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- develop and promote links with academics in other Australian universities and in other countries who specialise in corporate law and securities regulation
- establish and promote links with similar bodies, internationally and nationally, and provide a focal point in Australia for scholars in corporate law and securities regulation
- promote close links with peak organisations involved in corporate law and securities regulation
- promote close links with those members of the legal profession who work in corporate law and securities regulation

The Director of the Centre is Professor Ian Ramsay.

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I Introduction

A statutory derivative action has been proposed for the United Kingdom and is contained in Part 11 of the Company Law Reform Bill. Australia has had a statutory derivative action for approximately 6 years. This article outlines the results of the first empirical study of the Australian statutory derivative action. The study provides insights into the way Australian courts have interpreted and applied this remedy.

Part 2F.1A of the Corporations Act 2001 (Cth) (“the Act”) came into operation on 13 March 2000. Part 2F.1A enables current and former members and officers of a company to bring an action on behalf of the company, or intervene in proceedings to which the company is a party. This action, known as the statutory derivative action, was introduced to rectify the perceived inadequacies of the common law derivative action, on the recommendation of several government reports. These reports perceived the statutory derivative action as an important remedy available to minority shareholders to enforce their rights. However, the statutory derivative action has not been uniformly welcomed. Some commentators have criticised Part 2F.1A, claiming that it does not significantly improve the position of shareholders.

The aim of this study is to examine the effectiveness of the Australian statutory derivative action during the 6 years it has been in operation. In particular, we evaluate Part 2F.1A in light of the reasons for its introduction, and assess whether it has made a significant improvement on the common law position.

Part II outlines the rationale for the introduction of Part 2F.1A, and includes a discussion of the common law position, the rule in Foss v Harbottle and its exceptions. An overview of the operation of Part 2F.1A is provided in Part III. Part IV details the empirical study and results. Part V is the conclusion.

II The Introduction of Part 2F.1A

The Role of Shareholder Litigation in Corporate Governance

Opinion on the utility of shareholder litigation differs widely. One author has argued from an economic analysis that a litigious model of corporate governance is difficult to support. However, many other commentators have suggested that – despite its limitations – shareholder litigation has an important role to play in effective corporate governance. Giving

1 The provisions were enacted by the Corporate Law Economic Reform Program Act 1999 (Cth) (“CLERP”).
shareholders effective remedies maintains investor confidence,\(^4\) by punishing improper
corporate conduct.\(^5\)

Coffee and Schwartz argue that the derivative action plays an important role in deterring
directors from breaching their duties and punishing breaches.\(^6\) Others have argued that
derivative litigation is a useful deterrent to management dishonesty.\(^7\) This is echoed in the
discussion of another author who argues that, although there is a concern as to how much
justice is received from a derivative suit, derivative actions play a useful role in deterring
directors and officers from wrongful behaviour.\(^8\) In deterring managerial misconduct, the
derivative action helps to align the interests of the managers with those of the company,\(^9\) and
can be a ‘key element in reducing the agency costs inherent in the management of public
companies’.\(^10\)

This divergence of opinion is reflected in debates in several countries.\(^11\) The United States
Supreme Court has stated that the derivative action has long been ‘the chief regulator of
corporate management and has afforded no small incentive to avoid at least grosser forms of
betrayal of stockholders’ interests’\(^12\). Others believe that derivative actions are ‘expensive,
hazardous and clumsy’ and do not provide adequate protection for minority shareholders.\(^13\)
The lack of a derivative action in China is said to be a serious deficiency in the remedies
available to shareholders.\(^14\)

The derivative action must provide a balance between giving an effective remedy to
shareholders while at the same time allowing the directors of a company reasonable freedom
from shareholder interference. This is based on the principle that, generally speaking,
shareholders should have little say in the ordinary management of a corporation.\(^15\) As a
consequence:

\[\text{[The ideal derivative suit statute would balance precisely the public concern for management}\]
\[\text{accountability and the corporation’s concern in avoiding frivolous and unfounded claims,}\]

\(^4\) Michael J Duffy, ‘Procedural Dilemmas for Contemporary Shareholder Remedies – Derivative Action or
University of British Columbia Law Review 443 at 451, 481.
\(^7\) Oliver C Schreiner, ‘The Shareholder’s Derivative Action – A Comparative Study of Procedures’ (1979) 96
South African Law Journal 203 at 211.
\(^8\) Thomas P Kinney, ‘Stockholder Derivative Suits: Demand and Futility Where the Board Fails to Stop
\(^9\) Kristina de Vere Stevens, ‘Should We Toss Foss?: Toward an Australian Statutory Derivative Action’ (1997)
\(^10\) Ian Ramsay, ‘Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Derivative
\(^11\) See, for example, Klaus J Hopt, ‘Shareholder Rights and Remedies: A View from Germany and the
\(^12\) Cohen v Beneficial Industrial Loan Corp 337 US 541, 548 (1949). See also Thomas M Jones, ‘An Empirical
Examination of the Resolution of Shareholder Derivative and Class Action Lawsuits’ (1980) 60 Boston
University Law Review 542.
\(^13\) George T Washington, ‘Stockholders’ Derivative Suits: The Company’s Role, and a Suggestion’ (1940) 25
Cornell Law Quarterly 361 at 375.
\(^14\) Daniel T L Lam, ‘The Derivative Action: The Only Option for Minority Shareholders in PRC Companies?’
\(^15\) Whincop, above n 3, at 438-40.
while maintaining the derivative action as a viable method of enforcing accountability in the modern corporation.\(^\text{16}\)

In summary, shareholder litigation can play a valuable role in corporate governance, by deterring managerial misconduct, but must balance the need for accountability with the need for managers to have freedom to run their company. This is the view taken by the government reports. The 1993 Companies and Securities Advisory Committee Report on a Statutory Derivative Action stated:

> A key objective of shareholder litigation is that of achieving managerial accountability. … Consequently, shareholder litigation can be seen as a mechanism for maintaining investor confidence. … At the same time however it is clear that management needs to be protected against vexatious and hostile minority shareholders who, when commencing litigation, are not acting in the interests of the company. Therefore, any proposal for law reform in this area must contain mechanisms which operate to prevent needless and harmful shareholder litigation.\(^\text{17}\)

**Foss v Harbottle and its Exceptions**

Although now abolished by s 236(3) of the Act,\(^\text{18}\) it is important to understand the common law position in order to properly understand the rationale for the enactment of Part 2F.1A.\(^\text{19}\) The common law is encapsulated in what is known as the rule in *Foss v Harbottle*, although there is some debate as to whether the rule is one rule with two limbs or two related rules.\(^\text{20}\) The weight of authority favours the view that it is a single rule, comprising two related components.\(^\text{21}\) In *Foss v Harbottle*, Sir James Wigram VC stated that in respect of wrongs done to the company, ‘the corporation should sue in its own name and in its corporate character, or in the name of someone whom the law has appointed to be its representative’.\(^\text{22}\) However, the classic statement of the rule was not in the case itself, but by Jenkins LJ in *Edwards v Halliwell*:

> The rule in *Foss v Harbottle*, as I understand it, comes to no more than this. First, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is *prima facie* the company or the association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quaestio*.\(^\text{23}\)

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\(^{18}\) Section 236(3) provides: ‘The right of a person at general law to bring, or intervene in, proceedings on behalf of a company is abolished’.

\(^{19}\) See generally H A J Ford, R P Austin & I M Ramsay, *Ford’s Principles of Corporations Law* (Looseleaf, Butterworths) at [11.300].


\(^{22}\) *Foss v Harbottle* (1843) 2 Hare 461, 491; 67 ER 189.

\(^{23}\) [1950] 2 All ER 1064 at 1066.
The rule in *Foss v Harbottle*, then, comprises two principles. The first limb is known as the "proper plaintiff" rule and is based upon the principle that a company is a separate legal entity, distinct from its shareholders.\(^{24}\) A wrong done to the company is not a wrong done to the shareholders, and should be redressed by the company itself, taking action in its own name.\(^{25}\) The second limb is known as the "internal management" principle. The courts will not interfere with the internal management of companies where those acting in management do so acting within their powers.\(^{26}\)

Although based on sound corporate law principles,\(^{27}\) the rule can lead to manifest injustices. As a consequence, a number of exceptions to the rule in *Foss v Harbottle* were developed:\(^{28}\)

(a) The illegal or ultra vires act exception

Where an action was illegal or ultra vires the company, a shareholder could sue to restrain the action, because the majority could not ratify acts ultra vires the company.\(^{29}\)

(b) The special majority exception

Where an action was taken in breach of a requirement in the constitution requiring a special majority to authorise the action, a member could sue to challenge the validity of the resolution.\(^{30}\)

(c) The personal rights exception

Where the personal rights of the shareholder had been infringed, the rule in *Foss v Harbottle* did not apply, for the shareholder could sue in their own name to protect their personal rights.\(^{31}\) Although a simple concept in theory, distinguishing in practice between personal and corporate rights can be a difficult task.\(^{32}\)

(d) The fraud on the minority exception

Where the action amounted to a fraud on the minority and the wrongdoers were in control of the company, the minority shareholders were permitted to bring an action against the wrongdoers on behalf of the company.\(^{33}\) Whereas any right of action under the first three

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\(^{24}\) *Salomon v Salomon & Co* [1897] AC 22, 29.


\(^{26}\) *Burland v Earle* [1902] AC 83 at 93.


\(^{28}\) Note that there is debate as to whether they are exceptions to the rule or merely instances in which the rule does not apply. See especially Wedderburn, above n 20 at 203. The exceptions are based on Jenkins LJ’s formulation in *Edwards v Halliwell* [1950] 2 All ER 1064 at 1067.

\(^{29}\) Wedderburn, above n 20 at 204-5.


