A Platonian Approach to Shareholder Derivative Claim: Rationale for Legislative Reforms in Cyprus with Lessons from England and Germany

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Abstract:

One of the most powerful tools of shareholder protection is the derivative action. The thesis argues that shareholder protection in Cyprus is weak, because Cypriot law lacks effective mechanisms of shareholder protection. In particular, it argues that the common law derivative action, as it stands in Cypriot company law, is deficient in protecting the interests of Cypriot shareholders against mismanagement. Its thesis is that a legal reform, which will replace the Cypriot common law on derivative claims with a statutory remedy, is necessary in order to strengthen the protection of minority shareholders against managerial misconduct and to improve the weaknesses of corporate governance practices within Cypriot markets. This aim will be achieved through the comparative analysis of Cypriot, English and German law and the development of a new conceptual framework, upon which the reform proposals would be based. This conceptual framework is rooted on the famous Plato's allegory of cave and provides an innovative outlook on how the law on derivative claims should be formulated, so that minority shareholders are equipped with an effective corporate governance mechanism against maladministration. Based on the allegory, the study argues that the derivative action can only amount to an effective corporate governance mechanism, if it is accessible to minority shareholders. The development of this conceptual framework provides for the introduction of a new model on derivative claims that the thesis named as Platonian Remedial Model (PRM).

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that can be found in Chapter 4 of my Thesis and illustrates how the company looks like when fraud has been perpetrated against it.

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Abbreviations

Select Terms and Statutes

AG	Aktiengesellschaft (German; Stock Corporation); Amtsgericht German; District Court)
AktG	Aktiengesetz (German; Stock Corporation Act)
BGH	Bundesgerichtshof (German; Federal Supreme Court)
CA	Companies Act 2006
CPR	Civil Procedure Rules
CUP	Cambridge University Press
EE	Edward Elgar
Ltd	Limited Liability Company
OUP	Oxford University Press
Plc	Public Limited Company
UMAG	Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (German; Act on Corporate Integrity and Modernization of Rescission Law)
ZPO	Zivilprozessordnung (German Civil Procedure Code)

Law Journals and Reports

All ER	All England Law Reports
AppCas	Appeal Cases
Ariz. L. Rev.	Arizona Law Review
BCC	British Company Law Cases
BCLC	Butterworths Company Law Cases
Brook. J. Int'l L	Brooklyn Journal of International Law
Bus. Law.	Business Lawyer
Cambrian L. Rev.	Cambrian Law Review

CFILR	Company Financial and Insolvency Law Review
CLJ	Cambridge Law Journal
CLR	California Law Review
Comp. Law.	Company Lawyer
Colum.L.Rev.	Columbia Law Review
Cornell L.Rev.	Cornell Law Review
DB	Der Betrieb (The Enterprise)
Del.J.Corp.L.	Delaware Journal of Corporate Law
EBLR	European Business Law Review
EBOR	European Business Organisation Law Review
ECL	European Company Law
ER	English Reports
ECFLR	European Company and Financial Law Review
EWHC	England & Wales High Court
ICCLR	International Company and Commercial Law Review
ICLQ	International & Comparative Law Quarterly
JBL	Journal of Business Law
JCLS	Journal of Corporate Law Studies
J. Civ. L. Stud.	Journal of Civil Law Studies
LMCLQ	Lloyd's Maritime and Commercial Law Quarterly
LQR	Law Quarterly Review
MLR	Modern Law Review
NJW	Neue Juristische Wochenschrift (New Juristic Weekly Bulletin)
S. African L.J.	South African Law Journal
Tul.L.Rev.	Tulane Law Review

UCLA	University of California, Los Angeles
UCLJL & J	UCL Journal of Law and Jurisprudence
U.Ill.L.R	University of Illinois Law Review
WLR	Weekly Law Reports
ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht (Journal of Business and Company Law)

Contents

Chapter 1: Introduction

1.1 Background of the study

The derivative action is one of the most powerful mechanisms of corporate control against managerial abuse.[1] The derivative action can be broadly described as a form of a lawsuit which is brought by minority shareholders on behalf of the company in order to strengthen accountability of those controlling the company and to prevent wrongdoing from being occurred without redress.[2] The remedial effect of the derivative action is inextricably linked to the protection of minority shareholders. Their role in monitoring the management and holding it to account, is considered as a challenging task, when the company itself is incapable of making a claim.[3] In Cyprus, such claims are governed by the well-entrenched English common law principles.[4] Since 2006, the English derivative action is subject to statutory regulation under Part 11 of Companies Act 2006.[5] The scope of the new statutory derivative claim in England, which has replaced the common law one, extended the claim '*in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company'.*[6] However, the Act is not applicable in Cyprus. Until now, Cyprus maintains the old English common law

[1] Dario Latella, 'Shareholder Derivative Suits: A Comparative Analysis and the Implications of the European Shareholders' Rights Directive' (2009) 6 ECFLR 307.
[2] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 18.
[3] Marios Koutsias, 'The Fallacy of Property Rights' Rhetoric in the Company Law Context: From Shareholder Exclusivity to the Erosion of Shareholders' Rights' (2017) 28(6) International Company and Commercial Law Review 216.
[4] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62, 64.
[5] Victor Joffe, David Drake, Giles Richardson, Daniel Lightman, Timothy Collingwood, *Minority Shareholders: Law, Practice, and Procedure*, 4th edition (Oxford University Press, 2011) page 35.
[6] s 260(3) of Companies Act 2006.

rules on derivative claims.[7] The UK Law Commission concluded that uncertainty as to the application of the common law derivative action in England, rendered minority protection in England inadequate.[8] The Law Commission recognized that this uncertainty surrounding the English common law, derived from procedural complexities governing locus standi to bring a derivative action, which extended the length and costs of litigation.[9] The Commission concluded that the common law remedy did not provide minorities with effective rules to bring a claim.[10] In the light of the concerns of the Law Commission, this paper will examine whether Cypriot shareholders still face similar problems to their respective British counterparts, when the common law action was in place. This study will identify whether the application of the remedy under Cypriot law, carries an element of uncertainty too.

This study will shed light into the shortcomings of the Cypriot derivative action and it will examine whether Cypriot shareholder law protects the interests of shareholders effectively. It will do so through a comparative analysis of the Cypriot and the abolished English common law on derivative claims. It will identify the deficiencies of the current legal framework in Cyprus and it will argue that the remedy is doctrinally problematic, weakening minority shareholder protection. The paper argues that a reform of the Cypriot derivative action will enhance shareholder protection. Its thesis is that such a reform is now a necessary precondition so as to protect minority shareholders in Cyprus.

[7] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62, 64.
[8] Law Commission, Shareholder Remedies: Consultation Paper, 1997, para.4.35.
[9] Ibid.
[10] Ibid.

In order to support its arguments, the thesis will examine a broader context of shareholder protection in Cypriot company law and it will demonstrate that there is an absence of effective alternative methods of shareholder protection. More specifically, it will examine the Cypriot oppression remedy, as an alternative mechanism to the derivative action in Cyprus and it will argue that the remedy in question is an insufficient means of shareholder protection too. It is incapable of filling any gaps left by the ineffectiveness of Cypriot common law derivative action. The oppression remedy is provided for by section 202 of the Cyprus Companies Law Cap.113; this is identical to the UK section 210 of the Companies Act 1948. However, since 1985, the UK has abolished the oppression remedy and introduced a new remedial model, which is now the unfair prejudice remedy of section 996 of the Companies Act 2006. The UK unfair prejudice remedy has proven a useful alternative remedial tool for minority shareholders, when the derivative action is not available to them.[11] Taking into account the criticism that the English oppression remedy faced and led to its abolition by the English legislator, the study will provide a comparative analysis between Cypriot and English law. It will compare the Cypriot oppression remedy and the English unfair prejudice remedy of section 994 of the CA 2006. This aims at looking at the alternatives to the derivative action in both jurisdictions. Based on this analysis, Chapter 3 will argue that the Cypriot oppression remedy is inferior to the English unfair prejudice remedy of section 994 because it is devoid of the protection that the English unfair prejudice remedy provides to minority shareholders. This assessment will provide a clear picture of the inadequate shareholder protection under Cypriot law. The main reason for the examination of the Cypriot oppression remedy is to demonstrate that there is no

[11] Martin Gelter, 'Mapping Types of Shareholder Lawsuits Across Jurisdictions' in Research Handbook on Shareholder Litigation by Jessica Erickson, Sean Griffith, David Webber and Verity Winship, eds., 2018, Fordham Law Legal Studies Research Paper No. 3011444, ECGI - Law Working Paper No. 363/2017, 1, 18-19, Available at SSRN: https://ssrn.com/abstract=3011444

alternative means of shareholder protection within the Cypriot company law that can protect the interests of minority shareholders from corporate malpractice. The study will therefore highlight the importance of improving those levels of protection against mismanagement, through a reform of the derivative action. This is even more imperative due to the lack of alternative protection for shareholders.

This study seeks to introduce a derivative action model in Cyprus, which would transform its current operation. Particularly, the paper will argue for a codified derivative action within the Companies Laws Cap 133, which will supersede the existing common law rules. In order to achieve that objective, the paper will provide a comparative analysis of the English and German jurisdiction, aiming at reforming the Cypriot one. The comparative analysis of the two jurisdictions will demonstrate that those two remedies also have imperfections in balancing adequate shareholder protection and managerial freedom. The paper argues that both the English and German law provide for more disincentives rather than incentives for shareholders to litigate. Despite that, both jurisdictions offer valuable lessons that Cypriot legislators should not disregard. For that reason, this study considers essential the development of a new conceptual framework, named as the Platonian Remedial Model (PRM). The paper argues that the adoption of this model would allow Cypriot legislators to select the English and German legal elements that will strengthen the function of the Cypriot derivative action. A legal transplant of any of the two remedies within Cypriot law will not work due to the different legal and political culture in Cyprus[12], but with the reforms that the paper will put in place, the two remedies will constitute the grounds for a new derivative action in Cyprus which will remedy the current deficiencies of Cypriot law.

[12] Frederique Dahan and Janet Dine, 'Transplantation for transition -discussion on a concept around Russian reform of the law on reorganisation' (2003) 23 Legal Stud. 284, 308-309.

1.2 Research Issues

1.2.1 The derivative action in Cyprus: an unexplored remedy

The derivative claims in many common law countries are now governed by statutes, which endeavor to give better access to the minority shareholders, providing greater transparency and certainty in relation to the procedural aspects of derivative litigation.[13] Even though the derivative action, originates in English common law, in the past decade has found its way into the English civil procedure. But, Cyprus has not followed the United Kingdom.[14]

1.2.1.A The Interrelations of Cypriot and English company law

The United Kingdom was the most recent dominion foreign ruler upon Cyprus before its independence in 1960.[15] Cyprus is an ex British colony and many of its customs and laws have been significantly influenced by the United Kingdom.[16] From 1878 until 1960 Cyprus adopted essential elements of the English common law tradition.[17] Along with the adoption of English common law, Cyprus incorporated important statutes of the British Parliament, such as the Cyprus Companies Law, Chapter 113 of the Laws of Cyprus, which was enacted in 1951 and remains until today a fundamental piece of corporate legislation, regulating the proper functioning of Cypriot companies. The statute has been subject to several amendments based on the implementation of EU Directives, following the accession of the island in the European Union. But, the very nature of the statute is largely reflective of the Anglo-Saxon

[13] Arad Reisberg, *Derivative Actions in Corporate Governance: Theory and Operation* (Oxford University Press, 2007) pages 176-177
[14] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62, 64.
[15] Symeon C. Symeonides, 'The Mixed Legal System of the Republic of Cyprus' (2003-2004) 78 Tul. L. Rev. 441.
[16] Ibid.
[17] Ibid.

tradition, as the Cyprus Companies Law is identical to the UK's former Companies Act of 1948.[18]

The UK Act of 1948 was subject to reforms, which led to today's Companies Act 2006. But, Cyprus has not followed the same legislative changes in its company laws and preserved the original statutory footing of the UK Act of 1948. In fact, this becomes emphatic in section 29.1 (e) of Courts of Justice Law No. 14 of 1960, which provides that only the pre-1960 statutes of the British Parliament would remain applicable in Cyprus.[19]

The legal and cultural affiliations between the Cypriot and the English common law become even clearer, by having a closer look at the country's legal history. Even though, after its independence, the country could have grasped the opportunity to structure its own legal framework, it appears that Cyprus had no intention to be weaned from the principles of English common law. After the creation of the independent Republic of Cyprus, a statute was enacted which permanently incorporated English common law into the Cypriot legal system.[20] That was the Courts of Justice Law No. 14, 1960 and in particular § 29(1)(c) provided that in the absence of applicable Cypriot statutory provisions, the Cypriot courts will apply the English common law.[21] What is remarkable in this provision is the fact that there are no temporal restrictions, as it authorizes the application of both pre-independence and post-independence English common law.[22] This means that any decision made by English courts after 1960 would still be binding on Cypriot courts, even when the English judicial precedent has been

[18] Maria Krambia-Kapardis, Jim Psaros, 'The Implementation of Corporate Governance Principles in an Emerging Economy: a critique of the situation in Cyprus' (2006) 14(2) Corporate Governance: An International Review 126, 128.
[19] 29.1 (e) of Courts of Justice Law No. 14 of 1960
[20] Symeon C. Symeonides , (n 15) 450.
[21] Courts of Justice Law No. 14, 1960, § 29(1)(c) (Cyprus)
[22] Symeon C. Symeonides , (n 15) 450.

replaced by subsequent Acts of the UK Parliament. This provision provides a clear idea of how derivative claims are perceived within Cypriot company law. So, this provision clarifies how the English common law regime on derivative claims was incorporated within Cypriot law and it still remains binding on Cypriot courts, regardless of the fact that England has subsequently decided to abolish the common law remedy and replace it with a statutory one with the enactment of the CA 2006.

1.2.1.B Fraud and wrongdoer control: Two problematic requirements

Following the English common law approach, shareholder litigation in Cyprus arises as an exception to the *Foss v Harbottle* rule. Cypriot courts, in *Panikou Livadioti and others v. The Fast Jap Co Ltd and others*[23], confirmed the proper plaintiff rule, stating that the company itself, as a separate entity, is the most appropriate claimant in private corporate disputes. However, the Cypriot common law recognised that the fundamental right of the company to litigate through its institutions, when a duty owned to it has been breached, can be circumvented allowing claims to be brought by an individual member only under the limited circumstances enshrined in the case of *Edwards v Halliwell*[24]. Specifically, the four exceptions were recently endorsed by the Supreme Court of Cyprus in the case of *Aimilios Thoma v Jacob Eliadis*[25]. The case in particular, concerned '*the fraud on minority'* exception which constitutes the only true exception to the proper plaintiff rule.

The fact that Cypriot courts have so willingly endorsed the English common law derivative regime, despite its reform in England, begs a crucial question. This question concerns whether the Cypriot derivative action remains fit for the purpose of

[23] Panikou Livadioti and others v. The Fast Jap Co Ltd and others, CY:EDLAR:2016:A121
[24] Edwards v Halliwell [1950] 2 All ER 1064.
[25] Aimilios Thoma v Jacob Eliadis (Civil Appeal No.11784, 24/11/2006)

maintaining a favourable litigation environment for minority shareholders, who seek protection against mismanagement. At this point, it is important to emphasise that the common law derivative regime in England was not considered to be an effective controlling mechanism of managerial behavior.[26] The remedy, having its roots on principles established on 19th century, was extensively criticised on the basis that the juridical development of the rules on derivative claims, could no longer respond to the needs of today's commercial context.[27] The UK pre-CA 2006 derivative action placed significant barriers to minority shareholders, who were seeking to initiate a claim.[28] However, the Cypriot legislators have not attempted to change the previous English common law regime and the Cypriot courts still endorse it.

The difficulties surrounding the initiation of derivative actions are linked with the need to prevent frivolous claims rather than a purpose of enhancing the enforcement of directors' duties.[29] The procedural restrictions contained in the narrowly circumscribed exceptions to the rule in *Foss* have a lot to account for in respect of limiting the scope of the remedial action and consequently restricting access to justice for minority shareholders.

The only true ground upon which derivative litigation can be allowed by a minority shareholder is the fourth exception to the *Foss v Harbottle* rule. The fraud on the minority rule is regarded as the most significant reason for the hardly occurrence of derivative claims in England, before the creation of the statutory remedy.[30] Common

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[26] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' [2006] 3 ECFR 69,70.
[27] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 14.1 to 14.4.
[28] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 81
[29] Deirdre Ahern, 'Directors' duties: broadening the focus beyond content to examine the accountability spectrum' (2011) 33 Dublin University Law Journal 116, 118.
[30] Derek French, Stephen Mayson and Christopher Ryan, *Mayson, French & Ryan on Company Law*, 36th edition (Oxford University Press, 2019) page 563.

law allows an individual shareholder to take action, if he could be able to satisfy two crucial elements. Firstly, the "fraud on the minority" element, which indicates that the wrong should be one that cannot be validly ratified by the majority, has been criticised for being of an uncertain nature, as its limits have not been precisely and plainly defined by the judges.[31] The concept of fraud has been broadly interpreted by the English courts, providing no clarity as to what kind of corporate behavior amounts to "fraud". Consequently, this ambiguity created practical difficulties to shareholders, who were trying to prove a concept that was not clearly defined.[32] The analysis of the relevant English cases of the past century or so is necessary to fully comprehend the nature of the derivative action.[33]

Regarding fraud, the English courts were facing difficulties in clearly defining what kind of conduct would meet the fraud requirement. For example, in *Cook v Deeks*[34], the court held that the fraud element was satisfied, because the defendant directors signed the contracts for themselves that should have been signed in the name of the company. Therefore, the misappropriation of company's property amounted to fraud.[35] On the other hand, the court in *Regal (Hastings) v. Gulliver*[36] stated that no fraud was found, as there was no misappropriation of corporate property on the part of the directors, who used corporate information to personally benefit from that use, while the company was not able to take advantage of this corporate opportunity.[37] It seems that the misappropriation of corporate property was viewed as the clearest example of fraud[38],

[31] Alan Dignam & John Lowry, *Company Law*, 8th edition (Oxford University Press, 2014) page 197, 198.
[32] G.R Sullivan, 'Restating The Scope of the Derivative Action' [1985] The Cambridge Law Journal 236, 240.
[33] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 4.35
[34] Cook v Deeks [1916] 1 A.C. 554
[35] Ibid.
[36] Regal (Hastings) Ltd v Gulliver [1942] UKHL 1
[37] [1942] UKHL 1
[38] Cook v Deeks [1916] 1 A.C. 554 564, per Lord Buckmaster L.C.

but the English case law failed to identify particular characteristics of wrongdoing behavior that would qualify as "fraud".[39] For instance the word "property" in *Burland v Earl*[40] referred to the misappropriation of money, property and advantages that belonged to the corporation or in which other members of the company were empowered to be associated with. In *Cook v Deeks* the appropriation of "advantages", in which the court referred in *Earl*, took the specific form of a contract, which the company should have signed.[41] Lord Buckmaster opposed the view of the Privy Council that the directors were holding the benefit of that contract on constructive trust for the company, as if the contract was considered to be held on trust, the directors should not have retained the benefit of it for themselves.[42] It can be argued that, Lord Buckmaster approaches the misappropriation of the contract from an equitable scope, as the corporate asset in the form of that contract meant to include what belonged in equity to the company. Except from this case, where fraud is explained as a diversion of the business from the company to directors in breach of their fiduciary duty, there are similar cases in which fraud is also understood in the form of dishonesty or bad faith, such as the *Atwool v Merryweather*[43]. The court in *Atwool*, upheld the plaintiff's claim, manifesting that the attempts of the majority to sell worthless assets to the company amounted to fraudulent conduct.[44] Additionally, James LJ in *Menier*[45], referring to *Atwool*, accepted the existence of fraud, as compromising litigation against bodies, in which the majority were interested in terms prejudicial to the company, was an adequate reason to entitle the claimant minority to raise a claim.

[39] Christopher A. Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2014) 34(4) Legal Stud. 582, 586.
[40] Burland v Earle [1902] AC 83
[41] [1916] 1 A.C. 554.
[42] [1916] 1 A.C. 554, 564 per Lord Buckmaster L.C.
[43] Atwool v Merryweather (1867) LR 5 Eq 464.
[44] (1867) LR 5 Eq 464.
[45] Menier v Hooper's Telegraph Works [1874] 9 Ch. App. 350.

A classic statement of the rule can be found in the words of Lord Davey, in *Burland v Earle*[46], who manifested that "when *the majority are endeavouring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company or in which the other shareholders are entitled to participate*", a derivative action can be brought, as these acts are of a deceitful character.[47] On similar grounds, Megarry V-C in the English case of *Estmanco*[48] explained that the meaning of 'fraud' was developed around the notion that the issue complained of is an abuse or misusage of power. It can be said that a similar approach to the fraud concept has been adopted by the Cypriot judges in the case of *Thoma v Eliadis*[49]. In that case the Supreme Court of Cyprus held that the actions of defendants shareholders were equivalent to fraud since their principal aim was to directly or indirectly extract assets or other benefits and rights from the company, whilst these benefits and rights belonged to the company itself.[50] Case law will be examined on how it influences the Cypriot approach on fraud on minority and how this is interpreted.

Further, Templeman J in the case of *Daniels v Daniels*[51] recognized that *'fraud is so hard to plead and difficult to prove'*[52] but also gave a more determined view on fraud, stating that the exception would give permission to a minority shareholder to sue, when the directors mismanage their powers, "*intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expenses of the company*".[53] This case also shows a substantial difference between the common law and the statutory derivative action in Part 11 of CA 2006. Negligence as examined in this case is

[46] Burland v Earle [1902] AC 83.
[47] [1902] AC 83 at [93] per Lord Davey.
[48] Estmanco (Kilner House) Ltd v Greater London Council [1982] 1 All ER 437.
[49] Emilios Thoma and ors. v. Iakovos Eliades (2006) 1 CLR 1263
[50] Ibid.
[51] Daniels v Daniels [1978] Ch 406.
[52] [1978] Ch. 406.
[53] [1978] Ch 406 at [414].

accompanied by profit of the wrongdoers. Negligence in the Act is a concept that stands on its own as a ground for a case.[54] Notwithstanding negligence seems to fall within the realm of fraud in the former case, in P*avlides v Jensen*[55], the judges approached differently this concept and held that the minority shareholders had no right to derivatively sue the wrongdoers, as the directors had not personally benefited from their negligent action. In *Prudential,* Vinelott J overruled this condition and considered "fraud" as a practice that should be remedied regardless of whether the wrongdoers have benefited from it.[56] Even though, the legal principle established in *Jensen* is no longer in force[57], this is one of the common law examples that shows the strictness of the law, regarding the bringing of a derivative claim. So, all these different approaches to the fraud on minority exception, will be extensively examined in this study and will be compared with the interpretations given by the Cypriot judges in the meaning of fraud in order to demonstrate that the ambiguity of the English common law, reflects on Cypriot common law, making it almost impossible for individual shareholders to bring a successful claim.[58]

Permission to procced with a derivative claim is not given only in respect of the nature of the wrong suffered by the company. The fraud element interlocks with the exercise of control of the general meeting by the wrongdoers.[59] This is the second element contained in the exception. This requirement was established by English courts on the basis that a decision to sue should be made collectively in the general meeting. The bringing of a derivative action by an individual shareholder should be preferable,

[54] Ibid.
[55] Pavlides v Jensen and Others [1956] 2 All ER 518
[56] Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2) [1981] Ch. 257.
[57] [1981] Ch. 257.
[58]Andrew Keay, Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 Journal of Business Law 151, 152
[59] David Kershaw, 'The rule in Foss v Harbottle is dead: long live the rule in Foss v Harbottle' (2015) 3 Journal of Business Law 274, 278

only when a fair collective decision cannot be concluded, for the reason that the wrongdoers control the majority of votes.[60] Difficulties were encountered in relation to the wrongdoer control element too.[61] There is no consistent approach as to whether the term refers to control that the wrongdoer has over the general meeting holding the majority of shares or de jure control to prevent any litigation proceedings. Even though, English common law allows a derivative action to proceed on the ground that the wrongdoers have de facto or de jure control, it is quite difficult for a claimant-shareholder to discern and reveal ownership and de facto control of shareholding.[62] So, it was questionable under English case law whether the application of that requirement would be suspended in circumstances, where the wrongdoer would not be in control of the meeting, but he would simply block the submission of the wrongful act to the meeting.[63] If, the requirement could not be established at all in the latter case, certain types of wrongful behavior to the company would escape legal sanctioning. The UK Law Commission expressed its concerns in relation to this element, arguing that evidence of wrongdoer's control is very difficult to be found.[64] It argued that identifying and disclosing share ownership in large public companies in which shares may be held be nominees or trustees, is an extremely challenging task for an individual shareholder.[65] Also, the Commission highlighted that control may be perceived in the form of some shareholders' engagement in commercial transactions with the wrongdoers, who would encourage the members to vote in favour of transactions that

[60] X Li, *A comparative study of shareholders' derivative actions. England, the United States, Germany and China*, (Kluwer – Deventer, 2007) page 26
[61] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L. Rev 40, 51
[62] Andrew Keay, Joan Loughrey, 'An assessment of the Present State of Derivative Proceedings' in Joan Loughrey (ed), *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis*, (Edward Elgar, 2013) page 218
[63] X Li, *A comparative study of shareholders' derivative actions. England, the United States, Germany and China*, (Kluwer – Deventer, 2007) page 26
[64] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 4.13
[65] Ibid.

answer to the self-dealing motives of the directorship.[66] The Commission did not exclude the possibility that the control element would be referring to a benefit that particular shareholders may enjoy, in a way that is not connected with the wrongful action and the company itself.[67] So, these allegations on the meaning of control by the Law Commission confirmed the broad spectrum within which the control element operates. This is also evident in *Prudential*, where the Court of Appeal explained that the term extends *"*from an overall absolute majority of votes at one end, to a majority of votes at the other end made up of those likely to be cast by the delinquent himself plus those voting with him as a result of influence or apathy".[68] This statement reveals that the judges accept the presence of wrongdoer control, even when the wrongdoer does not own the majority of the company's shares. Such control can be subject to private agreements, internal arrangements or even personal influence between members.[69] Additionally, board control by directors is not excluded from this concept, mainly in cases where there are no members holding a sufficient amount of votes to take control in their own hands.[70]

The Supreme Court of Cyprus in *Theodoros Pirillis v Eleftherios Kouis*[71] confirmed the control principle based on the English case of *Prudential Assurances v Newman*[72]. Cypriot courts adopted the control requirement in the sense that a derivative claim could be allowed, even in cases where, the wrongdoers do not actually hold the majority of voting rights, as shares may be held by nominees, who are manipulated by the wrongdoers and are bound to vote as the wrongdoing members desire.[73] In *Pyrillis*

[66] Ibid.
[67] Ibid.
[68] [1982] Ch 204, 219
[69] MA Pickering, 'Shareholders' Voting Rights and Company Control' (1965) 81 LQR 248, 269-272
[70] Ibid.
[71] Theodoros Pirillis and Another v Eleftherios Kouis (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[72] Prudential Assurance Co Ltd v Newman Industries Ltd and others (No 2) [1982] 1 All ER 354
[73] [1982] 1 All ER 354

case, the Supreme Court of Cyprus recognised the significance of the control element and held that the fulfillment of the control requirement lies on whether the company could by itself bring legal proceedings or not, in order to protect its interests.[74] Also, the possibility of initiating a claim with success becomes even more unlikely, when the claimant has to provide evidence of wrongdoer control, while there is no clarity regarding on whose behalf the shares are held.[75] Identification and disclosure of ownership is a separate page in the realm of corporate law. It is an inherent problem with economic implications for the litigant shareholder, a problem that discourages the pursuit of the claim, especially if the disclosure system is not highly developed to support the effort of the claimant. [76] So, even if the individual shareholder is capable of proving the "fraud" element, despite its ambiguous nature, the satisfaction of the wrongdoer control element is an even more challenging mission, when the minority shareholder has no clue as to the acquirer of the actual ownership of shares. The combination of these two elements illustrates the fear of excessive litigation by the English judiciary. The thesis will examine whether the Cypriot judicial interpretation and application of these rules entails the same fear and follows the same restrictive approach to maintain the efficient safeguards against undesirable litigation.

