THE DERIVATIVE ACTION IN THE COMPANIES ACT 1993

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I. Introduction

If a company suffers a wrong then prima facie it is the company that should seek redress for that wrong.[1] In most cases it is the majority of either the board of directors or the company in general meeting that acts as the company in making the decision as to whether it will commence or otherwise become involved in legal proceedings. There is good reason for this. It avoids the multiplicity of actions that would arise if individual shareholders or directors could take action in a company's name - some of which would likely be actions designed to harass, with the ulterior aim or achieving a personal benefit for the initiator, rather than to compensate the company. The derivative action in the Companies Act 1993 creates an exception. It confers standing on a single director or shareholder of a company to seek the leave of the High Court to bring proceedings in the name of or on behalf of a company or related company, or, to intervene in proceedings to which the company or related company is a party.

Although the derivative action can clearly be used to pursue actions that the company has against outsiders the focus in this paper is on the role of the derivative action in the enforcement of directors' duties. The law has long recognised that a director of a company owes certain duties to that company.[2] In many ways there are incentives for a director to comply with these duties. Those who do not may face removal by the shareholders that appointed them. Alternatively, shareholders may vote with their feet and exit the company. In the case of a publicly listed company the market may operate to punish a wrongdoing director. If information about the misconduct is available to the market then this will likely be reflected in the price of the company's shares. It the price of its shares falls then a company becomes a more likely target for a takeover. The wrongdoing director is then at risk of being removed by a new controlling shareholder. However, in some circumstances a director's breach of a duty that he or she owes to the company will not result in adverse consequences of the aforementioned kind. The classic situation is where a director has or controls a majority shareholding. The director in such an instance will not be removed from office and nor will action be taken against him or her by the company. In the absence of the availability of a derivative action the position for dissenting minority shareholders would be bleak - particularly if they lacked a ready market for their shares and/or faced restrictions on their ability to sell their shares. Thus, at least in theory, it can be seen that the derivative action has a key role to play in the enforcement of directors' duties. Conventional analysis suggests that an effective derivative action plays a dual role this respect - it not only acts as a deterrent mechanism but in the case of actual wrongdoing it operates to compensate a company for the harm it has suffered because of the actions of a director.[3]

The derivative action at common law was so circumscribed by the sub- rules that together made up the rule in Foss v Harbottle that it was ineffective as either a deterrence or compensatory mechanism.[4] The rule in Foss v Harbottle was made up of a number of parts. First, was the uncontroversial rule that if a wrong is done to the company then it is the company that must sue. Second, a minority shareholder was prevented from taking action in respect of a wrong that the majority of shareholders were able to do or approve. Third, a shareholder was able to exercise his or her vote on any matter that the majority was competent to deal with "although he may have a personal interest in the subject matter opposed to, or different from, the general or particular interests of the company."[5] A shareholder could take action in the company's name if he or she could establish two elements. First, that the wrong was one that was unable to be confirmed or ratified by the majority because it was a "fraud on the minority."[6] The problem was that the authorities on the subject of what exactly amounted to a fraud on the minority were difficult and conflicting.[7] The second element that a shareholder had to establish was that the perpetrators of the fraud were in control of the company - it being recognised that this did not necessarily mean that the perpetrators held more than 50% of the available votes.[8]

The need for reform was accepted. The New Zealand Law Commission in its Report No 9 on Company Law Reform said of its proposed derivative action that:[9]

> *Any shareholder, with the leave of the Court, may bring a derivative action to remedy a wrong done to the company ... This provision, which is modelled on the Canadian reforms, does away with the rule in Foss v Harbottle while preserving, through Court supervision, protection against abuse.*

These comments not only acknowledge the balancing act that the enacted derivative action must perform but suggest one measure of its practical effectiveness, that is, how does it rate when compared to the Canadian system on which it is modelled. This paper aims to assess this matter. However, to restrict the focus to this point would be to ignore the fact that the statutory derivative action is only one of a series of measures that those adversely affected by the actions of a director may elect to take. Thus, this paper also aims to assess the effectiveness of the statutory derivative action in the Companies Act 1993 in relation to the enforcement of directors' duties in the wider context in which it operates.

II. Standing

Section 165(1) of the Companies Act 1993 confers standing on a shareholder or a director of a company to seek the leave of the High Court to bring or intervene in proceedings on behalf of a company or a related company. This grant of standing is wider than that which existed at common law where a company's shareholders, but not its directors, could seek to act in its name. Nevertheless the grant of standing in the Companies Act 1993 is considerably narrower than that conferred by Canadian legislation. Section 239(1) of the Business Corporations Act[10] confers standing on a "complainant." Those falling within the definition of "complainant" in s 238 include directors and shareholders, both present and former, and "any other person who, in the discretion of the Court, is a proper person to make an application."[11]

The grant of standing in the Canadian legislation reflects a view that corporate law should be self-enforcing so that all those who might be adversely affected by misconduct on the part of directors should be able to take action in respect of it.[12] Although, in theory, a wide grant of standing appears to have merit in the sense that it gives the derivative action teeth as a deterrent mechanism it gives rise to practical difficulties - difficulties to which the Canadian judiciary have paid heed. Human nature being what it is there is a greater risk that former shareholders and directors will be acting in their own interests rather than in the company's interests - an example being a desire to "pay back" those in the company against whom a grievance is harboured. Further, even if such applicants are not culled when other criteria for the granting of leave are taken into account they are likely, for the reason already identified, to require increased supervision if leave is granted. Thus, there exists a line of Canadian authority that, despite the statutory definition of "complainant", limits the standing of shareholders and directors to seek leave to bring a derivative action to those who are current shareholders or directors.[13] In Schafer v International Capital Corporation an application of a former director was declined because of a lack of what was described by Baynton J as "sufficient interest".[14] Bayton J continued:[15]