\(^{31}\) Berkahn, above n 21 at 80-1.


exceptions was personal, an action brought under the fraud on the minority exception was derivative,\(^{34}\) and it has thus been described as ‘the only true exception’ to the rule in \textit{Foss v Harbottle}.\(^{35}\) In order to bring a common law derivative action, the plaintiff had to bring evidence that ‘the defendants were in a position of control within the company and had perpetrated a fraud on the minority’.\(^{36}\) Due to the ambiguity of these terms, proving fraud and control was by no means an easy task.\(^{37}\) English courts adopted a conservative approach to control, usually requiring that the defendants control a majority of the voting shares,\(^{38}\) which made derivative actions difficult to bring except in small private companies,\(^{39}\) and anything less than expropriation of corporate assets would be unlikely to be considered fraud.\(^{40}\) As a consequence, it was difficult to bring an action under this exception.\(^{41}\)

(e) The interests of justice exception

There has been debate as to whether a fifth exception existed based on the “interests of justice”. That is, the courts would permit a shareholder to bring an action despite the rule in \textit{Foss v Harbottle} when the interests of justice required it. Boyle has succinctly stated the position:

There has … been a thin but steady stream of \textit{obiter dicta} … which adopt a more flexible approach to \textit{Foss v Harbottle}. They are to the effect that a minority action will be allowed by exception to the rule whenever justice requires it in the circumstances of the case, even though the requirements of one of the established exceptions cannot be met.\(^{42}\)

Sealy argued that the interests of justice was not so much an exception but ‘the very foundation of the court’s willingness to lend its aid to a minority member who seeks redress for a corporate wrong’.\(^{43}\) Another commentator argued that the “interests of justice” was not an exception to the rule as it was ‘too nebulous, vague and infinitely elastic’.\(^{44}\)

The Rationale for the Introduction of Part 2F.1A

The Inadequacy of the Common Law

Although \textit{Foss v Harbottle} does have its advantages, for example by reducing a multiplicity of shareholder legal actions, leaving significant decisions in the hands of management who


are qualified to make those decisions, and reducing the scope for vexatious litigation, the case has been the object of sustained criticism.

Described as ‘complex and arcane’, and as ‘140 years’ accumulation of procedural codswallop’, seeking redress under an exception to the rule in *Foss v Harbottle* was an ‘onerous undertaking’. The two limbs of the rule in *Foss v Harbottle* created ‘considerable, sometimes insurmountable, barriers to any shareholder or interested party seeking to enforce a cause of action vested in the company’, and had a ‘leaden impact’ on shareholder litigation. Ever since *Foss v Harbottle*, ‘shareholders of companies have been fighting to widen the ambit of their rights to bring actions against directors and controlling shareholders’.

In short, the common law derivative action was complex in both legal theory and procedural hurdles. Not only were shareholders limited to the elusive exceptions to the rule in *Foss v Harbottle*, they also faced threshold tests, applications to strike, interlocutory appeals, an uncertain prospect of meaningful recovery, uncertain funding for their legal expenses, and a judiciary inclined to defer to the “corporate will”.

Criticisms of the common law situation highlighted, in particular, the following issues:

(a) The Cost of Litigation

In *Wallersteiner v Moir (No 2)*, Lord Denning held that a shareholder who brings a derivative action should be entitled to be indemnified by the company for all costs incurred in bringing the action, because if the action succeeds, the company will take the benefit. Although considered by some to finally resolve the issue of costs, subsequent cases limited its utility. In *Smith v Croft* Holton J held that interim funding orders should not be made until after discovery, and only in cases of genuine need. The situation was similar in Australia. The outcome was that minority shareholders could not rely on their costs being indemnified, for although cases gave some comfort that costs would be paid, comprehensive indemnity rules were not developed.

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50 Kaplan and Elwood, above n 5 at 450.
52 Ibid at 391-2 (Denning MR); see concurring statements by the other judges at 403-4 (Buckley LJ); 407 (Scarman LJ).
53 See Schreiner, above n 7 at 215.
54 [1986] 2 All ER 551.
56 Watkins, above n 46 at 48.
57 Kluver, above n 49, at 9, 23.
In addition to not being assured that their costs would be paid, plaintiff shareholders faced the prospect that any money recovered would accrue to the company, giving the shareholder only a small pro-rata benefit. The combination of these factors left potential plaintiff shareholders with a serious disincentive to commence litigation. One commentator summarised the position:

the main impediment to shareholders contemplating litigation is … a lack of incentive to commence litigation deriving from a number of factors including the cost of litigation and the fact that if the action is successful any recovery accrues to the company and not the plaintiff shareholder.

The government reports also underlined the importance of the question of costs, describing it as ‘possibly the greatest inhibitor to shareholder litigation’ and noting that the cost of litigation ‘effectively prevents shareholders from pursuing the legal remedies open to them’.

(b) Restrictive Standing Requirements

The restrictive standing requirements facing a potential plaintiff shareholder were also a significant barrier. In *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* it was held that the question of standing had to be considered as a preliminary issue. Given that, as previously mentioned, proving fraud and control was a difficult process, these preliminary hearings developed into long and expensive hearings.

However, the courts in Australia took a different direction. King CJ in *Hurley v BGH Nominees Pty Ltd* considered that the procedure set out in *Prudential* should not be followed in all situations, and other cases followed King CJ’s approach. Unlike English courts, Australian courts ‘usually consider it inappropriate for the question of standing to be tried as a preliminary issue’. As a result of this ‘pragmatic and sympathetic approach to the question of standing’:

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63 Ramsay, above n 10 at 150.
66 [1982] 1 Ch D 204 at 221-2.
67 Cf *Biala Pty Ltd v Mallina Holdings* (1993) 11 ACSR 785 at 840-4, where the plaintiff failed to satisfy the court.
68 Kaplan and Elwood, above n 5 at 448. See the strident criticisms of *Prudential* in Sealy, above n 43.
70 Cf *Aloridge Pty Ltd (prov liq apptd) v Western Australian Gem Explorers Pty Ltd* (1995) 127 ALR 410; *Dempster v Mallina Holdings Ltd* (1994) 15 ACSR 1.
[i]t is fair to conclude from these decisions that the courts are willing to overcome the procedural obstacles to the common-law derivative action, thus minimizing the impact of *Foss v Harbottle*. 

Stevens has stated that ‘[t]he major impetus for Australia’s move toward adopting a statutory derivative suit is the very restrictive nature of the standing requirements at common law’. Several statements in the government reports seem to support this statement. However, given that standing has not proven to be as problematic in Australia as it has been in England, the validity of this reasoning is questionable.

(c) Ratification

The law relating to ratification has been described as ‘[u]ndoubtedly the greatest legal difficulty with the existing derivative remedy’. 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. Indeed, ‘the mere possibility of ratification was sufficient to deprive a shareholder of the ability to bring a derivative action’. There is conflicting authority as to what types of acts and omissions by directors are ratifiable by the company, to such an extent that it has been described as a ‘labyrinthine case-law’ and a ‘legal quagmire’. This ‘uncleared minefield’ could often lead to unjust outcomes.

(d) Uncertainty of the Rule and Exceptions

Although the rule in *Foss v Harbottle* can be stated with ‘disarming simplicity’, the simplicity ends there. ‘Few areas of the law are more beleaguered by confusion and misconception than the rule in *Foss v Harbottle*’. The law is ‘complex and obscure’, with conflicting authority as to the exact scope of the exceptions to *Foss v Harbottle*, making it

73 Stevens, above n 9 at 135.
75 See Ramsay, above n 10 at 159-62.
80 Kluver, above n 49 at 9.
81 Hargovan, above n 72 at 646.
82 Fridman, above n 78, 252, 255.
84 Dick, above n 25 at 547.
85 Cheffins, above n 45 at 233.
difficult to accurately state the law. It is not surprising that the government reports recognised the uncertainty inherent in the common law derivative action as an area needing reform.

(e) The Inadequacy of Alternative Remedies

A more controversial view is that existing remedies such as the oppression remedy did not furnish shareholders with adequate protection. This was the position held by CASAC in its 1993 report. One author agreed that ‘the oppression provision has not enjoyed great success as a response to *Foss v Harbottle*’. However this view is by no means unanimous. One author argued that the ‘liberal approach currently favoured in the interpretation of the oppression remedy has made it a very useful remedial tool for minority shareholders’, while another argued that due to its wide interpretation by the courts the oppression remedy ‘has been used effectively by the courts to combat the rule in *Foss v Harbottle*’. An empirical study of the use of the oppression remedy found there has been a ‘significant increase in the use of the oppression remedy’.

*Overcoming the Problems with the Common Law*

The preceding discussion indicates the reasons for the introduction of Part 2F.1A. The government reports all highlighted the inadequacy of the common law and existing remedies in providing shareholders with adequate remedies. The Companies and Securities Law Review Committee said in its 1990 Discussion Paper:

> The focus of this paper has resulted from recognition of a widespread assessment that due to the restrictive nature of the rule in *Foss v Harbottle*, existing law does not provide adequate means for the enforcement of the duties of directors and officers where the company improperly refuses or fails to take action.

The Companies and Securities Advisory Committee subsequently stated:

> Despite the existence of [the exceptions to the rule in *Foss v Harbottle*] there have been continued calls for reform of this area of law on the basis that the exceptions are too narrow and hinder shareholder litigation.

The CLERP Proposals for Reform Paper contained a similar statement:

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90 Bottomley, above n 50 at 142.
91 Berkahn, above n 21 at 89.
92 Hargovan, above n 72 at 637.
The existing law is unsatisfactory both on the question of standing of a shareholder to take action and the disincentive to commence proceedings because of the potential costs which might be incurred.\textsuperscript{96}

The reports recommended the enactment of a statutory derivative action to overcome the inadequacy of the common law: ‘[t]he main proposal to improve the ability of shareholders to take proceedings to enforce their rights is to implement a form of statutory derivative action’.\textsuperscript{97} It was believed that a statutory derivative action would be ‘a more effective avenue of enforcement than has previously been available’ and the procedures ‘would make a derivative action more feasible and practical than under the common law’.\textsuperscript{98}

In particular, the statutory derivative action was enacted to overcome the common law problems with respect to ratification, the prohibitive cost of litigation, and the restrictive standing requirements confronting shareholders. The Explanatory Memorandum to the \textit{Corporate Law Economic Reform Program Bill 1999} stated:

\begin{quote}
The main difficulties associated with the common law action centre around:

- the effect of ratification of the impugned conduct by the general meeting of shareholders;
- the lack of access to company funds by shareholders to finance the proceedings; and
- the strict criteria which need to be established before a Court may grant leave.
\end{quote}

Numerous cases have described the rationale for the statutory derivative action in a similar way. In \textit{Talisman Technologies Inc v Queensland Electronic Switching Pty Ltd}\textsuperscript{99} Mullins J stated that ‘[t]he intention of the legislation was to overcome the practical and legal difficulties regarding what used to be called derivative actions, while maintaining appropriate checks and balances’. In \textit{BL & GY International Co Ltd v Hypec Electronics Pty Ltd}\textsuperscript{100} Einstein J stated:

\begin{quote}
The matter that the legislature sought to address appears to have been the difficulties which had arisen when under the common law, a party sought to proceed on the basis of an exception to the rule in \textit{Foss v Harbottle}.
\end{quote}

The statutory derivative action is designed to overcome the problems with the common law derivative action and increase the effective remedies available to shareholders:

\begin{quote}
It may be accepted that ss 236 and 237 were not intended to preserve the former law; but they should surely be approached as measures of reform designed to improve, rather than to place novel obstacles in the way of, such proceedings.\textsuperscript{101}
\end{quote}

\textbf{The Purpose of the Statutory Derivative Action}

As well as rectifying the defects inherent in the common law derivative action, the statutory derivative action has several significant purposes.