1.2.1.C Restrictions, ambiguity and procedural hurdles on English common law derivative litigation: A problematic model for Cyprus

The English over-restrictive common law remedy does not favor meritorious claims and declares the tendency of the courts to erect as many hurdles as possible to discourage a minority applicant from pursuing such a claim.[77]. The Law Commission

[74] Pirillis v Kouis (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[75] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in UK, Germany and Greece* (Routledge, 2020) page 94
[76] Ibid.
[77] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 101

recognised the strictness of the exception, stating that the English common law does not allow minority members to bring a claim on behalf of the company, unless the actual commission of the wrong by those controlling it is proven by the plaintiff.[78] It is to be noted that the Law Commission confirmed the deficiencies of the exception, identifying the English pre-codification derivative claim as an unsatisfactory mechanism of corporate litigation and highlighting that the rule is based on case law decided many years ago, rendering it inflexible and outmoded.[79] In other words, it was assumed that case law established almost two centuries ago, cannot correspond to the expectations of the modern corporate world, as the needs of shareholders have changed over the years and amendments should always be considered in the light of promoting good corporate governance. The paper taking into account the concerns of the Law Commission will investigate whether these concerns are relevant for Cyprus too and will argue that Cypriot law is not moving towards to provide shareholders with better access to the remedy by applying the old English common law on derivative claims.

Except from the uncertainty in the language of the exception itself, case law developed further obstacles that render the derivative claim completely inaccessible to minority shareholders. In *Prudential Assurance Co Ltd v Newman Industries Ltd* the Court of Appeal held that the standing of the member to bring a derivative action should be formulated as a preliminary issue by evidence, demonstrating a prima facie case on the merits.[80] So, this consideration was formed around questions of whether the claim could be brought on the basis that the company was *prima facie* entitled to the relief sought and whether the claim was *prima facie* falling within the boundaries of the *Foss*

[78] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 14.1 to 14.4
[79] Ibid.
[80] [1981] Ch 257

exception.[81] However, in *Prudential* and in subsequent cases there was no clarification on the part of the judges, as to what kind of proof the claimant should provide to establish a prima facie case.[82] Even if that point was clearer, when the wrongdoing directors are in control of the company, they can arbitrarily exercise their powers to block access of minorities to sensitive information that would otherwise be capable of revealing their unlawful actions. Thus, common law remains silent on the exact scope of the "*prima facie*" concept, a fact that the Law Commission mentioned that it could cause the preliminary stage to be long-lasting and excessively expensive, without any positive results for the claimant.[83]

In cases following the *Prudential* the judges raised further questions concerning whether it is in the corporate interest to give permission for the continuation of the claim and whether an individual shareholder is the appropriate person to litigate against the wrongdoers.[84] Based on the *Nurcombe v Nurcombe*[85] case the Court of Appeal in *Barrett v Duckett*[86] stated that a derivative action would be permitted, only if it is brought '*bona fide for the benefit of the company*' and not for the fulfillment of the plaintiff's personal ambitions.[87] In that case, even though the wrongdoer control requirement was satisfied, the claim was rejected on the basis that the claimant was not acting to serve the company's interests, but to satisfy his personal repulsion for the wrongdoing director.[88] The fact that a claim should be brought in the interests of the company is a common criterion, which can be found not only in English common law

[81] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 172
[82] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 14.1 to 14.4.
[83] Ibid.
[84] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 172
[85] Nurcombe v Nurcombe [1985] 1 WLR 370
[86] Barrett v Duckett [1995] 1 BCLC 243
[87] [1995] 1 BCLC 243
[88] David Kershaw, 'The rule in Foss v Harbottle is dead: long live the rule in Foss v Harbottle' (2015) 3 Journal of Business Law 274, 280

and later in the statutory remedy of CA 2006, but also in German law too.[89] The inclusion of this requirement in many jurisdictions indicates the need to filter vexatious claims, in which the claimant might play the role of a complicit shareholder, seeking to benefit a business competitor or another member of the company, who avails himself of the claimant's bad faith.[90] Also, the rationale behind the fulfillment of this requirement by the claimant shareholder lies on the courts attempt to bring shareholders in the position of directors who have a fiduciary duty to act in the interests of the company.[91] Considering that the purpose of the derivative action is to allow an individual member to act on behalf of the whole company, it is assumed that the person representing in these circumstances the corporate mind is expected to defend the interests of the company through litigation. So, the prohibition of the action, when its pursuit is motivated by personal interests, which conflict with those of the company, is to some extent justified.

However, common law does not provide us with further guidance as to whether the pursuit of any collateral interests, non-conflicting with those of the company could possibly have a deterrent effect in the decision of the judges to permit a derivative claim to proceed. Cases coming before the English courts after the creation of statutory remedy suggested that the collateral motives would be trivial to the continuation of the claim, as long as these incentives do not stultify the essential purpose for which the derivative action is brought.[92] Although, under the previous common law, lack of clarity

[89] s.148 of the Aktiengesetz (the UMAG)
[90] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 101,102
[91] Paul L. Davies and Sarah Worthington, *Gower & Davies' Principles of Modern Company Law*, 9th edition (Sweet & Maxwell, 2012) 662
[92] Iesini v Westrip Holdings [2009] EWHC 2526 (Ch)

in relation to the open-textured meaning of "*good faith*" and "*interests of the company*" phrases allowed courts to provide different interpretations.[93]

Additionally, another debatable criterion was introduced in the case of *Smith v Croft*[94]. In specific, Knox J underlined the fact that even if the wrongful act cannot be ratified by the company as a whole, because the wrongdoers control the general meeting, the individual shareholder is still prevented from initiating a derivative claim, when the majority of minority independent shareholders disapproves such an action.[95] This rule relates to the concept of ratification, a process under which the members of the company consent to actions made by the management, including those that might be fraudulently or negligently undertaken.[96] However, under common law '*the independent majority within the minority*' rule entails considerable ambiguity.[97] Knox J recommended that the 'independent organs' can be defined as a group of members, whose views would be taken into account in relation to the bringing of the claim and whose votes would not be regarded as being casted in support of the defendants wrongful behavior.[98] However, in the absence of a process, capable of tracking frivolous claims, it is difficult to ascertain who is interested in supporting a wrongful action and who is not. For instance, the law does not provide neither for the size of the independent body nor for any required ownership threshold for minority shareholders to obtain, determining who might be included in the category of 'disinterested'

[93] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 101
[94] Smith v Croft (No 2) [1988] Ch 114
[95] David Kershaw, 'The rule in Foss v Harbottle is dead: long live the rule in Foss v Harbottle' (2015) 3 Journal of Business Law 274, 280
[96] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in UK, Germany and Greece*(Routledge, 2020) page 97
[97] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 77
[98] Smith v Croft (No.2) [1987] 3 All E.R. 909 at 957

members. [99] The vagueness surrounding this approach, creates further difficulties to the minority shareholder litigant, who needs to provide evidence for any lack of independence.[100] In specific, if there is a possibility that the votes have not been casted to benefit the company, the burden lies on the minority shareholder applicant to prove dependence.[101] Hence, the failure of the old English regime to produce a valid answer to the issue of disinterested views led to over-cautious judicial decisions and increased the risk of wrongful conduct going unremedied. The thesis examines whether the same degree of uncertainty can be found in the Cypriot interpretations of this factor, barring meritorious claims, intrigued by the views of members, who seek to support the wrongdoers, by hiding their motives behind the "disinterested member" label. In general, the thesis examines how all the aforementioned English procedural requirements are interpreted by Cypriot judges and how likely it seems that the Cypriot derivative action, as it currently stands, can effectively be used by minority shareholders, as a mechanism of enforcing directors' duties, when these indirect terms mentioned above are not clear enough to assist Cypriot judges in determining the continuance of the claim. Thus, by providing a comparative analysis between Cypriot and English common law on derivative claims, the thesis aims at addressing what this study considers as a weak level of minority protection in Cyprus.

1.3 Research Questions

The thesis examines two main research questions:

RQ.1: Is minority shareholder protection in Cyprus weak?

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[99] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 93
[100] Ibid.
[101] Ibid.

Sub- questions for RQ.1

a) Is the derivative action in Cyprus problematic?
b) Are there any alternative methods of shareholder protection in Cypriot company law?
c) Is the Cypriot oppression remedy dysfunctional?
d) Is the reform of the Cypriot derivative action necessary?

AND

RQ.2: How Cypriot company law can improve the weaknesses of shareholder protection mechanisms?

Sub-questions for RQ.2

a) What lessons Cyprus can learn from the English and German statutory derivative actions?
b) Which common and civil law elements, Cypriot legislators should incorporate in the reform of the derivative action in Cyprus to make the remedy more accessible to minority shareholders?
c) What should be the key consideration for Cypriot legislators in order to introduce an effective derivative action?

1.4 Research Objectives and Research Arguments

1.4.1 Assessment of the Cypriot derivative action and call for reform

Addressing the problems of the English common law on derivative claims, the study argues that the same imperfections reflect upon the Cypriot system, disclosing a number of deficiencies in terms of shareholders' access to justice that render the remedy inoperative in many respects. Cyprus following UK's lead, benefits from the common law regime in terms of placing the individual shareholder in the unique position of defending the company's rights, when the company itself is incapable of doing so. However, along with this benefit, Cyprus adopts the tendency of English courts to provide disincentives to prospective plaintiffs. The UK Law Commission itself admits the courts' discouraging attitude, stating that this restrictive policy does not favor at all minority shareholders.[102]

Although, someone might argue that the fact that English common law regime was proven to be defective, does not automatically entail that it is not workable under the legal system of another jurisdiction. But, it cannot be regarded as a coincidence that many common law jurisdictions have admitted that the common law rules on derivative claims are characterised by doctrinal confusion, being unwieldy with the expectations of shareholders, who look for accessible and flexible means of legal and economic redress.[103] This admission on the problematic nature of this remedial model is confirmed by many Commonwealth jurisdictions. The United Kingdom, New Zealand, Australia, Canada, Singapore, South Africa, have successfully abolished common law rules, placing the remedy on a statutory footing in order to confront the deficiencies of

[102] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69,99

[103] Deirdre Ahern, 'Directors' duties: broadening the focus beyond content to examine the accountability spectrum' (2011) 33 Dublin University Law Journal 116, 123

the previous regime.[104] Hence, providing a procedural and functional analysis of the English and Cypriot law, the study will confirm that the Cypriot remedy is dysfunctional, as its genesis and synthesis heavily relies on the English judicial preference for non-interference with the corporate policy-making. To put it differently, the reluctance of English courts to give permission for the initiation of derivative litigation, is reflected upon the rules themselves, making the remedy unapproachable to minority shareholders. The strictness and confusion encapsulated within the English common law regulation constituted the main reason for the abolition of the regime and the introduction of a statutory derivative action in the above jurisdictions.[105]

Even though, the English common law derivative framework had been criticised for its complexity, lack of clarity and vagueness, even before the codification of the English remedy, the number of derivative suits brought before the English courts was much greater than the Cypriot cases. Except from the *Pyrillis v Kouis* and the *Thoma v Eliadis* cases which approved and applied the '*fraud on minority*' exception, there are no Cypriot reported cases, in which the judges have applied the procedural restrictions of the English common law. As it will be explained in Chapter 3, Cypriot courts have not practically applied all of the English common law procedural criteria in these two successful cases.[106] For instance the good faith criterion and the views of disinterested members had not been considered by the Cypriot judges in these two reported cases.[107] This is an important observation and it might imply that the derivative action, as an accountability mechanism has been forgotten in Cyprus. The absence of litigation could

[104] Sh Goo,' Multiple Derivative Action and Common Law Derivative Action Revisited: A Tale of Two Jurisdictions' (2010) 10 Journal of Corporate Law Studies 255, 261.
[105] Law Commission, Company Law: Reform and Restatement (NZLC R9, 1989) (New Zealand) [564], [568]; Law Commission, Shareholder Remedies (Law Com No 246, 1998) (United Kingdom) para 6.4; Arad Reisberg, (n 102)
[106] (2006) 1 CLR 1263 (Civil Appeal No.11784, 24/11/2006); (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[107] Ibid.

be considered as twofold. On the one side, it can be assumed that a Cypriot shareholder, in the sight of all these strict conditions might had not even attempted to bring proceedings. On the other side, it can be said that, the ambiguity of applicable case law challenges the judicial task in respect of the interpretation that the Cypriot judges would provide for conditions that are not properly weighted. The ambiguity in the interpretation of the English case law might be one of the reasons that the Cypriot courts have ignored the consideration of some procedural requirements in allowing the claims to proceed in *Kouis* and *Pyrillis* cases. In other words, the complexity of these conditions creates a number of difficult questions for Cypriot judges that still remain unanswered by the English common law.

The paper, examining relevant Cypriot case law, argues that some aspects of the strict English common law rules on derivative claims are flexibly interpreted by Cypriot courts. Although, the study further argues that the flexible interpretations of some procedural criteria by the Cypriot courts, cannot guarantee the effectiveness of the remedy in future cases. As the doctrinally problematic English common law regime disappointingly performed in the English system, it is likely that the Cypriot system would experience the same disappointment, especially, if we take account the absence of litigation in Cyprus. As the common law regime was rightly abolished in England and other common law countries, the paper argues that Cyprus should act accordingly, in an attempt to review and remove the current problems encountered with the Cypriot derivative action. A statutory derivative action presents a fresh opportunity for Cypriot shareholders and the courts to appraise the value of the remedy from a new perspective, which would emphasize on managerial accountability.[108] Thereafter, in the absence of

[108] Anil Hargovan, 'Under Judicial and Legislative Attack: The Rule in Foss v. Harbottle' (1996) 113 S. African L.J. 631, 639, 640.

recent changes in the Cypriot legal framework the paper proposes the reform of the common law derivative action.

1.4.2 In need of a reform of the derivative action in Cyprus: The absence of alternative methods of minority shareholder protection

The paper argues that the need for a reform of the Cypriot derivative action emanates from the absence of effective alternative methods of shareholder protection. Arguing that the Cypriot derivative action, in its current form is problematic in protecting the interests of shareholders, the paper assesses whether the Cypriot oppression remedy can guarantee the preservation of those interests. The paper further argues that this alternative remedial device is also quite dysfunctional, strengthening the paper's thesis that there is a need for adequate minority protection in Cyprus in the form of the suggested remedial model that will be presented in Chapter 4.

The Cypriot oppression remedy is widely influenced by English law. In *Re Pelmako Development Ltd*[109] the Supreme Court of Cyprus stated that section 202 of the Companies Law, Cap. 113, complies with the UK section 210 of the Companies Act 1948. The rule in both sections offers the minority shareholders a way out of the company when the company's affairs are conducted in a manner that amounts to an oppression of some parts of the members.[110] The term 'oppression' has been criticized in English case law. Particularly, Lord Simonds in *SCWS Ltd V Meyer*[111], held that the term was very narrowly construed, covering only concepts of wrongful conduct on the part of the majority, leaving matters of unfairness and actual illegality outside the sphere of the remedy. Considering the criticism that the oppression remedy received in

[109] Re Pelmako Development Ltd [1991] 1 CLR 246.
[110] s 202 of Companies Laws Cap 133; s 210 of Companies Act 1948
[111] Scottish Co-operative Wholesale Society Ltd v Meyer [1959] AC 324.

England, it is likely that this mechanism would not be adequate for Cypriot shareholders too. Since 1985, England has abolished the oppression remedy and introduced a new remedial model, which today falls within the section 996 of CA 2006. This is the remedy on unfair prejudice.[112] This statutory provision encourages the courts to provide a more flexible interpretation, awarding a remedy to aggrieved members, where the unfairly prejudicial conduct of the company involves breaches of fiduciary duties. A large number of English cases reveal that the unfair prejudice remedy constitutes a valuable mechanism, capable of affording effective shareholder protection and substituting the need of individual shareholders to resort to a derivative action.[113] For instance, in *Barrett*, the court did not allow the litigation to proceed, not only on the basis of the personal interest of the litigant in the action, but also on the basis of the availability of an unfair prejudice remedy on the part of the litigant, which was key factor that contributed to the judges' decision to bar the initiation of the derivative claim.[114]

The paper, providing a comparative analysis of Cypriot and English law, argues that the Cypriot oppression remedy cannot deliver the benefits that the English unfair prejudice remedy delivers to minority shareholders. The English unfair prejudice remedy was proven to be a much more readily available tool in the hands of minority shareholders than the previous English oppression remedy.[115] In contrast to the English remedy on unfair prejudice, Cypriot law allows courts to make an order to wind up the company, only when *'some part'* of the members have been treated in an oppressive

[112] s.996 of the UK Companies Act 2006
[113] Arab Reisberg 'Shareholders' Remedies: In Search of Consistency of Principle in English Law' (2005) 5 EBLR 1063
[114] [1995] 1 BCLC 243
[115] Brenda Hannigan, 'Drawing Boundaries between Derivative Claims and Unfairly Prejudicial Petitions' [2009] Journal of Business Law 606, 617

way.[116] It is interesting to look at the wording of this provision, as the phrase 'some part' of the members reveals that the petitioner has to show discrimination. This means that a case of a breach of director's duties would not fall within the ambit of the provision, as such a breach would affect all the shareholders and not only some of them.[117] Considering that Cypriot courts interpret section 202 in such a manner, it is apparent that minority members would remain unprotected and particularly vulnerable in cases of directors awarding themselves excessive remunerations or mismanaging the company to the minority's detriment. This discrimination requirement is no longer in place in England, after inserting the words 'of its members generally' that can be found in s994 of CA 2006.[118] The problematic wording and interpretation of the Cypriot oppression remedy, is extensively discussed with reference to relevant case law, in order to show that the remedy cannot stand as a viable alternative for minority shareholders, when the derivative action would not be available to them. The study explains that the Cypriot oppression remedy cannot effectively protect the interests of minority shareholders from wrongs that the derivative action is intended to protect. So, in the absence of viable alternatives within the Cypriot company law, it argues that the reform of the derivative action seems to be necessary in order to improve at least to some extent the level of shareholder protection in Cyprus.

1.4.3 Proposal for the introduction of a statutory derivative action in Cypriot company law

Examining the imperfections of Cypriot law and the necessity for a reform, the thesis advances a proposal for the abolition of the common law derivative action in Cyprus and its replacement with a codified remedy, which will be integrated within the

[116] s 202 of Companies Laws Cap 133, s 210 of Companies Act 1948
[117] Alan Dignam & John Lowry, *Company Law*, 10th edition (Oxford University Press, 2014) page 215
[118] s 994 of Companies Act 2006

Cyprus Companies Laws Cap 133. This proposal is structured upon the comparative analysis of the English and German law on derivative claims.

1.4.3A Jurisdictional Focus and Legal Comparison

English corporate law has influenced Cyprus for many decades and this is apparent not only in the adoption of English legal precedents, such as the common law on derivative actions, but also in the Cyprus Companies Law (Chapter 113 of the Laws of Cyprus), which is substantially formulated upon the UK's former Companies Act 1948. In an effort to overcome the procedural hurdles of the common law, the UK Companies Act 2006 introduced a statutory derivative action. The creation of the new remedy was prompted by the recognition that an active shareholder role was an absolute necessity, if directors' duties were to be dealt with integrity and responsibility.[119] The UK's legislative updates are of interest in the paper's objective to examine the reformed English law and evaluate whether Cyprus could possibly adopt a similarly updated approach. Taking into account the reformed English law and the cultural and legal affiliations between Cyprus and England, it can be said that England constitutes a qualified candidate for legal comparison.

In contrast with the old English common law, the new derivative action under Part 11 of the Companies Act 2006, abolishes the wrongdoer control restriction and sets aside the fraud on the minority exception. This is apparent in the interpretation of section 260(3), which provides that a claim can be brought "*in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company*".[120] This is a significant

[119] Deirdre Ahern, 'Directors' duties: broadening the focus beyond content to examine the accountability spectrum'(2011) 33 Dublin University Law Journal 116, 128
[120] s 260(3) of the UK Companies Act 2006

change, as it extends the sphere of liability regarding the illegal activities of directors and increases the possibilities for a successful claim on the part of minority shareholders, even in occasions of a simple presumption of negligence.[121] Even though, the wrongdoer control requirement has been removed under the statutory remedy, the Act outlines several factors that the court would take into account in exercising its discretion to grand permission for the continuation of the claim. Specifically, sections 262(3), 263(3) and 263(4) will be examined in great detail, as they place procedural hurdles that individual shareholders need to overcome in order to ensure that their claim would be successful.[122] A number of cases, which came before the courts after the codification of the Act, will be discussed to demonstrate that the strict application of these conditions does not significantly differ from the language and formulation of the old common law.[123] For instance, in *Mission Capital plc v Sinclair*[124], the discretionary factor of section 263(3)(b), which displays that the importance that a person acting in accordance with s172 (the duty to promote the success of the company) would attach to continuing the claim, was a decisive factor that led the court to the denial of permission. Also, court considerations on s263(3)(e), led to the conclusion that an action was unnecessary, as the claimants could resort to other remedial means, such as the unfair prejudice petition of s994 of the UK Companies Act 2006. Similarly, other cases, where the decision of the court was of the same nature, like *Franbar Holdings*[125], *Stimpson v Southern Landlords*[126], *Iesini*[127] will be examined to show the uncertainty that surrounds the Act in relation to the discretionary factors of s 263(3) and decrease

[121] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) pages 159-160
[122] Ibid, 143-146.
[123] Edwin C. Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) 33(4) Company Lawyer 99,106.
[124] Mission Capital plc v Sinclair and another [2008] EWHC 1339 (Ch)
[125] Franbar Holdings v Patel and others [2008] EWHC 1534 (Ch)
[126] Stimpson v Southern Private Landlords Association [2010] BCC 387
[127] Iesini v Westrip Holdings [2009] EWHC 2526 (Ch)

the possibilities of a successful claim due to these strict conditions that have to be met by the plaintiff.

Considering these procedural barriers within the Act, it can be said that the statutory derivative action does not intend to make it materially easier for minority shareholders to bring a claim.[128] However, it definitely intends to provide more clarity, through the criteria established in sections 262 and 263, than what the previous common law has ever provided.[129] Hence, the paper argues that the English statutory remedy should definitely be taken into consideration by Cypriot legislators, if amendments to the common law regime tend to put the remedy on a statutory footing. Also, each country's company governance system is a product of its history, philosophy, culture and economics.[130] In the United Kingdom, the prevailing model is based on the "nexus of contracts" theory, according to which the company is understood as a purely private affair founded on the notion of shareholder primacy. In other words, the company as a collection of private contractual relationships amongst its members, is free from social responsibilities and operates under none or minimal regulatory interference by the state, while at the very center of its operations lie the interests of the shareholders.[131] The contractual theory can be found in the UK doctrine in *Foss v Harbottle*, which accepts that the majority decision of the shareholders to sue on behalf of the company is the one that represents the will of company.[132] As it was explained above, Cypriot common law has adopted the proper plaintiff rule and so it seems reasonable to argue that Cypriot company law is mainly influenced by the contractarian corporate governance model.

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[128] Arad Reisberg, 'Shadows of the Past and Back to the Future: Part 11 of the UK Companies Act 2006 (in)action' (2009) 6 ECFLR 219, 225

[129] Andrew Keay Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 Journal of Business Law 151, 177

[130] Janet Dine, Marios Koutsias, *Company Law*, 8th edition (Palgrave Macmillan, 2014) page 20

[131] Ibid, pages 21-22

[132] Janet Dine, *The Governance of Corporate Groups* (OUP 2000) page 7

Nonetheless, it would be unreasonable to assume that a legal transplant from England would be able to remedy all the problems of Cypriot law. For that reason, the paper will examine the German derivative action too. The nexus of contracts theory conflicts with the corporate governance model prevailing in Germany, which is known as the concession theory. According to this theory, the company does not operate exclusively for the benefit of its members, but the institutional structure of the company reflects the interests of stakeholders too. In other words, this communitarian approach to corporate governance, reflects the idea that the company should not serve only its commercial interests, but it should also serve wider social purposes, such as the interests of employees, creditors and the society in general.[133] As it will be explained in Chapter 2, both German and English law on derivative claims, are drafted in a way that reflects the distinctive corporate governance models that preside in each of the examined jurisdictions. Germany offers an alternative corporate governance model directly opposing that of the UK. Therefore, taking into account the mixed nature of the Cypriot legal system[134], it is suggested that the proposed remedy should be formed in both sides of the European corporate governance spectrum. Considering the pre-eminence of Germany as a major European economic power and its formative influence on the growth of the EU corporate law[135], it can be assumed that it constitutes a valuable example for a Cypriot company law reform. Even though, the origins of Cypriot law are deeply rooted within the English legal system, the accession of Cyprus into the European Union, in 2004, resulted in Cypriot law gradually moving towards the direction of Continental civil law tradition, without by no means discarding the English

[133] Ibid, page 56.
[134] Nikitas E. Hatzimihail, 'Cyprus as a Mixed Legal System' (2013) 6 J. Civ. L. Stud. 38; N. Hatzimihail, 'On Law, Legal Elites and the Legal Profession in a (Biggish) Small State: Cyprus', in P. Butler and C. Morrris (eds.), Small States in a Legal World (Springer, 2017) page 213
[135] Peter Muchlinski, 'The Development of German Corporate Law Until 1990: A Historical Reappraisal' (2013) 14(2) German Law Journal 339, 341

element.[136] There is no doubt that the Europeanisation of the island created economic incentives, which have a positive impact on the competitiveness of the country's economy, triggering direct foreign investment.[137] Especially now, that the UK exited from the European Union, in January 2020, Cyprus has a chance to move even closer to the civil law element and make legislative reforms, which will further secure and enhance its economic relationship with the EU. Hence, it would not be surprising, if reforms on Cypriot company law would be partly inspired by a civil law jurisdiction, such as Germany, a powerful trading partner for most of the EU countries, whose corporate law guides the development of the European market.[138]

In contrast to the Cypriot law, both the English and Germany are at a more progressive stage in derivative litigation, provide for high degree of flexibility and legal certainty and present similarities in their derivative proceedings. For instance, both jurisdictions have adopted a system of judicial control that includes a preliminary stage at which the court needs to approve the continuation of the derivative claim by the plaintiff.[139] However, the two examined remedies provide for different levels of access to the remedial mechanism.[140] For example, under the German corporate law and specifically under AktG, s148 individual shareholders are able to apply to the court for admission of the derivative action only if they have acquired their shares no later than they knew or ought to have known about the alleged wrongdoing.[141] In contrast with this criterion, s261 of CA 2006 does not impose a requirement on the applicant

[136] Symeon C. Symeonides, (n 15) 441
[137] Angelos Sepos, *The Europeanization of Cyprus: Polity, Policies and Politics* (Palgrave Macmillan, 2008) page 53,54
[138] Janet Dine, Marios Koutsias. *The Nature of Corporate Governance: The Significance of National Cultural Identity* (Edward Elgar Publishing, 2013) page 239-312
[139] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 106.
[140] Ibid, 107.
[141] AktG, § 148(1), second sentence, no 1.

shareholder regarding the time of the acquisition of shares. The absence of such a criterion offers a degree of flexibility to English courts and possibly a clearer incentive on minority shareholders to initiate a derivative claim. However, examining s263(3)(a), it can be assumed that the wide discretion of English judges may allow them to consider this German criterion in the interpretation of this section. In detail, the factor of s 263(3)(a) of CA 2006 states that the court when exercising its discretion to grant permission should take into account whether the plaintiff is acting in good faith.[142] Therefore, this English provision does not clearly incorporate the German criterion regarding the time of the acquisition of the shares, but it can be argued that this requirement might fall within the "good faith" concept that English judges examine in order to allow the claim to proceed.[143] Considering the wide discretion of the English courts to define and examine the circumstances under which a claim would be allowed, it could be said that the English approach on the derivative action procedure is more flexible than the German one.