> *Such a rule is required to distinguish between applicants who have a bona fide potential financial stake in the outcome of the derivative action and applicants who seek leave for an improper purpose ... The latter category of applicant has no right to meddle in the affairs of the company regardless of whether or not the derivative action is in the interests of the corporation.*

Similar difficulties also go to explain the mixed success that creditors have met in satisfying a court that they are "proper" persons to take proceedings in a company's name - the Canadian experience being that creditors have sought to utilise the derivative action in order put a company in funds to meet a debt that it would otherwise be unable to pay.[16] This only reflects the reality that the vast majority of creditors will not concern themselves with the actions of management of one of their debtors unless and until that debtor is unable to meet its obligations. The Companies Act 1993 does not ignore the impact that the actions of a director may have on a company's creditors.[17] There exist alternative methods by which a creditor can attempt to ensure that action is taken in respect of misconduct by a director - methods which avoid one creditor acting alone and so prevent the likely conflict between the interests of that creditor and the wider interests represented by the company.

Creditors are granted standing to make application to appoint an independent individual, a liquidator, who could, of course, elect to pursue an available cause of action against a director.[18] Further, a creditor of a company in liquidation has standing pursuant to s 301(1) of the Companies Act 1993 to apply to the High Court for an inquiry as to whether a director or manager of the company has acted in breach of a duty owed to the company. If, after an inquiry, an order is made that the director repay or restore money or property, rather than contributing a sum to the assets of the company by way of compensation, then s 301(1)(c) gives the Court a discretion to order that any part of the property or funds that the director or manager is ordered to repay or restore to the company be paid or transferred to the applicant creditor.[19]

Additionally, a creditor may seek an order pursuant to s 179(1) of the Companies Act 1993 that a named individual be appointed to investigate a company's records. The Court may make such an order if it is satisfied that the creditor is acting in good faith, that the proposed inspection is to be made for a proper purpose and that the person to be appointed is a proper person for the task.[20] Even if a creditor is only recognised as having standing to seek information relating to an application that he or she is able to make under the Act,[21] an investigation may incidentally reveal information concerning a breach of duty by the company's director(s). This information is likely to come to the Court's attention as the person appointed to conduct the investigation is, pursuant to s 179(3), directed to make a "full report" to the Court. Section 179(4) provides that the Court may make such order relating to the disclosure or use of the information as it thinks fit. It is conceivable that the Court could order such information be disclosed to the company's shareholders who may elect to take action against the director(s). If the information is disclosed to the applicant creditor then it could be used as a basis for an application that a liquidator be appointed on the grounds that the company or board has persistently or seriously failed to comply with the Act, or, that it is just and equitable to do so.[23]

III. The Factors to Which the Court Must Have Regard

Section 165(2) of the Companies Act 1993 provides that, when determining whether to exercise its discretion to grant leave to an applicant shareholder or director, the Court shall have regard to:

A. The likelihood of the proceedings succeeding:
B. The costs of the proceedings in relation to the relief likely to be obtained:
C. Any action already taken by the company or related company to obtain relief:
D. The interests of the company or related company in the proceedings being commenced, continued, defended or discontinued as the case may be.

These criteria take the form of a practical checklist that an individual might follow when making a decision whether to commence proceedings. The legislation makes it clear that the factors in s 165(2) do not limit the residual discretion of the Court to grant leave - assuming that the other requirements in s 165 are made out.[24] This recognises that the circumstances of every company will be different and that there may well be situations where the negative aspects associated with one or all of the criteria in s 165(2) may be outweighed by other positive reasons supporting the commencement of proceedings. Such an approach also explains the diversity of results to date in the New Zealand cases.

Fisher J first considered the criteria in s 165(2) in the High Court in Vrij v Boyle.[25] Here the applicant's complaint on behalf of the company was that Boyle, the defendant director and majority shareholder, had diverted custom and opportunities of the company to another business he and his family had set up. The plaintiff sought leave to commence proceedings in the company's name for breach of fiduciary duty against Boyle, Boyle's wife (also a shareholder), and Boyle's children who were involved in the new business.

Fisher J considered all of the criteria in s 165(2) but that in s 165(2)(a) - the likelihood of the proceedings succeeding - received the greatest attention. Fisher J said of this criterion that it did not require him to conduct an interim trial of the merits of the proceedings. Instead he adopted the standard utilised by Walton J in Smith v Croft, that is, the test "which would be exercised by a prudent business person in the conduct of his or her own affairs when deciding whether to bring a claim."[26] Fisher J added

> *22. that a prudent business person would consider such matters as the amount at stake, the apparent strength of the claim, the likely costs and prospect of executing any judgment - matters that were not specifically mentioned in Smith v Croft. Fisher J's test certainly recognises the practical consideration that the decision to commence proceedings will be affected by many factors and that the likelihood of entry of judgment is just one such factor. However, it has to be said that there seems little justification for such a wide interpretation of this particular criterion given the existence of the other, and overlapping criteria, to which the Court is directed to have*

> *regard in the remainder of s 165(2). Further, it seems odd not to recognise that the "prudent business person test" must also have application to the other criteria in s 165(2).*

When applying the prudent business person test to the facts before him Fisher J did only focus on the likelihood of judgment being given in the company's favour. He rejected the proposed claim against Boyle's wife and sons on the grounds that neither owed fiduciary duties to the company. In relation to the proposed claim against Boyle, Fisher J referred to the existence of affidavit evidence, which if accepted, would take the plaintiff's claim in respect of the alleged breach of fiduciary duty some distance. Fisher J also expressed the unsolicited view that "[i]t is also just conceivable ... that there is some form of contract between the company and Mr Boyle and that this contains an implied duty of fidelity which might give rise to a parallel cause of action in contract." However, this statement must be taken in a context where the consideration of the other factors in s 165(2) all favoured the commencement of proceedings.