\textsuperscript{96} CLERP Proposals for Reform, \textit{Directors’ Duties and Corporate Governance: Facilitating Innovation and Protecting Investors} (Paper No 3, 1997) at 31.
\textsuperscript{98} CLERP Proposals for Reform, \textit{Directors’ Duties and Corporate Governance: Facilitating Innovation and Protecting Investors} (Paper No 3, 1997) at 32, 34.
\textsuperscript{100} (2001) 164 FLR 268; (2001) 19 ACLC 1622; [2001] NSWSC 705 at [70].
Managerial Accountability

A key problem that confronts shareholders is that the division of management and ownership has the potential to encourage misuse of company resources by some directors for their own benefit and this division can pose significant obstacles for shareholders seeking to bring an action against directors for breach of their duties. If maintaining good corporate governance is essential to investor confidence, there must be effective ways of deterring managerial misconduct. The primary purpose of the statutory derivative action is to enhance managerial accountability by deterring wrongful conduct:

the statutory derivative action has primarily a deterrent objective – by empowering the shareholders and others, it serves to deter managerial misconduct by imposing the threat of liability.

The government reports indicate that achieving managerial accountability is very much a key objective of the statutory derivative action: ‘[a] statutory form of derivative action should provide strong encouragement for company managers to be accountable to shareholders’. Stevens writes that the statutory derivative action was enacted from a ‘desire for a more potent, accessible weapon to deter and punish managerial misconduct’. Another author has spoken of the statutory derivative action allowing shareholders to act ‘as some form of corporate watchdog, to pursue an action against a wrongdoer, when the board refuses to act’. This goal is reflected in the final form of Part 2F.1A. Section 237(3) establishes a rebuttable presumption that actions against third parties are not in the best interests of the company if the company has decided not to bring those proceedings and the directors made that decision reasonably and in good faith. The statutory derivative action is not designed to usurp the ordinary functioning of the board of directors, but to provide a remedy when the board has acted improperly.

Compensating the Company

One author has posed the question: ‘what does the derivative action accomplish – is it to deter corporate malfeasance or to provide some form of compensation?’ The CLERP

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104 CLERP Proposals for Reform, Directors’ Duties and Corporate Governance: Facilitating Innovation and Protecting Investors (Paper No 3, 1997) at 7-11.
105 Choo, above n 61 at 69.
107 CLERP Proposals for Reform, Directors’ Duties and Corporate Governance: Facilitating Innovation and Protecting Investors (Paper No 3, 1997) at 40.
108 Stevens, above n 9 at 127.
110 See the Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1999 (Cth) at 22.
111 Griggs, above n 109 at 94.
Proposals for Reform Paper states that ‘the statutory action is not intended to be regulatory in nature but to facilitate private parties to enforce existing rights attaching to the company’. The same view has been expressed by Heenan J:

The action for relief …under the statutory derivative action [is a remedy] to vindicate an interest of the company as a whole, with consequent benefit to all current shareholders or members.

However, it is appropriate to see these purposes as complementary. Deterrence is achieved through the means of the enforcement of company rights: ‘private enforcement accomplished via shareholder litigation may be preferable to public enforcement’. The statutory derivative action serves both purposes:

it seeks to provide some level of deterrence against abuses of managerial or directorial authority, and it provides an avenue whereby, through shareholder activism in the absence of action by the board of directors, the corporation can recover damages or property belonging to the corporation.

In giving shareholders an effective means of enforcing their rights and recovering money owed to the company, the goal of deterrence is achieved.

**Remedying Internal Disputes**

The government reports recognised the ‘clear need to protect directors and officers of companies from unreasonable interruption of their day to day affairs’. The courts are also keen to exclude unwarranted interference with the internal management of companies. However, sometimes interference by the courts is necessary in order to remedy internal disputes where those managing the company are unable to do so:

Part 2F.1A is concerned with the domestic process by which a company makes decisions relevant to initiation and continuation of legal proceedings. The statutory provisions aim to counter the effects of inaction on the part of those who would normally decide such matters internally.

The statutory derivative action is concerned with the internal decision-making process of a company. The objective is to ensure that members are not disadvantaged by the self-interested actions of other shareholders or the directors, and also to ensure they are able to bring an action to vindicate their rights. McPherson JA stated in *Metyor*:

It is because one group of members are in control of the management or affairs of the company and refuse to permit it to take proceedings that there is a dispute between the two groups of shareholders or members here. It is only by permitting proceedings to be taken on behalf of the company that the dispute in question can be resolved at all and that the complaint of one set of members against the others can be remedied. Otherwise the majority

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113 Westgold Resources NL v Precious Metals Australia Ltd [2002] WASC 221 at [21].
115 Kaplan and Elwood, above n 5 at 455.
will be able to prevent the minority and through them the company from obtaining redress against the actions of the majority.\textsuperscript{119}

An example is Braga v Braga where Hamilton J stated:

\ldots it would appear from the correspondence that the plaintiff and the first defendant are ad idem that the company has valid claims for defalcation against these outside parties, but that the present state of disagreement between them cripples the company from taking those proceedings.\textsuperscript{120}

\textbf{Initial Appraisal of the Statutory Derivative Action}

Although many commentators strongly criticised the common law situation, this was by no means unanimous, particularly in the Australian context. Some commentators argued that the development of corporate law by Australian judges minimised the problems arising from \textit{Foss v Harbottle}. After examining the application of \textit{Foss v Harbottle} by Australian courts, L S Sealy concluded in 1989:

\begin{quote}
The picture that consistently comes through is one of a willingness to get at the substantial issue undistracted by any consideration of \textit{locus standi} or procedure. Where a \textit{Foss v Harbottle} point has in fact been taken, one frequently finds the judge putting the issue on one side.\textsuperscript{121}
\end{quote}

Prior to the introduction of Part 2F.1A, Australian courts took a much less restrictive approach to the question of standing than their English counterparts. They gave a broad interpretation of the interests of justice exception to the rule in \textit{Foss v Harbottle},\textsuperscript{122} and expanded the personal rights category.\textsuperscript{123} For these reasons, other commentators have followed Sealy’s analysis, arguing that the implications of \textit{Foss v Harbottle} were not as severe as they were made out to be.\textsuperscript{124} It was also argued that there were adequate remedies under the pre-CLERP situation, because every action brought under Part 2F.1A could have been brought under s 1324\textsuperscript{125} (which empowers the court to grant an injunction for breaches of the \textit{Corporations Act}) or the oppression remedy.\textsuperscript{126}

In consequence, some commentators considered that the statutory derivative action would have little impact. Thai argued that Part 2F.1A is ‘no more than reformulation of the common

\begin{itemize}
\item \textsuperscript{120} Braga v Braga Consolidated Pty Ltd [2002] NSWSC 603 at [9].
\item \textsuperscript{121} L S Sealy, ‘The Rule in Foss v Harbottle: The Australian Experience’ (1989) 10 Company Lawyer 52.
\item \textsuperscript{124} McConvill, above n 62 at 310.
\end{itemize}
Griggs argued that ‘a solution has been found to a problem for which there is arguably, little, if any demonstrated evidence’ and that ‘the available evidence suggests that the statutory derivative action will have little impact on shareholder litigation in Australia’. Fitzsimons argued that the statutory derivative action has failed to make a major impact in Canada, and the Australian experience would prove to be similar.

However, despite the expansive approach of the Australian courts, there were difficulties in the common law which needed to be overcome. As one commentator put it:

…if there are difficulties in enforcing the duties of directors and officers as asserted by the CSLRC, this is not because of deficiencies in the common law resulting from Foss v Harbottle. … Rather, the reason why breaches of directors’ duties may go unpunished is because of the lack of incentive to commence litigation.

Corkery said, in an oft-quoted statement:

Despite judicial innovations, under the present law there are just too many hurdles to jump before bringing derivative suits. You must identify the wrongdoers, gather sufficient information, show there is fraud, prove the alleged wrongdoers control the company, and discover whether or not the acts complained of are ratifiable by a majority at a general meeting. Then you must somehow fund the action. In the face of all this and more, genuine grievances go unremedied.

The cost of litigation was a significant hurdle to the bringing of common law derivative actions. Moreover, s 1324 did not occupy the prominent place in corporate law that some believed it should.

Some commentators have criticised the particular form in which the statutory derivative action is framed, arguing that it is a weakening of the position of shareholders as compared with their position under the common law. Clyne argued that the statutory derivative action puts significant hurdles in the path of minority shareholders, and will not assist them. Prince argued that Part 2F.1A is ‘harder to use than its New Zealand equivalent’ and so the ultimate outcome from the shareholders’ point of view is worse than under the common law. Fletcher believes that ‘[e]nactment of subs 236(3) significantly weakened the legal position of minority shareholders’, and that ‘it is difficult not to conclude that shareholders have been short changed by these legislative developments.’


128 Griggs, above n 109 at 90, 93.


130 Ramsay, above n 10 at 162.


132 Baxt, above n 125.


135 Keith Fletcher, ‘CLERP and Minority Shareholder Rights’ (2001) 13 Australian Journal of Corporate Law 290 at 295, 300. Note that he later argues that due to the ‘likelihood that many actions that previously were brought under the “exceptions” to the rule in Foss v Harbottle will now be brought under’ the oppression provision, ‘it is difficult to assert that the CLERP changes have adversely affected minority shareholders’ (at 303).
Others have assessed the impact of the statutory derivative action more positively. These authors have argued that the reforms are ‘a vast improvement on the previous position’, and that ‘the introduction of the statutory derivative action would greatly enhance the range of remedies available to the minority shareholder’.  

**Summary**

The statutory derivative action has displaced any potential recourse to any of the exceptions to the rule in *Foss v Harbottle*, so that, except where the company is a foreign company, a derivative action must now be commenced under Part 2F.1A.  

As the statutory derivative action now covers the field, it is important to compare the present situation with the pre-Part 2F.1A position. The government reports identified three key defects in the common law derivative action which were to be rectified by the statutory derivative action:

- ratification;
- the cost of litigation; and
- the restrictive standing requirements.

In our empirical study of the statutory derivative action, we pay particular attention to considering whether these problems have been rectified by Part 2F.1A.

**III Outline of Part 2F.1A**

Section 236(1) of the Act provides that:

- a member, former member, or person entitled to be registered as a member, of the company or of a related body corporate; or
- an officer or former officer of the company may apply for leave to bring a derivative action.

The application may be to:

- bring proceedings on behalf of a company, or
- intervene in any proceedings to which the company is a party for the purpose of taking responsibility on behalf of the company for those proceedings, or for a particular step in those proceedings.