Nonetheless, the paper, examining the variable interpretations provided by English judges in post-Act 2006 cases, argues that the interpretation of the English procedural requirements creates more uncertainty rather than flexibility. On a similar basis, following the examination of the German provisions, the paper argues that the legal certainty that rests upon the German approach, on the one hand tends to provide a clear view of the requirements that minority shareholders needs to meet in order to have a chance of success, but on the other hand limits the range of applicants and the range of conditions that could give rise to the bringing of desirable claims.[144]

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[142] s 263(3)(a) of the UK Companies Act 2006

[143]Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 107

[144] Ibid, 113

Hence, the paper examining the English and German statutory provisions on a comparative basis, argues that both statutory remedies provide for more disincentives rather than incentives to prospective claimant-shareholders. It should be noted, though, that these disincentives are present in different aspects of the English and German derivative proceedings. Thereafter, the rationale behind the examination of German and English law, lies on the notion that the implementation of the law in both jurisdictions leads to a different level of protection for minority shareholders and the benefits that each jurisdiction offers could be selectively used for the adoption of a workable remedial model in Cyprus, which would be able to defend the interests of minority shareholders in cases of managerial misconduct.

It is remarkable to mention, though, that the lack of shareholder litigation in both England and Germany raises issues of complexity regarding the bringing of an action. Recent investigations have shown that the claims brought before the English courts were only twenty-six(26) between 2004 and 2006, in which the directors were considered as defendants[145], while Germany falls behind with only two derivative suits brought between 2000 and 2007.[146] Nevertheless, the introduction of a statutory remedy in both England and Germany could be seen as an attempt of both jurisdictions to address in clearer terms the difficulties regarding the private enforcement of directors' duties. The benefit that both jurisdictions confer to minority shareholders by giving consideration to a statutory remedy relates to the transparency provided by the statutes regarding the initiation of derivative proceedings. This is an important function in itself, despite the fact that many claims in England and Germany have not practically

[145] John Armour, Bernard Black, Brian Cheffins & Richard Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 J. EMPIRICAL LEGAL STUD. 687,699.
[146] Martin Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 Brook. J. Int'l L. 843, 848-849

materialised. From that perspective, it is difficult to predict that a statutory derivative action would increase the level of derivative litigation in Cyprus, where the number of derivative suits is quite low too. However, what can be assumed is that a reformed model can address some of the obstacles that the common law remedy underpins in order to inculcate in Cypriot boards the perception that accountability and transparency in decision-making matter immensely and their absence should be deterred, when it leads to mismanagement.

The thesis's proposal purports to introduce a new legal framework in Cyprus that will provide efficient safeguards against malicious shareholder interference, will boost the bringing of meritorious claims and will restrict the unmeritorious ones. Principally, the reform seeks to remove the '*fraud on the minority*' and '*wrongdoer control*' requirements and replace them with specific provisions regarding the detailed legal procedure that the plaintiff shareholder needs to follow in order to initiate a derivative claim on the company's behalf. These recommendations will rest on the examination of what is described as a two-stage court process within both the English and German statutory remedy. As English and German derivative law set out certain disclosure requirements for the discontinuance of vexatious derivative proceedings, similarly the proposed remedy will try to remove the ambiguity of the common law and to determine clearly through express statutory requirements whether the plaintiff shareholder acts in the corporate interest in bringing a claim.

Except from provisions relating to the filtering of frivolous shareholder practices, the proposed reform will have regard to provisions that will provide adequate shareholder incentives for bringing a derivative claim. Particularly, these incentives will concern provisions regarding the access of minority shareholders to corporate

information and their engagement to litigation costs.[147] In many EU jurisdictions, like England and Germany, the plaintiff shareholders are exposed to considerable risks, as the court is capable of making a cost order against them, if the claim fails.[148] But, even if the claim is successful, the benefit of the claim is dispensed to the company as a whole, and not to the shareholder, who brought the claim.[149] As a result, damages are payable to the company as a separate legal entity, while the economic benefit for minority shareholders, if their claim is successful, depends solely on the value of their shareholding.[150] Derivative suits seem to fall within the ambit of free-riding, as it is difficult to see what kind of incentives would encourage individual shareholders to bear a private cost for the benefit of all the other members.[151] It appears that, every single shareholder would wait for the other to bring the action, as no one would be willing to carry the burden of litigation costs, when the possibilities for adequate reimbursement are significantly low.[152] Lastly, for a derivative claim to be brought successfully, corporate information should be effectively disseminated to shareholders. In most European countries the number of derivative suits is disappointingly limited.[153] This is not only due to the costs of legal proceedings, but also to the difficulty to access corporate information to sustain a derivative claim.[154] So, the paper will examine both

[147] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) pages 232-236
[148] James D. Cox, Randall S. Thomas, 'Common Challenges Facing Shareholder Suits in Europe and the United States' (2009) 6 ECFLR 348
[149] Jean du Plessis, B. Großfeld, C. Luttermann, I. Saenger, O. Sandrock, M. Casper, *German Corporate Governance in International and European Context*, 3rd edition (Springer, 2017) page 70
[150] Ibid.
[151] Dario Latella, Shareholder Derivative Suits: A Comparative Analysis and the Implications of the European Shareholders' Rights Directive (2009) 6 ECFLR 307, 320
[152] Kristoffel Grechenig and Michael Sekyra, No Derivative Shareholder Suits in Europe – A Model of Percentage Limits, Collusion and Residual Owners (2007) The Center for Law and Economic Studies Columbia University School of Law, Working Paper No. 312, http://papers.ssrn.com/paper.taf?abstract_id=933105 (accessed 01/03/2020)
[153] Pavlos E. Masouros, 'Is the EU Taking Shareholder Rights Seriously?: An Essay on the Impotence of Shareholdership in Corporate Europe' (2010) 7(5) European Company Law 195, 201
[154] Arab Reisberg, *Derivative Actions and Corporate Governance (*Oxford University Press, 2008) page 217

the cost allocation and mandatory disclosure schemes under German and English law, in order to assess whether their approaches are shareholder-friendly for Cyprus to adhere to.

1.4.3B The conceptual framework of the thesis: A Platonian approach to derivative litigation

On the basis of the comparative analysis of the English and German law, the paper argues that both jurisdictions entail problems, which render the two statutory remedies difficult for minority shareholders to access. Undoubtedly, though, both remedies contain common and civil law elements, which Cypriot legislators should definitely take into account in the light of a reformed derivative action in Cyprus. The question that the paper is called to answer, is which criteria from the examined jurisdictions, should be integrated to the reform proposals for the introduction of a more effective derivative action in Cyprus.

This question cannot be answered without the development of a new conceptual framework that will assist the task of Cypriot legislators to distinguish the legal elements that would promote the effectiveness and accessibility of a reformed remedy from these elements that move towards the opposite direction. The paper introduces a theoretical framework that aims to determine the key factor upon which the rules on derivative claims should be formed. The paper, uses Plato's allegory of the cave, to develop its conceptual framework. This theoretical approach, which the thesis introduced as a Platonian Remedial Model (PRM), is consisted of two main pillars. The first pillar describes the problem and the second pillar provides useful insights to the solution. In particular, the first part of the allegorical analysis, describes how the company underperforms, when wrong has been perpetrated against it and shows the problems that minority shareholders face, when the derivative action is inaccessible to

them. The second part describes how minority shareholders could deal with the aforementioned problem. Specifically, the allegorical analysis aims to show that the term "accessibility" should be the key consideration for legislators in order to introduce an effective remedial scheme that could increase the levels of minority shareholder protection. Applying this theoretical approach to the Cypriot reality, the study, firstly, argues that Cypriot legislators should select the English and German criteria that will form the new statutory derivative action in Cyprus, on the basis of whether these English and German rules are accessible outright within the English and German derivative proceedings. Secondly, they should also incorporate within the new Cypriot remedy, the English and German rules, as they should have been formulated, so as to render the English and German statutory remedies more accessible to minority shareholders. Thirdly, the thesis argues that the PRM model can be of help to the reform of the Cypriot oppression remedy, broadening the scope of effective methods of minority shareholder protection that Cyprus Companies Laws Cap 133 have to offer. All in all, this allegorical analysis, has a practical purpose, which is the identification of problems in shareholder protection and measures the legislature should take to solve the latter, within the context of the Cypriot company law.

In addition to the proposals for the reform of the Cypriot derivative action, the study includes some complementary recommendations to increase minority shareholder protection in Cyprus. These additional recommendations relate to the English unfair prejudice remedy and the valuable insights that it has to offer to Cypriot law. There is no doubt that the English unfair prejudice remedy carries its own weaknesses. For instance, uncertainty surrounds the circumstances under which the payment of

excessive remuneration would give rise to a successful unfair prejudice petition.[155] This uncertainty is attributed to the fact that unfair prejudice petitions invariably involve many interrelated claims, that challenge the judicial task to determine the importance attached to the individual allegations of unfairly prejudicial conduct.[156] However, given the large number of successful petitions brought under s994[157], it would be unfair to argue against the usefulness of the English remedy, as a mechanism of minority shareholder protection. Chapter 5 argues that it can provide valuable lessons to the problematic Cypriot oppression remedy. Even though, this study does not intend to introduce a detailed regulatory framework on the reform of the oppression remedy in Cyprus, it suggests that the replacement of the Cypriot oppression remedy with an unfair prejudice remedy - as this is enacted in the English provision of s994-996 of the UK Companies Act 2006 - can be a useful addition to the agenda of the legislative changes that Cypriot legislators should be concerned with, in order to increase the levels of minority shareholder protection in Cyprus.

1.5 Statement of Methodology

This research aims to make the Cypriot derivative action an effective mechanism of shareholder protection. To achieve this objective, the thesis adopts a comparative qualitative research methodology. Legal comparisons offer valuable insights to the evaluation of national laws, allowing the researcher to conduct profound and critical analysis.[158] For the purposes of this study, comparative law enables the researcher to address the weaknesses of the Cypriot company law and to demonstrate whether and

[155] R. Goddard, 'Excessive Remuneration and the Unfair Prejudice Remedy' (2009) 13 Edinburgh Law Review 517
[156] Ibid.
[157] D. Cabrelli, 'Derivative Actions: Part of the Minority Shareholder's "Forensic Arsenal" in Scotland' (2003) 9 Scots Law Times 73, 75
[158] Peter De Cruz, *Comparative Law in a Changing World*, (3rd edn, Cavendish-Routledge 2007), page 22.

how other jurisdictions, including the United Kingdom and Germany address issues of minority shareholder protection better than the Cypriot law does.

1.5.1 Research Methodologies

The approach followed by this study in comparing laws and formulating reform proposals is based on the doctrinal, comparative and case study research methodologies. Firstly, the study is based on the doctrinal or as it is called "black letter" law methodology, which aims to describe a body of law and how it applies.[159]Particularly, it focuses on the law itself as a self-sustained set of principles that can be examined through the access to statutes and case law.[160] By using this doctrinal approach, the study provides a proper evaluation of the law on derivative claims in the selected jurisdictions, calling the Cypriot legislator to reconsider the unsatisfactory aspects of the existing legal framework in Cypriot company law. The extensive examination of the statutory regulations on derivative claims, under the English and German approach, aligns with the thesis's argument that a reform of the Cypriot derivative action should rely on transparent rules, which would be able to remove the ambiguity of the common law and to induce Cypriot boards to conduct corporate affairs in a manner that would not promote self-interest. Secondly, this study adopts a comparative research methodology, to assert that some of the approaches undertaken by Cypriot law on derivative litigation are unsatisfactory from certain points of view and should be reformed. Additionally, comparative law, as a research methodology provides examples of better law on derivative claims, illustrating how the German and English law on derivative claims address problems of shareholder protection that have not been

[159] Mike McConville, Wing Hong Chui, *Research Methods for Law*, 2nd edition (Edinburgh University Press, 2017), page 21.
[160] Ibid, page 2.

considered by the existing Cypriot legal framework.[161] However, there is no reasonable expectation that the insights offered by the comparative examination of the German and English legislation, would create a legal transplant that the Cypriot jurisdiction would incorporate within its legal order, as an identical rule, without any modifications. This is based on the perception that the transposition of a legal rule from one legal system to the another can be successfully made.[162] Essentially, what comparative considerations aim at, is the synthesis of a Cypriot regulatory framework on derivative claims that would combine common and civil law elements, so that the proposed framework could be compatible with the mixed legal nature of the Cypriot jurisdiction and comply with the objective of effective shareholder protection, that Cypriot law lacks. Thirdly, the study deploys a qualitative case study methodology, since research arguments are based on the availability and clarity of relevant case law on derivative claims.

1.5.2 Research Methods and Tools

A common feature amongst studies on comparative law is that there is no single method of comparative legal research.[163] Nevertheless, a core principle in comparative methodology, is the element of "tentium comparationis", which means a point of reference to which the studied subjects are compared.[164] The functional method of legal comparison, identifies such a point of reference in a factual situation that is in need of a legal solution. In other words, this method of legal comparison explores how the law addresses factual problems. So, the analysis in this study selects and compares rules on the basis of the functions they perform in the context of minority shareholder protection.

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[161] Rudolf B Schlessinger, Hans W Baade, Mirjan R Damaska and Peter E Herzog, *Comparative Law, Cases-Text-Materials*, 5th edition (Foundation Press 1988) page 6.
[162] Frederique Dahan and Janet Dine, 'Transplantation for transition - discussion on a concept around Russian reform of the law on reorganisation' (2003) 23 Legal Stud. 284, 308-309
[163] Peter De Cruz, *Comparative Law in a Changing World*, 3rd edition (Cavendish-Routledge 2007) pages 231-232.
[164] M Bogdan, *Comparative Law* (Kluwer, 1994) page 60.

For example, the study examines how a shareholder can enforce a breach of directors' duties, on what grounds the shareholder can initiate a derivative claim and what criteria needs to fulfill to enjoy legal standing under the laws of the selected jurisdictions. Also, this functional method of comparison appears in the conceptual framework of the thesis. Principles that they differ in substance and wording, may be functional equivalents in the sense that they provide a similar solution to a given problem.[165] Additionally, many problems are contingent on the solutions to other problems.[166] On that basis, the thesis compares a corporate governance problem of minority shareholder protection with a political problem and the protection of the citizens' interests in the democratic Athenian society, as this is described in Plato's Republic. Essentially, the thesis deploys the most famous of Plato's similes, providing a functional analysis, that compares a problematic corporate structure with a problematic political structure in order to propose a legal avenue, that would be functionally equivalent to the solution that Plato implied through his allegorical analysis.

This study, examining a variety of primary and secondary sources such as, relevant case law, English, German and Cypriot legislation, existing literature and academic commentary, journal articles, online articles, books, law reports, parliamentary reports and other online sources, explores the shortcomings of the Cypriot derivative action and proposes a reform of its defective derivative regime. Even though, the research is not substantially based on statistical information, it refers to statistical evidence, so as to show that the practical use of the remedy in the jurisdictions examined is quite low. Finally, except from the examination of these three jurisdictions, the paper refers to the

[165] HC Gutteridge, *Comparative Law, An Introduction to the Comparative Method of Legal Study & Research* (CUP, 1946) page 7.
[166] Walter Goldschmidt, *Comparative Functionalism: An Essay in Anthropological Theory* (University of California Press, 1966) pages 30, 106.

statutory provisions and relevant case law of other common law jurisdictions that serve the objectives of this study.

1.10 Structure of the thesis

The arguments of this research which have been discussed in this chapter (Chapter 1) are addressed throughout the whole thesis as follows.

Chapter 2(two) provides a comparative analysis of the German and English statutory derivative actions. It examines the benefits and the deficiencies of both the English and German law and argues that both remedies are inaccessible to minority shareholders in different aspects of their derivative proceedings. The comparative considerations on both statutory remedies, are deployed in Chapter 5 to explain which common and civil law elements from the English and German approaches on derivative litigation can inspire the creation of a new remedial model in Cyprus.

Chapter 3(three) identifies the shortcomings of the Cypriot derivative action that emanate from English common law. This Chapter argues that the ambiguity of the English common law features in Cypriot law too, rendering the Cypriot remedy problematic in many respects. Furthermore, the Chapter addresses the problems of the Cypriot oppression remedy, by providing a comparative analysis of Cypriot and English law. Reviewing the dysfunctional nature of the Cypriot oppression remedy, the chapter argues that Cypriot company law is devoid of effective alternative methods of shareholder protection. So, it argues that, in the absence of viable alternative mechanisms of shareholder protection, the introduction of a statutory derivative action, seems to be a necessary legal change for Cyprus.

Chapter 4(four) provides the conceptual framework of the thesis. It conceptualizes the functions of the derivative action, its objectives and how the remedy can address

problems of management control over the corporate structure through an allegorical analysis that is based on the famous simile of Plato's allegory of the cave. The allegorical analysis highlights the problems that shareholders face when the rules on derivative claims are inaccessible to them and introduces a new approach to the way that derivative actions should be formed in order to provide adequate shareholder protection in cases of mismanagement. This approach, named as the Platonian Remedial Model (PRM), focuses on the accessibility that shareholders should have to the rules on derivative proceedings, so that the remedy can assume its effectiveness in disciplining bad corporate governance practices.

Chapter 5(five) applies the conceptual framework developed in Chapter 4 and formulates reform proposals for the introduction of a statutory derivative action in Cyprus. The Chapter applies the Platonian Remedial Model (PRM) to the Cypriot law, in order to effectively assess which elements of the English and German statutory derivative actions could positively contribute to the introduction of a more accessible derivative action within Cypriot company law. The Chapter argues that the proposed reforms can improve the level of shareholder protection in Cypriot companies. The Chapter also, introduces additional strategies to improve minority shareholder protection. Particularly, it recommends amendments to alternative methods of shareholder protection, namely the Cypriot oppression remedy. It argues that an amended oppression remedy that would be inspired by the English law on unfair prejudice remedy could strengthen minority shareholder in Cyprus. The Chapter argues that these supplementary legal changes are welcomed, but they cannot assert the accessibility and effectiveness that derivative action intends for the protection of the company and its members as a whole. The Chapter concludes that priority should be given to the reform of the common law derivative action in Cyprus.

Chapter six is the thesis conclusion. It includes a summary of the research arguments, an outline of the proposal for the Cypriot reform, the thesis contributions to knowledge and some recommendations for future research.

Chapter 2

The English and German Derivative Claim: A comparative analysis

2.1 Introduction

Shareholder-initiated litigation on behalf of the company is a highly complicated issue that has been repeatedly criticised by academics and scholars for being a rare phenomenon in both common and civil law jurisdictions. The paucity of derivative actions is ascribed to the inability of the law to strike a fine balance between the accessibility to the remedy and its abuse.[167] The Chapter is concerned with the question of whether the statutory remedies in the English and German law have achieved the balancing of the aforementioned competing goals.

The Chapter undertakes an analytical review of the statutory derivative actions in England and Germany. The comparative study of the English and German law serves two main objectives. Firstly, it aims to analyse the relevant law, considering its construction and function, in order to bring to the surface problems on shareholder's accessibility to the remedy. This aim would be achieved by examining on a comparative basis the rules on cause of action, legal standing, cost allocation procedure and admissibility of the derivative claims. Secondly, this Chapter, will examine the features that would formulate the reform proposals for the introduction of an effective regulatory product in Cypriot company law, as it will be explained thoroughly in Chapter 5. The

[167] Martin Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 Brook. J. Int'l L. 843.

Chapter considers whether the statutory remedies in England and Germany create a favourable litigation environment and whether they have achieved to strike the optimum balance between the principle of majority rule and non-interference of minorities with decision-making on one hand, and appropriate investor protection against abusive corporate practices on the other. Specifically, the Chapter examines which features enhance the operation of the remedy and which features prevent the remedy from being an effective corporate governance mechanism. Through the comparative analysis of the German and English law, the Chapter argues that both jurisdictions have failed to a great extent to make the remedy accessible to minority shareholders. The Chapter concludes that accessibility to flexible legal provisions is the keystone for the creation of an effective derivative action.

2.2 The origins of the derivative action: The English common law regime

For almost two centuries the derivative action, was the '*chief regulator of corporate governance'*[168] which protected the interests of shareholders, by removing the deadlock of '*the proper plaintiff principle'*, which was established in the well-known English case of *Foss v Harbottle*[169]. According to this legal doctrine, only the corporation, as a separate legal entity can sue to enforce its legal rights, when those have been infringed. The origins of this principle are rooted in English common law. The principle of majority rule is integral to the operation of the company and its decision-making process. It also, constitutes the main hurdle for oppressed minorities to bring an action on behalf of the company.[170] This is because, majority shareholders

[168] Cohen v Beneficial Industrial Corp 337 US 541 (1949), at 548
[169] Foss v Harbottle [1843] 67 ER 189
[170] Dario Latella, 'The Shareholder Derivative Suits: Disfunction and Remedies Against a Paradox Inactivity' (2010) 7 Corporate Ownership & Control Journal 297.

can stop the company from suing the management at the general meeting. This is especially the case if the majority is either part of the management or linked to it. The importance of the majority rule is underlined in a number of English cases followed by *Foss*, such as in *MacDougall v Gardiner*[171] and *Gray v Lewis*[172], where Mellish LJ and Sir W.M. James LJ respectively, emphasized the advantage of the rule in preventing frivolous litigation.

The main concern that emerges out of the *Foss* rule is that the majority shareholders can influence the litigation process, determining whether an action should be pursued, even if they themselves are involved in corporate wrongdoing.[173] During the nineteenth century English courts raised concerns relating to the unfairness that the *Foss* rule might had created in the commencement of meritorious claims by minority shareholders. Jenkins LJ in *Edwards v Halliwell*[174] considered four circumstances under which this rule would not be applicable, enabling an individual shareholder to sue on behalf of the company. These are known in common law parlance as exceptions to the *Foss* rule, which under special circumstances can confound the *proper plaintiff rule.*[175] Specifically, the operation of the *proper plaintiff* rule is suspended, when the alleged wrong is ultra vires the corporation, because the majority cannot ratify the transaction, when the complaining act requires sanctioning of a special majority and such an approval has not been obtained, when a member's personal rights have been infringed and when fraud has been perpetrated against the company and wrongdoers are in control.[176] However, the practical reality of a number of cases coming before the

[171] Macdougall v Gardiner [1875] 1 Ch D 13
[172] Gray v Lewis [1872-73] 8 Ch. App. 1035 at 1049–1051
[173] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 167
[174] Edwards v Halliwell [1950] 2 All ER 1064
[175] K. W. Wedderburn, 'Shareholders' Rights and the Rule in Foss v. Harbottle' (1957) 15 C.L.J. 194, 208
[176] [1950] 2 All ER 1064

English courts validated that the fourth exception, known as the '*fraud on the minority'* exception constitutes the only situation, under which an individual shareholder can bring a derivative claim.[177] This rule can be found in a number of commonwealth jurisdictions with Cyprus being one of them, as it will be extensively discussed in Chapter 3.

2.3 The derivative action under English and German Corporate Law: The challenges of the law impacting shareholder's access to the statutory remedies

The derivative actions commonly appear in the form of statutory remedies, in many common and civil law systems with the aim of deterring mismanagement and protecting the interests of the shareholders.[178] However, the dead letter law of many jurisdictions restricts the ability of the minority shareholder to initiate such an action.[179] This could happen in two ways, which can appear in tandem. Firstly, the statutory rules might not provide for appropriate incentives for minority shareholders to recover the losses that the company and themselves suffered as a result of the wrongdoing.[180] Secondly, the legislation might be over-restrictive in attempting to safeguard the company from unwarranted lawsuits.[181] Viewing these factors either independently or integrally linked to each other, it is clear that the law could end up being ineffective for the minority shareholders.[182] For that reason, it is crucial that the minority shareholders are strongly

[177] B. A. K. Rider, 'Amiable Lunatics and the Rule in Foss v. Harbottle'(1978) 37 Cambridge Law Journal 270, 273
[178] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 82-83
[179] Ibid.
[180] Ibid.
[181] Ibid.
[182] Ibid.

incentivised to bring a derivative claim, as their personal benefit of the awarded damages is only a small part of the company's overall value recovery, which in many instances might be less than the litigation costs.[183] On the other hand, it is necessary that the law restricts the arrogant individuals from engaging in lawsuits, that are vexatious in nature.[184] The question remains for the law-makers on how the law should be formed to provide for a cost-effective remedy that would restrict the right to litigate to arrogant members and will incentivize the honest ones. The Chapter discusses whether and to what extent the statutory schemes in the English and German law have achieved to balance these two opposing forces. Furthermore, it examines the statutory provisions of each jurisdiction, emphasizing on whether the procedural rules provided in each jurisdiction are accessible to minority shareholders or whether they are too narrow to worth the nuisance of applying them in cases of mismanagement.

2.3. A1 The derivative action in the UK Companies Act 2006

As it was briefly explained in Chapter 1 and it will be extensively discussed in Chapter 3, before the enactment of Chapter 1, Part 11 of the Companies Act 2006, which came into force in 1 October 2007, a derivative action in England was raised under common law. The common law remedy has given its place to a statutory procedure, which can be found in sections 260-264 of CA 2006. The provisions in Part 11, do not seek to completely alter the substantive rule in *Foss v Harbottle*, but they seek to build upon the principles that the courts have established the last 150years.[185] This view aligns with the aspiration of the UK Law Commission on the rationalization

[183] Ibid.
[184] Ibid.
[185] See David Kershaw, 'The rule in Foss v Harbottle is dead: long live the rule in Foss v Harbottle' (2015) 3 Journal of Business Law 274.

and modernization of the remedy through its reform.[186] Particularly, the Commission provided recommendations for the introduction of a flexible, accessible and modern statutory scheme, which would clearly determine the circumstances under which a shareholder could bring a derivative claim.[187] The recommendations were calling for a speedy, fair and cost-effective mechanism that would serve as a means of redressing corporate wrong and monitoring those running the company in certain occasions, without unreasonably interfering with company's daily operations.[188] Nevertheless, the Law Commission clarified that the law should prioritise the establishment of efficient safeguards to protect the management from unnecessary claims of challenging shareholders.[189] The approach of the Commission to suggest the reform of the law that would primarily prevent undesirable claims, and subsequently would favour the management, was based on the idea that the derivative action is an exceptional remedy, arising as a last resort solution[190], which is subject to strict judicial control before it leads to successful recovery for the plaintiff and the company.[191]

The statutory provisions of the English remedy are examined below to demonstrate to what extent the Act has achieved to make the remedy accessible to shareholders and prevent unmeritorious litigation, where interference with the good faith commercial judgment of directors is unnecessary. It should be noted that the sections of the UK Companies Act 2006 under discussion, are also applicable to Northern Ireland and separate but comparable, provisions apply for the derivative suits in Scotland. For the purposes of demonstrating the inaccessibility of the remedy, the Chapter, except from analysis of English cases, will employ some relevant Scottish case law, as the

[186] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 6.12- 6.13.
[187] Ibid.
[188] Ibid.
[189] Ibid.
[190] Hansard, HL, Vol.679 (Official Report) cols GC4-5 (Lord Goldsmith) (February 27, 2006)
[191] Law Commission, Shareholder Remedies: Report, 1997, at para.6.4.

interpretations provided by the judges coincide with the views of the English courts on the criteria that are taken into consideration for granting permission to continue with a derivative claim. Also, it is worth mentioning that the UK is one of the last common law jurisdictions that have enacted a statutory scheme for derivative actions. Before the UK reform, other Commonwealth countries such as Canada, Australia and New Zealand have replaced their common law remedy with a statutory derivative litigation process. Even though, the thesis does not intend to provide an extensive comparative analysis of the law on these common law countries, some comments on the provisions on the aforementioned jurisdictions will be made, to highlight the deficiencies of the English statutory remedy.