McFarlane v Barlow,[27] like Vrij v Boyle, concerned a company that was still trading - a company that was, in fact, extremely profitable. The applicant shareholders sought leave to commence proceedings against the directors of the company alleging breaches of their statutory duties to act in good faith and to use their powers for a proper purpose and, additionally, alleging breach of fiduciary duty. Master Venning accepted that the claim was arguable. Here, as in Vrij v Boyle, a consideration of the other factors in s 165(2), as well as the substantial size of the proposed claim, supported the commencement of proceedings.

The remaining cases have all involved companies that had ceased trading and here the rate of applicant success has been mixed. Elias J in Techflow (NZ) Ltd v Techflow Pty Ltd [28] took the sensible view that all of the criteria in s 209X(2) of the Companies Act 1955[29] ought to be considered from the point of view of a prudent business person. Techflow involved an application for leave to defend an application to rescind an interim injunction issued in the District Court arising out of a disputed understanding of an agreement between shareholders and directors as to how a company that had ceased trading would have its affairs wound up. Elias J rejected the application on a number of grounds. One fundamental reason for refusing leave was that the wording of the statute did not allow leave to be granted in respect of proceedings issued in the District Court. Elias J also expressed the obiter view that a prudent business person would not have commenced proceedings in this instance because the costs of the litigation (some $5300 to date) were disproportionate to the amount at issue (some $17,000). This represents a justifiable shift in relation to the interests seen as represented by the company. At the date of the application it appeared that there were sufficient funds to meet the claims of all creditors but that these funds could well be eroded if the company had to meet the costs of the proposed proceedings - the applicant having made it clear that the main reason why leave was sought pursuant to s 165 was so that the company, rather than he, would meet the costs of the proceedings.

In Thorrington v McCann,[30] in contrast, the company had operated a tavern that it leased from a third party. The applicant, who held 50% of the shares in the company, alleged that the director and the other 50% shareholder had renewed the lease for the benefit of another company that he had since incorporated. The applicant sought leave to commence derivative proceedings claiming an account of a profit that the proposed defendant had made by use of his fiduciary position vis a vis the company. There was no challenge to the facts as alleged by the applicant. Laurenson J accepted that the rules regarding accounting of profits made by those in a fiduciary position were clear and strict.[31] Further, Laurenson J held that the other factors in s 165(2), as well as the fact that the size of the claim was substantial and the chances of recovery were good, supported the commencement of proceedings. It seems that the nature of the alleged breach of fiduciary duty was also significant - Laurenson J noted when considering the interests of the company that it was "desirable as a matter of principle" that this matter be resolved.[32]

The specific criteria in s 165(2) can be compared with the more general criteria in Canadian legislation which provide that the Court must be satisfied of three factors before granting leave.[33] First, there is a procedural requirement, of which the equivalent provision is s 166(3) of the Companies Act 1993,[34] that the complainant must have given reasonable notice to the directors of the company of his or her intention to apply for leave if the directors do not diligently take action.

The second requirement is that the complainant be acting in good faith. It has been held that the onus on the applicant to demonstrate good faith is a high one but which can be met if the applicant can show that she or she is not motivated by a private vendetta or that the action is not frivolous or vexatious.[35] Self interest, in the sense that the interests of the company and the applicant are both met by the commencement of proceedings against the director(s) allegedly guilty of wrongdoing does not, of itself, constitute bad faith.[36] Although the requirement of good faith has no direct equivalent in the New Zealand legislation one would expect that an objective consideration of the factors in s 165(2) would give no support to an applicant seeking to pursue a claim that could be categorised as frivolous or vexatious or who was acting in his or her own interests when those interests did not accord with those of the company.

Finally, the Canadian courts must be satisfied that the proposed action appears to be in the interests of the company. Despite the breadth of this last criterion the focus has been placed squarely on the chances of judgment being given in the company's favour and, as will be seen, an applicant does not have to establish that the chances of success are particularly high. The British Columbia Court of Appeal has said that the claim must be an "arguable one"[37] and emphasised that the wording of the legislation does not require that the proceeding be in the interests of the company but only that it appear that they be so. In Acapulco Holdings Ltd v Jegen[38] the Alberta Court of Appeal said that statutory wording "plainly indicates that certainty is not needed." Other courts have held that the bringer of the action must adduce sufficient evidence to show that a possibility that the alleged wrongs occurred[39] or that the applicant has raised "fair questions"[40] or that the action has a "reasonable chance of success."[41] In McKenzie v Craig,[42] Medhurst J, after reviewing many of the tests described above, held that the proper test was that the applicant must show that the proposed action in the company's name is not bound to fail. These tests use language not unlike that employed in Vrij v Boyle[43] and Macfarlane v Barlow[44] to describe the likelihood of judgment being entered in the company's favour. But, as already noted, in the New Zealand cases a host of other factors, including the chances of recovery and the size of the claim in relation to the likely costs, were also taken into account in the making of the decision as to whether the applicant should be granted leave.