Proceedings brought on behalf of a company must be brought in the company’s name (s 236(2)). The right to bring a derivative action at general law is abolished (s 236(3)).

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138 Section 236(3) does not apply to a foreign company, and so the general law still applies with respect to such companies: *Irawan v AWB Ltd* [2001] VSC 374 at [39]-[41].


140 Section 236(3); McConvill, above n 136 at 301.
Leave of the court must be obtained for the action to proceed. Pursuant to s 237(2), the court must grant the application if it is satisfied that:

(a) it is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in 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; and
(d) if the applicant is applying for leave to bring proceedings – there is a serious question to be tried; and
(e) either:

(i) at least 14 days before making the application, the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying; or
(ii) it is appropriate to grant leave even though subparagraph (i) is not satisfied.

All these criteria must be satisfied for leave to be granted, and leave must be granted if they are satisfied.

Section 237(3) establishes a rebuttable presumption that granting leave is not in the best interests of the company if it is established that:

- the proceedings are by the company against a third party or by a third party against the company; and
- the company has decided not to bring the proceedings or not to defend the proceedings or to discontinue, settle or compromise the proceedings; and
- all of the directors who participated in that decision:
  - acted in good faith for a proper purpose; and
  - did not have a material personal interest in the decision; and
  - informed themselves about the subject matter of the decision to the extent they reasonably believed to be appropriate; and
  - rationally believed the decision was in the best interests of the company.

The director’s belief that the decision was in the best interests of the company is a rational one unless the belief is one that no reasonable person in their position would hold. The definition of a third party is in s 237(4). A person is a third party if:

- the company is a public company and the person is not a related party of the company; or
- the company is not a public company and the person would not be a related party of the company if the company were a public company.

Ratification of conduct by the members of a company does not:

- prevent a person applying for leave under s 237;
- prevent an applicant from bringing or intervening in proceedings if leave has been granted; nor
- have the effect that proceedings brought or intervened in with leave under section 237 must be determined in favour of the defendant, or that an application for leave under that section must be refused.
However, the court may take the ratification into account in deciding what order to make in the actual proceedings or in deciding whether to grant leave (s 239).

Section 240 provides that proceedings brought or intervened in with leave must not be discontinued, compromised or settled without the leave of the court.

Section 241 empowers the court to make any orders, and give any directions, that it considers appropriate in relation to proceedings brought or intervened in with leave, or an application for leave.

Section 242 provides that the court may at any time make any orders it considers appropriate about the costs of:

- the person who applied for or was granted leave;
- the company; or
- any other party to the proceedings or application,

in relation to proceedings brought or intervened in with leave under section 237 or an application for leave under that section. An order under s 242 may require indemnification for costs.
IV Empirical Study and Analysis of Data

Research Methodology

The objective of the research methodology was to locate and analyse every case decided under Part 2F.1A. Research was conducted using a number of electronic databases, with search terms based on the relevant legislative provisions. Only those cases which involved an application for leave under s 237 to either bring or intervene in proceedings, or an appeal from such an application, were reviewed for the study. Each case was read and, for each case, the following 14 questions were, to the extent possible, answered:

1. When was the case decided?
2. What court was the case decided in?
3. Was it at first instance or on appeal?
4. Who was the applicant?
5. What type of company was it?
6. What were the allegations pleaded?
7. Was the oppression remedy also relied on?
8. Who defended the application?
9. Was leave granted?
10. If the application was not successful, why not?
11. What were the sections of Part 2F.1A relied on?
12. Did the court refer to the substance of the case?
13. What was the length of the hearing?
14. Did the court award funding for the litigation by the company?

The research located 31 cases for the period from March 2000 (the introduction of Part 2F.1A) to 12 August 2005.

141 The LexisNexis AU, Austlii and Centre for Corporate Law and Securities Regulation databases were searched.
143 There have been subsequent cases up to the date of completion of this paper (February 2006). However, the authors do not believe these cases alter the conclusions reached in this study.
Background Information

Table 1 shows the distribution of cases according to the year in which the leave application was decided.

Table 1: When was the case decided?

<table>
<thead>
<tr>
<th>Year of Application</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000 (from 12 March)</td>
<td>3</td>
<td>9.7%</td>
</tr>
<tr>
<td>2001</td>
<td>7</td>
<td>22.6%</td>
</tr>
<tr>
<td>2002</td>
<td>6</td>
<td>19.4%</td>
</tr>
<tr>
<td>2003</td>
<td>4</td>
<td>12.9%</td>
</tr>
<tr>
<td>2004</td>
<td>9</td>
<td>29%</td>
</tr>
<tr>
<td>2005 (to 12 August)</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>100%</td>
</tr>
</tbody>
</table>

For the time period of study, the research yielded only 31 cases. This is a modest number of cases. It is possible, as some have argued,\(^\text{144}\) that the statutory derivative action has failed to make a significant impact. Yet the issue of impact cannot be determined solely on the basis of the data in Table 1.

In order to gain additional insight into the impact of the statutory derivative action, the following research was undertaken. A search of electronic databases of judgments of Australian courts was undertaken for judgments in which *Foss v Harbottle* was considered by courts for the 5 year period immediately preceding the introduction of the statutory derivative action (ie, 1995-1999). This research found 30 judgments. This indicates that when a similar period of years is examined (1995-1999 for *Foss v Harbottle* and 2000-2005 for Part 2F.1), the statutory derivative action is not resulting in a greater number of judgments than the common law derivative action which it replaced.

Table 1 indicates that the distribution of cases across the five years is fairly even, and does not seem to indicate either increasing or decreasing popularity.

Table 2 shows the distribution of cases according to the court in which the application was heard.

\(^{144}\) See above notes 127-29 and accompanying text.
Table 2: What court heard the application for leave?

<table>
<thead>
<tr>
<th>Court</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supreme Court of Victoria</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Supreme Court of New South Wales</td>
<td>18</td>
<td>58.1%</td>
</tr>
<tr>
<td>Supreme Court of South Australia</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>Supreme Court/Court of Appeal of Western Australia</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>Supreme Court/Court of Appeal of Queensland</td>
<td>7</td>
<td>22.6%</td>
</tr>
<tr>
<td>Federal Court of Australia</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>100%</td>
</tr>
</tbody>
</table>

The court in which the most cases have been heard is the New South Wales Supreme Court. Only two cases have been heard in the Federal Court.

Table 3 shows the distribution of cases according to whether the decision was a decision at first instance or on appeal.

Table 3: Was the case at first instance or on appeal?

<table>
<thead>
<tr>
<th>Nature of case</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>First instance</td>
<td>27</td>
<td>87.1%</td>
</tr>
<tr>
<td>Appeal</td>
<td>4</td>
<td>12.9%</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>100%</td>
</tr>
</tbody>
</table>

Few leave applications have been appealed. The majority of applications decided were decisions at first instance.
Who was the Applicant?

Table 4 details information about the applicant.

**Table 4: Who was the applicant?**

<table>
<thead>
<tr>
<th>Applicant</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Former director with no shareholding</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>Former director and current minority shareholder</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Former director and current 50% shareholder</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td><strong>Total number of cases involving former directors</strong></td>
<td><strong>4</strong></td>
<td><strong>12.9%</strong></td>
</tr>
<tr>
<td>Director and minority shareholder</td>
<td>4</td>
<td>12.9%</td>
</tr>
<tr>
<td>Director and 50% shareholder</td>
<td>5</td>
<td>16.1%</td>
</tr>
<tr>
<td>Director and shareholder, shareholding unknown</td>
<td>3</td>
<td>9.7%</td>
</tr>
<tr>
<td><strong>Total number of cases involving current directors who are also shareholders</strong></td>
<td><strong>12</strong></td>
<td><strong>38.7%</strong></td>
</tr>
<tr>
<td>Minority shareholder</td>
<td>6</td>
<td>19.4%</td>
</tr>
<tr>
<td>50% shareholder</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>Majority shareholder</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Shareholder with unknown shareholding</td>
<td>3</td>
<td>9.7%</td>
</tr>
<tr>
<td><strong>Total number of cases involving shareholders who are not also current or former directors</strong></td>
<td><strong>12</strong></td>
<td><strong>38.7%</strong></td>
</tr>
<tr>
<td>Not specified</td>
<td>3</td>
<td>9.7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>31</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

145 In Table 4 the singular is used for ease of presentation. It should be noted that some cases involved multiple applicants (ie, several minority shareholders were applicants in some cases).
Almost all applicants are shareholders as at the date of the application or were former shareholders. Excluding those applicants whose position is unknown, only one case involved an applicant who was not a current shareholder. Nineteen cases involved either minority or 50% shareholders, which is 86.3% of those applicants whose shareholding is known (22 in total).

In 16 of the 31 cases (51.6%) the applicant was a current or former director and in 15 of these 16 cases the director was also a shareholder.

**What Type of Company is Involved?**

Table 5 details whether the company concerned is a public or privately held company.

**Table 5: Is the company public or privately held?**

<table>
<thead>
<tr>
<th>Type of company</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td>27</td>
<td>87.1%</td>
</tr>
<tr>
<td>Public</td>
<td>4</td>
<td>12.9%</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>100%</td>
</tr>
</tbody>
</table>

The vast majority of cases involved privately held companies. The government reports saw the statutory derivative action as an important means of maintaining investor confidence,\(^{146}\) which seems to indicate that the primary role of the statutory derivative action was intended to be in large public companies, where shareholders were to act as watchdogs, guarding their investments by monitoring the actions of management. Instead, the statutory derivative action has been much more widely used in small proprietary companies, to overcome internal disputes.

It is also significant that a large number of cases involved companies which were under some form of administration, for example liquidation, receivership or other external administration. Table 6 presents this information.

**Table 6: Was the company solvent or under some form of administration?**

<table>
<thead>
<tr>
<th>State of company</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solvent</td>
<td>21</td>
<td>67.7%</td>
</tr>
<tr>
<td>Under some form of administration(^{147})</td>
<td>10</td>
<td>32.3%</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>100%</td>
</tr>
</tbody>
</table>

\(^{146}\) See CLERP Proposals for Reform, *Directors’ Duties and Corporate Governance: Facilitating Innovation and Protecting Investors* (Paper No 3, 1997) at 8.

\(^{147}\) This is broadly defined for ease of presentation, and includes liquidation, receivership or other external administration.
In nearly a third of the cases considered the company in question was subject to some form of administration and was thus in financial difficulty. This has presented difficult problems for courts with respect to the question of costs, which is discussed in more detail below.

Several cases have considered the applicability of Part 2F.1A to a company in liquidation. Although Einstein J of the NSW Supreme Court held in *BL & GY International* that Part 2F.1A does not apply to a company in liquidation, the Western Australian Supreme Court expressed doubt as to whether Part 2F.1A has any application to a company in liquidation, the majority of cases have held that it does. Einstein J, in light of these cases, has since reversed his opinion. ‘The question should now be regarded as settled’ that Part 2F.1A applies to a company in liquidation.

