareholders.¹⁰ The second principle is the 'internal management' doctrine, based on the premise that the courts should be slow to interfere with the internal management of companies where management act in accordance with their powers.¹¹ These two principles work together to restrict the standing of individual shareholders to bring derivative actions.¹²

At least one author has suggested that the decision not to allow the action may have stemmed from 'a desire to uphold contemporary norms of company management and ownership.'¹³ The underlying vein of the argument, that control and management of the company is properly vested in its directors, is apparent. It would be

the very antithesis of the statutory control structure to allow shareholders to make, in essence, a management decision. Injustice, we are to assume, is not a problem because individual shareholders contract into this arrangement upon entering the company and therefore should be aware of the consequences.¹⁴

The rule in *Foss v Harbottle* reflected the courts at that time – to lean towards the 'best interests of the company', and such interests, as determined by its directors or the majority, should take precedence over any minority shareholders.¹⁵ As one judge held, '[e]ven if the minority is profoundly convinced that a decision not to sue is wrong, the minority is a minority and not the majority.'¹⁶

The rationale for the decision is understandable, given the context in which *Foss v Harbottle* was being decided. The modern form of a corporation as we know it and the concept of limited liability was still some years away,¹⁷ and it has been suggested that corporations incorporated via individual private statute

¹⁰ *Salomon v Salomon & Co* [1897] AC 22, 29.

¹¹ *Burland v Earle* [1902] AC 83, 93.

¹² Stephen Bottomley, 'Shareholders' Derivative Actions and Public Interest Suits: Two Versions of the Same Story?' (1992) 15 *University of New South Wales Law Journal* 127, 137; I Ramsay, 'Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Derivative Action' (1992) 15 *University of New South Wales Law Journal* 149, 158.

¹³ M Maloney, 'Whither the Statutory Derivative Action?' (1986) 64 *Canadian Bar Review* 309, 312–313.

¹⁴ M Maloney, 'Whither the Statutory Derivative Action?' (1986) 64 *Canadian Bar Review* 309, 313 cited in Matthew Berkahn, 'Derivative Action in Australia and New Zealand: Will the Statutory Provisions Improve Shareholders' Enforcement Rights?' (1998) 10 *Bond Law Review* 74, 78.

¹⁵ Bottomley, above n 12.

¹⁶ *Eastmanco (Kilner House) Ltd v Greater London Council* [1982] 1 All ER 437, 443.

¹⁷ Berkahn, above n 3, 78.

was little more than private partnerships.¹⁸ Accordingly, the usual notions of mutual trust and good faith, akin to a partnership, underline the relationship in the consultation process of such a company. Necessarily then, it was considered that in promoting risk taking and entrepreneurship, protection should be afforded to directors against undue shareholder interference.¹⁹ It was deemed that members knowingly enter into this statutory contract and should therefore be cognisant of its control mechanisms and any consequences that flow.²⁰

C *Exceptions to the Rule*

However as the corporate group, rather than the private partnership model, is becoming more prominent and accepted as a means for business operations,²¹ there have been concerns that without judicial interference, there may be an increasing inability for members to control the actions of errant directors.²² This has given rise to some lifting of the restrictions in shareholder remedies, perhaps in recognition of that fact that such corporate groups, being the ‘quintessential model of corporate business activity’,²³ has moved the concern of errant directors from the private to the public realm and as such, requires greater judicial supervision to ensure shareholder’s rights are appropriately protected. Since *Foss v Harbottle*, this has been encapsulated in a number of exceptions:²⁴ (1) the ‘special majority’ exception,²⁵ where action has been taken expressly against provisions in the constitution requiring a special majority to authorise the action, a shareholder could commence proceedings to challenge the validity of the resolution, (2) the ‘ultra vires’ exception,²⁶ where no illegal or

¹⁸ (1843) 2 Hare 461, 491.

¹⁹ Stephen Bottomley, ‘Shareholders’ Derivative Actions and Public Interest Suits: Two Versions of the Same Story?’ (1992) 15 *University of New South Wales Law Journal* 127,138.

²⁰ Maloney, above n 13, 313.

²¹ Bottomley, above n 19.

²² S Chumir, ‘Challenging Directors and the Rule in *Foss v Harbottle*’ (1965) 4 *Alberta Law Review* 96.