However, to leave the comparison at this point creates a misleading impression for there is evidence that the Canadian courts have utilised the issue of who is to bear the costs of the proceedings as a practical gate- keeping mechanism to prevent proceedings that will result in no real benefit to the company from continuing. The Canadian legislation provides that "the court may at any time make any order it thinks fit including ... an order requiring the corporation or subsidiary to pay reasonable legal fees incurred by the complainant in connection with the action."[45] A number of factors have been accepted as having a bearing on whether an order be made that the company meet the reasonable costs of the proceedings. The first is the financial standing of the applicant. In Johnson v Meyer[46] it was held that an order for costs was only appropriate when an applicant would otherwise be unable to continue the proceedings on his or her own account because of a lack of the necessary finances. The rationale behind such a view is not difficult to discern but was clearly articulated by Tysoe J in Intercontinental Precious Metals Inc v Cooke:[47]

> *Many decisions in the course of litigation in my view are influenced by attendant legal costs and it is appropriate in my view that the person having the conduct of a derivative action should make the legal decisions bearing in mind that they will not necessarily be reimbursed for the legal costs.*

Further, in Intercontinental it was accepted by Tysoe J that the proposed proceedings were unlikely to be cost effective in the sense that the legal costs associated with the proceedings were likely to outweigh any recovery. He continued:[48]

> *The matter of the legal fees will, in a sense, be the litmus test for this proceeding. If IPM and Mr Quam are prepared to prosecute the derivative proceeding with the risk that they may not be reimbursed for the legal costs incurred by then, it will tend to substantiate their positions that they are acting in good faith and that they do believe the pursuit of the action to be in the best interests of [the company].*

In New Zealand, in contrast, section 166 of the Companies Act 1993 provides that, on the application of a shareholder or director granted leave to bring or intervene in proceedings on a company's behalf, the Court shall order that the whole or any part of the reasonable costs of the proceedings be met by the company unless the Court considers it would be unjust or inequitable for the company to bear those costs. The issue of costs has not been the subject of detailed discussion in the New Zealand cases to date. In MacFarlane v Barlow[49] and Thorrington v McCann[50] orders were made that the company meet the reasonable costs of the proceedings and in Vrij v Boyle[51] and Porritt v Weir[52] the issue of costs was reserved pending the outcome of the derivative proceedings. In Porritt v Weir the appropriateness of such an order was conceded by the applicant but this is not surprising given that an application to appoint a liquidator was pending and the applicant's further concession that if a liquidator was appointed then it might well be unjust for any award of costs to be made pursuant to s 166.

Overall, this writer's preference is for the New Zealand system. It is debatable whether the preparedness of an applicant to meet the costs of the proceedings is a consistently accurate indicator of his or her good faith and the interests of the company. It takes no account of the situation where an applicant is pursuing what he or she might discern as being "the principle of a matter" and is not concerned with issues such as the costs of the proceedings in relation to the recovery sought. It also shifts a considerable part of the final decision to commence proceedings from an independent body to an individual who more than likely has a personal interest, whether or not it is financial, in pursuing the alleged misconduct on the part of a director.

On a different note, in the New Zealand cases to date the wrongdoers together with the individuals seeking leave to bring or intervene in proceedings pursuant to s 165 have either made up or controlled the entire shareholding of the proposed plaintiff companies. It is, however, possible to envisage a scenario where there may be independent shareholders and/or directors who have a view as to whether the interests of the company will be met in pursuing the proposed proceedings. In Bellman v Western Approaches Ltd[53] the British Columbia Court of Appeal accepted that regard must be had to the decision not to proceed by so-called independent directors but added that the Court had to consider whether their decision was, in fact, made impartially. Here the Court found that the so-called independent directors were not truly impartial as they had been appointed though the voting power of the same group of shareholders that had appointed, and who retained close connections to, the directors allegedly guilty of misconduct. A similar approach was taken by Walton J in the context of the common law derivative action in Smith v Croft[54] but where a different conclusion was reached as to both the independence of the directors and fullness and impartiality of the report they had relied upon in reaching their decision not to go ahead with the proposed proceedings. There is one small sign that this sensible approach is likely to be followed in New Zealand - in AIDC Ltd v ANZ Banking Group New Zealand Ltd Master Thomson set out, without disapproval, a submission made on behalf of the proposed defendant that "the Court should be reluctant to grant leave to the applicant to bring an action in the absence of evidence of improper refusal or failure of the board ... to investigate and pursue any legitimate action."[55]

IV. The Factors the Court Must be Satisfied of

Pursuant to s 165(3) of the Companies Act 1993 the Court can only grant leave to an applicant to bring or intervene in proceedings in a company's name if it is satisfied that either:

A. The company or related company does not intend to bring, diligently continue or defend or discontinue the proceedings as the case may be; or
B. It is in the interests of the company that the conduct of the proceedings should not be left to the directors or to the determination of the shareholders as a whole.

The Court does not hear from the applicant alone. Notice of the application must be served on the company or related company which may appear and be heard with respect to the application.[56] Further, s 165(5)(b) provides that the company must inform the Court whether it intends to bring, continue, defend or discontinue the proceedings.

Given that all of the applications for leave pursuant to s 165 in New Zealand have been made in the case of closely held companies where the applicant is a minority or 50% shareholder the Courts have had no difficulty in concluding that s 165(3)(a) has been made out. In general terms the criteria in s 165(3) are likely to met when the alleged wrongdoers make up or control a majority shareholding. In these circumstances the company is likely to inform the Court that it does not intend to take proceedings. If those in control indicate that the company does intend to take proceedings then it may be that the Court will be satisfied that either the company does not intend to diligently continue the proceedings or that it is not in the interests of the company that control of the proceedings be left to the directors or shareholders as a whole.