2.3. A2 Locus standi: Extending the range of actions

The statutory derivative action can be brought only in respect of a cause of action that is vested in the company.[192] Section 260(3) determines the types of breaches of duty under which a derivative claim may be initiated. A derivative claim could be brought ‘‘only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company’’[193]. This means that, any alleged breach of any of the general duties of directors in Chapter 2 of Part 10 of the Act, including the duty to exercise reasonable care, skill and diligence could give rise to the bringing of a derivative claim. So, any occasion of a director’s breach of his duty of care and skill, regardless of whether the breach could be ratified, can give rise to an application for permission to start a derivative action. As it will be explained in Chapter 3, the previous common law benefited the wrongdoer, as negligence claims were not covered under the equitable

[192] s. 260(1) of the UK Companies Act 2006
[193] s. 260(3) of the UK Companies Act 2006

regime, unless negligence resulted from bad faith or was self-serving.[194] Therefore, it can be argued that the new statutory remedy, avoiding the complex distinctions of the common law "fraud on minority" exception, potentially permits a wider range of actions.[195] For instance, an environmental group holding shares in the company could bring a derivative claim, arguing that the directors are in breach of their duty to take into consideration the impact of their actions in the environment under s 172(1)(d).[196] Hence, the new provision is considered to be a liberal approach, capable of assuming more easily corporate accountability and promoting the interests of the shareholders.

However, some could allege, that such liberalization in the range of actions could increase the fear of directors, willing to undertake directorship tasks.[197] For example, the phrase "proposed act or omission" included in the provision, it implies that extra legal actions might give rise to a derivative claim, actions that have not come before the English courts yet.[198] This phrase exposes the directors to the risk of being liable for potential future acts or omissions that have not been recognised by the law itself and the courts, as actions capable of giving rise to a derivative claim. However, it has been argued that the broadening of the cause of action, would not necessarily open the floodgates of derivative litigation and might not even provide great assistance to the minority shareholders.[199] The reason that this provision might not confer to the minority shareholders the benefit that it seems to confer, lies on the fact that negligence acts often

[194] Pavlides v Jensen [1965] Ch 565; Daniels v Daniels [1978] Ch 406.
[195] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 48
[196] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 343.
[197] Lee Roach, 'An equitable solution for non-executive directors' (2006) 17 International Company and Commercial Law Review 117, 119
[198] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 344.
[199] Hansard HL Vol 679, Official Report, 27/2/06, col GC4–5

concern an allegation of the director's judgement and the English judges, traditionally are quite reluctant to doubt the commercial judgment of the management.[200] As explained in Chapter 1, such reluctance is reflective of the English corporate governance model, which renders outside intervention into corporate decision making an undesirable practice, allowing shareholders to enjoy absolute supremacy in the corporate structure.[201] Under this contractarian approach that presides in the UK, judicial intervention amounts to an imposition of implied terms in the contractual relationship between the company and the shareholders, to redress the imperfections that arise in the enforcement of directors' duties, when the interests of the latter and that of the shareholders are not perfectly aligned.[202]

Moreover, compared with the legislation of other common law jurisdictions, the English provision is still not going as far as it seems. The Canadian, New Zealand and Australian provisions have no limit to the range of actions under which a derivative action can be brought.[203] In the aforementioned jurisdictions, an action that occurs and it is independent of the actions of the directors can also be subject to a derivative claim. The English scheme, provides for derivative claims only as a result of directors' actions.[204] It seems unlikely that an action under the English scheme, which is not dependant on a director's breach of duty would be easily pursued, unless it is an action against third parties, where the loss suffered by the company arose from an act involving a breach of duty.[205] Obviously, the English approach is more restrictive than the other commonwealth approaches, but there is no doubt that it complies with the

[200] Ibid.
[201] Janet Dine, Marios Koutsias, *Company Law*, 8th edition (Palgrave Macmillan, 2014) pages 21-22
[202] Janet Dine, *The Governance of Corporate Groups* (OUP 2000) page 10
[203] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 48
[204] S260(3) of CA 2006
[205] Ibid.

recommendations of the UK Law Commission to introduce a remedy that is more accessible to minority shareholders.

2.3. A3 Range of Applicants: Who is allowed to bring a derivative claim?

The English statutory scheme allows standing to bring a derivative claim only to the members of the company. Once again, this approach is reflective of English corporate governance model, which considers the shareholders as the only insiders of the company[206], who enjoy the right to legal standing. In this regard, the word "members" covers any person who is not a member, but to whom shares in the company have been transferred or transmitted by the operation of the law.[207] For example, the right to bring a derivative claim is conferred to a non-member, who could be acting as a trustee for another member or being a personal representative of a deceased member. Also, s260(4) provides that a derivative claim may be initiated by a member as a result of a wrong committed before his registration, as a member of the company.[208] This statutory provision is not an innovation in respect of bringing derivative claims, as the same position was historically present in the previous English common law remedy.[209] As Lord Goldsmith explained, it is immaterial at which point the claimant became a member.[210] This approach reflects the idea that the right to sue is that of the company.[211] The provision clarifies that the acquisition of shares by a person, comes along with all the benefits and the losses that the shareholding carries with it.[212] In other words, it is likely that the incoming shareholders would benefit from the successful management

[206] Janet Dine, Marios Koutsias, *Company Law*, 8th edition (Palgrave Macmillan, 2014) pages 21
[207] S 260(5)(c) of CA 2006
[208] S 260(4) of CA 2006
[209] Seaton v. Grant (1867) LR 2 Ch App 459, Birch v. Sullivan [1957] 1 WLR 1247
[210] Hansard, HL, Vol.679 Official Report, 27/2/2006; col. GC15
[211] Hansard, HL, Vol.679 Official Report, 27/2/2006; col. GC13.
[212] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 346-347

decisions and at the same time they might suffer loss in the value of their shareholding from director's previous wrongs or omissions. So, once those who seek to engage in litigation are members of the company at the time that the derivative proceedings commence, then, they are principally allowed to do so.

Once again, other common law jurisdictions are more flexible in the relation to those who are allowed to bring a derivative claim. For example, Australia and New Zealand legislation allow also former members and directors to bring derivative claims.[213] Also, the Canadian jurisdiction is even more flexible allowing members, certain creditors, directors, and "any other person who, in the discretion of a court, is a proper person to make an application."[214] Extending the range of applicants to a variety of corporate groups, increases the possibilities of the company's interests to be protected, as sometimes abusive actions might be more easily observed in other corporate groups, such as the employees, while they will remain unnoticed by members who do not have sufficient access to relevant information to reveal them.[215] However, even in jurisdictions with a broader range of applicants, evidence shows that the vast majority of derivative claims is brought by current members, while applications by other corporate groups are not frequently initiated.[216] This seems reasonable as, for instance, former shareholders might be acting in their own interests that could be motivated by personal abhorrence, family feuds or other ulterior motives. As a result, it would be inappropriate to authorize a former member to represent the company in order to redress a corporate wrong suffered by the company, when that person is not

[213] s.165 of the New Zealand Companies Act 1993; s 236 of the Australian Corporations Act 2001
[214] s.238 of the Canada Business Corporations Act 1985
[215] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 46
[216] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 347

connected with the company in respect of his shareholding entitlement and he will not receive any monetary benefit, as a consequence of his successful action.[217] Thus, it seems unreasonable for a member to sell his shares and then seek to bring such a claim. For instance, in Canada, the applications by former members were rejected by the court on the basis that the applicants had no sufficient interest to engage in derivative litigation.[218] It is true that there might be instances where, the former members may have been compelled to sell their shares and leave the company in the light of a potential commercial dispute, which occasionally could justify their interest in the bringing a derivative claim.[219] However, these occasions are rare and are subject to tight judicial scrutiny.

In essence, it can be argued that the English approach is not deprived from any considerable benefit that the other common law jurisdictions are enjoying. Even if these additional classes of applicants have a legitimate right to bring an action, the lack of interest in the daily corporate affairs suffice to justify the decision of the court to reject an application made by a non-member. In this regard, it does not seem unwise for the English jurisdiction to allow claims made only by members, especially, if we consider that the broadening of the range of applicants can lead to an opening of litigation floodgates.

2.3. A4 The first stage of application for permission: The prima facie requirement

A minority shareholder, who seeks to bring a derivative claim, must apply to the court for permission to continue with such a claim. The granting of permission by the

[217] Ibid.
[218] Jacobs Farms Ltd v. Jacobs (1992) OJ No 813 (Ont Gen Div)
[219] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 347

court is included in the two-stage procedure of sections 261-264 of the UK Companies Act 2006. At the first stage of the permission process, the applicant needs to prove that he has a prima facie case for bringing the derivative claim.[220] If the court is satisfied that a prima facie case on the merits exists, then permission to proceed to the second stage of the process will be granted. This first stage usually involves a hearing regarding the papers filed at court by the claimant shareholder.[221] The court considers the case, based on the evidence filed and decides whether permission should be granted or refused. If the court rejects the application at this stage the plaintiff can request a review by way of an oral hearing.[222] This stage of the statutory process ensures that frivolous claims, are quickly rejected, as incapable of withstanding this initial judicial scrutiny.[223] However, the first problem that the claimant faces in this stage, relates to the information that he needs to present to the court. It seems difficult for the claimant to provide such evidence without discovery, as the legislation does not require the defendant to be involved in this initial permission stage.[224] Also, the plaintiff shareholder can access the company's documents only if the company or the directors authorize them to do so.[225] In this regard, it seems likely that the controlling members could block the access of the minority shareholder to sensitive information that would be harmful for their reputation and can bring them to the defendant's position against the company.[226] Essentially, if the plaintiff shareholder has no access to relevant

[220] s.261(2) of the UK Companies Act 2006
[221] r.19.9A(4)(a) Civil Procedure Rules 1998
[222] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 154.
[223] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 350
[224] Ibid.
[225] Arab Reisberg, 'Shadows of the Past and Back to the Future: Part 11 of the UK Companies Act 2006 (in)action' (2009) 6 ECFLR 219, 235
[226] Randall S Thomas, 'Improving Shareholder Monitoring of Corporate Management by Expanding Statutory Access to Information' (1998) 38 Ariz L Rev 331, 332; Arab Reisberg, *Derivative Actions and Corporate Governance*: *Theory and Operation* (Oxford University Press, 2007) chs 3 and 5

information in order to demonstrate that his case is strong enough to be heard, the first stage of the statutory remedy can turn into a very time-consuming and costly process, especially when plaintiff needs to get permission from the court to start the investigation into the company's documents.[227] Thereafter, this initial stage can be considered as an accessible one, if the shareholder has better access to relevant information rights, so that the first stage of the statutory process can be easily dealt with. However, the significance of information rights in bringing a derivative claim will be discussed in greater detail below.

However, information asymmetries is not the only difficulty that the shareholder needs to overcome at this first stage of the statutory process. The prima facie requirement remains an ambiguous aspect of the remedy, that has its roots in the previous common law. The ambiguities of the common law in relation to this requirement will be explained in Chapter 3. This Chapter examines the interpretation of the prima facie requirement in the post-Act 2006 cases. The post-Act 2006 case law, does not seem to provide clarity, as to what exactly the plaintiff shareholder needs to prove in order to gain permission to proceed in the second stage.

In the Scottish case of *Wishart*[228], the court held that the establishment of a prima facie case is not based on whether the evidence filed demonstrate such a case, but whether there is no prima facie case for granting permission. This means that the applicant should not be concerned with the task of satisfying the court that his case is a strong one to the extent that it is considered a prima facie case. But, the question is for the court to refuse or accept the application to proceed, based on whether the matters

[227] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 94-96
[228] Wishart v Castlecroft Securities Ltd. [2009] CSIH 65

that the court specifies and considers demonstrate a prima facie case. These matters relate to the whether the applicant is a member of the company, whether the application relates to derivative proceedings, and whether that the application clearly states the cause of action and facts upon which the derivative claim is based.[229] Also, the court in *Wishart,* held that the factors of s.268(1)(2) and (3) should also be considered in order to determine whether the permission should be granted.[230] These provisions normally should be considered at the second stage of the permission process and are equivalent to s.263(2) and (3) of the UK Act 2006. Even though, this view was expressed by a Scottish court, it was also supported by English courts in the case *Stimpson v Southern Landlords Association*[231], where Judge Pelling Q.C. held that the factors in s.263(2),(3) and (4), being equivalent to s.268(1),(2) and (3) in the Scottish provisions, in determining whether the plaintiff has a prima facie case.[232] These factors will be extensively discussed below, as they form part of the second stage of the statutory procedure. The legislation in UK and Northern Ireland and Scotland does not require the courts to consider the second stage factors, in order to be satisfied that the applicant has a prima facie case.[233] In other words, there is nothing in the legislation linking s261 of the first stage with s263 of the second stage. So, the interpretation given by the judges regarding the integration of s263 into the first stage process, as a necessary consideration for the establishment of the prima facie case, places the applicant shareholder before a substantial hearing, that goes beyond what the legislation has envisaged.

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[229] [2009] CSIH 65; 2009 S.L.T. 812 at [31].
[230] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 155.
[231] Stimpson v Southern Landlords Association [2009] EWHC 2072 (Ch).
[232] [2009] EWHC 2072 (Ch) at [46].
[233] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 156

However, the judges in other cases do not seem to abide by the interpretations provided in *Wishart* and *Stimpson*, adopting a more liberal approach. For example, in *Franbar Holding Ltd v Patel*[234], the court conflated the two-stage threshold into one, and the parties automatically moved to the second stage of the process, as the defendant conceded that there was a prima facie case, with William Trower Q.C. stating that the applicant had not sought to establish a prima facie case for permission to continue the proceedings.[235] This seems to be a sensible practice in particular cases[236], where the parties and the court are in an agreement of bypassing this initial stage. However, this practice was severely criticised by the court in *Re Seven Holdings, Langely, Ward Ltd v Trevor*[237]. Particularly, it was stated that if the first stage of the process is ignored, this can increase the cost and time of litigation, regarding cases that eventually are met to fail in the second stage and their inability to proceed was not detected at the earlier stage. A strict view was expressed by Lewison J in Iesini v Westrip Holdings[238]. The judge explained that the determination of the prima facie case should be based on the previous common law principle established in *Prudential Assurance Co Ltd v Newman Industries*, where the court ruled that the prima facie case could be established if the claimant shows that the company has a good cause of action, which arises as a result of the director's breach of duty.[239] It can be argued that the strict approach in *Iesini*, does not show the intention of English courts to significantly deviate from the previous common law approach on derivative claims. Hence, the ambiguity of the prima facie requirement, the conflicting interpretations provided in post-Act case law and the

[234] Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch)
[235] [2008] EWHC 1534 (Ch); [2008] B.C.C. 885 at [24]
[236] Franbar Holdings Ltd v Patel [2008] EWHC 1534 (Ch); Mission Capital v Sinclair [2008] EWHC 1339 (Ch)
[237] Re Seven Holdings, Langely, Ward Ltd v Trevor [2011] EWHC 1893 (Ch) at [6]-[7]
[238] Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch)
[239] [2009] EWHC 2526 (Ch) at [78]-[79].

information asymmetries create concerns as to whether the first stage of the English statutory procedure facilitates access to the remedy for the minority shareholders.

2.3. A5 The second stage of application for permission: strict barriers and additional criteria

Once the prima facie threshold is met, the applicant is allowed to move to the second stage of the screening process. At this stage the court may give directions as to the evidence to be obtained and may adjourn the proceedings to ensure that the evidence will be collected and presented before the courts.[240] At this stage the court must decide whether the bringing of derivative claim should be permitted to proceed. The legislation sets out a number of factors that the court should take into account in order to decide upon the refusal or permission of the claim. Particularly, s263(2) provides an absolute bar to derivative claims, requiring the court to refuse permission, if the case falls within any of the conditions that s263(2)(a-c) prescribes. According to this section the court must refuse permission, if it is satisfied that a person acting in accordance with the general duty of directors to promote the success of the company (s172 of CA 2006) would not seek to continue the claim or if the act or omission that give rise to the bringing of the derivative claim has been authorized in advance or ratified by the company.[241] If the case does not fall within one of these conditions, the court still needs to exercise its discretion to grant permission pursuant to a range of the factors set out in s263(3) and (4) and s264. So, the absolute barriers of s 263(2) are supplemented by a list of factors in s263(3) and (4) and s264 that the court should consider in order to grant permission. Specifically, the court in exercising its discretion to grant or refuse permission takes into account the good faith of the plaintiff shareholder, the importance

[240] s.262(3) and (4) of the UK Companies Act 2006
[241] s.263(2) (a-c) of the UK Companies Act 2006

that a director acting in accordance with section 172 would attach to continue the claim, whether the proposed action is likely to be authorised or whether the alleged breach is likely to be ratified, whether the company has chosen not to pursue the claim; whether the member has an alternative personal remedy; and the views of the disinterested members on the derivative litigation.[242] It is questionable whether the consideration of all these factors make the remedy materially more accessible to minority shareholders. In this regard, it is important to examine the uncertainty that each criterion entails and how it is interpreted by the English judges in the post-Act 2006 case law. This analysis will demonstrate whether English rules governing derivative claims are accessible to minority shareholders or discourage their intention to engage in derivative litigation, when the wrongdoing has no other way of being redressed.

The UK Companies Act 2006 sets out a significant duty of the director to act in what he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole.[243] The English statutory derivative action refers to this duty in two sections. Firstly, s 263(2)(a) provides that the court should refuse permission to continue with the derivative action, if it is satisfied a person acting in accordance with this duty would not seek to pursue such an action.[244] Secondly, the same consideration is presented slightly different in the list of factors of s263(3)(b), where the court should take into account the importance that a director, who acts in accordance with s172, would attach to the continuation of the claim, in order to grant permission.[245]

[242] s.263(3), (4); s.264 of the UK Companies Act 2006
[243] s.172 of the UK CA 2006
[244] s.263(2)(a) of the UK CA 2006
[245] s.263(3)(b) of the UK CA 2006

The double appearance of this particular factor in the second stage of the statutory procedure implies that even if the claimant manages to bypass the barrier of s263(2), his application might encounter several difficulties when the court will consider the factor of s263(3)(b).[246] This particular factor both in the form of the barrier and as an additional consideration for the court to allow the initiation of the derivative proceedings, raises a number of problems. One of the problems lies in the implementation of this factor, as the meaning of s.172 has been the subject of controversial commentary from scholars, academics and practitioners.[247] The duty of s172 states that the directors should promote the success of the company for the benefit of its members as a whole and, in doing so, they should also have regard to the factors listed in section 172(1) (a)–(f).[248] This is a non-exhaustive list, that concerns issues of responsible corporate behaviour, such as the consideration of the interests of employees and creditors, the effect of the company's functioning on the community and the environment.[249] In other words, this section highlights the duty of directors to exercise their good faith judgement in order to engage in effective business strategies and subsequently to promote the company's interests. This means that the English judges need to place themselves in the position of a director and decide whether a hypothetical director that seeks to promote the success of the company, would have decided in relation to allowance or refusal of a derivative claim. However, the legislation provides

[246] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 158

[247] Andrew Keay, 'Enlightened Shareholder Value, the Reform of the Duties of Company Directors and the Corporate Objective' [2006] L.M.C.L.Q. 335; Sarah Kiarie, 'At crossroads: shareholder value, stakeholder value and enlightened shareholder value: which road should the United Kingdom take?' (2006) 17 (11) ICCLR 329; D. Fisher, 'The enlightened shareholder leaving stakeholders in the dark: will section 172(1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?' [2009] I.C.C.L.R.10; A. Alcock, 'An accidental change to directors' duties?' (2009) 30 Company Lawyer 362.

[248] s.172 of the UK CA 2006

[249] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 354.

no clarity as to whether the court should follow a subjective or objective approach on that matter. There is a considerable debate as to whether the court should consider what the particular board of directors would have done or what an objective director would have decided on the matter.[250] There is little academic commentary on whether this test is of an objective or subjective nature.[251] Hannigan states that that the test is a subjective one[252], while Reisberg supports the view of Lord Goldsmith that the interpretation of this section is coupled with a mixture of both objective and factual assessments by the court.[253] These views appear to be in agreement that the assessment of this test focuses on the actual company in question and not to a hypothetical corporate structure.[254] Clearly, the use of a pure objective test would lead to an assessment of standards that would be applicable to all companies, disregarding the individual needs of the company in question. On the other hand, a strictly subjective approach, would focus on the views of the actual board; a practice that falls outside the scope of the section, which is concerned with the issue of whether a notional director would continue the claim and not with the issue of what the actual board would have done.[255] Academic literature does not clarify whether we can talk about a test that combines both subjective and objective elements. Keay and Loughrey agree that the test is objective in assessing the interests of the company, but they also state that the court should consider specific factors related to the actual company in question.[256] Obviously, it cannot be said that this requirement provides clear incentives for the minority shareholders to fill in an

[250] David Gibbs, 'Has the statutory derivative claim fulfilled its objectives? The hypothetical director and CSR: Part 2' (2011) 32(3) Comp. Law. 76, 77
[251] Ibid.
[252] Brenda Hannigan, *Company Law*, 2nd edition (OUP, 2009), page 456.
[253] Arab Reisberg, *Derivative Actions and Corporate Governance*, (2007) p.156; Hansard HL Vol 679, Official Report, 27/2/2006, col GC26
[254] David Gibbs, 'Has the statutory derivative claim fulfilled its objectives? The hypothetical director and CSR: Part 2' (2011) 32(3) Comp. Law. 76, 78
[255] Mission Capital Plc v Sinclair [2008] EWHC 1339 (Ch); [2008] B.C.C. 866 Floyd J. at [38]
[256] Andrew Keay and Joan Loughrey, 'Something old, something new, something borrowed: an analysis of the new derivative action under the Companies Act 2006' [2008] L.Q.R. 469, 492

application, as it is uncertain how far and on what basis the considerations of the court are likely to be developed in order to permit the claim to proceed.

The interpretation of this requirement in relevant case law demonstrates the reluctance of the judges to interfere with the internal management of the company and their intention to repeal their discretion in certain occasions.[257] For example, Lewison J in *Iesini*, considering the issue of whether a hypothetical director acting in accordance with section 172 would continue the claim, stated that "the weighing of all of these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case."[258] However, there is no indication as to what amounts to a clear case.[259] If the English judges adopt the reluctant approach presented in *Iesini* and decide to refrain from assessing the commercial decisions of directors pursuant to s263(2)(a) and s263(3)(b), the applications for the bringing of derivative claims by the minority shareholders might become redundant, as they will be rejected in most instances. However, the court in *Franbar Holdings* stated that it is unlikely that a case would come before the judges, where the bringing of the derivative claim would be so unmeritorious that no reasonable director acting in accordance with s172 would seek to approve it.[260] Although, the consideration of this factor in *Iesini* and *Stimpson* resulted in the refusal of permission by the court.[261] Also, the view of Newey J in *Kleanthous v Pathitis*[262] is an interesting one, as the judge sough to rely on the views of the two directors of the company in order to assess whether the bringing of the derivative claim

[257] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 354.
[258] [2009] EWHC 2526 (Ch) at [85].
[259] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 161
[260] [2008] EWHC 1534 (Ch); [2008] B.C.C. 885.
[261] Iesini [2009] EWHC 2526 (Ch) at [102]; Stimpson [2009] EWHC 2072 (Ch).
[262] Kleanthous v Paphitis & Ors | [2011] EWHC 2287 (Ch)

was in the commercial interests of the company.[263] However, the plaintiff shareholder argued that the directors were not independent enough, as they were involved in the company's affairs and one of them was closely connected with the respondent.[264] So, on the one hand the interpretation of this factor in relevant case law suggest that the judges are not willing to engage in the actual assessment of business considerations. On the other hand, the statutory process itself, inevitably requires the judge to examine the directors' decisions in order to decide whether the initiation of derivative proceedings is in the company's commercial interests.[265] Therefore, the above analysis demonstrates that the test is undoubtedly uncertain. Nonetheless, it can be argued that the statutory scheme gives wide discretion to the court to decide whether it will adopt a flexible or a restrictive approach on how this particular factor should be interpreted in order to grant permission.

Another factor that the court takes into account in granting leave to proceed with the derivative claim relates to the concept of ratification. This concept is relevant in two occasions. Firstly, the concept appears as a barrier to the refusal of leave by the court under s.263(2)(b) and (c) which, specifically, provides that a court must refuse permission if the act or omission, subject to derivative claim, has been authorized or ratified by the company.[266] Also, the likelihood of the cause of action being ratified if it had not been ratified before the permission hearing is an additional consideration for the court in its decision to grant leave under s 263(3)(c).[267] The appearance of these provisions in the statutory procedure of the derivative action, imply that the wrongdoing

[263] [2011] EWHC 2287 (Ch) at [45]-[68].
[264] Ibid at [75].
[265] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 53-54
[266] s. 263(2)(b) and (c) of the UK CA 2006
[267] s.263(3)(c) of the UK CA 2006

could be authorized or ratified by the potential wrongdoers themselves.[268] These provisions bring to the surface two main problems that they are rooted in the previous common law rules on derivative claims. Firstly, the common law regime on derivative claims was filled with uncertainty as to what kind of wrongs could be ratified.[269] So, the uncertainty that surrounded this question still concerns the courts in the post-Act era. Secondly, the Act seems to reintroduce the previous common law requirement of wrongdoer control and what amounts to wrongdoer control of the general meeting.[270] This common law concept would inevitably be considered by the courts in order to determine whether the majority shareholders who can ratify the alleged wrong are independent or whether they are the wrongdoers themselves, and so the wrong would be unratifiable. These issues give rise to substantial difficulties which will be discussed in Chapter 3, as part of the English common law regime on derivative claims, which Cyprus has blindly adopted.

It should be noted though, that in the post-Act case law there is only one reference to the concept of ratification.[271] This is made in *Franbar Holdings*, where the court confirmed that the legislation has not altered the old common law position that certain wrongs are non-ratifiable.[272] The fact that only this case considered the concept of ratification implies that the English judges may wish to avoid the complexities of the common law on ratification and to get away from the difficult questions that concerned the courts before the enactment of CA 2006.

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[268] Official Report, 27/2/2006; col. GC24

[269] Christopher Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2013) 34 Legal Studies 582; K. Wedderburn, 'Shareholders Rights and the Rule in Foss v. Harbottle' [1958] C.L.J. 93, 105; J. Payne, 'A Re-Examination of Ratification' [1999] C.L.J. 604, 614

[270] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 355.