²³ Berkahn, above n 3, 79.

²⁴ There is however, some question as to whether these are true exceptions or merely circumstances where the rule does not apply. See K W Wedderburn, ‘Shareholders’ Rights and the Rule in *Foss v Harbottle*’ [1957] *Cambridge Law Journal* 194, 203.

²⁵ Peter Lawrence Black, *The Rule in Foss v Harbottle, Corporate Governance and the Derivative Action* (LLM Thesis, University of Melbourne, 1983) 7–8; *Bailie v Oriental Telephone Co Ltd* [1915] 1 Ch 503; *Cotter v National Union of Seamen* [1929] 2 Ch 58.

²⁶ K W Wedderburn, ‘Shareholders’ Rights and the Rule in *Foss v Harbottle*’ [1957] *Cambridge Law Journal* 94; 198; *Northwest Transportation Co Ltd v Beatty* (1887) 12 App Cas 589; *Hutton v West Cork Railway Ltd* (1883) 23 Ch D 65; *Devlin v Slough Estate Ltd* [1983] BCLC 497.

ultra vires action may be taken, (3) the ‘personal rights’ exception,²⁷ which allowed for remedies by way of personal action, and (4) the ‘fraud on the minority’ exception,²⁸ comprising two components – where the action amounted to a fraud on the minority and the wrongdoers were in control of the company,²⁹ the minority shareholders were permitted to bring an action against the wrongdoers on behalf of the company.³⁰ There is some debate as to whether the fifth ‘interest of justice’ exception exists (as will be discussed further below),³¹ where an action could be brought where the interests of justice demands it. It has been suggested that this exception is ‘too nebulous, vague and infinitely elastic’,³² though it has seen increasing acceptance in Australian courts.³³

II THE AUSTRALIAN STATUTORY DERIVATIVE ACTION

A *Dissatisfaction with the Common Law*

While the restrictions of *Foss v Harbottle* had the advantage of allowing decisions to be left in the hands of management and directors and protecting them from individual shareholder’s interference,³⁴ this was deemed unsatisfactory as the rule was too limited in scope and could leave errant directors unaccountable. There was also argument as to the inconsistency and complexity of the exceptions to *Foss v Harbottle*. Additionally, issues of ratification, standing and costs were often cited as barriers to interested shareholders in initiating action.³⁵

²⁷ Pamela F Hanrahan, ‘Distinguishing Corporate and Personal Claims in Australian Company Litigation’ (1997) 15 *Company & Securities Law Journal* 21; Berkahn, above n 3, 76; *Edwards v Halliwell* [1950] 2 All ER 1064, 1067 (Jenkins LJ).

²⁸ Arguably the only ‘true exception’, see Berkahn, above n 3, 81; Maloney, above n 17, 311; Stefan Lo, ‘The Continuing Role of Equity in Restraining Majority Shareholder Power’ (2004) 16 *Australian Journal of Corporate Law* 96, 105.

²⁹ G R Sullivan, ‘Restating the Scope of the Derivative Action’ (1985) 44 *Cambridge Law Journal* 236.

³⁰ I Ramsay and B Saunders, ‘Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action’ (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne 2006) 35.

³¹ *Ibid.*

³² O A Osunbor, ‘A Critical Appraisal of “The Interests of Justice” as an Exception to the Rule in *Foss v Harbottle*’ (1987) 36 *International and Comparative Law Quarterly* 1, 13.

³³ *Biala Pty Ltd v Mallina Holdings Ltd (No 4)* (1993) 13 WAR 11, 69 n 73; *Aloridge Pty Ltd v West Australian Gem Explorers Pty Ltd* (1995) 127 ALR 410, 414; *Cadwallader v Bajco Pty Ltd* (2001) 189 ALR 370, 420; *Virgtel Ltd v Zabusky* [2006] QSC 066 [88]–[89].

³⁴ Brian R Cheffins, ‘Reforming the Derivative Action: The Canadian Experience and British Prospects’ (1997) 2 *Company, Financial and Insolvency Law Review* 227, 229–231.