V. The Residual Discretion

Even if the Court is satisfied that a consideration of the factors in s 165(2) favour the commencement of proceedings and that one or more of the mandatory criteria in s 165(3) are met it retains a discretion as to whether leave will be granted to an applicant shareholder or director. In New Zealand, to date, the most common submission made under this head is that the Court ought to refuse leave because the applicant is also seeking personal relief from the company and/or the proposed defendant director and this will lead to double recovery by the applicant.[57]

In Vrij v Boyle[58] the applicant shareholder had already commenced proceedings seeking personal relief in respect of an array of other causes of action including the prejudiced shareholders remedy in s 209 of the Companies Act 1955.[59] Fisher J said:[60]

> *One can well understand that if a shareholder tried to recover both personal damages for indirect losses caused by a reduction in the value of the shareholder's shares due to a wrong done to the shareholder's company and a derivative action with respect to the same wrong, there would be duplication and the risk of double recovery.*

Fisher J distinguished the above situation from one where an applicant was also seeking personal relief in respect of an independent wrong done to him or her. In the end Fisher J categorised the claim for relief under the prejudiced shareholders remedy as one where the shareholders would "resolve their differences inter se." This, in his view, was no reason for refusing to allow the company to pursue an independent claim against Boyle.

Fisher J's treatment of this issue follows the commonly accepted boundary between a personal and corporate cause of action against a director.[61] However, it takes no account of the historical role of the prejudiced shareholders remedy in New Zealand. Prior to the enactment of the Companies Act 1993 the prejudiced shareholders remedy, along with the application to appoint a liquidator on the just and equitable ground, were viewed as alternatives to the derivative action as it existed at common law.[62]

Holden v Architectural Finishes Ltd[63] is a recent example of the prejudiced shareholders' remedy being used to grant individual relief in respect of a wrong done to the company. In Holden it was held that the formation of a competing company by directors was a breach of their fiduciary duties to the company but also constituted oppressive conduct that was deserving of relief for the reason that it "severely prejudiced" the value of the applicant shareholder's investment.[64] In practical terms the wrongdoing directors were penalised for their conduct in the form of an order that they purchase the applicant's shares at a price that reflected the value of the company prior to the conduct categorised as "oppressive". Although technically this is not an order of damages it did have the effect of returning the minority shareholder to the financial position he enjoyed prior to the oppressive conduct. If the approach in Holden and like cases continues, and there is no statutory signal that it should not, then there must be little incentive for shareholders to seek leave to bring a derivative action where there is an allegation of wrongdoing by a director. The only clear benefit in bring derivative proceedings is the possibility that an order may be made that the company bear the costs of the proceedings.[65] Further, again assuming the approach in Holden continues, in the case of a wrong suffered by the company but where an applicant under the prejudiced shareholders remedy cannot establish oppression then the odds are that he or she will receive no personal benefit, even in an indirect way, from a successful derivative action.[66] In such circumstances it would be a very rare individual who would seek to pursue an action in the company's name and for the company's, rather than his or her, benefit.

In Canada, where the statutory derivative action and prejudiced shareholders remedy have existed alongside each other for over two decades, a different attitude prevails. The existence of an application for relief pursuant to the prejudiced shareholders' remedy is a factor to which courts have paid little heed when considering an application for leave to bring derivative proceedings. Although it is accepted that there may be circumstances where there is overlap between the two, rather more attention is paid to whether an applicant is entitled to relief under the prejudiced shareholders head if he or she is seeking relief for conduct that could well be the subject of derivative proceedings than vice versa.[67] In Pappas v Acan Windows Inc, for example, Barry J said:[68]

> *I do not accept, however, that what would normally be a derivative action may be justified simply because the sort of remedy sought is available under the oppression remedy sections of The Corporations Act. In my opinion, before a shareholder can place himself within the oppression remedy sections of The Corporations Act, the shareholder must first pass the hurdle or meet the condition that ... "a finding of oppression or unfairness first opens the door to the exercise of the Court's discretion." And I do not believe that oppression or unfairness can be established merely by showing that the corporation itself has been damaged, with consequential damage to the shareholder. In that sense, there will always be damage found to occur to shareholders. To permit a personal action under the oppression remedy sections of The Corporations Act in all such cases would be to eviscerate the derivative action sections of the Act.*

In the case of a closely held company that is unlikely to continue trading the question as to whether the boundaries of a corporate cause of action and an application for personal relief ought to be strictly maintained at least deserves consideration. An order for personal relief avoids returning funds to an entity that may still be controlled by the wrongdoer and may simply pre-empt the next step in the company's existence, that is, the distribution of its assets in the course of liquidation.[69] The New Zealand legislation does, however, provide a way of maintaining a strict division between a corporate and personal cause of action while still allowing a commonsense result. Section 167(d) of the Companies Act 1993 expressly authorises the Court, when it has granted leave to an applicant to bring or intervene in proceedings in a company's name, to order that any amount finally ordered to be paid by a defendant in the proceedings be paid to former or present shareholders of a company rather than to the company.[70]

Even if a change in attitude to the circumstances in which relief is granted under the prejudiced shareholder remedy occurs, the role of the statutory derivative action is undermined by other provisions in Part IX of the Companies Act 1993. Pursuant to s 164 a director, shareholder or entitled person may seek an order restraining a company or a director of a company from engaging in conduct that would contravene the Companies Act 1993, the Financial Reporting Act 1993 or the company's constitution.[71] Further, shareholders are given standing pursuant to ss 170 and 172 of the Companies Act 1993 to seek an order requiring a director or the board to take action required to be taken by the Companies Act 1993, the Financial Reporting Act 1993 or the company's constitution. In Canada the possible conflict between the derivative action and these other enforcement mechanisms has been resolved in the same manner as that between the derivative action and the prejudiced shareholders remedy. In Re Goldhar and Quebec Manitou Mines Ltd Reid J concluded, albeit reluctantly, that the compliance order procedure did not confer alternative or concurrent rights with the statutory derivative action and that shareholders who sought to enforce the obligations imposed upon directors by statute must utilise the derivative procedure.[72] Reid J also expressed the view that the making of a compliance order ought to be reserved for ""mechanical omissions" of a type that might lend themselves to summary disposition."[73] Even if the second limitation is accepted it does not resolve the difficulty that ss 164, 170 and 172 of the Companies Act 1993 make no mention of the derivative action and are phrased sufficiently broadly to overlap with it.[74]