[271] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 162

[272] Franbar Holdings [2008] EWHC 1534 (Ch); [2008] B.C.C. 885 at [897].

Once again, the approach adopted by the English judges on the concept of ratification is stricter than other common law jurisdictions. For example, the Canadian legislation mentions that the fact that a wrong has been ratified will be considered by the court only on the basis of choosing what kind of remedial relief it should grant to the company.[273] Similarly, the Australian legislation includes a ratification provision, but specifies that a ratifiable wrong, would not prevent the claimant shareholder from commencing derivative proceedings.[274] Finally, the New Zealand legislation is presented as the most flexible of all, as it is does not contain any ratification provisions in the context of derivative claims.[275] Thus, in the light of this flexible approach adopted by other countries of the Commonwealth, it seems paradoxical that the UK Act itself introduces ratification, as a major barrier to the bringing of derivative claims, while it has failed to answer the substantial question of what kind of wrong is ratifiable.[276]

The good faith of the litigant shareholder in bringing the derivative claim, is an additional consideration for the court under s263(3)(a). The good faith requirement can be found in almost all jurisdictions where the derivative action has been placed on a statutory footing.[277] This requirement has its roots in the previous English common law and it has been criticised as to whether it should be an important consideration for the courts to take into account, if the case brought before them is itself a meritorious one. The previous English common law was raising questions of whether permission should be refused when the derivative claim is in the interests of the company, but the litigant

[273] s.242 of the Canada Business Corporations Act 1985.
[274] s.239(1) of the Australia Corporations Act 2001.
[275] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 52.
[276]Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 165.
[277] Arab Reisberg 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) E.C.F.R. 69, 101

also has collateral motives for bringing the claim.[278] The case law before the enactment of the UK Companies Act 2006, indicated that an ulterior motive could render the claimant an improper litigant and for that reason the court might not allow the claim to proceed.[279]

However, post-Act cases reveal that the ulterior motive of the litigant in bringing a derivative claim does not necessarily amount to lack of good faith. This means that the collateral motive of the applicant is not equivalent to the absence of good faith, if it is proven that the claim is brought for the benefit of the company.[280] For instance, in *Mission Capital v Sinclair*[281], the defendants argued that the plaintiffs brought the claim for the purpose of being awarded the benefit of the cost indemnity order.[282] Similarly, in *Iesini*, it was argued that the claim was brought for the benefit of third parties, who were funding the claim and would benefit from its successful outcome.[283] However, in both cases the court held that the good faith requirement was met, as the ulterior motives of the litigants were immaterial, since it was proven that the claim could benefit the company.[284] The same view was accepted by Lord Glennie in the Scottish case of *Wishart*, where he explained it seems unreasonable for a derivative claim, that benefits the company to be estopped, simply because the litigant has additional motives for bringing it.[285] Moreover, in *Franbar*, the defendants alleged lack of good faith on the basis that the claimant denied the offer made by the defendants for the purchase of his shares.[286] The court held that there was no evidence of bad faith in the decision of the

[278] J. Payne, "'Clean Hands' in Derivative Actions" (2002) 61 C.L.J. 76
[279] Barrett v Duckett [1995] 1 B.C.L.C. 243 CA (Civ Div).
[280] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 165.
[281] Mission Capital v Sinclair [2008] EWHC 1339 (Ch); [2008] B.C.C. 866.
[282] [2008] EWHC 1339 (Ch); [2008] B.C.C. 866 at [875].
[283] [2009] EWHC 2526 (Ch) at [114] and [120].
[284] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151, 166
[285] [2009] CSOH 20; 2009 S.L.T. 376 at [33].
[286] [2008] EWHC 1534; [2008] B.C.C. 885

applicant to reject the offer and to seek a fair return in the value of his shareholding through the bringing of a derivative claim.[287] The English judges consider s263(3)(a) in almost all post-Act cases, and the interpretation of the requirement usually favours the litigant, who can prove that the action benefits the company. The only exception arises in Stimpson, where the court found lack of good faith, as the claimant failed to show that the action was brought for the company's benefit.[288] It can be concluded that the interests of the company are closely connected with the satisfaction of the good faith requirement.[289] Thereafter, it seems that the interpretation of the good faith requirement by the court in the above cases is made in a flexible manner, which demonstrates that the English judges entrust the minority shareholder to properly enforce a derivative action that benefits the company, regardless of his collateral motives.

Furthermore, section 263(4) states that in considering whether to give permission the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter.[290] This consideration seems to replace the previous common law principle established in *Smith v Croft*, where it was held that the views of an independent majority of the minority shareholders could bar the bringing of a derivative action.[291] In *Smith*, the claim could be estopped regardless of whether an independent majority of the minority have a personal interest in the matter, while the wording of the Act seems to be stricter, dictating that the member should have no interest in the action.[292] The previous common law was criticised by the UK Law Commission as unclear, on the

[287] Ibid at [894].
[288] Stimpson v Southern Landlords Association [2009] EWHC 2072 (Ch).
[289] Edwin. C. Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) 33 Comp. Law. 99, 103
[290] s.263(4) of the UK CA 2006.
[291] Smith v Croft (No.3) (1987) 3 B.C.C. 218
[292] Edwin. C. Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) 33 Comp. Law. 99, 105.

basis that it had not provided clarifications as to the meaning of the "independent" members and how it can be determined by the court whether a member's view is independent.[293] The Act, raises a similar question, using different wording, as it remains unclear who are considered to be the "disinterested" members and how much weight should be given in their views by the court. Especially, it seems illogical for a member to be disinterested in the bringing of the derivative action, since the derivative action, by nature, is brought in respect of a wrong done against the company and provides redress for all members to the extent that the value of their shareholding has been affected by the wrongdoing.[294] In this regard, the interest of every member in the action is predetermined and as Lewison J confirmed in *Iesini*, it is difficult for the judges to understand how the provision should be interpreted.[295] The judge also stated the provision was directed to those members who were not involved in the alleged wrongdoing and who did not seek to benefit from the action in a way other than in their capacity as members of the company.[296] This seems to be a reasonable interpretation, but it still leaves the question of "independence" unanswered. In other words, there is nothing in the legislation stating how the courts would determine whether the members, by expressing their "independent" views on the bringing of the claim, benefit only to their capacity as members of the company and not to any other personal way.[297] Also, the interpretation of this section may bring further difficulties to the judges in case that they will have to decide whose view of a group of disinterested members will be prioritised, especially when these views are opposing.[298]

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[293] Law Commission, Shareholder Remedies: Report, 1997, at para.6.89.
[294] Edwin. C. Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) 33 Comp. Law. 99, 105.
[295] [2009] EWHC 2526 (Ch) at [86]
[296] Ibid at [129]
[297] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151,171.
[298] David Gibbs, 'Has the statutory derivative claim fulfilled its objectives? The hypothetical

In addition, it is of particular importance to have a look at the terminology of s263(4) compared with the wording provided in other criteria of s263(3). Firstly, it should be noted that s263(4) forms a separate provision and it is not included in the list of factors of s 263(3) that the court needs to take into account in deciding to grant leave. This observation raises questions in relation to whether the order and structure of the statutory provisions is intentional.[299] It is not clear whether the legislator intended to put the views of disinterested members in a separate section in order to give the impression that the consideration of this factor should be more or less influential to the decision of the court.[300] Finally, the wording of s263(4) is different from s263(3). S263(4) states that the court "shall have particular regard", while s263(3) states that the court "must take into account in particular". It is not clear, if these phrases carry equal weight. In either case, it is questionable how the uncertainty that surrounds them would help a respectable litigant to access the remedy. Even though, Lord Goldsmith was of the view that this factor would assist the task of the court in deciding whether permission should be granted[301], in *Stimpson*, where the facts of case justified the consideration of s263(4) by the court, the views of some members that were considered by the court, have made no practical difference to the court's opinion.[302]

Finally, the availability of alternative remedies, is another factor that the court should consider in order to grant permission. Particularly, s 263(3)(f) states that the court must consider whether there is an alternative cause of action which the member could pursue in his or her own right.[303] Conflicting views are expressed by the court in

director and CSR: Part 2' (2011) 32 Comp. Law. 76, 79

[299] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 352-353.

[300] Ibid.

[301] Official Report, 9/5/2006; col. 888

[302] [2009] EWHC 2072 (Ch) at [42]

[303] s.263(3)(f) of the UK CA 2006

post-Act 2006 cases, in respect of whether the availability of alternative remedial solutions for the claimant would lead to permission being rejected. For example, Proudman J. in *Kiani*[304] stated that the availability of the unfair prejudice remedy under s.996 should not block a member's access to derivative proceedings, a view that was also supported by Lord Reed in *Wishart,* who stated that the use of the unfair prejudice remedy provide an indirect way of attaining a monetary benefit that could be directly attained through the initiation of derivative proceedings.[305]. The above judicial findings show that the availability of an alternative remedy should not necessarily give rise to the refusal of permission by the court, but it can simply be treated as another factor for consideration by the judges. But the decisions in *Franbar*[306] and *Iesini*[307], revealed that the availability of an unfair prejudice remedy could be a compelling reason for the court to refuse permission. These oppositions in the interpretation of s263(3)(f), create uncertainty as to whether the provision is considered to be a comprehensive barrier or simply a factor to be taken into account for the granting permission to proceed with a derivative action. It seems that the answer lies on the court's discretion to interpret rigorously or flexibly the provision.

However, confusion seems to be also present in the way that the court exercises its discretion in deciding whether a claim falls within the boundaries of a derivative claim or an unfair prejudice petition. Recent case law shows that the derivative claim could overlap with s.994 petition for unfairly prejudicial conduct, as an alleged breach of directors' duties could, in many cases, give rise to an unfair prejudice petition as well as to a derivative action.[308] This overlapping has raised concerns as to whether the

[304] [2010] EWHC 577 (Ch), [2010] BCC 463
[305] Wishart [2010] B.C.C. 161 at [46]
[306] [2008] EWHC 1534 (Ch); [2008] B.C.C. 885 at [30].
[307] [2009] EWHC 2526 (Ch) at [86].
[308] B. Hannigan, 'Drawing boundaries between derivative claims and unfairly prejudicial petitions' [2009] J.B.L. 606

unfair prejudice petitions under s994 could supersede the derivative actions.[309] The Chapter does not aim to provide an extensive analysis of the UK unfair prejudice remedy, but the focus of the below analysis is on the interaction between the two remedies and, in particular on those aspects which may affect the viability of the derivative action in England.

In England, the unfair prejudice remedy and the derivative action are viewed as two remedial mechanisms, which are different in nature.[310] A petition under s994 grants the minority shareholder personal relief, while the bringing of a derivative claim purports to redress a wrong done to the company as a whole.[311] It is interesting though, that the UK Companies Act 2006 enhances the interrelationship of the two remedies. Specifically, section 996(2)(c) gives the court wide discretion to authorise the initiation of a derivative claim on behalf of the company by an individual shareholder, who has been unfairly prejudiced. [312] Also, a reference to the availability of a derivative action under section 996 is made in section 260(2)(b) of the Act, which provides that there is a possibility of a derivative action to be brought "*in pursuance of an order of the court in proceedings under section 994"*.[313] Clearly, these two sections reinforce the possibility of corporate relief granted under an unfair prejudice remedy. This approach adopted within the UK Act confirms the predictions of the Jenkins Committee, that the unfair prejudice remedy would have a role to play in relation to wrongs done to the company.[314]

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[309] J. Payne, 'Sections 459-461 Companies Act 1985 in Flux : The Future of Shareholder Protection' (2005) 64 CLJ 647, 676-677
[310] Arab Reisberg, 'Shareholder Remedies: In Search of Consistency of Principle in English Law' [2005] EBLR 1065, 1074
[311] Ibid.
[312] UK Companies Act 2006, s.996(2)(c)
[313] UK Companies Act 2006, s.260(2)(b)
[314] Report of the Company Law Committee (1962) Cmnd 1749, para. 206

Before the codification of the derivative action, the availability of unfair prejudice petitions in the vast majority of previously common law derivative claim cases was undoubtedly considered to be a blessing against the procedural complexities of the common law derivative claim.[315] The conventional position regarding the scope of the remedy was plainly given by the Millett J in the case of *Re Charnley Davies Ltd*[316]. Particularly, the judge explained that "The very same facts may well found either a derivative action or a s459 petition. But that should not disguise the fact that the nature of the complaint and the appropriate relief is different in the two cases."[317] This means that it is important to distinguish the scope of application of the two remedies by focusing on the real substance of the complaint[318], as an unfair prejudice petition cannot be brought in a situation where a wrong has been perpetrated against the company and has caused loss to the company as whole. Such a situation would call for a derivative claim and not for an unfair prejudice petition, which is entitled to give personal relief to the petitioner.

However, this position had been overshadowed by a few English cases, where the circumstances of the cases found grounds for the bringing of either a derivative claim or an unfair prejudice petition. The English judiciary had shown its willingness to apply s459 to redress wrongdoing related to breaches of directors' fiduciary duties. Indeed, the perception that the unfair prejudice remedy can redress wrongs that fall within the capacity of the common law derivative claim, appears in *Re Saul D Harrison*[319], where Hoffmann J stated that in appropriate circumstances the unfair prejudice remedy is capable of outflanking the proper plaintiff rule, as this is one of the purposes for which

[315] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L Rev 40, 53
[316] Re Charnley Davies Ltd (No 2) [1990] BCLC 760
[317] Re Charnley Davies Ltd [1990] B.C.C. 605 Ch D at [625].
[318] Re Charnley Davies [1990] B.C.L.C. 760 at [783]
[319] Re Saul D Harrison & Sons plc [1995] 1 BCLC 14, [1994] BCC 475

the remedy has been formulated.[320] Also, cases following the *Re Saul D Harrison*, where decided on the same basis, allowing the company to be reimbursed in the context of an unfair prejudice petition. In specific, the decisions in *Clark v Cutland*[321] and *Bhullar v Bhullar*[322] significantly changed the position provided by Millett J.[323] The courts in both cases took advantage of the phrase "such order as the court thinks fit" within s996, to exercise the widest possible discretion in granting relief not only for the petitioner, but for the company in general.[324]

Firstly, in *Clark v Cutland* the order sought and granted related to the repayment to the company of money appropriated by a director in breach of his fiduciary duty. The order for the repayment of the company's funds, which had been misappropriated by the director, fell within the ambit of the unfair prejudice remedy, but it was made for the benefit of the company.[325] So, as Arden LJ established, the court was willing to order the company to indemnify the petitioner for the costs incurred on that matter[326], treating the unfair prejudice petition as a derivative claim, where the costs of the proceedings usually burden the company and not the petitioner.[327] Similarly, in *Bhullar v Bhullar*[328], the acquisition of property by two directors conflicted with their duties to the company and the Court of Appeal made an order for corporate relief on the basis of an unfair prejudice petition. Consequently, the above cases extended the scope of the

[320] [1995] 1 B.C.L.C. 14
[321] Clark v Cutland [2003] EWCA Civ 810; [2004] 1 W.L.R. 783.
[322] Bhullar v Bhullar [2003] EWCA Civ 424; [2003] B.C.C. 711.
[323] Jennifer Payne, 'Shareholders' Remedies Reassessed' (2004) 67 M.L.R. 500
[324] Brenda Hannigan, 'Drawing boundaries between derivative claims and unfairly prejudicial petitions' (2009) 6 Journal of Business Law 606, 620
[325] [2003] 2 B.C.L.C. 393
[326] Ibid at [405].
[327] Wallersteiner v Moir [1975] 1 All E.R. 849 CA (Civ Div).
[328] Bhullar v Bhullar [2003] 2 B.C.L.C. 241 CA (Civ Div).

s.994 petitions permitting claims of corporate relief, contrary to the ruling of Millett J.[329]

The question that arises in relation to the above cases, is whether the decisions made by the English judges reveal their implied intention to supersede the derivative action.[330] We should be hesitant to answer affirmatively this question, as a more recent decision of the Court of Final Appeal of Hong Kong in *Re Chime Corp*[331] doubted the maintenance of this flexible position on unfair prejudice petitions. Briefly, Lord Scott of Foscote NPJ, being in agreement with the dictum of Millett J, explained that "in order to circumvent the rule in *Foss* in a case where the nature of the complaint is misconduct rather than mismanagement is, in my opinion, an abuse of process".[332] It is interesting to observe the difference between the Millett J's approach, who established a strict separation of corporate and personal relief between the two remedies, whereas Lord Scott focused on the distinction between "misconduct" and "mismanagement" cases, in order to clarify which remedy should be applicable in respect of these two categories of wrongful conduct. In detail, his Lordship stated that misconduct cases, for which a remedy is sought, should be subjected to a derivative claim. Regarding the mismanagement cases, Lord Scott opined that corporate relief under s994 petitions should be permitted, if it is clear, during the pleading stage, that the degree of director's liability to the company can be determined through this petition and if the order that would be made by the court, is equivalent to the order that would have been obtained, if a derivative claim had been pursued.[333] This dividing line between mismanagement

[329] A.M. Gray, 'The statutory derivative claim: an outmoded superfluousness?' (2012) 33 Comp. Law. 295, 298.
[330] Jennifer Payne, 'Sections 459–461 Companies Act 1985 in flux: the future of shareholder protection' (2005) 64 C.L.J. 647, 654
[331] Nina Kung v Tan Man Kou (Re Chime Corp) [2004] 7 HKCFAR 546
[332] [2004] 7 HKCFAR 546 at [63].
[333] Ibid at [62].

and misconduct cases was considered again by Lord Scott in the English case of *Gamlestaden Fastigheter AB v Baltic Partners Ltd* [334]. Surprisingly, though, the court did not consider the competing interpretations of Lord Scott's judgment, but simply accepted the legitimacy of allowing a corporate relief to be sought under s994 proceedings.[335]

The legal outcome in the above cases shows the preference of English judges to apply the unfair prejudice remedy rather than the derivative action and to accept as the correct conception, the decision made by Arden LJ in *Cutland*.[336] However, there is no suggestion in these cases that the derivative action can be replaced by the unfair prejudice remedy, as the court in these cases had not provided evidence of establishing and effectively applying any criteria for the granting of corporate relief on unfair prejudice petitions.[337] The criteria laid down by the Millett J in *Charnley Davies* and by Lord Scott in *Re Chime Corp,* had been clearly disregarded in all three cases.[338] The decisions were simply left to the court's wide discretion to define whether the circumstances of the particular case would allow the matter to be conveniently dealt with an order for corporate relief under a 994petition. While, it can be argued that the considerably expanded scope of the unfair prejudice remedy constitutes a distinctly interpretation of how the remedy impacts on corporate relief, it is difficult to assume that this interpretation amounts to a replacement of the derivative action with the unfair prejudice remedy. Firstly, the wide discretion that the court exercised in these English cases to broaden the scope of the unfair prejudice remedy to situations, involving

[334] Gamlestaden Fastigheter AB v Baltic Partners Ltd[2007] B.C.C. 272; [2008] 1 B.C.L.C. 468 at [475]-[476]
[335] A.M. Gray, 'The statutory derivative claim: an outmoded superfluousness?' (2012) 33 Comp. Law. 295, 298
[336] Ibid.
[337] Brenda Hannigan, 'Drawing boundaries between derivative claims and unfairly prejudicial petitions' (2009) 6 J.B.L. 606, 624.
[338] Ibid.

corporate wrongdoing, does not rest on established criteria that determine the willingness of the English judges to remove the derivative action from the list of shareholders remedies.[339] Secondly, these cases have received strong criticism by the academic community for being wrongly decided.[340]

Significantly, Hannigan observes that all three cases were decided before the enactment of the statutory derivative action and the procedural complexities of the common law derivative claim precluded the bringing of the claim by the petitioners.[341] So, she argued that in the absence of a derivative claim, the court recognized the need to award a remedy and did so under the prism of the unfair prejudice petition. Truly, it had been argued that if the action in *Gamlestaden*, which concerned negligence, was brought when Pt 11 of the 2006 Act was in force the case would have proceeded as a derivative claim, as negligence is covered by the English statutory derivative action.[342] Similarly, Hannigan argued that the same need to find a remedy was present in *Cutland*[343], while *Bhullar* was a classic example of a derivative claim, which had been wrongly decided.[344] Hannigan viewed that the facts in all three cases were exceptional. Specifically, she opined that the actual practice of the court to exercise its discretion should not create a misleading impression that the cases evidence any abuse of the unfair prejudice remedy, purporting to undermine the rule in *Foss v Harbottle* and the standing requirements of the common law derivative claim.[345] In other words, she suggested that the cases were treated as exceptional situations that warranted a remedy,

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[339] Ibid.
[340] Ibid.
[341] Ibid.
[342] A.M. Gray, 'The statutory derivative claim: an outmoded superfluousness?' (2012) 33 Company Lawyer 295, 299
[343] Brenda Hannigan, 'Drawing boundaries between derivative claims and unfairly prejudicial petitions' (2009) 6 J.B.L. 606, 624
[344] Anderson v Hogg [2002] B.C.C. 923 per Lord Prosser at [934].
[345] Brenda Hannigan, 'Drawing boundaries between derivative claims and unfairly prejudicial petitions' (2009) 6 J.B.L. 606, 624

where a derivative claim could not provide one. On the other hand, Payne disagrees with this statement and supports the decision of Arden LJ in *Cutland*, arguing that it would be presumptuous to disapprove the lack of analysis in her Ladyship's judgment, as compelling reasons do exist for her decision to grant a corporate remedy on the basis of an unfair prejudice petition, regardless of whether these reasons have not been clearly determined.[346] An interesting view is also presented by Gower, who supported the decision of Lord Scott of Foscote in *Re Chime Corp* and argued that the principles deriving from his judgment are correctly established and they should be adopted.[347] This view was also supported by Hannigan, who argued that the *Cutland* case represented an example of mismanagement and so Lord Scott's criteria in *Re Chime Corp* should have been applicable to justify the decision of the court to award an unfair prejudice remedy for corporate wrongdoing.[348]

Therefore, considering the above criticism, it is difficult to conclude whether the cases were exceptional situations or whether the courts were simply mistaken in the application of the law on unfair prejudice petitions. If coherence is to be maintained on the law of English shareholder remedies, it is important to distinguish the different functions of the two remedies.[349] In this way the unclear interaction between them will be improved and the derivative action would be able to improve its usefulness as a remedy per se, where the main ground for minority relief is apparently a corporate wrong.

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[346] Jennifer Payne, 'Shareholders' Remedies Reassessed' (2004) 67 M.L.R. 500, 501

[347] Paul.L. Davies, *Gower and Davies' Principles of Modern Company Law*, 8th edition (Sweet & Maxwell, 2008) para.20-5.

[348] Brenda Hannigan, 'Drawing boundaries between derivative claims and unfairly prejudicial petitions' (2009) 6 J.B.L. 606, 624-625

[349] C. Hale 'What's Right with the Rule in Foss v Harbottle?' [1997] 2 CFILR 219, 222

2.3. A6 Cost Allocation

In the procedural requirements discussed above, there is no financial barrier imposed by the statutory procedure to discourage unmeritorious claims.[350] Even though, English common law and the Companies Act 2006 did not establish any requirements of financial character for minority shareholders to satisfy, the enforcement of directors' duties through the use of the derivative action entails considerable economic risks for the litigant shareholder. Cost allocation under English law is structured upon the presumption that the costs follow the outcome of the case. This means that, the unsuccessful party is obliged to pay not only his own costs but also the costs of the winning party.[351] This is known as the "*loser pays principle*" and can be found in the legal systems of many European jurisdictions.[352] This approach seems more reasonable when litigation is vexatiously brought. However, when this is not the case, it is considered to be quite unfair for a minority shareholder to get involved in a costly and possibly lengthy litigation process, in which his personal benefit reflects only the reinstatement of the loss suffered in his shareholding.[353] So, it can be said that the rationale of this rule does not fully align with the exceptional nature of the derivative action. For that reason, the English common law provides a solution, that is also enforced under the Act, in order to make derivative litigation an inexpensive process for the claimant shareholder.[354] This solution is illustrated in the case of *Wallersteiner v Moir*[355]. In that case, the Court of Appeal established that the plaintiff shareholder,

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[350] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 96

[351] CPR 44.3 (2) (a)

[352] Susanne Kalss, 'Shareholder Suits: Common Problems, Different Solutions and First Steps towards a Possible Harmonisation by Means of a European Model Code' (2009) 6 ECFLR 324, 331

[353] Pavlos E. Masouros, 'Is the EU Taking Shareholder Rights Seriously?: An Essay on the Impotence of Shareholdership in Corporate Europe' (2010) 7(5) European Company Law 195, 202

[354] Neshat Safari, 'A blended approach to derivative litigation costs in the UK: lessons from New Zealand and the US' (2018) 9 I.C.C.L.R. 558, 559

[355] Wallersteiner v Moir (No2) [1975] QB 373

regardless of the outcome of the litigation, should be entitled to request indemnification by the company for all the costs incurred in the action.[356] In other words, under this principle, even if the claim fails, the court can exercise its discretion to order the company to relieve the shareholder plaintiff for the financial burden of the action, as long as the action is brought on reasonable grounds.[357] This order provides indemnity against any costs incurred in relation to the permission application or the derivative action or both. The test applicable by the court for a successful indemnity cost order relied upon the presumption that an independent board of directors would have brought a derivative action on the same grounds.[358] In a first glance, it seems that this common law principle, called *'Wallersteiner order'*, reflects the representative nature of the derivative action and the notion that the rights being enforced, belong to the company, so the costs ensuing from that enforcement should be channeled to the company too.

Nevertheless, relevant cases following the *Wallersteiner* case proved that this solution is not always effective in relieving minority shareholders from the economic implications of the derivative action. For instance, in *Smith v Croft* the court confined the circumstances under which the *Wallersteiner* order can be granted.[359] In specific, court set significant hurdles that encumber the plaintiff shareholder, who had to provide evidence that he requested the indemnity order, because he did not obtain the sufficient funds to afford the action.[360] A more supportive attitude to the scope of the *Wallersteiner* order was considered in *Jaybird Group Ltd v Greenwood*[361], where the court acknowledged that the order should not answer only to the requests of

[356] Ibid at [391] per Lord Denning
[357] [1975] QB 373
[358] Ibid at 404, per Buckley LJ
[359] Smith v Croft [1986] 1 WLR 580
[360] [1986] 1 WLR 580 at [597]
[361] Jaybird Group Ltd v Greenwood [1986] BCLC 319.

impecunious shareholders.[362] Except from the flexible view expressed in *Jaybird*, there are several examples in which the courts are quite reluctant in granting an indemnity order.[363] Therefore, it can be argued that the English common law approach on cost allocation, which has not significantly changed after it was placed on a statutory footing in the Civil Procedure Rules Practice Direction 19.9E, provides a solution that at least in theory does not leave minority shareholders completely exposed to litigation costs.[364] Practically though, it is difficult for them to enjoy the benefits of the indemnity cost order, taking into consideration the cautious approach that judges have adopted on that matter.[365] It should be noted that some judgments from post-Act 2006 cases seem to be more encouraging for future applicant shareholders.[366] For instance, in *Stainer v Lee*[367] Roth J held that when the shareholder obtains permission to proceed with the derivative claim, it is reasonable to expect an indemnity from the company for the costs incurred, a view that was also supported by Arden LJ in *Carlisle & Cumbria United Independent Supporters' Society Ltd v CUFC Holdings Ltd*[368]. The cautious approach of the English courts in cost allocation, resulted in only two out of eight cases to be granted an indemnity order, and still the cost orders were not granted, without limitations in these cases.[369]

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[362] [1986] BCLC 319, at [327]
[363] McDonald v Horn [1995] 1 All ER 961; Halle v Trax B W Ltd [2000] BCC 1020; Mumbray v Lapper [2005] BCC 990, Ch.
[364] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 96-97
[365] Susanne Kalss, 'Shareholder Suits: Common Problems, Different Solutions and First Steps towards a Possible Harmonisation by Means of a European Model Code' (2009) 6 ECFLR 324, 331, 332.
[366] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 55
[367] [2010] EWHC 1539 (Ch) at [56]
[368] [2010] EWCA Civ 463; [2011] BCC 855
[369] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 57.