The inherent jurisdiction of a court to permit a proceeding to be taken in the name of a company in liquidation at the instigation of a creditor or contributory has survived. Section 237(3), which creates a rebuttable presumption against commencing actions against third parties, will not operate to create a presumption that proposed proceedings are not in the best interests of the company if the company is in liquidation. Section 237(3):

…cannot create any rebuttable presumption that the granting of the leave [the applicant] seeks is not in the best interests of the company. This is because s 237(3) is capable of operating to create such a presumption only if the relevant company’s decision not to bring the proceedings itself was a decision of the company’s directors: see s 237(3)(c). Here, corporate decision-making is no longer in the hands of the company’s directors.

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149 *HPM Pty Ltd v Fear* [2002] WASCA 249 at [18]-[19].
154 Ibid at [18].
What Were the Allegations Pledged?

Table 7 details the allegations pleaded in the various cases.

Table 7: What were the allegations pleaded?

<table>
<thead>
<tr>
<th>Allegations pleaded</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Breach of directors’ duties</td>
<td>10</td>
<td>32.3%</td>
</tr>
<tr>
<td>Breach of directors’ duties and contract</td>
<td>6</td>
<td>19.4%</td>
</tr>
<tr>
<td>Breach of contract</td>
<td>5</td>
<td>16.1%</td>
</tr>
<tr>
<td>Oppressive conduct</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Recovery of debt</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>Set aside default judgment</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Not specified</td>
<td>5</td>
<td>16.1%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>31</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Breaches of directors’ duties were pleaded in 51.7% of the cases. This confirms, as discussed above, that managerial accountability is a key focus of the statutory derivative action.

Comparison of the Oppression Remedy and Part 2F.1A

Table 8 shows those cases in which the judgment of the court indicates that an oppression application (under Part 2F.1) was also brought in addition to the application to bring a statutory derivative action under Part 2F.1A.

Table 8: Was an oppression application also brought?

<table>
<thead>
<tr>
<th>Oppression application also brought?</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>9</td>
<td>29%</td>
</tr>
<tr>
<td>No</td>
<td>22</td>
<td>71%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>31</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The data in Table 8 indicates significant overlap between Part 2F.1A applications for leave and oppression applications under Part 2F.1. This appears to be at variance with the experience in Canada, where the statutory derivative action has been little used due to the availability of the oppression remedy.155

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There is perhaps an uncertain relationship between the oppression remedy and the statutory derivative action.156 In *Goozee v Graphic World Group Holdings Pty Ltd*, Barrett J held that ‘the court may, under s 237, grant leave to the plaintiffs to initiate proceedings based on s 232’ [the oppression remedy].157 Part 2F.1A has sometimes been used as a vehicle to bring an oppression action.158 In *Chapman v E-Sports Club Worldwide Ltd* the application was refused because oppression was a more suitable remedy.159 In *Fiduciary Ltd v Morningstar Research Pty Ltd*, security for costs had been required for oppression proceedings to continue.160 As a consequence, an action under Part 2F.1A was commenced. Leave was granted, but on the condition that security for costs also be paid.161 Thus bringing a statutory derivative action as opposed to an oppression action made little difference to the applicant’s position. In *Hassall v Speedy Gantry Hire Pty Ltd*, oppression proceedings were already on foot. Moynihan J, in dismissing the Part 2F.1A application, held that:

…the proposed proceeding will largely duplicate and is founded essentially on the same complaints as those pursued in the oppression action, and it has not been satisfactorily demonstrated that the relief available in the oppression proceeding will not be adequate.162

---

156 Kluver, above n 49 at 10.
Who Defended the Application?

Table 9 details who defended the application.

**Table 9: Who defended the application?**

<table>
<thead>
<tr>
<th>Defender of application</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director and majority shareholder</td>
<td>3</td>
<td>9.7%</td>
</tr>
<tr>
<td>Director and 50% shareholder</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Director and shareholder, shareholding unknown</td>
<td>7</td>
<td>22.6%</td>
</tr>
<tr>
<td><strong>Total number of cases involving directors or directors who are also shareholders</strong></td>
<td>12</td>
<td>38.7%</td>
</tr>
<tr>
<td>Majority shareholder</td>
<td>5</td>
<td>16.1%</td>
</tr>
<tr>
<td>Minority shareholder</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td><strong>Total number of cases involving shareholders who are not also current or former directors</strong></td>
<td>6</td>
<td>19.4%</td>
</tr>
<tr>
<td>Former director</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>Liquidator</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>3rd party</td>
<td>6</td>
<td>19.4%</td>
</tr>
<tr>
<td>None</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>Not specified</td>
<td>3</td>
<td>9.7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>31</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The defender of the application is used in this context to mean the person who opposed the application, and is to be distinguished from a defendant. In a leave application there is no formal defendant, however if the leave sought is granted, there may be a defendant in the actual trial, depending upon the allegations pleaded. Obviously, in many cases they will coincide, particularly in cases where breach of directors’ duties is alleged, for the directors will seek to prevent the case proceeding to trial and oppose the Part 2F.1A application. But this is not so in all cases. In *Carpenter v Pioneer Park Pty Ltd*, the applicant sought leave to bring an action on behalf of the company against ANZ Bank; however, it was the liquidator who opposed the application.

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163 For example *Advent Investors Pty Ltd v Goldhirsch* (2001) 37 ACSR 529.
Was Leave Granted?

Table 10 details the successful and unsuccessful cases.

**Table 10: Was leave granted?**

<table>
<thead>
<tr>
<th>Holding of court</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leave granted</td>
<td>19</td>
<td>61.3%</td>
</tr>
<tr>
<td>Leave refused</td>
<td>12</td>
<td>38.7%</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>100%</td>
</tr>
</tbody>
</table>

In a large proportion of the cases the applicant was able to satisfy the court of the leave criteria and leave was granted. This suggests that the leave criteria and their application by the courts do not present ‘insurmountable hurdles” for applicants, and the leave criteria do not make it overly difficult to bring a statutory derivative action.165

If the Application was not Successful, why not?

Table 11 details the reasons why the unsuccessful cases were unsuccessful.

**Table 11: Why the application was not successful**

<table>
<thead>
<tr>
<th>Reason unsuccessful</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Not proven that company will not bring proceedings</td>
<td>1</td>
<td>8.3%</td>
</tr>
<tr>
<td>(b) Not in good faith</td>
<td>1</td>
<td>8.3%</td>
</tr>
<tr>
<td>(b),(c) Not in good faith and not in company’s best interests</td>
<td>3</td>
<td>25%</td>
</tr>
<tr>
<td>(b),(c),(d) Not in good faith, not in company’s best interests and no serious question to be tried</td>
<td>2</td>
<td>16.7%</td>
</tr>
<tr>
<td>(c),(d) Not in company’s best interests, no serious question to be tried</td>
<td>1</td>
<td>8.3%</td>
</tr>
<tr>
<td>(d) No serious question to be tried</td>
<td>1</td>
<td>8.3%</td>
</tr>
<tr>
<td>Total number of cases in which criteria were not met</td>
<td>9</td>
<td>75%</td>
</tr>
</tbody>
</table>

Barred by s 236(3) | 1 | 8.3% |

---

165 As Clyne argued, see above n 133.
The total percentage of the unsuccessful cases in which the criteria were not met is 75%. The main reason why applications are unsuccessful is a failure to satisfy the court of the leave criteria. This confirms that the role of the leave criteria, which is discussed in more detail below, is to screen proposed actions and prevent unmeritorious or vexatious claims from being litigated. This data also indicates that in unsuccessful cases, it will often be the case that more than one criterion will not have been satisfied.

**What Sections were Considered?**

Table 12 provides information on which sections of Part 2F.1A were discussed by the courts.

**Table 12: What sections were considered?**

<table>
<thead>
<tr>
<th>Sections</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>236</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>236, 237</td>
<td>23</td>
<td>74.2%</td>
</tr>
<tr>
<td>237</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>237, 242</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>237, 239</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>236, 237, 240</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>236, 237, 241, 242</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>236, 237, 242</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>31</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

The vast majority of cases consider only the leave criteria in s 237 and pay little attention to the other provisions of Part 2F.1A. In particular, s 242, which deals with the costs of the application, has received scant consideration, being discussed in only three cases.

**Did the Court Consider the Substance of the Case?**

Table 13 provides information on whether the court considered the substance of the case. Five categories of analysis have been used:

- Not referred to: the allegations were not mentioned.
- Briefly referred to: the allegations were mentioned with no particulars.
- Referred to: the allegations were mentioned with some particulars.
- Referred to in detail: the allegations were considered in detail with detailed discussion of the facts and particulars.
- Determined: the substantive case was finally decided.

Table 13: Did the court consider the substance of the case?

<table>
<thead>
<tr>
<th>Substance of case</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not referred to</td>
<td>6</td>
<td>19.4%</td>
</tr>
<tr>
<td>Briefly referred to</td>
<td>7</td>
<td>22.6%</td>
</tr>
<tr>
<td>Referred to</td>
<td>10</td>
<td>32.3%</td>
</tr>
<tr>
<td>Referred to in detail</td>
<td>7</td>
<td>22.6%</td>
</tr>
<tr>
<td>Determined</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>100%</td>
</tr>
</tbody>
</table>

It cannot be said that courts are inclining towards over-extensive discussion, nor can it be said that courts are not considering the issues in sufficient detail. It seems that judicial scrutiny of the proposed action appropriately reflects the complexity of the case at hand.

**What was the Length of the Hearing?**

Table 14 indicates the length of the leave hearing.

Table 14: What was the length of the hearing?

<table>
<thead>
<tr>
<th>Length of hearing</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 day</td>
<td>4</td>
<td>12.9%</td>
</tr>
<tr>
<td>2 days</td>
<td>20</td>
<td>64.5%</td>
</tr>
<tr>
<td>3 days</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>4 days</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>5 days</td>
<td>2</td>
<td>6.5%</td>
</tr>
<tr>
<td>7 days</td>
<td>1</td>
<td>3.2%</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>100%</td>
</tr>
</tbody>
</table>

Over 75% of leave applications involved hearings of two days or less. The longest hearing was 7 days, but this case involved a particularly complex fact situation.166 The mean hearing length was 2.4 days, the median length was 2 days. When this information is considered in light of the information presented in Table 13, it can be seen that the fears of some, as noted...

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166 *Cannon Street Pty Ltd v Karedis* [2004] QSC 104.
in the discussion above, that the need for applicants to satisfy the court of the leave criteria would turn leave applications into mini-trials, have not been borne out.