³⁵ Explanatory Memorandum to the Corporate Law Economic Reform Bill 1988 [6.14]–[6.15]; See also Companies and Securities Law Review Committee, *Enforcement of the*

B Introduction of Part 2F.1A

The statutory derivative action ('SDA') came into effect in Australia in the form of Part 2F.1A of the *Corporations Act 2001* (Cth) replacing the right to such an action under the general law,³⁶ and allows current and former members and officers of a company to bring an action on behalf of the company.³⁷ Born as a result of the perceived inadequacies of the common law,³⁸ its distinction with its predecessor is marked by notable attempts to cure its defects.

1 Standing and Leave

Under the general law, the onus of establishing the restrictive standing requirements was often a long and difficult process.³⁹ However, the SDA removes the uncertainty of the common law on the standing requirements, leaving the decision to be exercised by the court, after having regard to the criteria in s 237(2) which states that the Court must grant leave where it is satisfied that (a) it is probable that the company will not itself bring the proceedings, or properly take responsibility for them; and (b) the applicant is acting in good faith; and (c) it is in the best interests of the company that the applicant be granted leave; (d) there is a serious question to be tried; (e) and the provision of relevant notice.⁴⁰

The courts will be satisfied that a company will not take action where the directors have denied allegations,⁴¹ where the company is a family-held one and

Duties of Directors and Officers of a Company by Means of a Statutory Derivative Action, Discussion Paper No 11, at <http://takeovers.gov.au/content/Resources/cslrc/cslrc_discussion_paper_no_11.aspx>.

³⁶ *Corporations Act 2001* (Cth) s 236(3).

³⁷ *Ibid.*

³⁸ Explanatory Memorandum to the Corporate Law Economic Reform Program Bill, 6.23; *CCH Australian Corporations Commentary*, CCH Australia, [54–100]; Corporate Law Economic Reform Program Proposals for Reform, Directors' Duties and Corporate Governance: Facilitating Innovation and Protecting Investors (Paper No 3, 1997) 32; Companies and Securities Advisory Committee, Report on a Statutory Derivative Action (July 1993) 6; Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, Corporate Practices and the Rights of Shareholders (November 1991) 193.

³⁹ *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] 1 Ch D 204, 221–2; William Kaplan and Bruce Elwood, 'The Derivative Action: A Shareholder's "Bleak House"?' (2003) 36 *University of British Columbia Law Review* 443, 451 n 481; L S Sealy, 'Foss v Harbottle – A Marathon Where Nobody Wins' (1981) 40 *Cambridge Law Journal* 29, 32.

⁴⁰ *The Corporations Act 2001* (Cth) s 237(2).

⁴¹ *Braga v Braga Consolidated Pty Ltd* [2002] NSWSC 603.

its family members do not wish to bring an action,⁴² where the company has insufficient funds,⁴³ or where it is rife with internal issues.⁴⁴ This can also happen where the board is unable to make a decision or where for example, the person accused of the wrongdoing has control or influence over the board.⁴⁵

The applicant must also satisfy the Court that the applicant has been made in good faith. This requires that the Court considers whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success; and the applicant must not have an ulterior motive for bringing the derivative action that would amount to an abuse of process.⁴⁶ Good faith will be lacking where the SDA is being used to place pressure on stakeholders in the corporation.⁴⁷

The criteria of ‘best interests of the company’⁴⁸ have caused most difficulty for the courts.⁴⁹ Sufficed to say, it is the financial state of the company in reference to its welfare that the courts are concerned with.⁵⁰ For example, while continuing to operate and trade profitably has been deemed to be in the best interests of the company,⁵¹ in circumstances where a company is insolvent, its best interest may turn to reflect its creditors.⁵² It is worth noting that this is a higher standard than the Canadian, New Zealand and Singapore counterparts, which only require that the action is in the *interests* of the company.⁵³

Finally, the Court must be satisfied that there is a ‘serious question to be tried’. The threshold for this criterion is a relatively low one,⁵⁴ with the applicant only

⁴² *Swansson v Pratt* [2002] NSWSC 583.

⁴³ *Carpenter v Pioneer Park Pty Ltd (In Liq)* [2004] NSWSC 1007.

⁴⁴ *Foyster v Foyster Holdings* [2003] NSWSC 135.