The place of the statutory derivative action is still further undermined by s 177(4) of the Companies Act 1993. Section 177 deals, in the main, with the issue of ratification by shareholders or others of the exercise of a power vested in them by a director or the board. However, s 177(4) provides:

> *Nothing in this section limits or affects any rule of law relating to the ratification or approval by the shareholders or any other person of any act or omission of a director or the board of the company.*

This section has been the subject of detailed comment by this writer elsewhere.[75] In summary, it has the arguable effect of making the statutory derivative action unavailable in respect of a breach of duty or other misconduct by a director that at common law the majority of shareholders were able to ratify.[76] This is a restriction for which there appears to be no valid justification. The common law rules relating to ratification developed as a gate-keeping mechanism. With the introduction of the statutory derivative action there appears to be no need for the retention of these common law rules - the Court acts as a replacement gate-keeper. In Canada, sensibly, statute provides and case law recognises that ratification of an alleged breach of duty is merely a factor to which a court may have regard when exercising its discretion to grant leave to an applicant to bring or intervene in proceedings on a company's behalf.[77]

One further factor that has been raised in passing in New Zealand in the context of the Court's residual discretion is whether leave ought to be granted to an applicant who was not a shareholder at the time that the alleged wrong to the company occurred and who purchased his or her shares at a fair price, that is to say, a price that took into account the effect of the misconduct on the value of the company's assets. One view is that if leave is granted to applicants within this category then it encourages speculative actions that result in an unjust enrichment to those who were not shareholders at the date the alleged wrong occurred.[78] In MacFarlane v Barlow Master Venning expressed the obiter view that in the case of a misappropriation of company assets there is no objection in principle to shareholders who acquired their shares after the misappropriation from seeking leave to bring derivative proceedings.[79] The fact that there is no such legislative limitation was seen as the determining factor in Canada where leave has been granted to an applicant who admitted acquiring shares in a company so it could challenge past actions of the company's directors.[80]

Whether the concerns relating to speculative actions and unjust enrichment are justified depends on how one assesses the interests represented by a company. The identified concerns only achieve significance if one equates a company with its current body of shareholders. Even if such a view prevails then the director(s) guilty of misconduct can still be penalised and unjust enrichment of current shareholders avoided by the making of an order pursuant to s 167(d) that any final recovery be paid to the former shareholders who sold their shares at an undervalue. In any case there is a strong argument that it is unjust not to allow a company that is continuing to trade to seek compensation for a wrong done to it - any recovery will clearly benefit it as a trading entity.

VI. Conclusion

This purpose of this article was to assess the effectiveness of the statutory derivative action in the Companies Act 1993 in terms of the enforcement of directors' duties both in the wider context in which it operates and as a stand alone enforcement mechanism. When the action is considered in isolation, using the Canadian statutory derivative action as comparative measure, favourable conclusions can be drawn. The New Zealand action incorporates many desirable features of its Canadian counterpart - such as the ability to order that recovery be made directly to shareholders or former shareholders - and avoids some areas of difficulty. Thus, unlike its Canadian counterpart, the New Zealand action is not made available those who are more likely to have a conflict between their own interests and those of the company. Further, the overall approach in New Zealand to the decision whether to grant leave to an applicant is far more pragmatic than its Canadian counterpart - the factors the Court takes into account are far wider and the Court retains a far greater control over the final decision as to whether the proceedings should be commenced.

On a wider assessment a quite different impression emerges. The place of the statutory derivative action in New Zealand is not yet clear but the indications are that it is overshadowed by a number of factors not present in Canada. First, it was introduced into a system where the prejudiced shareholders remedy plays a recognised role in compensating shareholders who have suffered through a breach of duty owed by a director to the company. There is no statutory signal that the prejudiced shareholders remedy is no longer to operate as an alternative to the derivative action. second, the statutory derivative action is further circumscribed by the retention of the common law rules relating to wrongs by directors that are ratifiable by a majority of shareholders and by the inclusion of new overlapping remedies such as the compliance orders specified in ss 170 and 172 of the Companies Act 1993. Given this context the only clear benefit to an applicant shareholder in going through the effort of making application for leave pursuant to s 165 is the possibility of an order that the Court will order that the company meet the reasonable costs of the proceedings. Thus, the effectiveness of the statutory derivative action in New Zealand in terms of the enforcement of directors' duties is theoretical rather than practical, and if the status quo remains, is likely to continue to be so.