**Data on Costs**

The following two tables set out evidence on the approach of the courts to the question of costs. The tables consider only successful applications, that is, those cases in which leave to bring a derivative action or intervene in proceedings was granted.

**Did the court award the applicant costs for the application?**

Table 15 indicates, in cases where the applicant was successful, whether the court granted the applicant costs for the leave application itself.

**Table 15: Was the successful applicant granted costs for the leave application?**

<table>
<thead>
<tr>
<th>Were costs granted?</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>3</td>
<td>15.8%</td>
</tr>
<tr>
<td>Yes in part</td>
<td>1</td>
<td>5.3%</td>
</tr>
<tr>
<td>No</td>
<td>4</td>
<td>21%</td>
</tr>
<tr>
<td>Costs not discussed</td>
<td>5</td>
<td>26.3%</td>
</tr>
<tr>
<td>Costs reserved</td>
<td>6</td>
<td>31.6%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>19</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

**Did the court award funding for the litigation from the company’s resources?**

Table 16 indicates, in cases where the applicant was successful in having leave granted, whether the court required the company to fund the applicant in relation to the substantive litigation (ie, to fund the subsequent trial as opposed to funding the leave application).

**Table 16: Was the company required to fund the applicant in relation to the substantive litigation?**

<table>
<thead>
<tr>
<th>Was funding granted?</th>
<th>Number of Cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>5</td>
<td>26.3%</td>
</tr>
<tr>
<td>Not discussed</td>
<td>14</td>
<td>73.7%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>19</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Table 16 indicates that of the 19 cases in which the leave application was successful, in none of these cases did the court, as part of granting the leave application, require the company to fund the applicant in relation to the substantive litigation to follow the leave application.
Analysis of Key Issues

The Cost of Litigation

Section 242 deals with costs in relation to derivative proceedings. The section ‘gives the court a broad discretion to make any orders it considers appropriate about the costs of the applicant, the company, or any other party to the proceedings or the application’. The section confers broad powers on the courts. Section 242:

…empowers the court to make “any orders it considers appropriate about the costs” of the persons to whom it refers. The court is thus free to approach matters with which the section deals unconfined by statutory prescriptions and by reference to the discretions that apply in the ordinary course in deciding applications for costs.

The purpose of this broad discretion is stated in the Explanatory Memorandum:

The Court’s discretion regarding the allocation of costs is aimed at providing an additional safeguard in respect of use of company funds. In particular, the Court would be able to protect a bona fide shareholder against liability for costs indemnifying them out of company funds while at the same time allowing the Court a further means of discouraging unmeritorious action.

Because the cost of litigation was the major disincentive attaching to common law actions, the operation of s 242 must be considered carefully. The Australian provision can be contrasted with the equivalent New Zealand provision. Section 166 of the Companies Act 1993 (NZ) provides that, when an application for leave is made, the court must order that the cost of the proceedings will be paid by the company. In contrast, under Part 2F.1A of the Corporations Act:

…the provisions are deliberately drafted in a manner that denies the successful applicant the assurance that court recognition will result in the company becoming liable for the reasonable costs of litigating on its behalf.

It has been argued has stated that the Australian provisions with respect to costs are ‘deficient and disappointing’:

…the problem for the minority shareholder is that these monetary incentives remain a mere prospect and might be affected by the uncertainty inherent in the exercise of judicial discretion.

There are some judicial statements that successful applicants should not be expected to bear the costs of a statutory derivative action. For example, in Foyster, Barrett J stated:

In the ordinary course, one would expect that a member or officer compelled to resort to s 237 to ensure that a defendant company was represented in proceedings should be protected, as to costs, by the company itself or by parties privy to the circumstances giving rise to the

167 Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1999 (Cth) at [6.66].
170 Ramsay, above n 10 at 162; Prince above n 134 at 494.
171 Fletcher, above n 135 at 299.
172 Hargovan, above n 72 at 648.
need for the s 237 application. Such a member or officer becomes, after all, the surrogate of the normal corporate decision makers whose decision has not been forthcoming.\(^{173}\)

However, courts may require applicants to bear the costs of the litigation for several reasons. First, courts are understandably reluctant to prevent the situation described in \textit{Swansson}:  
An order under s 242 that [the company] bear the costs of the litigation would have required the company to sell a substantial part of its assets in order to fund what can only be described as a litigation with questionable prospects of success.\(^{174}\)

Second, there is the “best interests of the company problem”. In several cases courts have only considered an action to be in the best interests of the company if the company stands to lose nothing if the action is ultimately unsuccessful. Therefore, the applicant must fund the litigation. This can be seen, for example, in \textit{Metyor}. If the action was ultimately successful, the company would benefit without cost to itself. If unsuccessful, the company would not be disadvantaged, for “[i]t will be the plaintiffs, and not [the company], that will bear the stigma, if any, of defeat as well as the not inconsiderable costs of the proceedings”.\(^{175}\) Only under these circumstances was the court prepared to hold that the action was in the best interests of the company.

This approach is also evidenced in \textit{Fiduciary}. The court was only prepared to find that the action was in the best interests of the company and grant leave on the condition that the applicant provide security for costs and indemnify the company for any costs incurred.\(^{176}\) In \textit{McLean}, leave was granted, but such leave was:  
conditioned on an undertaking that in the absence of consent by all directors to payment, the funds of the company would not be utilised to pay solicitors’ fees and outlays without leave of the court.\(^{177}\)

Third, there is what might be termed the “additional safeguard” problem. As discussed, s 242 is designed to provide ‘an additional safeguard in respect of use of company funds’. While courts have the power to grant funding to the applicant from the company’s resources, this section is also ‘a further means of discouraging unmeritorious action’. The effect of this approach to the question of costs can be seen in \textit{Charlton v Baber}. The court found that the leave criteria had been met, and had granted leave to bring the action. The court then held that any costs order should be:  
designed to cater for the possibility that those proceedings will achieve no more than a pointless recycling of funds. It would, of course, be an entirely different matter if the derivative claims produced enough to see some return generated for unsecured creditors.\(^{178}\)

That is, in this case company funds should not be provided to fund the litigation unless some distinct benefit accrues to the general body of creditors.\(^{179}\) Section 237(2)(c) had previously required the court in \textit{Charlton} to find that the action was in the best interests of the company,

\begin{footnotesize}
\begin{itemize}
\item \(^{173}\) \textit{Foyster v Foyster Holdings Pty Ltd} (2003) 44 ACSR 705; [2003] NSWSC 135 at [13].
\item \(^{175}\) \textit{Metyor Inc (formerly Talisman Technologies Inc) v Queensland Electronic Switching Pty Ltd} [2002] QCA 269; [2003] 1 Qd R 186; (2002) 42 ACSR 398; (2002) 20 ACLC 1517 at [19].
\item \(^{176}\) \textit{Fiduciary Ltd v Morningstar Research Pty Ltd} (2005) 53 ACSR 732; [2005] NSWSC 442.
\item \(^{177}\) \textit{McLean v Lake Como Venture Pty Ltd} [2003] QCA 562; [2004] 2 Qd R 280 at 297.
\item \(^{179}\) Ibid at [74].
\end{itemize}
\end{footnotesize}
that is, that the action clearly presented genuine prospects of enhancing returns to creditors. This the court had found. Yet this was not considered sufficient for the court to grant funding – some further ‘distinct benefit’ must accrue to the company for funding to be granted from the company’s resources. This approach to s 242 places a higher threshold on the granting of costs than the high threshold of “the best interests of a company” which is used to determine if the application for leave should be granted.

Kaplan and Elwood have criticised this approach in the Canadian context:

It is curious that a test for interim funding would revisit the merits of the action, when the court will have already found that the action has sufficient merit to satisfy the “interests of the company” requirement for leave.

Another issue arises from the fact that in 32% of the cases considered, the relevant company was under some form of external administration. This presents a significant problem for the courts. If there are no funds available for the company to finance such litigation, it is impossible that it should do so, for before a court can make an order for costs under s 242, there must be evidence of the company’s ability to pay such costs.

In Carpenter v Pioneer Park Pty Ltd, Barrett J stated:

In the present circumstances of the company, unsecured creditors will receive nothing as all funds in the liquidator’s hands have been exhausted. The absence of funds also means that if the company … sues and is unsuccessful, any costs order that may be made against the company itself will not be able to be satisfied. And of necessity, pursuit of the proceedings on the company’s behalf will have to be financed by [the applicant].

In these proceedings, security for costs was required to be provided by the applicant in the sum of $600,000.

Neither the statutory provisions, nor the approach of the courts, provide any certainty of litigation funding. The analysis of the cases indicates that courts have been cautious in relation to the issue of costs.

**Examination of the application of the leave criteria**

Section 236(1)(b) provides that in order to bring a derivative action, the applicant must obtain the leave of the court. Section 237(2) sets out five criteria which must be satisfied for a court to grant leave. The Explanatory Memorandum highlights the crucial importance of the proper application of the leave criteria in the scheme of Part 2F.1A:

The criteria seek to strike a balance between the need to provide a real avenue for applicants to seek redress on behalf of a company where it fails to do so and the need to prevent actions proceeding which have little likelihood of success.

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180 Ibid at [53].
181 Kaplan and Elwood, above n 5 at 465.
185 Thai, above n 127 at 136.
186 Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1999 (Cth) at [6.33].
The statutory derivative action has replaced the exceptions to *Foss v Harbottle*, so that no derivative action can now be commenced except under Part 2F.1A and with leave of the court.\(^{187}\) The court plays a key role in the operation of the statutory derivative action.\(^{188}\) The court’s role was stated by Barrett J in *Carpenter v Pioneer Park*:

> The court’s function is essentially a screening function. It must assess against specified criteria the litigation proposal the applicant has in mind for the company. If that proposal is found by the court to meet the criteria, it must grant leave enabling the applicant to pursue it for the company.\(^{189}\)

There are good reasons for requiring leave to be obtained:

If any member or officer or former member or officer was able to cause the company to commence proceedings before leave was granted, a multiplicity of suits might arise. Moreover a member or officer could usurp the proper functions of the company. A company is entitled to decide for itself whether it wishes to bring, defend or intervene in legal proceedings. Where a company will not itself bring, defend or intervene in proceedings it is necessary that there be some filtering system such as the requirement for leave before proceedings are commenced in the name of the company.\(^{190}\)

The leave criteria seek to balance these aims:

Part 2F.1A is, by its terms, intended to keep a careful balance between facilitating the bringing of derivative actions, where the earlier rule in *Foss v Harbottle* and its exceptions were seen to create undue difficulty, and protecting a company from too ready and unwarranted interference in its internal management.\(^{191}\)

There are indications in the Explanatory Memorandum that a pragmatic and practical approach ought to be taken in deciding whether leave should be granted.\(^{192}\)

Under s 237(2), the court is required to grant leave if it is satisfied that all of the criteria in paras (a)–(e) have been met. If the court is not satisfied that all the criteria have been met, it must refuse leave.\(^{193}\) The court does not retain a residual discretion to grant leave if the


\(^{190}\) *RTP Holdings Pty Ltd v Roberts* (2000) 36 ACSR 170; [2000] SASC 386 at [14].