⁴⁵ *Swansson v R A Pratt Properties Pty Ltd* (2002) 42 ACSR 313; *Cannon Street Pty Ltd v Karedis* [2004] QSC 104, [145]; *Braga v Braga Consolidated Pty Ltd* [2002] NSWSC 603, [5]; *Lakshman v Law Image Pty Ltd* [2002] NSWSC 888, [22]; *Reale v Duncan Reale Pty Ltd* [2005] NSWSC 174, [10]; *Saltwater Studios Pty Ltd v Hathaway* [2004] QSC 435, [6]; *Metyor Inc (formerly Talisman Technologies Inc) v Queensland Electronic Switching Pty Ltd* (2002) 42 ACSR 398; *RTP Holdings Pty Ltd v Roberts* (2000) 36 ACSR 170 cited in Ramsay, above n 30.

⁴⁶ *Swansson v RA Pratt Properties Pty Ltd* (2002) 42 ACSR 313, 320.

⁴⁷ *Chapman v E-Sports Club Worldwide Ltd* (2000) 35 ACSR 462.

⁴⁸ *Corporations Act 2001* (Cth) s 237(2)(c).

⁴⁹ Ramsay, above n 30.

⁵⁰ *Charlton v Baber* (2003) 47 ACSR 31. See also *Swansson v RA Pratt Properties Pty Ltd* (2002) 42 ACSR 313, 324 for a list of factors the court considers.

⁵¹ *Goozee v Graphic World Group Holdings Pty Ltd* [2002] NSWSC 640, [73].

⁵² *Charlton v Baber* (2003) [2003] NSWSC 745, [53].

⁵³ Ramsay, above n 30 (emphasis in original).

⁵⁴ *Swansson v Pratt* [2002] NSWSC 583, [25].

having to prove an ‘arguable case’.⁵⁵ While the SDA has in place notice provisions of up to 14 days,⁵⁶ the courts have evinced a willingness to grant leave even when this has not been met.⁵⁷

2 Ratification

As a derivative action could only be brought by a shareholder against a director for the director’s breach of duty if the breach was unable to be ratified by the company, ratification has been described as ‘[u]ndoubtedly the greatest legal difficulty with the existing derivative remedy.’⁵⁸ The law on ratification is also at times inconsistent, and it is difficult to discern what actions can and cannot be ratified.⁵⁹ Section 239 deals with the barrier of ratification, stating that while it is taken into account by the court it alone would not prevent a person from bringing an action.⁶⁰

3 Costs

Access to company funds in bringing an action also posed a barrier to interested shareholders under general law.⁶¹ While s 242 does give the Court broad discretion in granting costs, it has been pointed out that the provisions were deliberately drafted in a manner that denies the successful applicant the assurance that court recognition will result in the company being liable for costs incurred.⁶² Indeed, in a study of 19 successful leave applications since the SDA in Australia, in none of the cases did the Court require the company to fund the applicant’s litigation.⁶³

⁵⁵ *Mhanna v Sovereign Capital Ltd* [2004] FCA 1300, [31].

⁵⁶ *Corporations Act 2001* (Cth) s 237(2)(e).

⁵⁷ *Braga v Braga Consolidated Pty Ltd* [2002] NSWSC 603, [8].

⁵⁸ Companies and Securities Advisory Committee, Report on a Statutory Derivative Action (July 1993) 6.

⁵⁹ Lynne Taylor, ‘Ratification and the Statutory Derivative action in the Companies Act 1993’ (1998) 16 *Company & Securities Law Journal* 221, 223. See also B H McPherson, ‘Duties of Directors and the Powers of Shareholders’ (1977) 51 *Australian Law Journal* 460, 468–9.

⁶⁰ *Corporations Act 2001* (Cth) s 239.

⁶¹ Sarah Watkins, ‘The Common Law Derivative Action: An Outmoded Relic?’ (1999) 30 *Cambrian Law Review* 40. See *Smith v Croft* [1986] 2 All ER 551 and *Parker v National Roads & Motorists Association* (1993) 11 ACSR 370, 382 which held that interim funding orders should not be made until after discovery and only in cases of genuine need cited in Ramsay, I and Saunders B, ‘Litigation by Shareholders and Directors: An Empirical Study of The Statutory Derivative Action’ (Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne 2006) 35.

⁶² K Fletcher, ‘Clerp and Minority Shareholder Rights’ (2001) 13 *American Journal of Comparative Law* 290, 300.

