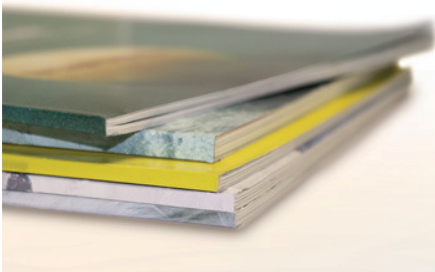


Derivative Actions: Avoiding Injustice without Redress

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As a general rule a shareholder cannot commence proceedings for a loss suffered by a company. The reason for this is because the company is the proper claimant in such circumstances. However, there is an exception to this where the wrongdoers are in charge of the company. The reasoning behind this exception was described in the English Court of Appeal by Lord Denning MR in *Wallersteiner v. Moir* (No. 2) [1975] QB 373:

*“It is a fundamental principle of our law that a company is a legal person, with its own corporate identity, separate and distinct from the directors or shareholders, and with its own property rights and interests to which alone it is interested. If it is defrauded by a wrongdoer, the company is the only one to sue for the damage. Such is the rule in **Foss v. Harbottle** (1831) 2 Hare 461. The rule is easy enough to apply when the company is defrauded by outsiders. The company itself is the only person who can sue. Likewise, when it is defrauded by insiders of*

*a minor kind, once again the company is the only person who can sue. But suppose it is defrauded by insiders who control its affairs - by directors who hold a majority of the shares – who then can sue for damages? Those directors themselves are the wrongdoers. If a board meeting is held they will not authorise the proceedings to be taken by the company against themselves... In one way or another some means must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress. In **Foss v. Harbottle** 2 Hare 461, 491-492, Sir James Wigram V-C saw the problem and suggested a solution. He thought that the company could sue ‘in the name of some one whom the law has appointed to be its representative’.”*

Thus, in the appropriate circumstances a shareholder is entitled to bring the action as a representative of the company – a derivative action.

Derivative actions form part of the law of many common law jurisdictions, examples of which are set

out below, and all of which broadly follow English law principles:

1. The British Virgin Islands – Derivative actions may be commenced pursuant to s184C-F of the **BVI Business Companies Act 2004**. Leave must be sought by the petitioning member.
2. The Cayman Islands – A shareholder is able to commence a derivative action under common law. Where a defendant to this action gives notice of his intention to defend the plaintiff the shareholder must apply to the court for leave to continue the action pursuant to Order 15, Rule 12A of the Grand Court Rules. See **Renova Resources Private Equity Ltd v. Gilbertson and Others** [2009] CILR 268.
3. Guernsey – Section 350 **Companies (Guernsey) Law 2008**, provides that where the court considers that the affairs of a company are being conducted in a manner which is unfairly prejudicial to the interests of members it is able to authorise proceedings to be brought on behalf of the company by such persons and on such terms as the court may direct.
4. Isle of Man – A derivative action may be commenced at common law in respect of companies incorporated under the **Companies Act 1931**, see **Belgravia**

Corporate Services Ltd v. B3 Group Ltd and Others 2005-06 MLR 139 (CHD & CLD). For companies incorporated under the **Companies Act 2006** a derivative action is available under Section 175 Companies Act 2006 – the court must grant leave for the member to bring the proceedings in the name of the company. Furthermore, the new rules of the High Court of the Isle of Man expressly provide for derivative actions.

5. Jersey – Article 141 of the **Companies (Jersey) Law 1991** provides that where the court considers that the affairs of a company are being conducted in a manner which is unfairly prejudicial to the interests of its members it is able to authorise proceedings to be brought in the name of the company by such persons and on such terms as the Court may direct. See **Guenier v. Fuller** [2005] JLR 137.

Multiple Derivative Action

There is also the possibility of a shareholder being able to commence a multiple derivative action. An example of this would be where a company has a wholly owned subsidiary which has suffered loss at the hands of its directors. A shareholder of the holding company may be able to commence a ‘double’ derivative action to prosecute the cause of action on behalf of the subsidiary.

Whilst multiple derivative actions have taken place

in England those cases did not include a challenge to the concept of a multiple derivative action and therefore it has been untested. However, this question has now been considered in two relatively recent offshore cases.

Hong Kong's Final Court of Appeal heard the matter of **Waddington Ltd v. Thomas and Others** [2009] 2 BCLC 82, and found that multiple derivative actions were available under Hong Kong law. In his reasoning that a shareholder has standing to bring a multiple derivative action, Lord Millet NPJ stated:

*“On a question of standing, the court must ask itself whether the plaintiff has a legitimate interest in the relief claimed sufficient to justify him in bringing proceedings to obtain it. The answer in the case of [a] person wishing bring a multiple derivative action is plainly “yes”. Any depletion of a subsidiary’s assets causes indirect loss to its parent company and its shareholders. In either case the loss is merely reflective loss mirroring the loss directly sustained by the subsidiary and as such it is not recoverable by the parent company or its shareholders for the reasons stated in **Johnson v. Gore Wood** (supra). But this is a matter of legal policy. It is not because the law does not recognise the loss as a real loss; it is because if creditors are not to be prejudiced the loss must be recouped by the subsidiary and not recovered by its shareholders. It is impossible to understand how a person who has sustained a real albeit reflective loss which is legally recoverable only by a subsidiary can be*

said to have no legitimate or sufficient interest to bring proceedings on behalf of the subsidiary.”

The above statement was cited with approval by Foster J when he found that multiple derivative actions were also available at Cayman law in **Renova**.

Overriding Rationale

The overriding rationale for derivative actions remains valid and consistent for multiple derivative actions. Whether they are recognised as valid causes of action outside of Hong Kong and Cayman currently remains to be seen, but without such recognition, there is the potential for serious loss to be suffered. In financial centres where complicated corporate structures are commonplace the ability for shareholders to avail themselves of a multiple derivative action appears to be a logical and desirable development.

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