1. [1] Burland v Earle [1902] AC 83.
2. [2] See the list, which is not exclusive, contained in s 169(3) of the Companies Act 1993. These duties encompass not only such obligations as the duty to act in good faith and in the best interests of the company but also a duty to act with care, skill and diligence. It is conceivable that these could be invoked where action is not taken in respect of loss caused to the company by a third party as well as when loss is caused to the company by the actions of a director.
3. [3] Richardson Greenshields of Canada Ltd v Kalmacoff (1995) 123 DLR (4th) 628 at 635 (Ont CA).
4. [4] J H Farrar & M W Russell, Company Law and Securities Regulation in New Zealand (1985), pp 258-265.
5. [5] NW Transportation Co v Beatty (1877) 12 App Cas 589 at 598 (PC).
6. [6] Despite the reference to the "minority" the exception was directed at wrongs done to the company and encompassed "not only fraud at common law but also fraud in the wider equitable sense of that term, as in the equitable concept of fraud on a power": Estmanco (Kilner House) v Greater London Council [1982] 1 All ER 437 at 445.
7. [7] Farrar & Russell, op cit n 4, at 262-265.
8. [8] Heatherington v Carpenter (1997) 8 NZCLC 261,290, at 261,298 (CA).
9. [9] New Zealand Law Commission, Company Law Reform and Restatement (1989) para 568.
10. RSC 1985 c C-44 (Can).
11. See also Business Corporations Act, RSA 1980 c B-15 s 232 (Alta); Company Act, RSBC 1996 c 62, s 201 (BC); Business Corporations Act, RSO 1990 c B 16 s 246 (Ont).
12. R A Dickerson et al, Proposals for a New Business Corporations Law for Canada (1971), Vol 2 para 480; S Beck, "The Shareholders Derivative Action" (1974) 53 Canadian Bar Review 159 at 159-160; M A Maloney, "Whither The Statutory Derivative Action?" (1986) 65 Canadian Bar Review 310 at 315; First Edmonton Place Ltd v 315888 Alberta Ltd (1988) 40 BLR 29 at 68-69 (Alta QB).
13. Discovery Enterprises Inc v Ebco Industries Ltd (1997) 35 BLR (2d) 111 (BCSC); Schafer v International Capital Corporation [1997] 5 WWR 99 (Sask QB).
14. [1997] 5 WWR 99 (Sask QB).
15. [1997] 5 WWR 99 at 104.
16. See, for example, Re Daon Development Corporation (1984) 26 BLR 38 (BCSC); First Edmonton Place Ltd v 315888 Alberta Ltd (1988) 40 BLR 29 at 68-69 (Alta QB); A E Realisations (1985) Ltd v Time Air Inc (1994) 17 BLR (2d) 205 (Sask QB).
17. An example of a specific innovation in the Companies Act 1993 designed with protection of creditors in mind is the requirement for a company to comply with the solvency test when a distribution to shareholders is authorised: Companies Act 1993, s 52. Other parts of the Companies Act 1993 said to be drafted with the protection of creditors in mind include the liability that directors face for breaches of their duties relating to reckless trading (s 135), company obligations (s 136) and the personal liability directors may face when a distribution is made when the solvency test is not met (s 56). See the commentary by the New Zealand Law Commission, op cit n 9, at para 214-222.
18. Companies Act 1993, s 241(2), (4).
19. Companies Act 1993, s 301(2); Mitchell v Hesketh (1998) 8 NZCLC 261,559.
20. Companies Act 1993, s 179(2)(a),(b).
21. Creditors are granted standing by the Companies Act 1993 to apply to the High Court for certain orders such as that an amalgamation proposal not proceed (s 226(1)), that a

liquidator be appointed on the grounds specified in s 241(4) (s 241(2)(c)) or that in a liquidation there be a pooling of assets (s 271(1)).
22. Companies Act 1993, s 241(4)(b).
23. Companies Act 1993, s 241(4)(d).
24. See Part IV below.
25. [1995] 3 NZLR 763. Fisher J was considering this in the context of s 209X(2)(a) of the Companies Act 1955. Although the Companies Act 1993 took effect from 1 July 1994 the statute it replaced, the Companies Act 1955, was only repealed from 30 June 1997. Companies incorporated under the Companies Act 1955 were given a three year period to reregister under the Companies Act 1993. The provisions of the Companies Act 1955 were also amended with effect from 1 July 1994 by the provisions of the Companies Amendment Act 1993 to include a new s 209X in terms identical to s 165 of the Companies Act 1993.
26. [26] [1985] 1 WLR 580 at 590. In fact this test was not suggested by Walton J, it originates from the judgment of Buckley L.J in Wallersteiner v Moir (No. 2) [1975] QB 373 at 404. Walton J was considering an appeal from an order by a Master that a company be responsible for 60% of the actual costs of bringing a derivative action at common law up to the completion of discovery and inspection of documents.
27. (1991) 8 NZCLC 261,410.
28. (1996) 1 NZCLC 261,138 at 261,140, 261,141.
29. This provision is identical in wording to s 165(2) of the Companies Act 1993.
30. (1998) 8 NZCLC 261,564.
31. See Keech v Sandford (1726) 25 ER 223; Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 (HL).
32. Allegations of a similar nature were made in Porritt v Weir, High Court, Wellington, 12.3.98, CP309/97 where Master Thomson was prepared to grant leave to a director and 50% shareholder of a company to commence derivative proceedings for breach of fiduciary duty against the other director and 50% shareholder when an application to appoint a liquidator to the company was pending.
33. See, for example, Business Corporations Act, s 232(2) (Alta); Business Corporations Act, s. 246 (2) (Ont).
34. See Part IV below.
35. Primex Investments Ltd v Northwest Sports Enterprises Ltd (1995) 13 BCLR (3d) 300 at 311-312; First Edmonton Place Ltd v 315888 Alberta Ltd (1988) 40 BLR 28 at 70 (Alta QB); Barnes v BWV Investments Ltd (1991) 101 Sask R 244 at 248 (Sask QB); Tkatch v Dr Heide (1996) 29 BLR (2d) 266 at 277 (BCSC); McKenzie v Craig (1997) 53 Alta LR (3d) [284] at 394 (Alta QB).
36. Bellman v Western Approaches Ltd (1981) 33 BCLR 45 at 53 (BCCA); Primex InvestmentsLtd v Northwest Sports Enterprises Ltd (1995) 13 BCLR (3d) 300 at 311-312;Intercontinental Precious Metals Inc v Cooke (1993) 10 BLR (2d) 209 at 218-219 (BCSC);McKenzie v Craig (1997) 53 Alta LR (3d) 284 at 394 (Alta QB); Acapulco Holdings Ltdv Jegen (1997) 193 AR 287 at 289 (Alta CA).
37. Bellman v Western Approaches Ltd (1981) 33 BCLR 45 at 53-54 (BCCA); Johnson v Meyer (1987) 62 Sask R 34 (Sask QB).
38. (1997) 193 AR 287 at 289.
39. Walter E Heller Fin. Corp v Powell River Town Centre (1983) 49 BCLR 145 (BCSC).
40. Appotive v Computrex Centres Ltd (1981) 16 BLR 133 at 137 (BCSC).
41. Intercontinental Precious Metals Inc v Cooke (1993) 10 BLR 209 at 221 (BCSC).
42. (1997) 53 Alta LR (3d) 284 at 297 (Alta QB).