⁶³ Ramsay, above n 30, 35.

4 *Concisely Stating the Law*

One of the successes of the SDA was that it clearly articulated the law on derivative action, rather than having to contend with the ‘complex and obscure’⁶⁴ nature of the common law relating to derivative action. It replaces ‘140 years of procedural codswallop’⁶⁵ with a more concise and understandable form.

III THE GATES TO SHAREHOLDER ACTIVISM – DERIVATIVE ACTION: SWORD OR SHIELD?

Shareholder activism by way of interference with company management is an issue that runs contrary to the traditional notions of the management principle.⁶⁶ Derivative action seeks to strike a balance between ensuring remedies for members, yet allowing for directors freedom to run the company.⁶⁷ There may be a concern that the SDA, in lifting much of the restrictions in *Foss v Harbottle*, could lead to overzealous shareholder litigation.

A *Australia’s Already Liberal Approach to Foss v Harbottle*

However, while standing and ratification have often been cited as obstacles to commencing litigation, Australian courts have already minimized the barriers of *Foss v Harbottle*. Indeed, as Sealy notes, ‘one frequently finds the judge putting the issue on one side’,⁶⁸ effectively circumventing the rule. For example, In *Hurley v BGH Nominees*,⁶⁹ King CJ found it inappropriate to follow the English’s restrictive position in *Prudential Assurance*.⁷⁰ Furthermore, Australian courts have developed a fifth ‘interest of justice’ exception, and were willing to allow derivative action where it was in the interest of justice.⁷¹ This ‘fifth exception’ however, was not always the accepted position and there was initial ‘doubt as to whether this judgment exception is part of the law’.⁷² *Cope v*

⁶⁴ Brian R Cheffins, ‘Reforming the Derivative Action: The Canadian Experience and British Prospects’ (1997) 2 *Company, Financial and Insolvency Law Review* 227, 233.

⁶⁵ L S Sealy, ‘Foss v. Harbottle – A Marathon Where Nobody Wins’ (1981) 40 *Cambridge Law Journal* 29, 32.

⁶⁶ *John Shaw & 875 Sons (Salford) Limited v Shaw* [1935] 2 KB 113,134.

⁶⁷ Lawrence A Larose, ‘Suing in the Right of the Corporation: A Commentary and Proposal for Legislative Reform’ (1986) 19 *University of Michigan Journal of Law Reform* 499, 503.

⁶⁸ L S Sealy, ‘The Rule in Foss v Harbottle: The Australian Experience’ (1989) 10 *Company Lawyer* 52.

⁶⁹ *Hurley v BGH Nominees Pty Ltd* (1982) 1 ACLC 387, 38.

⁷⁰ *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] 1 Ch D 204, 221–2.

⁷¹ *Biala Pty Ltd v Mallina Holdings Ltd* (1993) 11 ACSR 785.

⁷² *Mesenberg v Cord Industrial Recruiters Pty Ltd* (1996) 19 ACSR 483, 486.

Butchland however, a matter before the Supreme Court of Western Australia, marked a milestone for the development and acceptance of this ‘fifth exception’ as in that case, even the defendants conceded the possibility of a ‘interest of justice exception’.⁷³ This pragmatic approach evinces a willingness to overcome the barriers to common law derivative action, effectively circumventing the rule in *Foss v Harbottle*.⁷⁴

B Barriers to Derivative Action

The other effective barrier to derivative action – costs, has not been entirely solved by the SDA. There is no automatic entitlement to costs and while the Court does exercise broad discretion in costs under s 242, Thai suggests that members continue to be at the mercy of the Court whether or to grant costs. This is further evinced in the study by Ramsay, which noted that in only three applications were costs granted outright.⁷⁵ As investors are after all interested in seeing a return on their investment, it is not a stretch of the imagination to see that shareholders may not be overly keen to engage in a derivative action if such a route offers no guarantee that their court costs would be covered. Accordingly, this would suggest that members are perhaps no better off under the statutory regime than the position at general law in Australia.