Judicial reluctance in granting an indemnity order, limits the incentive of minority shareholders to initiate a claim, given that neither the claimant can predict with certainty a successful outcome in the case nor the court can provide any assurance that the plaintiff will obtain the indemnity order to cover the costs of litigation.[370] Thereafter, it is more likely that the plaintiff shareholder will bring proceedings when the prospects of success are more promising.[371] The indemnity rule may alleviate the claimant from the burden of reimbursable costs. But, incentive problems on the part of minority shareholders are also generated by non-reimbursable costs, for which there is no provision under the English law. A lengthy derivative litigation process causes disruption in the ordinary business affairs of a minority shareholder, who decides to bring an action.[372] Involvement in such court proceedings results in loss of precious time that the shareholder could have invested in other business opportunities and in loss of confidence, as a costly and lengthy litigation can harm his reputation and have detrimental effects in his future relations with the investment community[373]. Especially, in complex cases of directors' liability, where managerial misconduct by controlling wrongdoers cannot be easily proven, non-reimbursable costs are even higher due to the time and money spent by the plaintiff shareholder to collect the relevant information and show the merits of bringing the claim before the courts.[374] In other words, if the costs of enforcement of directors' duties exceeds the benefit, then the probability that an action will be brought by a minority shareholder falls down to zero.[375] This cost allocation model may drive minority shareholder to indirectly accept managerial

[370] Ibid.
[371] Susanne Kalss, 'Shareholder Suits: Common Problems, Different Solutions and First Steps towards a Possible Harmonisation by Means of a European Model Code' (2009) 6 ECFLR 324, 331, 332
[372] Ibid.
[373] Ibid.
[374] Ibid.
[375] Ibid.

misfeasance, if the benefit to be accrued from the proceedings is estimated to be lower than the amount sued for. This could be observed in closely held companies, such as the Cypriot ones, where ownership and control are highly concentrated and the corporate affairs usually take the form of a cozy quasi-partnership.[376]

It is true that non-reimbursable costs place the plaintiff shareholder in a difficult position, of carrying a heavy financial burden, if he chooses to start a derivative claim. But, it seems rather difficult for the plaintiff shareholder to understand the reasons that the court would refuse to provide an indemnity order for the reimbursable costs, once the applicant has gained permission to proceed with the claim and he had managed to satisfy all the procedural requirements of the two-stage procedure.[377] The English position on cost allocation is strict and it does not seem to meet the expectations of the UK Law Commission on the creation of a cost-effective derivative action.

2.3.A.7 Access to Information Rights

Except from the procedural requirements that the claimant needs to satisfy, the initiation of derivative proceedings is accompanied by the difficult task of obtaining more detailed information, which allow the minority shareholders to gather the evidence needed to support their claim on the alleged wrongdoing.[378] Information asymmetries constitute a major obstacle in the bringing of derivative litigation, when claimant-shareholders have no access to records and documents that may contain clear and substantive evidence of managerial misconduct.[379] The bringing of a derivative

[376] Deirdre Ahern, 'Directors' duties: broadening the focus beyond content to examine the accountability spectrum' (2011) 33 Dublin University Law Journal 116, 119
[377] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 57.
[378] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 86
[379] Samantha S. Tang, 'Corporate avengers need not be angels: rethinking good faith in the derivative action' (2016) 16(2) Journal of Corporate Law Studies 471, 477

claim has greater prospects of success, when information related to the management of the company become available to minority shareholders. The disclosure schemes that English law provides, have been repeatedly criticized for being inadequate to balance the information asymmetries that exist between the management and the shareholders in respect of an alleged managerial wrongdoing.[380]

Under English case law, a shareholder of a company is allowed to obtain discovery of documents irrespective of the company's size.[381] However, the rights that English case law confers on shareholders to access internal corporate documents are of little importance[382], while the UK Companies Act 2006, does not grant shareholders any right to inspect board minutes or board papers.[383] Such right, is usually restricted by the Articles of Association of most companies, allowing only the controllers of the company to afford a discovery or inspection of the corporate records and books.[384] Nonetheless, s 261(3) (a) of the CA 2006 confers the court power to grant a discovery order, requesting the company to provide evidence as to the merits of the complaint.[385] But, post-Act 2006 case law has shown that English courts were particularly reluctant to use the powers granted under this section. The cases of *Franbar* and *Sinclair* revealed the difficulty that litigants face in continuing their claims, when their limited access to corporate records affects their ability to present a clear case of breach of duty.[386] For

[380] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81 111; Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 364-365

[381] CAS (Nominees) Ltd v Nottingham Forest plc [2002] BCC 145 at [150].

[382] Arrow Trading and Investments v Edwardian Group Ltd [2004] EWHC 1319; Re DPR Futures Ltd [1989] BCLC 634

[383] Arab Reisberg, 'Shadows of the Past and Back to the Future: Part 11 of the UK Companies Act 2006 (in)action' (2009) 6 ECFLR 219, 235

[384] Ibid.

[385] s. 261(3) (a) of the UK CA 2006

[386] Arab Reisberg, 'Shadows of the Past and Back to the Future: Part 11 of the UK Companies Act 2006 (in)action' (2009) 6 ECFLR 219, 234.

instance in *Franbar*, the court held that despite the meaningful complaints made, more evidence was needed to establish a clear case of maladministration.[387] Disregarding the application of s261(3), the English judges lost the opportunity to order a more detailed investigation on the company's affairs, which might had changed the way they examined and decided on the aforementioned cases.[388]

Except from the UK statute, the UK Civil Procedural Rules allow the court to order a pre-action disclosure.[389] If the applicant shows that "disclosure is desirable in order to (i) dispose fairly of the proceedings, (ii) assist the resolution of the dispute without proceedings, or (iii) save costs" then the court can exercise its discretion to decide in granting the investigation order for the disclosure of relevant corporate documents.[390] The English case law has revealed that it is likely that the court will grant an order for pre-action disclosure, if the establishment of a prima facie case needs to be further supported by relevant documents, or in the case that the claim has been reasonably brought, but a prima facie case has not been established.[391] In general, the clearer the claim is and the narrower the disclosure sought, the easier it is for the court to exercise its discretion in allowing the disclosure order.[392] Also, recent case law has shown that English judges are particularly cautious in granting an order, when the claim is based on allegations of fraud, dishonesty or wrongful conduct.[393] As indicated by Rix J in Black v Sumitomo, when the alleged claim lies on fraudulent, dishonest or wrongful behavior, then the courts would assume that it is inappropriate to grant a pre-action

[387] [2008] EWHC 1534 (Ch)
[388] Arab Reisberg, 'Shadows of the Past and Back to the Future: Part 11 of the UK Companies Act 2006 (in)action' (2009) 6 ECFLR 219, 235.
[389] CPR 31.16(3)(a) to (c)
[390] CPR 31.16(3)(d)
[391] Black v Sumitomo Corp. [2001] QBD, per Michael Brindle QC (unreported)
[392] Moresfield Ltd v Banners [2003] EWHC 1602, Ch, per Lawrence Collins J; SES Contracting Ltd v UK Coal plc [2007] EWHC 161, QB
[393] Black v Sumitomo Corp. [2002] 1 WLR 1562, 1579, CA; XL London Market Ltd v Zenith Syndicate Management Ltd [2004] EWHC 1182 (Comm.); SES Contracting Ltd v UK Coal plc [2007] EWHC 161, QB.

disclosure order, unless the claimant's allegations are specified and carry some credibility and his request for disclosure is appropriately determined.[394] The cautious approach of the courts in allowing claimant-shareholders to access corporate information, is not the only disadvantage of this pre-action disclosure mechanism. Under UK CPR 48.1 the applicant is obliged to bear not only the costs of his application, but also the costs of the respondent for complying with the disclosure order. However, CPR 48.1(3) states that the court may disregard this rule, considering the circumstances of the case, including "the extent to which it was reasonable for the person against whom the order was sought to oppose the application and whether the parties to the application have complied with any relevant pre-action protocol".[395] Under this rule, it is likely that in certain circumstances, the defendants would be engaged in the costs for the pre-action disclosure.[396] Nevertheless, the fact that claimant-shareholders do not have free of charge access to documentation under the pre-action disclosure mechanism, might work as a disincentive in applying for such an order in the first place. But, even if the most confident of the litigants does, the cautious approach of the English judges in granting the disclosure order might end up blocking their efforts.

2.3.B.1 The German Derivative Action

The history of German derivative action dates back to the nineteenth century.[397] The proper plaintiff principle was strongly supported in German law, as for many decades the shareholders had no right to enforce a corporate claim on behalf of the company. The strict litigation culture in Germany disregarded the protection of

[394] Black v Sumitomo Corp. [2002] 1 WLR 1562 at [1579]
[395] CPR 48.1 (3) (a), (b)
[396] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 96.
[397] B. Großfeld, *Aktiengesellschaft, Unternehmenskonzentration und Kleinaktionär* (Tübingen: J. C. B. Mohr, 1968) pages 226–233

minority shareholders until 1998.[398] Therefore, a number of statutory amendments led to introduction of s147 of the AktG (Aktiengesetz) 1998, meaning the German Stock Corporation Act, which sought to enhance investor protection in quoted companies. According to this section, the minority shareholders had no right to bring a derivative claim, but they simply had a right to initiate an assertion of a corporate claim.[399] This means that they had the right to cause the company to bring a claim in its own name or through the appointment of a special representative by the court. Specifically, section 147 AktG 1998 stated that a corporate claim could be asserted by a simple majority of shareholders holding 5% of share capital or 500.000euros at market prices. If the minority shareholders could satisfy this threshold, they could force the company to bring its own claim. Alternatively, the shareholders, who were satisfying the 5% threshold, could request the court to appoint a special representative, who will bring the claim on behalf of the company. In this regard, it cannot be argued that German law was recognizing the possibility of a minority shareholder to bring a derivative action on the company's behalf, as it was established under the English common law approach of the "fraud on minority" on minority exception. It should be noted that before the 1998 reforms the shareholder ownership requirement was reaching 20% in 1884 Act and it was lowered to 10% in the 1965 reforms.[400] Thus, only the billionaire-shareholders could force the company or the court to take action and remedy the wrong that the company suffered, but even this privilege that rich shareholders were granted, was not considered to be a direct right to enforce a derivative claim on the company's behalf, as it is understood in the English common law sense.

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[398] Ibid.
[399] s147 of the AktG (Aktiengesetz) 1998
[400] Zhong Zhang, 'The Shareholder Derivative Action and Good Corporate Governance in China: Why the Excitement is Actually for Nothing' (2011) 28(2) UCLA Pacific Basin Law Journal 174, 181-182

Such a direct right was conferred on minority shareholders after the introduction of new statutory derivative action into German law, as part of the new German Act Regarding Integrity of Companies and Modernization of Shareholder Suits (Gesetz zur Unternehmensintegritat und Modernisierung des Anfechtungsrechts), the so-called UMAG, which came into force in November 2005. The UMAG significantly amended the German Stock Corporations Act (the AktG), as it incorporated for the first time the shareholders' right to bring a derivative action. The need for a radical legislative reform in Germany was prompted by a number of different factors.[401] Firstly, the previous amendments provided by the AktG were heavily criticized, as less shareholder-friendly measures, which were inadequate to provide effective investor protection and to discipline corporate mismanagement. Also, the development of the European company law, the globalization of the economy, which insisted in the adaption of national laws with the current market needs, were some of the reasons that encouraged the introduction of a new derivative litigation model in Germany.

2.3.B.2 The statutory procedure under ss148-149 AktG

Sections 148 and 149 of the AktG regulate the right of minority shareholders to bring a claim on behalf of the company, replacing the previous provision of s147 and abandoning the concept of a special representative.[402] Similarly to the English statutory scheme, the German law seeks to effectively screen out frivolous claims through the initiation of a two-stage procedure, which is subject to strict judicial control. The preliminary stage provides for an admission procedure, where the minority shareholder needs to meet a number of procedural requirements, so that the court could permit the bringing of the derivative action. If the action is admitted by the court, the plaintiff

[401] Bernd Singhof, Oliver Seiler, 'Shareholder Participation in Corporate Decision-making Under German Law: A Comparitive Analysis' (1998) 24(2) Brooklyn Journal of International Law 493.
[402] ss. 148-149 of the AktG (the UMAG)

shareholder can proceed to the second stage, which is the enforcement of the derivative action.[403] It appears that both the English and the German statutory proceedings on derivative claims are similar in formation. The main question is whether the German statutory provisions create a desirable balance between effective investor protection and non-interference in decision making. The analysis of the procedural requirements in the English statutory scheme have demonstrated that the English courts are cautious in facilitating access to the remedy and that they are more concerned with the second aspect of these balancing forces, which is not other than the frustration of unmeritorious actions. It remains to be seen whether the German approach differs from the English one.

In the preliminary certification proceedings, s148(2) provides that the alleged wrongdoers must be made respondents to the relevant application for permission, while the court must order the company to engage in this pre-trial process, as a non-party (notwendige Beiladung), since the action itself concerns the company and its affairs as a whole.[404] The court will consider whether the claim should be admitted, examining the evidence filed by the applicant shareholders. If the court is satisfied that the applicants meet the requirements of s 148(1) then the claim should be allowed to proceed to the second stage. Under section 148(4) AktG, the shareholders can enforce the derivative action within three months after the decision for the admission of the action has become binding.[405] The action procedure, which is brought by the plaintiff shareholders, it is covered by the General Civil Procedure Rules.[406] However, in order to ensure that the directors would not be exposed to multiple actions for the same

[403] s. 148 (1) of the AktG (the UMAG)
[404] s.148(2), seventh sentence of the AktG (the UMAG)
[405] s. 148(4) of the AktG (the UMAG)
[406] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 100

wrongdoing, the UMAG includes a specific provision under s148(5), which states that the judgment of the court in relation to the outcome of the action would be binding for the company and all of its shareholders.[407] Finally, it should be noted that the company is entitled to take over the derivative proceedings at any point of the two-stage procedure. The rationale behind the company's right to bring the action in its own name, extinguishing the claim initially brought by the plaintiff shareholders, will be further explained below.

2.3.B.3 Legal standing: Who is entitled to sue on behalf of the company?

In contrast with the English remedy, which confers legal standing to individual members, section 148(1) of the AktG states that the applicant shareholder would be allowed to bring a derivative claim, only if he holds 1% of the company's overall share capital or 100,000 Euros in nominal capital.[408] This provision aims to make the remedy available to a wider range of applicants, as the quorum requirement was reaching 5% under the previous s147 of Aktiengesetz. So, under the new provision, the right to bring a derivative claim, is attached to 1% qualified minority and not to every single share, as the English scheme prescribes.[409] This restrictive provision constitutes a screening mechanism against undesirable litigation.[410] Practically, the plaintiff shareholder needs to satisfy the 1% threshold to bring a claim. So, the rationale of this provision lies on the idea that it would be less likely that shareholders with a significant stake in the company would engage in litigation that could be harmful for the company's interests, considering that the corporate interests are strongly connected with their large

[407] s. 148(5) of the AktG (the UMAG)
[408] s.148(1), sentence 1 of the AktG (the UMAG)
[409] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 106.
[410] Harald Baum and Dan W. Puchniak, *The Derivative Action in Asia: A Comparative and Functional Approach,* (Cambridge University Press, 2012) page 88

shareholding contribution.[411] In other words, a minority shareholder must be fool or crazy to buy shares of millions just for the purpose of damaging the company through the initiation of derivative proceedings. Although, the application of this ownership requirement does not preclude the possibility of preventing actions made by respectable litigants.[412] This means that a restriction on legal standing which is based on share capital participation, cannot ensure that the plaintiffs will not bring the action for ulterior purposes to the detriment of the company's interests.[413]

Even though, the German legislature provides an ownership threshold, which is lower than some other European countries[414], and it is in alignment with the shareholding structure of German companies, which are mainly composed of blockholders, who, in most cases, can exercise tight control on management, it is questionable whether the imposition of such a locus standi requirement would facilitate access to the remedy by the minority shareholders. This share ownership restriction on legal standing give rise to a number of problems. Firstly, it might necessitate the collaboration between the shareholders, so that they can meet the ownership requirement.[415] In this case, the shareholders in cooperation face a collective action problem, as they need to create alliances that would allow them to litigate. This seems to be a difficult task, as it raises additional costs of forming these alliances and it creates

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[411] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 104.

[412] Harald Baum and Dan W. Puchniak, *The Derivative Action in Asia: A Comparative and Functional Approach*, (Cambridge University Press, 2012) page 88

[413] Klaus Ulrich Schmolke, 'The Shareholder Derivative Action according to § 148 of the German Stock Corporation Act: Incentives of Current Law and Proposals for Reform' (Die Aktionärsklage nach § 148 AktG – Anreizwirkungen de lege lata und Reformanregungen de lege ferenda –) [2011] ZGR 398 https://ssrn.com/abstract=1716929 (accessed January 2020)

[414] K. Grechenig and M. Sekyra, "No Derivative Shareholder Suits in Europe –A Model of Percentage Limits, Collusion and Residual Owners", (2007) The Center for Law and Economic Studies Columbia University School of Law, Working Paper No. 312 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=933105> accessed August 2020

[415] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in UK, Germany and Greece* (Routledge, 2020) page 83

impediments on how the shareholders will identify their allies' intentions to engage in litigation.[416] Also, another problem for meritorious members relates to the maintenance of the ownership threshold during the derivative proceedings. If one of the applicants loses his membership status, or if he decides to abstain from the proceedings, the remaining shareholders would not be able to satisfy the quorum requirement and even meritorious claims may be rejected on that basis.[417]

Arguably, the quorum requirement could possibly prevent unmeritorious claims, when the shareholder who seeks to abuse the derivative proceedings and he does not hold the requisite threshold, needs to resort to counterparts with the same abusive intentions.[418] This is undeniably a task that shareholders with frivolous intentions might not be willing to undergo. It seems that the imposition of the quorum requirement on German provision reflects a strict policy that safeguards the company against abusive litigation and favours applicants with substantial share participation, as it is less likely that a millionaire applicant with strong commitment to the corporate interests, would bring a frivolous claim to the detriment of the company.[419]

2.3.B.4 Range of applicants

Another requirement to combat vexatious claims relates to the "point in time" that the applicants became members of the company. In particular s 148(1)(1) states that the applicant shareholders must prove that they have acquired their shares no later than they

[416] Ibid.
[417] Ibid, page 84.
[418] N. Paschos & K-U Neumann, 'Die Neuregelungen des UMAG im Bereich der Durchsetzung von Haftungsansprüchen der Aktiengesellschaft gegen Organmitglieder' (2005) Heft 33 DB 1779, 1780
[419] Theodor Baums, 'Personal Liabilities of Company Directors in German Law' (1996) 9 ICCLR 318, 322.

know or ought to have known about the alleged wrongdoing suffered by the company.[420] This means that, if the alleged breach of fiduciary duties by a member of the management or supervisory board has been publicized in major public sources(newspapers, magazines, television, radio, online services) authorized by the company, the plaintiff shareholders need to provide evidence that they held their shares before the publication of the alleged breach.[421] This provision constitutes another screening mechanism against frivolous claims, as it is designed to prevent shareholders from purchasing their shares, with the sole purpose of filing a derivative suit, which might not necessarily serve the interests of the company.[422] Also, the restriction seem to be less strict, if we consider that it does not force the applicant shareholders to prove that they have gained actual knowledge through the publication.[423] The indication of imputed knowledge of the alleged wrongdoing through the publication is sufficient to satisfy the requirement of this provision.[424]

This provision appears to be a perfect illustration of how predictable and certain are considered to be the criteria that minority shareholders need to meet in order to bring a derivative action under the German law.[425] Such legal certainty and predictability cannot be detected in the English statutory provisions, as English law does not include a similar requirement, paying no attention to the timing that the shareholder became a member. However, "the point in time" that the plaintiff

[420] s.148(1), second sentence, no 1 of the AktG (the UMAG)
[421] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 98.
[422] H. Fleischer, 'Act on Corporate Integrity and Modernization of Rescission Law' [Das Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts] [2005] NJW 3525, 3526.
[423] L. Eisen, 'Limitations on Derivative Actions in Germany and Japan to Prevent Abuse' (2012) 34 Z. JapanR / J. Japan.L. 199, 205.
[424] s.148(1), second sentence, no 1 of the AktG (the UMAG)
[425] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 107.

shareholder became a member, is not completely disregarded by English judges in exercising their discretion to decide on whether the claim should proceed.[426] This consideration could fall within the ambit of the applicant's good faith, that the court needs to consider in the second stage of the statutory process.[427] So, English law seems to be more flexible than the German law, giving wide discretion to the court to examine the particular circumstances of each case and decide whether the time of acquisition of the shares, is a relevant consideration for determining the applicant's good faith to engage in derivative litigation.[428] It is concerning though, that the English provisions, such as the good faith criterion, which are labelled as flexible in the way that the judges interpret them, bring along a number of difficult questions that they are unable to answer for decades and this lack of legal certainty may prevent meritorious shareholders from bringing a derivative action.

2.3.B.5 Discontinuance of proceedings: The Demand Rule

Furthermore, according to s148(1) the shareholders should produce evidence that the company has failed to resolve the claim itself within a reasonable period of time, despite having been notified of the claim by the shareholders.[429] Once again, this provision acts as a screening mechanism, calling the company to overtake litigation itself. The provision reflects the idea that the rights to be enforced belong to the company and it provides a reasonable deadline of two months for the shareholders to prove that they requested the company to bring proceedings itself and their request has been rejected.[430] A second demand rule, is included in section 148(3), which applies at

[426] Ibid.
[427] s 263(3)(a) of the UK CA 2006
[428] Andrew Keay and Joan Loughrey, 'An assessment of the present state of derivative proceedings', in Joan Loughrey (ed), Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis, (EE, 2013)187, 211.
[429] s.148(1), second sentence, no 2 of the AktG (the UMAG)
[430] Ibid.

the second stage of the statutory procedure, after the action is admitted by the court.[431] In specific, the German legislation allows the company to obtain control of the litigation even at the second stage, rendering the action itself and the preliminary stage of the statutory procedure inadmissible. So, the plaintiff shareholders need to prove in both stages that the company is not willing to bring the action itself, in order to gain permission by the court and proceed with the claim. A double demand requirement, calling the company to overtake pending proceedings in both stages of the statutory process, reveals that the sole intention of the German legislature is to constrain malicious shareholder interference rather than to protect minority shareholders, by giving them access to the remedy. There is no doubt, that such demand requirements, disincentivize frivolous litigants to commence a derivative claim, on the notion that at any stage the company may assert the claim itself.[432] However, the excessive degree of predictability that these demand requirements entail, adversely affect meritorious claims and it reduces the possibility of the derivative action being understood as a means of effective shareholder protection. The only flexibility that this provision offers is included in the last sentence of s148(3), which summons the members, who initiated the derivative proceedings to join the action that the company continues, as non-parties.[433] Although, this part of the provision does not confer a significant advantage to the minority shareholders. It simply enables them to remain observers of the action that they have initially brought, while their right to participate in the assertion of the claim has been suspended.[434]

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[431] s.148 (3) sentences 1, 2 of the AktG (the UMAG)

[432] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 108.

[433] s.148 (3) of the AktG (the UMAG)

[434] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in UK, Germany and Greece* (Routledge, 2020) page 113

By contrast, there is no relevant threatening remark in the English statutory scheme, reminding the plaintiff shareholder that their action may be vainly brought, once the company decides to assert it. Hence, the wide discretion that the court has been granted under the English statutory remedy and the negligible importance that it gives to these demand requirements seems to bring respectable plaintiffs in a better position to litigate on the company's behalf.[435]

Moreover, it should be noted that if the company decides to assume the position of the plaintiffs and undertake the action itself, it can withdraw the action under s148(6) of AktG.[436] The action can be withdrawn, if the company passes a resolution of shareholders meeting, in which the shareholders holding at least 10% of the company's share capital, do not oppose to such withdrawal.[437] The discrepancy between the requisite thresholds of 1% of share capital to file a derivative action and 10% of share capital to object to the termination of the action, highlights the subsidiary nature of the derivative action under the German statutory scheme. This substantial difference on quorum requirements for filing and terminating a derivative action, reveals, once more, the pre-emptive dimension of the German law, which ensures that malicious litigants, who initiated the derivative action, would not be in a position to prevent its termination, after it has been overtaken by the company.[438]

2.3.B.6 Range of actions

Another procedural requirement that limits the circumstances under which the company may be redressed for the wrong that it has suffered, relates to the range of

[435] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 108.
[436] s.148 (6) sentence 4 of the AktG (the UMAG)
[437] s.93(4) sentences 3, 4 of the AktG (the UMAG)
[438] L. Eisen, 'Limitations on Derivative Actions in Germany and Japan to Prevent Abuse' (2012) 34 ZJapanR / J.Japan.L. 199, 210-211.

actions, which give rise to the initiation of the German derivative action. According to section 148(1)(3) the plaintiff shareholders need to provide evidence that enhance the suspicion that the company has suffered wrong, caused by dishonesty or gross violation of the law or of the articles of association.[439] The term "dishonesty" responds to deceitful behavior, that reaches the levels of criminality, while the term "gross violations" amounts to fraudulent actions, that are completely intolerable in terms of both their nature and their effect on the company.[440] It can be said that the term "gross violations" reflects the previous English common law approach on the "fraud on minority" exception, which was restricting the cause of action only to cases of severe breaches of fiduciary duties. In England, the previous "fraud on minority" exception was criticized for over restricting the range of actions under which a derivative claim could be brought.[441] Consequently, the broadening of the range of actions, including negligence, under the new English statutory scheme, does not seem to be an unexpectable change, considering the criticism that the old law had received. On the contrary, the criticism that the old version of s147(3) of Aktiengesetz received before the introduction of the UMAG, did not suffice to prevent the survival of the equivalent rule in the new German approach on misfeasance covered by the provision 148(1)(3).[442] German case law evidences the strictness that the provision entails, considering that claims for excessive remuneration of directors had not met the prerequisite to gain certification to proceed.[443] Thus, the German provision maintains a less permissive

[439] s.148 (1) sentence 2 no. 3 of the AktG (the UMAG)
[440] Uwe Hüffer, *Aktiengesetz*, 10th edition (C.H. Beck, 2012) page 867.
[441] P. Davies, *Gower and Davies' Principles of Modern Company Law*, 9th edition (Sweet & Maxwell, 2012) page 654.
[442] Klaus Ulrich Schmolke, 'The Shareholder Derivative Action according to § 148 of the German Stock Corporation Act: Incentives of Current Law and Proposals for Reform' (Die Aktionärsklage nach § 148 AktG – Anreizwirkungen de lege lata und Reformanregungen de lege ferenda –) [2011] ZGR 398, 419-422, https://ssrn.com/abstract=1716929 (accessed January 2020)
[443] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in UK, Germany and Greece* (Routledge, 2020) page 96

attitude towards the duties, that if violated, they could lead to the initiation of a derivative action. This restrictive attitude, focusing on the reduction of potential abuse by the plaintiff shareholders for any kind of negligence or unimportant breach of law, further limits the admissibility of valuable claims.