43. [1995] 3 NZLR 763.
44. (1997) 8 NZCLC 261,470.
45. Business Corporations Act, s 240(d) (Can); Business Corporations Act, s 233(d) (Alta); Company Act, s 201(4),(5) (BC)
46. (1987) 62 Sask R 34 at 40 (Sask QB).
47. (1993) 10 BLR (2d) 203 at 225 (BCSC).
48. (1993) 10 BLR (2d) 203 at 226.
49. (1997) 8 NZCLC 261,470.
50. (1998) 8 NZCLC 261,564.
51. [1995] 3 NZLR 763.
52. High Court, Wellington 12.3.98, CP309/97.
53. (1981) 33 BCLR 45 (BCCA).
54. [1986] 1 WLR 581 at 593-594.
55. (1996) 1 BCSLR 194 at 202.
56. Companies Act 1993, s 165(4) & (5)(a).
57. Vrij v Boyle [1995] 3 NZLR 763; Thorrington v McCann (1998) 8 NZCLC 261,564.
58. 58 [1995] 3 NZLR 763.
59. Companies Act 1993, ss 174, 175.
60. [1995] 3 NZLR 763 at 767.
61. Companies Act 1993, s 169(2). The rule has its origins at common law: Prudential Assurance Co Ltd v Newman Industries Ltd [1982] 1 All ER 354 (CA). The exception is where a company has suffered a loss at the hands of a director and a shareholder is induced by that director to part with his or her shares at a price that reflects the reduction in value of the company's assets. In these circumstances it has been recognised that shareholders will not benefit from any recovery made by the company in respect of the wrong done to it: Stein v Blake [1997] EWCA Civ 2474; [1998] 1 All ER 724 at 727 (CA); Heron International Ltd v Lord Grade [1983] BCLC 244 at 260 (CA).
62. Farrar & Russell, op cit n 4, at 266.
63. (1996) 7 NZCLC 260,796; affirmed, Court of Appeal, 7.4.97, CA 272/95.
64. (1996) 7 NZCLC 260,796 at 260,995; Oppenheimer New Zealand Ltd v Struthers [1994] MCLR 156.
65. This benefit was admitted by the applicant in Techflow (NZ) Ltd v Techflow Pty Ltd (1996) 7 NZCLC 261,138 and suspected of the applicant in AIDC Ltd v ANZ Banking Group New Zealand Ltd (1996) 1 BCSLR 194.
66. See, for example, Willems v Stars Corporation Ltd (1990) 5 NZCLC 66,113.
67. Goldex Mines Ltd v Revill (1974) 7 OR (2d) 216 (Ont CA); Bellman v Western Approaches Ltd (1981) 33 BCLR 45 (BCCA); Boulay & Frenette v Kenny (1994) 155 NBR (2d) 46 (NBCA).
68. (1991) 2 BLR (2d) 180, 214 (Nfld SC).
69. See McKay v PHC Holdings Ltd (1998) 8 NZCLC 261,603 at 261,609; Techflow (NZ) Ltd v Techflow Pty Ltd (1996) 7 NZCLC 261,138 at 261,140-261,141.
70. A similar power exists in Canada: Business Corporations Act, s 240(c) (Can). It does not appear that this power has yet been exercised by the Canadian courts but the obiter view has been expressed that the ability to make such an order operates as an incentive to former shareholder to seek leave to bring derivative proceedings when the wrongdoers remained in control of the company: Bretons Bomix Concrete Ltd v Kenny (1994) 149 NBR 373 at 392 (NBQB).
71. The limitation is that the application must be made in respect of conduct that has not yet been completed: Companies Act 1993, s 164(4).

72. (1975) 61 DLR (3d) 612 (Ont HC).
73. (1975) 61 DLR (3d) 612 at 615.
74. BL Welling, Corporate Law in Canada (2nd ed, 1991), pp 551-552.
75. L Taylor, "Ratification and the Statutory Derivative Action in the Companies Act 1993" (1998) 16 C&SLJ 221.
76. This is the position accepted by Master Venning in MacFarlane v Barlow (1997) 8 NZCLC 261,470.
77. Business Corporations Act, s 242 (Can); Bellman v Western Approaches Ltd (1981) 33 BCLR 45 at 55 (BCCA).
78. JD Cox, TL Hazen & FH O'Neal, Corporations (1995), para 15.9; American Law Institute, Principles of Corporate Governance: Analysis and Recommendations (1994) (Vol 2), pp 35-39.
79. (1997) 8 NZCLC 261,471 at 261,476. Such a view also reflects the long standing authority of Regal (Hastings) Ltd v Gulliver [1967] 2 AC 134 (HL) where insistence on the strict application of the principle that directors who make a profit through use of their fiduciary position must account for that profit excluded a consideration of whether those behind the action taken in the company's name would be unjustly enriched if it was successful.
80. Richardson Greenshields of Canada Ltd v Kalmacoff (1995) 123 DLR (4th) 628 at 637- 638 (Ont CA).