Ramsay and Saunders found that in the five years since the introduction of the SDA, there have been a modest thirty-one delivered judgments on statutory derivative action compared to the thirty in the five years prior to the introduction of Part 2F.1A.⁷⁶ Of the thirty-one applications, only nineteen was granted leave.⁷⁷ Another article suggests that while the SDA does provide some mechanism for shareholders to intervene, its own restrictions effectively minimizes the potential for abuse and vexatious litigation.⁷⁸ These studies seem to demonstrate that the courts have not seen a significant increase in derivative action litigation since the commencement of the SDA. It would seem then that the SDA has not, as one might have feared, opened the floodgates to overzealous shareholder activism.

⁷³ (1996) 20 ACSR 37, 40.

⁷⁴ Anil Hargovan, ‘Under Judicial and Legislative Attack: The Rule in *Foss v Harbottle*’ (1996) 113 *South African Law Journal* 631, 636–7.

⁷⁵ Out of 19 applications, 3 were successful in being granted costs outright, 1 was successful in part, 4 were not granted costs and 6 had costs reserved. In the remaining 5 cases, costs were not discussed; see Ramsay, above n 30.

⁷⁶ *Ibid.*

⁷⁷ *Ibid.*

⁷⁸ Hofmann, above n 63.

There is of course, a more practical commercial concern that may also be a barrier to invoking the SDA. Shareholders who commence statutory derivative action imply corporate mismanagement. Accordingly, court proceedings and the associated negative publicity that inevitably flows may result in a decrease in the value of the company's shares (where the company is listed on the stock exchange).⁷⁹ Similarly, even where the allegation may be ultimately unfounded, it is difficult for a company to recover from the negative impact on reputation the proceedings might have had and this may accordingly affect future performance of the company's shares.⁸⁰

Where the Australian SDA allows judicial discretion in awarding costs — and as argued above the courts have evinced a general reluctance to do so — Australia's closet neighbour, New Zealand, has in its SDA, express provisions that the court must order the costs of proceedings to be paid by the company,⁸¹ unless this would be unjust or unequitable.⁸² This has, in some ways, removed much of the barriers to commencing a derivative action. While some have suggested that Australia should consider adopting the New Zealand position,⁸³ it is contended that the purpose of the Australian SDA, as articulated in the Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998 was to find an appropriate balance in providing recourse to shareholders for corporate wrongdoings and to prevent any unnecessary and frivolous proceedings designed to usurp the traditional norms of company management, that would be in any case, unsuccessful in court.⁸⁴ The current regime does this effectively. By leaving the award of costs at the discretion of the courts the Australian SDA forces potential litigants to consider their position seriously before commencing a claim.

IV CONCLUSION

It is contended that other than clearing up much of the confusion at general law, the SDA does little more than to merely encapsulate the common law.⁸⁵ While English courts have been conservative in their approach, Australia has generally

⁷⁹ Ibid 16.

⁸⁰ Ibid.

⁸¹ Berkahn, above n 3, 96.

⁸² *Companies Act 1993 (NZ)* s 166; Melissa Hofmann, 'The Statutory Derivative Action in Australia: An Empirical Review of its Use and Effectiveness in Comparison to the United States, Canada and Singapore' (2005) 1 *Bond Law Review* 17, 13.

⁸³ Thai, above n 77.

⁸⁴ Explanatory Memorandum to the Corporate Law Economic Reform Bill 1988 [6.33]; 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, 131.

⁸⁵ Thai, above n 77.

taken a less restrictive interpretation to the exceptions in *Foss v Harbottle*.⁸⁶ As such, while much of the ‘complex and arcane’⁸⁷ inconsistent authority have been cleared up by the SDA, its approach is arguably no more liberal than what Australian courts were already prepared to accept prior to the SDA. Indeed, if the above mentioned studies hold true, it would appear that the modest number of judgments before and after the SDA demonstrate that derivative action in Australia both under general law and the statutory regime strike an effective balance in ensuring shareholders have avenues to hold managers accountable where necessary, yet allowing sufficient freedom for managers to effectively run the company without interference.

⁸⁶ *Biala Pty Ltd v Mallina Holdings* (1993) 11 ACSR 785; *Ruralcorp Consulting Pty Ltd v Pynery Pty Ltd* (1996) 21 ACSR 161; *Mesenberg v Cord Industrial Recruiters Pty Ltd* (1996) 19 ACSR 483, 487; *Cope v Butcher* (1996) 20 ACSR 37.

⁸⁷ Watkins, above n 59.