2.3.B.7 The interests of the company

The final requirement that German shareholders need to satisfy relates to whether the claim is in the interests of the company. In specific, s 148(1)(4) states that the court must refuse the certification of derivative proceedings, if the company has overriding interests that prevent the enforcement of the potential action.[444] This provision is rooted in previous German case law, and particularly, in the decision of the Federal High Court (Bundesgerichtshofj BGH) in ARAG v. Garmenbeck case.[445] In this case the court held that the enforcement of the claim against the members of the management could be refused, in the exceptional situation, that the grave interests of the company demand such a refusal.[446] At this point, it is worth comparing the language between the court decision and the German statutory provision. The wording of the previous decision refers to "grave" interests, which could be interpreted as particularly important company's interests that could potentially block access to the claim. But, it seems that the language of the statutory provision is more powerful, setting a higher threshold on the company to show that its interests are not simply important, but "predominant" to the enforcement of the claim.[447] Hence, the wording of the provision itself evidences that the circumstances, which would bar the enforcement of the claim are

[444] s.148(1), second sentence, no 4 of the AktG (the UMAG)
[445] BGH, Decision of 21 April 1997 – II ZR 175/95 (ARAG v. Garmenbeck), BGHZ (Official collection of decisions of the BGH in civil cases) 135, 255
[446] Ibid.
[447] L. Eisen, 'Limitations on Derivative Actions in Germany and Japan to Prevent Abuse' (2012) 34 Z. JapanR / J. Japan.L. 199, 207.

exceptional.[448] In this exceptional case, the court will proportionately examine whether the arguments against the bringing of the claim, which are formed under the prism of company's interests, outweight the arguments for the admission of the claim.[449] Even though, the requirement operates as a filter to the bringing of frivolous actions, the nature of the provision is truly exceptional. It seems very rare that a case would come before the courts, where the facts would justify the suspicion for a serious violation of the law, and at the same time predominant reasons would be found by the company, rendering the continuance of the claim unreasonable, while the company's interests are the ones that have been harmed by the alleged violation in the first place.[450] To put it differently, it is difficult to imagine what overriding interests of the company would bar the claim, since the very same interests of the company might have been harmed by the alleged breach, giving the company the opportunity to recover the damage to those interests through the initiation of the derivative claim.

Equivalent provisions to this German requirement can be found in the English jurisdiction too. As it was explained above, the English statutory scheme bars the continuance of the derivative claim, if the claimant fails to show that the action serves the company's interests[451], while the same consideration appears as a discretionary factor for the court to take into account, in allowing the claim to proceed.[452] It can be said that the German approach is more permissive than the English one. Specifically, the German provision does not place a barrier to the derivative proceedings on the basis of whether a hypothetical director that acts in accordance with the company's interests would not seek to continue the claim. It simply, blocks access to the claim, in the

[448] RegE-UMAG, BT-Drucks 15/5092, 22
[449] Karsten Schmidt and Marcus Lutter, *Aktiengesetz: Kommentar* (Otto Schmidt, 2010) page 2142
[450] L. Eisen, 'Limitations on Derivative Actions in Germany and Japan to Prevent Abuse' (2012) 34 Z. JapanR / J. Japan.L. 199, 207.
[451] s.263(2)(b) of the UK CA 2006
[452] s.263(3)(c) of the UK CA 2006

exceptional condition that the company itself has predominant reasons for not pursuing it. In other words, it can assumed that the German courts rely on actual facts to decide the continuance or rejection of the claim, rather than on hypotheses that could lead to uncertainty in their interpretation. Nonetheless, it can be concluded that the common characteristic of both statutory schemes, in examining whether the claim aligns with the corporate interests, is their reliance on the discretion of the court to allow the derivative claim, when its initiation reflects the corporate mind.[453]

2.3.B.8 Cost Allocation

The German approach on litigation costs follows the English "loser pay" principle and it is covered by s 148(6) AktG. Particularly, if the admission of the action is refused by the court in the first stage, the plaintiff shareholders should bear the costs of the admission process.[454] However, there is an exception to this ruling under German law. Specifically, if the court dismisses the action for the reason that the company has predominant grounds for not allowing its continuance and the company fails to produce evidence on the existence of these overriding interests, then the company will be liable for the costs of the preliminary stage.[455] In general, it seems that both the German and English law seek to hold the shareholders liable for the costs of the preliminary process, if their claim fails to proceed.[456] This could be viewed as an effort to safeguard the company against frivolous claims, on the basis that nuisance shareholders would not test their baseless claims, without exposing themselves to any financial risk.[457]

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[453] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in UK, Germany and Greece* (Routledge, 2020) page 105.
[454] s.148 (6) first sentence of the AktG (the UMAG)
[455] s.148 (6) second sentence of the AktG (the UMAG)
[456] s.261(2)(b) of CA 2006, s148(6)(1) AktG
[457] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 110.

German law makes a distinction between the costs of the preliminary stage and the costs of the actual action. The latter, fall within the general rules of sections 91 and 92 of the Civil Procedure Code (Zivilprozessordnung, ZPO), which are similar to the English approach on litigation costs, providing that if the action fails, the shareholders need to bear the costs and vise versa, in the case that the court decides in favour of the defendants.[458] In the first glance, it seems that the shareholders are liable for the litigation costs of the main trial. But, s 148(6) AktG seems to be advantageous for the plaintiffs, who manage to reach the second stage of the procedure. In detail, s148(6)(5) provides that if the shareholders fail or partly fail in the main trial, they are entitled to be reimbursed by the company, not only for the costs of the main action, but also for the costs of the preliminary process.[459] The only case that indemnification would not be granted, arises when the plaintiff shareholders bring the claim by way of an intentional or grossly negligent application.[460] So, the provision, focusing on predictability, ensures that abusive shareholders, would not be relieved from litigation costs, if they have presented an intentionally or grossly negligent case.[461] On the contrary no specific provision is made under English law.[462] The conduct of the plaintiffs is subject to the wide discretion of the English courts to decide whether an indemnity order should be granted.[463]

It can be argued that the German law does not place a significant financial burden on respectable shareholders, as it ensures that once the action is admitted, and regardless

[458] N. Paschos & K-U Neumann, 'Die Neuregelungen des UMAG im Bereich der Durchsetzung von Haftungsansprüchen der Aktiengesellschaft gegen Organmitglieder' (2005) Heft 33 DB 1779, 1786.
[459] s.148 (6) fifth sentence of the AktG (the UMAG)
[460] Ibid.
[461] L. Eisen, 'Limitations on Derivative Actions in Germany and Japan to Prevent Abuse' (2012) 34 Z. JapanR / J. Japan.L. 199, 212.
[462] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 110.
[463] CPR 44.3(4)(a)

of its outcome, the plaintiffs' right to reimbursement for the costs incurred in the whole two-stage process, is secured.[464] In other words, once admission is granted to the German shareholders to proceed with the derivative action, they know that they will be indemnified for their efforts to protect the company from wrongdoing. The same degree of predictability as to the reimbursement of the plaintiffs for the litigation costs, is provided even in the case that the company decides to take over the derivative proceedings and bring the action in its own right.[465] So, the German legislators seem to comprehend and introduce in the legislation the idea that the rights to be enforced are those of the company, and so it is reasonable that the company should bear the litigation costs for meritorious claims brought on behalf of it.

On the contrary, English law does not rely on predictability, but on the flexibility of the court to decide whether an indemnity order should be granted. Nevertheless, it is not clear whether the discretionary powers of the English courts are exercised for the benefit of minority shareholders on that matter, since relevant English case law evidences their reluctance in reimbursing even the meritorious claimants.[466] If the plaintiff shareholder manages to overcome the barrier of s263(2)(b), and the court gives permission for the action to proceed, on the basis that the action is one that a notional director would have sought, it seems peculiar that the costs could be still hanging on the plaintiff shareholders.[467] So, it is difficult to understand, why English judges would refuse to grant an indemnity order to the plaintiffs, if the judges themselves, examining the facts of the case, have already decided that the bringing of the claim serves the

[464] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 102.
[465] s.148 (6) fourth sentence of the AktG (the UMAG)
[466] McDonald v Horn [1995] 1 All ER 961; Halle v Trax B W Ltd [2000] BCC 1020; Mumbray v Lapper [2005] BCC 990, Ch.
[467] Arab Reisberg, *Derivative Actions in Corporate Governance: Theory and Operation* (Oxford University Press, 2007) page 245.

corporate interests. Compared to the German framework, which provides a more sensible regime on cost allocation, the English framework places the minority shareholders in a disadvantageous position, exposing them to uncertainty as to whether they will be reimbursed for their honest efforts to protect the company and themselves from managerial wrongdoing.[468]

It could be argued that the English approach on litigation costs, has been influenced by the suggestions of the UK Law Commission, which, before the enactment of the statutory remedy, has raised concerns that the possibility of making indemnity costs orders could incentivize vexatious claimants to engage in litigation.[469] Allegations of this sort, could disincentivize meritorious claimants, as it is difficult for a minority shareholder to comprehend this rationale, regarding that the indemnification itself is not assumed to be an incentive.[470] The incentive offers an additional benefit for the course of action that is taken and the derivative action does not grant such a benefit. It simply, leaves the minority shareholders in the position that they would have been, if their shareholding had not been harmed by the alleged wrongdoing.[471] As it has been explained in English case law, indemnity orders are not aimed at directly incentivizing the shareholders to use the remedy, but they are simply considered to be a form of legal aid.[472] Arguably, the German law seems to encourage an unconvincingly flexible and

[468] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 113.
[469] Law Commission, Shareholder Remedies, Consultation Paper No 142, 1996, para 18.1
[470] Arab Reisberg, 'Funding Derivative Actions: A Re-examination of Costs and Fees as Incentives to Commence Litigation' (2004) 4 JCLS 345, 355.
[471] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 56-57.
[472] Smith v Croft [1986] 2 All ER 551, 565.

shareholder-friendly approach on litigation costs that contrasts with the strict requirements of the German preliminary stage.[473]

2.3.B.9 Access to information rights

Under German law, shareholders enjoy only the right to request a verbal information by the board of directors.[474] However, this right can be easily restricted, if the company's articles provide otherwise.[475] Except from shareholders' access to scant verbal information rights, accessibility to corporate information can be achieved through a special audit procedure. The special audit can be found in sections 142-146 of the AktG, allowing shareholders to get access to the internal affairs of the management in order to assess the merits of their potential claims.[476]

The right to appoint special auditors is primarily vested in the general meeting by way of an ordinary resolution.[477] However, if there is no majority to cast the votes, then the appointment is made by the court upon request of a qualified minority of 1% or 100,000euros of the registered share capital.[478] This is not the only prerequisite that conforms to the requirements of s148 AktG on derivative claims. In order to prevent malicious litigants from starting derivative proceedings, with the sole purpose of requesting the appointment of auditors, s 142(2) second sentence prescribes that the court will make an appointment of special auditors, if the claimant-shareholders show their shares have been acquired no later than three months prior to the general meeting and that they will hold those shares until the court makes its decision in relation to the

[473] Harald Baum and Dan W. Puchniak, *The Derivative Action in Asia: A Comparative and Functional Approach*, (Cambridge University Press, 2012) page 89.
[474] s.131(1) sentence 1 of the AktG (the UMAG)
[475] s.131(2) of the AktG (the UMAG)
[476] ss. 142-146 of the AktG (the UMAG)
[477] s.142(1), first sentence of the AktG (the UMAG)
[478] s.142(2), first sentence of the AktG (the UMAG)

appointment of the auditors.[479] Furthermore, in analogy to section 148, the court will make the appointment if it is satisfied that the facts of the potential claim justify the suspicion that the company has suffered damage as a result of dishonesty or gross violation of the law or the company's articles.[480] The appointed special auditors are entitled to carry out a detailed investigation on the company's books and documents, as directed by the court.[481]

In contrast with the UK CPR rules on costs allocation for the pre-action disclosure, the German provision of s146 places the burden of the court fees and the costs deriving from the investigation on the company and not on the claimant-shareholders.[482] This provision applies only if the special auditors are appointed through a court order and not by a simple majority of the ordinary resolution.[483] The only case, that the claimants will have to compensate the company for the investigation costs arises, when the appointment has been caused by way of an intentional or grossly negligent submission of the applicants.[484]

All in all, the degree of shareholders' accessibility to corporate information is equivalent to the degree of their accessibility to the remedy itself. German legislators intended to adapt this disclosure regime to the reality of the German derivative action, so that the prospective litigants' access to corporate information could be facilitated. Despite the predictability and clarity of the law in the requirements that the claimant shareholders need to satisfy to access both the action itself and the relevant information to effectively proceed with the action, the quorum requirement, makes it difficult for an

[479] s.142(2), second sentence of the AktG (the UMAG)
[480] s.142(1), first sentence of the AktG (the UMAG)
[481] s.142(1) of the AktG (the UMAG)
[482] s.146, first sentence of the AktG (the UMAG)
[483] Ibid.
[484] s.146, second sentence of the AktG (the UMAG)

individual minority shareholder to find the required evidence and subsequently to reveal the alleged wrongdoing by raising a claim. The German shareholders seem to be in a more disadvantageous position than the English ones, who enjoy the individual right, in their capacity as members, to initiate derivative proceedings and get access to corporate information, without the need to seek for allies to do so. It should be admitted though, that German legislators have adopted a more shareholder-friendly approach for the costs arising in the course of the investigation compared to the English one. Both laws carry their own merits and demerits. It remains to be seen in Chapter 5, which are the elements that could fit in Cypriot company law for the creation of a more accessible derivative action in Cyprus.

2.4 Concluding Remarks on the English and German statutory schemes

Even though both the German and the English schemes have been formulated with the intention of introducing a more effective remedy, they seem to be more concerned with the frustration of vexatious claims, rather than the enrichment of minority shareholder protection. Both statutory schemes similarly tend to avoid "killing the company by kindness"[485], but they adopt different ways to achieve this objective.

In general, the English statutory derivative action does not seem to have achieved what the UK Law Commission recommended that the remedy needed to achieve.[486] The limitations for the bringing of derivative claims appear in the court's interpretation and application of the procedural requirements in a complex body of case law that has developed after the creation of the statutory remedy. The director's exposure to the risk of shareholder interference in their daily corporate affairs largely lies on how the

[485] Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1981] Ch 257 at [263].
[486] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 67

English judges discharge their wide discretion that is entrusted on them.[487] The interpretation of the two-stage process by the English courts in the aforementioned cases, has demonstrated that the English statutory rules on derivative claims, are not all favourable to the minority shareholders and the so called balancing of meritorious claims against the management's good faith judgment has turned into a strict set of legal safeguards that protect more the directors than the shareholders.[488] On the one hand, the statutory scheme undoubtedly broadens the range of applicants that could be allowed to bring a derivative action and the range of wrongdoing that might give rise to the bringing of such action, maintaining at the same time efficient safeguards against the establishment of an excessive litigation culture. On the other hand, the retention of ratification as a barrier, the unclear interpretation of s172 by the judges and the reluctance of the courts in granting indemnity costs orders seem to maximize complexity and minimize accessibility to the remedy, while the opposite was presumed to be achieved through the enforcement of the statutory scheme. [489] Considering that permission to continue the derivative claim was refused, on the basis of s263, in four out seven post-Act cases, it cannot be said that the English judges interpret the statutory provisions in a flexible manner.[490]

Also, the implied suggestion of the courts that the factors of s263 might be relevant to the preliminary stage, in order to determine whether the plaintiff has a prima facie

[487] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 361.
[488] David Gibbs, 'Has the statutory derivative claim fulfilled its objectives? The hypothetical director and CSR: Part 2' (2011) 32(3) Comp. Law. 76, 82.
[489] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 365-366.
[490] Edwin. C. Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) 33 Comp. Law. 99, 107.

case on the merits, imply that there will be substantial hearings in both stages.[491] The interpretation provided by the English courts confirms the concerns of the UK Law Commission that the creation of a two stage-process could possibly lead to a mini-trial at the preliminary stage, increasing the risk of a detailed, time-consuming and expensive investigation into the merits of the case.[492] For instance, in *Iesini*, the hearing lasted for four days.[493] This is particularly discouraging for prospective plaintiffs, who would have to be engaged in lengthy and costly proceedings, without any assurance that their legitimate efforts would be heard.[494]Arguably, the regulatory design of the English derivative action, is too rigidly enforced compared with the other common law jurisdictions, such as Canada, New Zealand and Australia.[495] It seems that the formation and the interpretation of the English statutory provisions reflect an implied statement that the company should not be not be exposed to undesirable shareholder litigation, disregarding to a large extent the accessibility to the remedy that the legislation was supposed to provide for respectable plaintiff-shareholders, who seek to protect their interests against corporate abuse. It remains to be seen in future case law, whether the strict interpretation of the procedural criteria by the judges, would leave minority shareholders in a worse position that they were under the previous common law regime.[496]

It seems that, by placing the remedy on a statutory footing, English legislators have not substantially minimized the complexity that was inherent in the previous common

[491] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151,157.
[492] Law Commission, Shareholder Remedies: Report, 1997, para.6.71
[493] Andrew Keay and Joan Loughrey, 'Derivative proceedings in a brave new world for company management and shareholders' (2010) 3 JBL 151,177.
[494] Ibid.
[495] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 67-68
[496] Edwin. C. Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) 33 Comp. Law. 99, 107.

law.[497] It is true that some of the English provisions, such as the cause of action, which broadened the circumstances that a claim could be raised, provide for a degree of flexibility that the previous common law was lacking. However, it could be argued that the wide list of factors that the court needs to consider in order to decide whether the claim is allowed to proceed, leads to more uncertainty rather than flexibility. The divergent views, expressed by the court in how they will assess the relevant criteria might deter the meritorious shareholders from testing their case, as the analysis of the post-Act case law above, has revealed that the English judges are keener to follow a strict rather than a flexible interpretation of the 2006 Act.

The German concept, emphasizing on predictability and legal certainty, presents a regulatory framework, that contains clear but also strict procedural requirements for the minority shareholders to satisfy in order to access the remedy. It is indisputable that legal certainty and predictability play a significant role in the procedural rules, governing the way that the applicant shareholders should act in order to make effective use of the remedy.[498] It would be reasonable to expect that legal certainty could possibly lead to effective application and interpretation of the law, and subsequently, to a number of successful claims in Germany. However, a relevant survey based on statements made by the chairs of commercial courts, that hear claims of that nature, reveals that very few claims have been examined on the basis of s148 and none of these few applications have succeed.[499] Therefore, it can be concluded that accessibility to the remedy is

[497] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in UK, Germany and Greece* (Routledge, 2020) page 122.
[498] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 114.
[499] Martin Peltzer "Das Zulassungsverfahren nach § 148 AktG wird von der Praxis nicht angenommen! Warum? Was nun?", in Ulrich Burgard, Walther Hadding, Peter O. Mülbert, Michael Nietsch & Reinhard Welter (eds) Festschrift für Uwe H: Schneider zum 70. Geburtstag 763, 764–65 (Otto Schmidt, 2011), 955.

severely restricted due to strict conditions that need to be met by the plaintiff shareholders. What has actually discouraged German shareholders to make use of the remedy, cannot be easily determined, since the number of cases examined on these grounds is limited. It can be assumed though, that the quorum requirement, the restricted scope of misfeasance, within which the claim should fall in order to be admitted, the fear that the company may instantly overtake proceedings are some of the reasons that can easily deter shareholders from testing their case. On the one hand, the German statutory framework achieved the purpose of becoming transparent and comprehensible, but not accessible to minority shareholders. It seems unlikely for minority shareholders to succeed in their applications, if the law is more concerned with the deterrence of frivolous litigants, rather than the deterrence of managerial misconduct.[500] Therefore, from a corporate governance perspective, it can be said that the German law has failed to promote the deterrent function of the derivative action. The same cannot be said for the compensatory function of the German remedy, as its cost allocation scheme seems to be particularly advantageous for the plaintiff shareholders. Although, this is of little practical importance, since no application has ever passed the admission stage in Germany, so that the shareholders could enjoy the benefits of this favourable cost litigation scheme.[501]

Therefore, the German approach, by introducing procedural requirements, surrounded by legal certainty and predictability, deters nuisance shareholders from initiating a derivative action. However, the high degree of legal certainty and predictability of the German law, moves to the wrong direction, restricting desirable

[500] Harald Baum and Dan W. Puchniak, *The Derivative Action in Asia: A Comparative and Functional Approach*, (Cambridge University Press, 2012) page 74.
[501] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in UK, Germany and Greece* (Routledge, 2020) page 113.

actions, from a corporate governance perspective. For example, legal certainty and predictability of the law on the cause of actions, clearly deters claims raised for trivial reasons, but at the same time swings the pendulum too far by limiting the range of the circumstances that a claim can be brought, only to wrongs that reach levels of criminality. It is unclear, why the German law assumes that only cases of severe breach of fiduciary duty should be deterred, but the same assumption cannot be made for cases of gross negligence. The German law has not clarified why the negligent actions of the management that result in severe losses for the company, equivalent to those that might have been caused by a breach of fiduciary duty, cannot fall within the ambit of the remedy.

Therefore, it can be concluded that both of these remedies are very difficult to access due to the rules introduced in the context of the two jurisdictions. The comparative considerations of this Chapter highlight the ways that these two jurisdictions address questions of shareholder protection. By virtue of this comparative examination, Chapter 5 provides a careful selection of both English and German law elements, discussed in this Chapter, to devise proposals for a reformed regulatory framework for the remedy in Cyprus. But, before we can develop proposals for measures that the Cypriot legislature should take to confront the problems of shareholder protection, it is important to identify these problems within the context of Cypriot company law. The next Chapter undertakes this task.

Chapter 3

Shareholder Protection in Cyprus: Challenges and Problems in Shareholder Remedies

3.1 Introduction

Cyprus has so far adopted the English common law derivative action; as it was thoroughly explained in Chapter 2 in England, this was replaced by the statutory derivative action of the CA 2006. However, in Cyprus it still remains in place. This Chapter argues that the English common law derivative action, as it is implemented by Cypriot company law fails to protect the interests of minority shareholders and to monitor mismanagement. The Cypriot derivative action is an underexplored corporate governance mechanism in literature, and scholarly analysis and commentary on Cypriot case law is limited. This Chapter examines the Cypriot law and explains why the Cypriot remedy is problematic adding significantly to the existing knowledge of the remedy in question. The Chapter examines in detail how the weaknesses of the English common law derivative action have been reflected upon the Cypriot company law. In addition to that, it investigates developments in English case law which have not yet been expressly considered by the Cypriot judiciary. The analysis focuses on the difficulties that Cypriot shareholders and Cypriot courts encounter, when following the well-established procedural rules of the English common law remedy. The Chapter argues that the common law derivative action, as it is implemented by Cypriot courts, failed to attain effective shareholder protection in Cyprus and therefore it needs to be reformed.

Moreover, the scholarly analysis of the English and Cypriot law on shareholder remedies extends to the comparison of alternative methods of shareholder protection; this is to show that the reform of the Cypriot derivative action is necessary, as even the alternative remedies are ineffective in protecting minorities, as it will be demonstrated in this Chapter. Therefore, a reform of the derivative action is imperative. The Chapter presents the broader context of shareholder protection in Cyprus and it explains the range of alternative remedies within the Cypriot and the English law. In particular, the Chapter examines whether the Cypriot oppression remedy is a viable alternative method of shareholder protection that would fill in the gaps left by the ineffectiveness of the Cypriot derivative action. The examination of the Cypriot oppression remedy provides a clearer picture of the overall level of shareholder protection under Cypriot company law. The Chapter examines the deficiencies of the so-called English "oppression" remedy, which was contained in s210 of the UK Companies Act 1948, and now has been abolished and replaced by a new remedy, the unfair prejudice remedy that can be found in s996 of UK Companies Act 2006. It then turns to have a look at the Cypriot oppression remedy within s 202 of the Cyprus Companies Laws, which is influenced by English law. The Chapter, examines whether the weaknesses of the abolished English regime have been transplanted into the Cypriot oppression remedy, rendering it a problematic descendant of the English oppression model. Taking into account, the recommendations and criticism of the UK Law Commission, the UK Jenkins Committee and the UK Cohen Committee on the English oppression remedy, the Chapter argues that the problems encountered in the abolished English remedy are relevant for Cyprus too. In the light of two problematic remedial models, the Chapter concludes that the need to review the Cypriot framework on derivative actions becomes all the more pertinent.

3.2 The Cypriot Derivative Action: An imperfect descendant of the English common law

As it was explained in great detail in the previous Chapter, before the codification of the derivative action in the United Kingdom under the Companies Act 2006, the derivative action was based on common law only. The English common law limited the ability of minority shareholders to sue a director for wrongdoing. This is because proof of fraud on the minority and of wrongdoer control were set as requirements that had to be fulfilled by the plaintiff shareholder when raising an action.[502] The Companies Act 2006 reformed the law of derivative actions. Gower & Davies argued that the "fraud on the minority' requirement needed to be 'consigned to the dustbin'.[503] This statement conveyed how problematic the English common law remedy had been. In many common law jurisdictions, the primary impetus for the enactment of a statutory derivative regime derived from the need to clarify the uncertainty and confusion arising from the inflexible and outmoded case law.[504] In the United Kingdom, the main aim of sections 260 to 263 of the 2006 Act was to enhance the access and effectiveness of the remedy, by removing 'the fraud on minority' exception as a precondition for the introduction of the claim.[505]

Cyprus, which adopted the English common law derivative action, has considered derivative actions twice in its shareholder litigation history. Particularly, in 2004, a successful derivative claim was examined in the case of *Pirillis v Kouis*[506]. In 2006, the

[502] Derek French, Stephen Mayson and Christopher Ryan, *Mayson, French & Ryan on Company Law*, 31st edition (OUP 2014) page 563.
[503] Paul L. Davies and Sarah Worthington, *Gower and Davies' Principles of Modern Company Law,* 9th edition, (Sweet & Maxwell, 2012) page 654
[504] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39-68.
[505] Wishart v Castlecroft Securities Ltd. [2009] CSIH 65 at [38]
[506] Theodoros Pirillis and Another v Eleftherios Kouis (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136.

second successful derivative action was brought before the courts in Cyprus, in the case of *Eliadis*[507]. It is notable that for decades the remedy has not been used by shareholders in Cypriot companies. English common law, and subsequently the English common law derivative action, have been incorporated into the Cypriot legal system, since 1960.[508] However, the remedy appeared in Cypriot case law in 2004 for the first time. This means that, for more than 40 years, the Cypriot remedy constituted an integral part of Cypriot common law only theoretically without being practically enforced by Cypriot courts. It is interesting to examine why Cypriot shareholders have not raised a derivative claim, since 1960. The answer lies on the defective nature of the common law remedy that discouraged a minority shareholder from raising a claim due to the non-exhaustive list of insuperable procedural barriers that the claimant shareholder needs to overcome. By the time that Cypriot judges interpreted the problematic English common law remedy, the UK Law Commission had already remedied some of the problems that the remedy entailed and had processed recommendations for the introduction of a new statutory derivative model in England.[509] Hence, it can be said, that for decades the Cypriot law does not offer effective shareholder protection, as it falls behind the drastic legislative changes that its mother-jurisdiction processed with the codification of the remedy in the UK Companies Act 2006.