\(^{192}\) *Herbert v Redemption Investments Ltd* [2002] QSC 340 at [32].

criteria are not fulfilled. The applicant bears the onus of satisfying the court that, on the balance of probabilities, all the requirements of s 237(2) have been fulfilled.

In this section, the leave criteria are examined separately and assessed against the objective identified in the Explanatory Memorandum.

(a) Inaction by the company

The court must be satisfied that ‘it is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in them’. Without this provision, ‘the ability of the board to manage a company would be undermined’. Although described as the ‘critical hurdle’, this criterion seems to have a low threshold. In Charlton v Baber, Barrett J only required grounds for finding that it was probable that the company would not bring proceedings. ‘In most cases, it will be readily apparent whether this requirement is satisfied’, all that is required is some evidence establishing the unlikelihood of action. Where the board is deadlocked, or the alleged wrongdoer controls the board, this is a clear inference that proceedings will not be brought, and is, of course, all the more easily satisfied when the allegations are that the directors have breached their duties. If there is not a clear-cut refusal, the applicant bears the onus of establishing that refusal is to be inferred. Lack of funding on the part of the company to commence litigation will also satisfy this criterion.
(b) Applicant’s good faith

The court must be satisfied that ‘the applicant is acting in good faith’.\(^{206}\) Good faith concerns the subjective motivation of the applicant for leave.\(^{207}\) Generally speaking, the courts have held that an applicant is acting in good faith unless some factor or inference establishes lack of good faith.\(^{208}\) For example, in BL & GY International Co Ltd v Hypec Electronics Pty Ltd, Einstein J held that there were ‘no indications that Mr Mead is acting otherwise than in good faith’.\(^{209}\)

The leading discussion of good faith is Palmer J’s widely followed approach in *Swansson v Pratt*.\(^{210}\) There are two factors to which the courts will have regard in considering good faith:

The first is whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success. Clearly, whether the applicant honestly holds such a belief would not simply be a matter of bald assertion: the applicant may be disbelieved if no reasonable person in the circumstances could hold that belief. The second factor is whether the applicant is seeking to bring the derivative suit for such a collateral purpose as would amount to an abuse of process.\(^{211}\)

(1) The honest belief of the applicant

Although mere bald assertion is not sufficient to establish honest belief,\(^{212}\) an honest belief can be satisfied on very low evidence. In *Lakshman v Law Image Pty Ltd*, even though the plaintiff admitted that he had no evidence on which to ground his allegations,\(^{213}\) the judge stated:

I am satisfied that the plaintiff has an honest belief that Raj has not acted in the best interests of the company and has in fact acted contrary to its interests and that there is some basis for that belief.\(^{214}\)

\(^{206}\) Section 237(2)(b).

\(^{207}\) Talisman Technologies Inc v Queensland Electronic Switching Pty Ltd [2001] QSC 324 at [31], see also Saltwater Studios Pty Ltd v Hathaway [2004] QSC 435 at [9].


\(^{213}\) Lakshman v Law Image Pty Ltd [2002] NSWSC 888 at [23].

\(^{214}\) Ibid at [26].
However, other cases have held that if there is no evidence to support the applicant’s claims, the court will infer that there was no honest belief.²¹⁵ Reliance on advice from counsel which is reasonably based on factual evidence can indicate honest belief.²¹⁶

(2) Collateral purpose

Seeking to bring an action for an ulterior purpose will establish lack of good faith.²¹⁷ In considering ulterior purposes the courts apply the principles of abuse of process set out in Williams v Spautz.²¹⁸ In that case Mason CJ, Dawson, Toohey and McHugh JJ said that an abuse of process is:

when the purpose of bringing the proceedings is not to prosecute them to a conclusion but to use them as a means of obtaining some advantage for which they are not designed or some collateral advantage beyond what the law offers.²¹⁹

Judicial examination shows that acting for a collateral purpose means pursuing interests other than those of the company.²²⁰ Good faith means that the application is being made in good faith having regard to the interests of the company.²²¹ The concept of good faith is inextricably linked with the obligations to act honestly and for no ulterior purpose.²²²

In seeking to determine whether the applicant is bringing an action for an ulterior purpose, courts may use evidence to draw inferences about the motives of the applicant.²²³ Not filing an affidavit or appearing can be evidence of lack of good faith.²²⁴ In Swansson, it was said that it will be relatively easy for the applicant to demonstrate good faith where:

(1) the applicant is a current shareholder of the company who has more than a token shareholding and the derivative action seeks recovery of property so that the value of the applicant’s share would be increased; or

(2) the applicant is a current director or officer of the company and the applicant has a legitimate interest in the welfare and good management of the company, which warrants litigation to recover property or ensure that the majority of the shareholders or of the board of directors do not act unlawfully to the detriment of the company as a whole.²²⁵

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²¹⁷ Cannon Street Pty Ltd v Karedis [2004] QSC 104 at [172]-[175].
²¹⁹ Ibid at 526-7.
²²¹ Talisman Technologies Inc v Queensland Electronic Switching Pty Ltd [2001] QSC 324 at [27]; Cannon Street Pty Ltd v Karedis [2004] QSC 104 at [169]-[175].
²²² Cannon Street Pty Ltd v Karedis [2004] QSC 104 at [175].
Although it can be possible for an applicant to satisfy the requirement of good faith even when they have no financial interest in the company and no present involvement in its management: 226 where the applicant is a former shareholder or officer with nothing obvious to gain directly by the success of the derivative action, the court will scrutinise with particular care the purpose for which the derivative action is said to be brought. 227

There is a degree of overlap between the requirement of good faith, the requirement that the action be in the best interests of the company, and also the requirement that there be a serious question to be tried. This is because: …the strength of the case, at a prima facie level, will have a bearing on the question whether it is in the best interests of the company that the case be run and this, in turn, will reflect on matters of motive and purpose that are relevant to the good faith question. 228

Our research indicates that where the applicant failed to satisfy the court of one leave criterion, often other leave criteria were not satisfied also, which reveals the close relationship of the leave criteria.

(c) Best interests of the company

The court must be satisfied that ‘it is in the best interests of the company that the applicant be granted leave’. 229 ‘This has proven to be the criterion which has occasioned the most difficulty for the courts. This criterion: …allow[s] the Court to focus on the true nature and purpose of the proceedings. It would recognise that a company might have sound business reasons for not pursuing a cause of action open to it and that its management might legitimately have decided that the best interests of the company would be served by not taking action.’ 230

Presumably this criterion has the financial state of the company in mind, but the closest the courts have come to defining the best interests of the company is to state that the best interests of the company is concerned with the welfare of the company. 231 Continuing to trade profitably is obviously in the best interests of the company. 232 Where a company is being wound up or is insolvent, its best interests are regarded as reflecting predominantly the interests of its creditors. 233

226 Ibid at [34].
227 Ibid at [39].
229 Section 237(2)(c).
230 Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1999 (Cth) at [6.38].

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Whereas good faith under s 237(2)(b) concerns the subjective motivation of the applicant, s 237(2)(c) is an objective test. Section 237(2)(c):

…requires the court to be satisfied, not that the proposed derivative action may be, appears to be, or is likely to be, in the best interests of the company but, rather, that it is in its best interests.

The inquiry ‘is not an inquiry into possibility or potential’. It must be found, on the balance of probabilities, that ‘pursuit of the particular legal action will positively serve the “best interests” of the company’. This is a higher threshold than that of Canadian, New Zealand and Singapore legislation, which require that the action be in the interests of the company. It was held in Swansson that in considering the best interests of the company, evidence will be required as to the following matters:

- the character of the company;
- evidence of the business of the company;
- whether redress is available through other means; and
- the ability of the defendant to meet the judgment – ie the practical benefit of bringing the action.

These matters have not received systematic treatment in the cases, although some of the matters have been significant in certain cases. For example, where alternative proceedings are available or on foot, and these present a genuine prospect of recovery and are capable of granting a suitable remedy, an action under Part 2F.1A will not be in the best interests of the company. In Goozee, the relief sought would have meant the winding up of a group of companies that were trading profitably. There was no basis for considering that to be in the best interests of those companies.

The fact that the applicant has a personal claim against the company does not automatically disqualify the applicant:

It cannot be said that merely because the applicant may also have a personal claim against the companies that it is not in the best interests of the companies to grant the application.

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234 Talisman Technologies Inc v Queensland Electronic Switching Pty Ltd [2001] QSC 324 at [31].
243 Saltwater Studios Pty Ltd v Hathaway [2004] QSC 435 at [10].
One judge held that internal disputes should be resolved before it can be determined what the best interests of the company are. On appeal, McPherson JA stated:

To require that disputes between members be resolved before leave is granted to bring proceedings on behalf of the company would defeat the very purpose which those statutory provisions are designed to serve.244

He went on to say:

…it appears to me it is just such a case as this that is contemplated by ss 236 and 237 as one in which it is in the best interests of the company that the plaintiffs should be granted leave to proceed on behalf of the company. There are two conflicting groups of shareholders, of whom one is, as the minority, unable to set the company in motion to vindicate its rights because the majority, who are alleged to be the wrongdoers, oppose the company’s doing so.245

This can require a court to make a judgment as to the best interests of the company in circumstances in which the directors have been unable to do so.246

The question of the best interests of the company does not involve a cost-benefit analysis:

I cannot accept that … what s 237(2)(c) has in mind is some kind of cost-benefit analysis of possible outcomes of the prospective litigation, which is an assessment that it would be almost impossible to make with any degree of confidence or accuracy.247

The strength of the case is directly relevant to the question of the best interests of the company: ‘the strength of the case, at a prima facie level, will have a bearing on the question whether it is in the best interests of the company that the case be run’.248 A consideration of whether an action is in the best interests of the company, then, must require the court to consider the strength of the case. If there is little probability of the action succeeding, it will obviously not be in the best interests of the company to bring it.249

Moreover, the Explanatory Memorandum contemplates a court weighing up the benefit of an action versus any potential detriment:

This criterion … would recognise that a company might have sound business reasons for not pursuing a cause of action open to it … For example, a decision may be taken in a case where, although it may be clear that there has been a breach of duty by a director, the loss to the company may only be nominal. In this case, the costs of taking proceedings may outweigh any benefit to the company.250

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245 Ibid at [19].
246 Cf Prendergast v DaimlerChrysler Australia Pacific Pty Ltd [2004] NSWSC 131 at [96], [98]-[99].
249 Herbert v Redemption Investments Ltd [2002] QSC 340 at [37]-[38].
250 Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1999 (Cth) at [6.38].

