

Short notes on:

IS THE COMMON LAW DERIVATIVE ACTION AVAILABLE TO CLOSE CORPORATIONS?

Introduction

A *derivative action* is an action instituted by a person on behalf of a company to protect a company's legal interests. It is a well-known remedy for companies, but what is the position in the Close Corporations Act 69 of 1984 ("Close Corporations Act")?

Yes, existing close corporations continued to live beyond the enactment of the Companies Act 71 of 2008 as amended (the "Companies Act"), but does this mean close corporations enjoy the same?

Recent Court Case

In *Naidoo and Another v The Dube Tradeport Corporation and Others* [2022] ZASCA 14 (the "case"), the facts were as follows:

The matter was an appeal against the order of the KwaZulu-Natal Division of the High Court, Durban. In action, Mr Sagadava Naidoo (Sagadava) and Odora Trading CC (Odora), a close corporation, sued Mr Sivaraj Naidoo (Sivaraj) and Dube Tradeport to set aside the sale of specific farms, known as the Penare Farm Properties (the properties) by Odora to Dube Tradeport. Sagadava and Sivaraj are brothers, hence the reference to them by their first names. Sivaraj is the sole registered member of Odora and accordingly holds the entire member's interest in it.

In December 2001, Odora purchased the properties. On 20 January 2001, Sagadava and Sivaraj concluded an oral agreement about which certain assets in Sagadava's possession would be divided between the two brothers on a 50/50 basis (the "2001 agreement"). Those assets included Sagadava members' interest and loan account in Odora. As already stated, the properties in issue were already the assets of Odora at that stage. Accordingly, the properties became part of the 2001 agreement. The ultimate agreement was that the assets would be registered in the personal names of Sagadava and Sivaraj. However, the latter repudiated the 2001 agreement and refused to sign any record of it. In response, Sagadava refused to accept Sivaraj's repudiation and elected to hold him liable to the agreement.

In the alternative to the 2001 agreement, Sagadava and Sivaraj concluded an agreement in which Sivaraj would hold certain assets on behalf of Sagadava as his nominee (the 1998 agreement). Shortly after that, in 2001, Odora purchased the properties, which became part of the 1998 agreement. On 13 January 2014, Sagadava instituted an action in the High Court against Sivaraj, seeking that his (Sagadava's) member's interest in Odora is transferred and delivered to him. Sivaraj defended the action, also claiming to act on behalf of Odora.

In its judgment, the High Court first considered whether a common law derivative action is available regarding close corporations and held that it was. Then, however, it concluded that because Sagadava was not a registered member of Odora, he was not entitled. Therefore, according to the High Court, neither section 49 nor section 50 of the Close Corporations Act granted Sagadava the right to institute an action in the name of Odora. In any event, concluded the High Court, as Sagadava had relied on the common law derivative action to advance the suit of Odora, he could not rely on section 50 of the Close Corporations Act.

The Law

In the English decision of *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189 that individual shareholders have no cause of action in law for any wrongs done to the corporation. Further, if an action is to be brought regarding such losses, it must be brought by the corporation itself. Moreover, the exception is available where what has been done amounts to fraud, and the wrongdoers are in control of the company. Although there has not been an express adoption by this Court of the English law of derivative actions as part of our common law, it has been consistently applied.

In this case the Supreme Court of Appeal, noted that before the promulgation of the Companies Act, a common law derivative action was recognised regarding companies, and by extension, to close corporations. Accordingly, the statutory rights have always been parallel and complementary to the common law rights of companies' shareholders and members of close corporations to pursue derivative actions on behalf of their respective corporate entities. They were never meant to oust the common law rights.

However, the Companies Act abolished the common law right of derivative action in section 165 and substituted it with a statutory right. However, this has not affected the common law rights in respect of close corporations incorporated before the commencement of the Companies Act but which have not converted to companies under that Act. Therefore, the situation remains that the common law

rights of members of close corporations, including an actual, unregistered owner of a member's interest, to bring a derivative action are still available. Consequently, the appeal was upheld.

Conclusion

In the case of agreements not honoured in equity or ownership interest – the common law remedy is still available. Therefore, these agreements should not be entered into lightly and should be accompanied by professional legal advice. Contact an expert at SchoemanLaw for assistance.