(d) A serious question to be tried

The court must be satisfied that ‘if the applicant is applying for leave to bring proceedings – there is a serious question to be tried’. The Explanatory Memorandum states:

It is important in this regard that the application for leave to take proceedings is not turned into a trial of the substantive issues, without the applicant having the usual plaintiff’s right to pre trial discovery and interrogatories. The applicant is simply required to show that proceedings should be commenced. On the other hand, this criterion would prevent the proceedings being abused by further frivolous or vexatious claims.

The serious question to be tried criterion was adopted by the legislature because of its existing place in civil procedure. Applying these established principles, the applicant must show ‘sufficient colour of right to the final relief, in aid of which interlocutory relief is sought’. Section 237(2)(d) requires some consideration of the merits of the case, but the courts are keen to avoid turning this into a mini-trial of the issues:

In order to ascertain whether there is a serious question to be tried for the purposes of s 237(2)(d), the court will not normally enter into the merits of the proposed derivative action to any great degree. The applicant has the same relatively low threshold to surmount as in the case of an application for an interlocutory injunction … cross-examination on the merits of the proposed derivative action will usually be permitted only with leave of the court and to a limited extent.

Some degree of assurance, based on reliable evidence, is necessary to demonstrate that the proposed action is viable. Although it has been described as a low threshold, the discussion in Charlton, and the approach in other cases, would seem to suggest that a reasonable body of evidence is required to satisfy the court there is a serious question to be tried, although the merits of the claim will not be discussed in great detail. Other cases have considered in some detail the merits of the proposed claim. The approach of the...
courts is expressed by Einstein J in *BL & GY International Co Ltd v Hypec Electronics Pty Ltd*:

> The claims sought to be litigated by Hypec Electronics appear at least on the materials and evidence adduced on the applications, to have a solid foundation in terms of giving rise to a serious dispute… Whether the material presently before the Court will ultimately withstand the heat of litigious contest is of course another matter.261

(e) Notice of proceedings to company

The court must be satisfied either that ‘at least 14 days before making the application, the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying’ or that ‘it is appropriate to grant leave’ even though notice was not given.262 This requirement ‘allows the company time to address the applicant’s concerns prior to the hearing date’.263 The courts have shown willingness to grant leave even if the notice requirement has not been satisfied.264

The fullest consideration of this provision was given by Barrett J in *Isak*:

> I agree that there is no point in insisting on form merely for form’s sake. At the same time, however, the discretion conferred by s 237(2)(e)(ii) must be exercised with the objectives of s 237(2)(e)(i) in mind. Those objectives entail awareness by the company concerned not only of the applicant's intention to seek leave under the section but also of the reasons for the application. A decision under s 237(2)(e)(ii) effectively to dispense with those requirements would, it seems to me, be justified only where it was clear to the court that the company was already aware of the matters with which s 237(2)(e)(i) is concerned or that there was some good reason to allow the applicant to represent the company despite its not being so aware.265

**Conclusions on Leave Criteria**

Of derivative litigation in Canada, it has been said that:

> …the practical reality is that the merits of the lawsuit have become a significant, costly and time-consuming battleground in leave proceedings … enormous amounts of time and money [are expended] in pursuing the factual minutia.266

In Australia, it seems this has not occurred although a reasonable evidentiary burden lies on any applicant.267 Failure to muster enough evidence will lead to the rejection of the

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262 Section 237(2)(e).
263 Explanatory Memorandum to the *Corporate Law Economic Reform Program Bill 1999 (Cth)* at [6.49].
266 Kaplan and Elwood, above n 5 at 460.
application or its adjournment. Some cases have subjected the criteria to extensive scrutiny. If the defendants accept that the criteria have been met, the court will be likely to accept that the criteria have been satisfied, however, some evidence may be necessary. In *BL & GY International Co Ltd v Hypec Electronics Pty Ltd*, Einstein J stated that ‘the Court ought … to closely consider the matters identified in subs 2(a) – subs 2(d)’. In other cases the leave criteria received scant consideration. In *Keyrate*, the court said only: ‘I am satisfied as to the matters pursuant to s 237(2)’, although it should be noted that the defendants had accepted that the other preconditions save s 237(2)(c) were met. In *Karam*, the court said: ‘I am equally satisfied that paras (b), (c) and (d) would be satisfied’. 

Our research indicates that leave applications are not turning into expensive and lengthy “mini-trials”. Rather, the length of the hearings and the judicial scrutiny of the proposed actions reflect the complexity of the cases. In general, we suggest the criteria are being applied appropriately to achieve the purposes which they are designed to achieve.

**Transitional Issues**

Part 2F.1A replaces the pre-existing law dealing with derivative actions. In several cases difficulties have confronted the courts when the acts complained of were committed before Part 2F.1A came into operation, but the application for leave was brought after it came into operation. In *Advent Investors*, Warren J held that Part 2F.1A is a procedural provision and therefore applies retroactively to causes of action arising prior to the commencement of Part 2F.1A:

The essential point is that as stated by Mandie J [in *Chapman v E-Sports Club*], the statutory derivative action has displaced the common law derivative action. Part 2F.1A is clearly a procedural provision. It does not purport to alter the substantive rights and liabilities of a company that could previously have been enforced by a plaintiff, who was given standing to bring a derivative action on behalf of the company under an exception to the rule in *Foss v Harbottle*. In this context, Pt 2F.1A provides for a new procedure by which proceedings might be brought on behalf of the company.

In *Swansson*, Palmer J held:

The acts of which Ms Swansson complains occurred in 1994. Whatever entitlement she had from that time onwards to bring a derivative action in the name of [the company] against

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269 *Glodale Pty Ltd v McLellan* [2003] QSC 261.


275 *Braga v Braga Consolidated Pty Ltd* [2002] NSWSC 603 at [2].

276 *Advent Investors Pty Ltd v Goldhirsch* (2001) 37 ACSR 529 at [40].
Mr Highland under any of the exceptions to the rule in *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189 has now been superseded by the provisions of CA Pt 2F.1A: s 236(3).  

In *Karam*, Santow J considered the history of Part 2F.1A and its remedial purpose, and concluded that the statutory derivative action had retrospective application and therefore displaced any potential recourse to the exceptions to the rule in *Foss v Harbottle* for the plaintiffs.  

However, the fact that a common law derivative action has actually been commenced may lead to a different conclusion. In *Brightwell* Austin J held:

> [there] may be cases where the application of Pt 2F.1A to displace an existing derivative proceeding would deprive the plaintiffs of substantive rights, contrary to the remedial purpose of the new provisions… This suggests that Pt 2F.1A might be taken not to prevent a general law derivative action from going forward where the action is properly constituted under the general law principles and the subject-matter can be seen to confer rights on the plaintiffs as well as on the company which they seek to represent.

In *Karam* and *Swansson* the court was being asked to constitute the proceeding as a derivative proceeding for the first time, so the court would not be taking away the plaintiffs’ rights to continue with a properly constituted general law proceeding.  

But in *Cadwallader* and *Shum Yip*, the proceedings had been properly constituted under the general law. Section 236(3) is not to be read to operate to discontinue proceedings which are already on foot, which would countermand the remedial legislative purpose. The decisions in these cases seem to conflict with *Advent Investors*, where the court held that ‘s 236(3) … was intended to apply to events that existed prior to 13 March 2000, that is, to existing common law derivative proceedings’ and stayed an existing common law derivative action.  

### Can a Company be a Defendant in the Proceedings when Proceedings are Brought in its Name?

Section 236(2) provides that proceedings brought on behalf of a company must be brought in the company’s name. Hamilton J has held that ‘the proceedings for which leave was granted must always be proceedings brought in the name of the company’. In *Metyor*, it was held that Part 2F.1A allows a company to be joined as co-defendant and is not confined to

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284 *Advent Investors Pty Ltd v Goldhirsch* (2001) 37 ACSR 529 at [48].

authorising proceedings to be brought on behalf of a company as plaintiff, and Santow J in
Keyrate held that s 236(2) does not require in every case ‘that the company be actually made
a plaintiff in a fresh summons or statement of claim, if it is already a defendant against whom
relief is claimed’. Barrett J stated in Charlton v Baber:
The circumstance that [the company] is, at the same time, both a potential plaintiff and a
potential defendant…. although perhaps at odds with a literal reading of s 236(2), … is a
course sanctioned by Santow J in Keyrate…, a decision subsequently endorsed by the
Queensland Court of Appeal in Metyor… which, in turn, was followed by Windeyer J in
Lakshman…. Keyrate was followed by Austin J in Brightwell.288

V Conclusion

The key findings of the empirical study of the statutory derivative action judgments are the
following:

• There have been only 31 judgments delivered during the period from 13 March 2000
  (the introduction of Part 2F.1A) to August 2005. This is a modest number of
  judgments By way of comparison, for the period 1995 to 1999 (the 5 years
  immediately preceding the introduction of the statutory derivative action) there were
  30 judgments in which Foss v Harbottle was considered. This indicates that when a
  similar period of years is examined, the statutory derivative action is not resulting in a
  greater number of judgments than the common law derivative action (represented by
  Foss v Harbottle) which it replaced.
• Most judgments (almost 60%) have been delivered by the Supreme Court of New
  South Wales.
• Part 2F.1A allows a member or officer (or former member or officer) to apply to
  bring a derivative action. Almost all applicants are shareholders. In 16 of the 31
  cases the applicant was a current or former director and in 15 of these 16 cases the
director was also a shareholder.
• Part 2F.1A mostly involves private companies (87% of the cases involve private
  companies).
• 32% of the cases involve a company which was under some form of external
  administration.
• In terms of allegations pleaded, the most common allegation was breach of directors’
duties (52% of the cases).
• Leave was granted by the court in 61% of the cases.
• 77% of leave applications involved hearings of 2 days or less.
• Of the 19 cases in which the leave application was successful, in 4 of these cases
  (21%) the applicant was granted costs relating to the leave application with costs
  being reserved or not discussed in another 11 cases. In none of these 19 cases did the
court, as part of granting the leave application, require the company to fund the
applicant in relation to the substantive litigation to follow the leave application.

286 Metyor Inc (formerly Talisman Technologies Inc) v Queensland Electronic Switching Pty Ltd [2002] QCA
omitted.
The results of the empirical study indicate that the statutory derivative action has brought benefits to shareholders although it appears to have had only a modest impact upon shareholder litigation in Australia in terms of the number of judgments. In particular, the statutory derivative action has brought greater clarity and certainty to an area of law which previously was renown for its complexity.289