3.2.1 Legal Standing for Derivative Claims in Cyprus: A comparative perspective

In both civil and common law jurisdictions the question as to who enjoys legal standing under different forms of derivative claims can be addressed in two ways. The right to sue can be conferred to an individual shareholder or to a minority of the

[507] Aimilios Thoma v Jacob Eliadis (Civil Appeal No.11784, 24/11/2006)
[508] 29.1 of Courts of Justice Law No. 14 of 1960
[509] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 6.12- 6.13.

contributors to share capital. In common law countries, the right of a shareholder to litigate is recognised as an individual right, and it does not oblige a prospective plaintiff to comply with particular requirements, such as holding a minimum stake, in order to be granted legal standing.[510] Civil law jurisdictions, such as Germany, France and Austria set ownership thresholds for the initiation of derivative proceedings.[511] Common law jurisdictions, such as the United Kingdom and other Commonwealth countries do not do set such requirements, because they consider the right to sue as an individual right. The different perceptions regarding this matter lie on the way that they define 'minorities'.[512] Most European jurisdictions define minorities as those shareholders of a certain proportion of the company's share capital, who need to satisfy the legal requirement of holding a minimum amount of shares in order to fill a derivative claim.[513]

On the other hand, the English law does not limit the availability of the remedy on such a basis. The UK Companies Act 2006 considers each individual shareholder to be a minority one for the purpose of bringing a derivative action.[514] The individual right confers locus standi to members to *'whom shares in the company have been transferred or transmitted by operation of law'*[515]. This right is rooted in English common law.[516]

[510] Dario Latella, 'Shareholder Derivative Suits: A Comparative Analysis and the Implications of the European Shareholders' Rights Directive' (2009) 6 ECFLR 1,8
[511] Kristoffel Grechenig and Michael Sekyra, "No Derivative Shareholder Suits in Europe –A Model of Percentage Limits, Collusion and Residual Owners", 2007, The Center for Law and Economic Studies Columbia University School of Law, Working Paper No. 312, 3 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=933105 (accessed November 2019)
[512] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 83
[513] Martin Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 Brook. J. Int'l L. 843, 856.
[514] s.370 of the UK CA 2006
[515] s.260(5) of the UK CA 2006
[516] [1950] 2 All ER 1064

It has no percentage limits for a minority shareholder to obtain locus standi. This condition is applicable in Cyprus too.

The percentage limits that many EU countries, such as Germany uphold, is supposed to constitute a screening mechanism against frivolous litigation.[517] Even though, percentage limits confine abusive litigation, it is difficult to consider how a minority shareholder would be able to file a suit under strict share ownership conditions.[518] Ownership thresholds limit the number of potential claimants, as those shareholders who do not meet the requisite ownership condition, are prevented from raising a derivative action. But, the avenue of derivative litigation is not blocked only for those shareholders who do not meet the percentage limits, but also for those who comply with the requisite share capital. This happens when shareholders, holding share blocks that render them eligible for raising a claim are involved in collusive practices with wrongdoing directors to drop the pursuit of a claim in exchange of a more advantageous self-dealing opportunity. Specifically, the presence of percentage limits allows the directors to make a pre-trial settlement offer to those members, who satisfy the ownership conditions, in order to wipe out the possibility of a shareholder suit that would compel them to pay damages to the company. The directors, buying off the right of those shareholders to sue, offer them more than what they would be awarded, if they were acting as prospective plaintiffs following a successful derivative suit.[519] In that way the concept of percentage limits, which according to Grechenig and Sekyra have played a decisive role in the absence of derivative suits in Continental Europe[520],

[517] Harald Baum and Dan W. Puchniak, *The Derivative Action in Asia: A Comparative and Functional Approach*, (Cambridge University Press, 2012) page 89
[518] Martin Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 Brook. J. Int'l L. 843, 856.
[519] Pavlos E. Masouros, 'Is the EU Taking Shareholder Rights Seriously?: An Essay on the Impotence of Shareholdership in Corporate Europe' (2010) 7(5) European Company Law 195, 201
[520] Kristoffel Grechenig and Michael Sekyra, "No Derivative Shareholder Suits in Europe –A Model of

transforms potential derivative plaintiffs to conspirators of corporate wrongdoing, while access to justice is further restricted.

The concept of percentage limits does not apply to the Cypriot reality. Similarly to what applies in English law, the right to sue derivatively under Cypriot law, belongs to each member of the company.[521] Conferring this right to shareholders individually, Cypriot law seems to support the view of a contractarian corporate structure, under which members' interests are of vital importance to the corporation, as explained in Chapter 1.[522] The Cypriot approach on legal standing seems to be more protective to shareholders, increasing the possibility of wrongs not remaining unpunished. So, it would be logical to assume that Cyprus, which traditionally adopts the British model on legal standing, creates a privileged background for derivative litigation to arise. However, the English common law remedy as it is interpreted by Cypriot courts allows only a small scope to be used by shareholders in Cyprus. Therefore, the following parts of the Chapter examine the problems of the common law remedy which are to blame for the absence of derivative litigation in Cyprus.

3.2.2 The Interpretation of the English common law derivative action by the Cypriot courts: Evidence of uncertainty from the Cypriot case law

Many authors argue[523] that the English courts preserve an unfriendly attitude towards minority shareholder litigation, an attitude that may be deemed as judicial

Percentage Limits, Collusion and Residual Owners", 2007, The Center for Law and Economic Studies Columbia University School of Law, Working Paper No. 312, 1 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=933105 (accessed November 2019)

[521] P. St. Kakopieros, *Directors of Limited Liability Companies in Cyprus* (in Greek, Nomiki Bibliothiki, 2016), page 261

[522] J. Dine and M. Koutsias, *The Nature of Corporate Governance* (EE, 2013); M. Galanis and A. Dignam, *The Globalization of Corporate Governance* (Ashgate, 2013)

[523] J Poole and P Roberts 'Shareholder Remedies—Corporate Wrongs and the Derivative Action' [1999] JBL 99, 125.

hostility.[524] English common law on derivative claims aims at non-interference in corporate decision-making.[525] This tendency of English courts to give directors the freedom and power to decide in the best interests of the company, without judicial interference in corporate decision-making, is based on the majority rule, which was developed as a result of the courts' historical reluctance to interfere in corporate conflicts over the internal management of business ventures.[526]

English common law sought to demarcate the nature of the defendant's misconduct which may or may not give rise to a derivative claim. The 'fraud on the minority' exception, which was considered as the only practical condition under which an individual shareholder had the right to sue expressed the court's desire "to give a remedy for a wrong which would otherwise escape redress"[527] As Jenkins LJ explained in *Edwards v Halliwell*, the reason for allowing such an action is based on the perception that "if they were denied that right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue"[528], an explanation that was also given in *Prudential*[529], regarding the necessity of the exception. As discussed in Chapter 1, two main requirements needed to have been met for a derivative action to be initiated. These were the 'fraud' requirement and the 'wrongdoer control' requirement. The challenge in interpreting them in a more specific and narrow way, has engaged many legal scholars, academics and judges.[530]

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[524] L.S. Sealy, "Problems of Standing, Pleading and Proof in Corporate Litigation" in B.G. Pettet (ed.), Company Law in Change (Stevens & Sons, 1987) page 3
[525] K.W. Wedderburn 'Shareholders' Rights and the Rule in Foss v Harbottle' [1957] CLJ 194, 195–8.
[526] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 4.2
[527] Burland v Earle [1902] AC 83 (PC), at [93] per Lord Davey
[528] [1950] 2 All ER 1064, 1067, per Jenkins LJ
[529] [1982] Ch 204, 211
[530] Colin Baxter, 'The True Spirit of Foss v. Harbottle' (1987) 38(1) Northern Ireland Legal Quarterly 6; D. DeMott, 'Demand in Derivative Actions: Problems of Interpretation and Function' (1986) 19 Davis Law Review 461.

The extensive review of the English common law derivative action by the Law Commission's Consultation Paper, led to the acknowledgment of the problematic nature of the remedy and the synthesis of a new statutory derivative model in England. The Law Commission's attempts to replace the remedy with a statutory one, allowing English courts to adopt a clearer approach to shareholder litigation, were assessed by the Company Law Review Steering Group too.[531] The Steering Group confirmed the recommendations of the Law Commission on reforming derivative claims and the proposed reforms after being authorized by the UK Government, were implemented in a new statutory scheme of the Companies Act 2006. It cannot be said that the English legal reform provides for a radical restructuring of the remedy, as certain procedural barriers continue to block access to shareholder litigation.[532] Despite the uncertainty that the English remedy carries, even within its statutory form, the elimination of the "*fraud on minority*" exception constituted a significant landmark.[533] In particular, it relieved judges from the burden of explaining what the terms "fraud" and "control" actually mean in different cases and absolved potential plaintiffs from proving that they are fulfilled. While the rule has been superseded by the somewhat more lawsuit-friendly Companies Act 2006, it continues to influence other common law jurisdictions such as the Cypriot one. Cyprus has not followed the English modifications on derivative claims, but decided to remain attached to the application of the previous English common law scheme. Applying the fourth exception to the proper plaintiff rule, the Supreme Court of Cyprus expressed its willingness to practically incorporate the two uncertain elements of fraud and wrongdoer control within Cypriot common law in

[531] Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: Final Report' (July 2001) URN 01/942 (CLR Final Report) at para 7.46-7.51
[532] Edwin C. Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) Company Lawyer 99, 107.
[533] J. Paul Sykes, 'The continuing paradox: a critique of minority shareholder and derivative claims under the Companies Act 2006' (2010) Civil Justice Quarterly 205, 233

Thoma v Eliadis[534] and in *Theodoros Pirillis v Eleftherios Kouis*[535]cases. The Chapter, in parts 3.2.2A. and 3.2.2B, analyses how the facts of the two cases unfolded before Cypriot judges and examines how Cypriot courts interpreted the English common law remedy.

3.2.2A The "fraud on minority" exception in Cyprus

It is very interesting that there is almost none relevant literature and academic commentary[536], on how Cypriot judges interpreted the ambiguity of the fraud on minority exception in these two cases. This study will do so.

In the *Kouis v Pirillis*[537] case, the claimant Eleutherios Kouis and the defendant Theodoros Pyrillis, who were relatives decided to form a company together, the Kouis & Pirillis Butchery Ltd.[538] They were both appointed as managing directors. Also, as members of the company, they offered their assets to the company for 500 shares each and so they were holding equal number of shares in the company. They were operating a joint bank account, where checks were deposited, while invoices and receipts were issued in the company's name. However, the cooperation between the two directors was problematic, as they unsuccessfully attempted to redeem each other due to the deterioration of their interpersonal relations. While Kouis was on leave to cease the tension between them, Pirillis started to sell the products of the company, using another company, the Theodoros Pirillis Enterprises Ltd. Pirillis misappropriated the equipment and corporate assets of Kouis & Pirillis Butchery Ltd, in order to increase the profits of

[534] Emilios Thoma and ors. v. Iakovos Eliades, (2006) 1 CLR 1263 (Civil Appeal No.11784, 24/11/2006)
[535] Theodoros Pirillis and Another v Eleftherios Kouis (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[536] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62, 68.
[537] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[538] Ibid.

Theodoros Pirillis Enterprises Ltd and personally benefit from that abuse. The Supreme Court of Cyprus endorsed the decision of the Court of First Instance (Distinct Court of Larnaka), which held that the egregious behavior of Pirillis amounted to fraud, giving rise to the bringing of a derivative action by Kouis. This was in his capacity as a shareholder of the company, as the company itself was not capable of enforcing its legal rights and requesting redress for the defendant's fraudulent behavior. So, the court concluded that the illegal channeling of the operations of the company to Theodoros Pirillis Enterprises Ltd satisfied the fraud element, as it deprived the company itself and consequently Kouis, as a member of the company, to participate to profits, advantages and benefits that originally belonged to Kouis & Pirillis Butchery Ltd.[539]

The decision of the Supreme Court of Cyprus in *Kouis* evidences the interpretation of the '*fraud on the minority*' concept by Cypriot courts. The fraud requirement is interpreted by Cypriot judges in a much wider way than by English judges. In English common law, it is judicially accepted, that the exception to the proper plaintiff rule, would be satisfied only if fraud has been perpetrated against the minority shareholders.[540] However, English judges are familiar with the concept of allowing a majority shareholder to bring a derivative claim, since there are cases, where the court accepted the bringing of the action by a 50% shareholder.[541] It is interesting that in the Cypriot case of *Kouis*, Kouis was not a minority shareholder, but his shareholding amounted to 50% of the company's shares. The court found that fraud was committed by Pirillis against a shareholder, but not a minority one. Hence, it seems the common law exception to the *Foss v Harbottle* rule is widely and not restrictively interpreted by

[539] Ibid.
[540] Edwards v Halliwell [1950] 2 All ER 1064
[541] Tonstate Group Ltd & Others v. Edward Wojakovski Edward Wojakovski v. Arthur Matyas & Others Arthur Matyas & Renate Matyas v. Edward Wojakovski [2020] 4 WLUK 311; Universal Project Management Services Ltd v. Fort Gilkicker Ltd and Others [2013] EWHC 348 (Ch), Phillips v. Fryer [2013] EWHC 1611 (Ch).

Cypriot judges in this case. In particular, Cypriot judges initiated a small amendment, which allows Cypriot shareholders to start a claim, without having a minority status. In the first glance, this amendment seems to be minor, but it definitely favours the litigant shareholder, who is not bound to be a minority one, in order to fill a suit on the company's behalf.

Also, it is notable that the interpretation that Cypriot courts provided on the exception, is also inspired by another common law jurisdiction. Similarly, in the Canadian case of *Glass v. Atkin*[542], the court held that the claimants, who were holding 50% of the company's shares, should be allowed to bring a derivative claim against the defendants irrespective of the fact that the claimants had not obtained a minority shareholder status. The Canadian court presumed that a derivative claim should be raised, as the wrongdoers, who, were in control of the company, holding the other 50% of the company's share capital, could prevent the initiation of derivative proceedings through the exercise of their voting power.[543] This flexible approach that was adopted in the *Kouis* case demonstrates that Cypriot judges by referring to *Atkin* case in their judgment and by following Canada's lead, pay greater attention to the company's inability to sue and the commission of the wrong itself to allow a derivative action to proceed, rather than to the capacity of the shareholder to sue.[544]

This interpretation seems to comply with the orthodox view that the concept of fraud simply answers to the character of the wrongdoing and should not be associated with any ratification procedures.[545] It can be assumed that the way in which Cypriot

[542] Glass v. Atkin [1967] 65 D.R.L. 2d 501.
[543] [1967] 65 D.R.L. 2d 501.
[544] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62, 68
[545] Christopher A. Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2014) 34(4) Legal Stud. 582, 586.

judges interpreted this exception coincides with the view of Lord Wedderburn, who stated that "fraud lies rather in the nature of the transaction than in the motives of the majority".[546] Specifically, Lord Wedderburn formed the opinion that it seems more appropriate to call the fourth exception to the *Foss* rule "*fraud on the company*" rather than "*fraud on the minority*".[547] In that sense, it can be argued that the Cypriot courts encouraged that perception by focusing more on the wrongful action itself, rather than on the ability of an individual shareholder to sue. Thereafter, it is clear that the term '*fraud*' is interpreted by the Supreme Court of Cyprus in a wider equitable scope that increases the possibilities of a successful claim, by disengaging the litigant shareholder from the obligation of being a minority member.

However, things become more unclear in cases where fraud falls within such a wider equitable sense. In *Estmanco*[548], the English court held that it is not clear what the word fraud means, but it operates within a wider spectrum than the common law fraud, with sir Robert Megarry V-C, explaining that fraud should not be interpreted narrowly, being capable of amounting to an abuse or misuse of power.[549] At first glance all these rulings could be understood as being interrelated, but in practice, the lack of consistency of these English judicial approaches rendered a common definition of fraud unattainable. There is not one single form of deceitful conduct that the Cypriot judges can account for "fraud" and as a result, there seems to be no clear indication of the stance of Cypriot law on this matter.

[546] K. W. Wedderburn, 'Shareholders' Rights and the Rule in Foss v. Harbottle (Continued)' (1958) 16(1) The Cambridge Law Journal 93, 96.
[547] Ibid, 93.
[548] Estmanco (Kilner House) Ltd v Greater London Council [1982] 1 All ER 437
[549] [1982] 1 All ER 437

The same wide interpretation in the meaning of fraud was given in *Aimilios Thomas v Iakovos Eliadis*[550]. In the second Cypriot case heard before the Supreme Court of Cyprus regarding the bringing of a derivative claim, the defendant wrongdoers, one of them being Aimilios Thomas, as controlling members and directors in Jam Restaurant Ltd, misappropriated the company's property and transferred its operations to another company, NMT Hotel Management Ltd (NMT Ltd), in which Aimilios Thomas was a majority shareholder. In specific, NMT Ltd deprived Jam Restaurant Ltd of the opportunity to run its business that had started since 1996. As the controlling wrongdoers of Jam Restaurant Ltd, they moved the activities of the company to NMT Ltd, using corporate funds and assets from the company, without the consent of Iakovos Eliadis and without paying back Jam Restaurant Ltd for exploiting its property to benefit another business. The court of First Instance held that the actions of the defendant directors and members of Jam Restaurant Ltd constituted fraud, as they appropriated to themselves money, property and advantages which belonged to Jam Restaurant Ltd and in which Iakovos Eliadis, as a member, had a right to participate. In contrast with *Kouis* case, in *Eliades* the '*fraud on the minority*' exception was applicable as an immutable rule, considering that the plaintiff in that case, was a minority shareholder and the court had not attempted to apply the "*fraud on the company*" exception, but kept the original model that English common law had established.[551]

Nevertheless, in both cases the Supreme Court of Cyprus highlighted that the concept of fraud should be broadly defined. The essence of fraud, as it is interpreted in *Eliadis* case, seems to stem from the words of Lord Davey in *Burland v Earl*, who

[550] Emilios Thoma and ors. v. Iakovos Eliades, (2006) 1 CLR 1263 (Civil Appeal No.11784, 24/11/2006)
[551] Ibid.

presented one of the most decisive explanations regarding the meaning of fraud.[552] His Lordship's view was also developed by Lord Wedderburn, who sought to distinguish between situations, where the breach of duty simply lies in the obtainment of an incidental profit, and situations, where the controlling members wrongfully act to withhold money, property or advantages, in which the company is legally or equitably entitled to participate.[553] However, the ambit of this distinction was not clearly determined under English common law.[554] The same observation can be made for Cypriot judges, who are struggling to specify the substantial nature of the wrong that should be committed to allow a derivative claim. This struggle is evident from their apathy to express any judicial concerns regarding the meaning of fraud, maintaining an impassive position that accepts fraud in a broader sense, without setting the boundaries that this broadness will reach. Hence, some could argue that the maintenance of this vagueness in the Cypriot approach might result in unfair judicial outcomes for plaintiff shareholders in future cases.

Also, in *Eliadis* case, reference is made to the meaning of fraud, as this was interpreted in *Daniels v Daniels.*[555] In most English cases, fraud is understood on the basis of an actual fraudulent practice and was not associated with any allegations of negligence. Common law fraud did not cover "mere negligence". This is evidenced in *Pavlides v Jensen*[556], where the claim failed as the negligent disposition of assets by the company's directors was not sufficient to confirm an allegation of fraud. Nonetheless, the court in *Daniels v Daniels*[557], approached this concept differently. Particularly, the

[552] Burland v Earle [1902] AC 83 at [93].
[553] (1981) 44 M.L.R. 202, 206
[554] G.R Sullivan, 'Restating the Scope of the Derivative Action' (1985) 44(2) Cambridge Law Journal 236, 240.
[555] Emilios Thoma and ors. v. Iakovos Eliades, (2006) 1 CLR 1263 (Civil Appeal No.11784, 24/11/2006)
[556] [1956] 2 Ch. 56.
[557] Daniels v Daniels [1978] Ch. 406

absence of an alleged fraud and the presence of a negligent action, which conferred a profit to the wrongdoers did not prevent the judges from approving the bringing of a derivative claim. This case displays how a negligent practice can influence the court to allow the bringing of a derivative claim, when this practice delivers a considerable profit to the negligent directors at the expense of the company.[558] Reference to this approach, by Cypriot judges in *Eliadis*, demonstrates their intention not to apply the fraud requirement narrowly, but such an intention was never balanced with a clear illustration of what this wider context of the requirement's application should include.

The English common law retained the level of uncertainty in the meaning of fraud. There was a notable attempt on the part of English courts to examine fraud on the basis of two positions. The orthodox position or as it is called "a transaction-based approach", which stated that fraud is simply an unratifiable wrong and the "voting-based approach".[559] The latter supports that even fraudulent actions could be ratified, but such a procedure needed to be conducted in a strict manner, independently of the wrongdoers.[560] For instance, Vinelott J in *Prudential* case discouraged the concept of fraud as an unratifiable wrong and perceived that fraud can be found, when the wrongdoing members use their voting power to impede the initiation of derivative proceedings.[561] According to his Lordship, "The 'fraud' lies in the use of their voting power and not in the character of the act or transaction giving rise to the cause of action."[562] In other words, this approach implies that fraud is proven through the use of the voting power by the wrongdoers in respect of the breach of duty that they are trying

[558] Mahmoud Almadani, 'Derivative actions: does the Companies Act 2006 offer a way forward?' (2009) 30(5) Company Lawyer 131, 132.
[559] Christopher A. Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2014) 34(4) Legal Stud. 582, 585.
[560] Ibid.
[561] Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2) [1981] Ch. 257 at [307].
[562] Ibid.

to condone. It can be assumed that the interpretation given in *Kouis* regarding the meaning of fraud tends to make Cypriot judges supporters of this orthodox position, but still this is a presumption that has not been confirmed by the Supreme Court of Cyprus.[563] So, the fact that Cypriot judges do not clearly side with one or the other position, verifies their unwillingness to adapt these two approaches to a model that would make such a distinction attractive enough in order to reflect the exact gravity of the wrongdoing.

Both Cypriot cases present an opportunity for Cypriot courts to acknowledge and assess the ambiguity of the common law derivative action. For instance in *Kouis*, Cypriot judges could have grasped this opportunity to provide for a clear distinction between a fraudulent and non-fraudulent transaction. On the contrary they decided to interpret the meaning of fraud in a way that did not take into account that the wrong should be perpetrated against a minority member. By allowing a majority shareholder to bring a derivative claim, the Cypriot judges extended the conditions under which the exception would be applicable. Thus, it can be argued that the Cypriot judiciary was not satisfied with the English common law exception, which was clearly referring to the ability of a minority shareholder to bring a claim, and not a majority one. Dissatisfied or not with the English common law approach, it would be surprising, though, if Cypriot judges would have been able to clearly determine what kind of wrong is ratifiable or not, while, in the past decades, English courts, holding a larger record of cases on that matter, had not achieved to provide a valid answer to that question. In the light of this frustration, a reform is necessary. Such a recommendation for a Cypriot reform could derive from the recommendations of the UK Law Commission. The Law

[563] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62, 70.

Commission highlighted the outdated nature of the law itself[564], an important parameter that Cypriot legislators should mind, as the tenacious attachment to outmoded case law tenets, restricts Cyprus from unrolling its own conceptions of corporate reality that would be able to fit with more modern dilemmas and not with cases decided almost a century ago.[565]

3.2.2B Wrongdoer control in Cyprus

Wrongdoer control is also interpreted in a vague manner by Cypriot judges. The English common law in leading cases[566] associated the term 'control' with the prevalence of votes in the general meeting. However, the meaning of the term is not related only to cases, where the claimant needs to show that the persons against whom the allegations are made own a majority of the shares, which confer voting rights. English judges sought to extend the scope of the requirement.[567] For instance, Vinelott J in *Prudential*, provided a liberal outlook on the notion of control. Treating control as a necessary component of fraud, his outlook entailed that the term control should include not simply the de jure, but also the de facto control.[568] His argument depicted a corporate reality, in which those in control of their deceitful policy can prevail through a variety of means.[569] These means are linked to the managerial power that the wrongdoers exercise over litigation proceedings or the exploitation of corporate information. So, Vinelott J relied on the idea that matters other than voting, such as

[564] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 14.2
[565] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L. Rev 40, 58.
[566] Menier v. Hooper's Telegraph Works (1874) 9 Ch. App. 350, 353; Mason v. Harris (1879) 11 Ch. D. 97, 108; Alexander v. Automatic Telephone Co. [1900] 2 Ch. 56, 69; Cook v. Deek (1916) 1 A.C 554; Russell v. Wakefield Waterworks Co. (1875) L.R. 20 Eq. 474; Gray v. Lewis (1873) 8 Ch. App. 1035; Pavlides v. Jensen [1956] Ch. 565.
[567] K. W. Wedderburn, 'Shareholders' Rights and the Rule in Foss v. Harbottle (Continued)' (1958) 16(1) The Cambridge Law Journal 93, 95.
[568] [1981] Ch. 257, at [307].
[569] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L. Rev 40, 51.

monopoly of information and the use of managerial vetoes over litigation sufficed, so that the control element could gain recognition by the judges.[570] Although, The Court of Appeal in *Prudential* remained silent, neither endorsing nor disapproving this open-minded approach on the notion of control by Vinelott J. The Court of Appeal, without giving further consideration of a conclusive nature to Vinelott J's ruling, simply commented that the majority may comprise those shareholders who are likely to vote in favour of the delinquent, as a result of influence or apathy.[571] The rule was not binding and had not become clearer in *Prudential*.[572] The UK Law Commission, criticised the above statement of the Court of Appeal in *Prudential*, and stated that the degree of "influence" that the wrongdoer must have over a particular shareholder for the shareholder's votes to be under the wrongdoer's control is very unclear.[573] Similarly, the term "apathy" is not determined in a way that demonstrates the kind of conduct that would characterize a particular shareholder, as apathetic in this context.[574] There is no doubt that a number of different circumstances could evidence "control". This is also confirmed by Lord Wedderburn who explains that, "control exists if it would be futile to call a general meeting because the wrongdoers would directly or indirectly exercise a decisive influence over the result"[575]. Having a closer look to the words "*directly or indirectly"*, someone can assume that they include a variety of controlling situations. But, practically the law on wrongdoer control, provides nothing but generic statements that do not create a transparent legal background upon which minority shareholders can base their attempts for bringing a successful claim.

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[570] G.R Sullivan, 'Restating the Scope of the Derivative Action' (1985) 44(2) Cambridge Law Journal 236, 246.
[571] |1982] Ch. 204, at [219].
[572] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 172.
[573] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 4.16
[574] Ibid.
[575] K.W. Wedderburn 'Derivative Actions and Foss v Harbottle' (1981) 44 MLR 202, 205.

This uncertainty is mirrored in the two Cypriot cases. Similarly, to the UK Court of Appeal in *Prudential*, the Cypriot approach seems to be subject to no comments on that matter by Cypriot judges.[576] In both cases, the Supreme Court of Cyprus indicated that the wrongdoer control element was satisfied. Especially, in *Kouis* case an obvious indication of control by the wrongdoer defendant was the fact that, while Kouis was on leave to relax the tension and the hostility of their relations, the calling of a general meeting was practically impossible, as the two directors and members of the company had no communication at all regarding the management of the company. The absence of Kouis from the company's affairs gave Pirillis the ability to exercise his managerial veto over the company, a condition which could definitely amount to de facto control. However, Cypriot judges in this case do not interpret in clearer terms the element of "control", providing a definite and binding ruling on what stands for de facto control. Unlike, Vinelott J in *Prudential*, who sought to recast the complexity of the law, providing some clarifications on what de facto control might include, Cypriot judges remain inactive on that matter, without making a dicta comment on how the control requirement could become clearer in order to merit judicial recognition for derivative action purposes. Lack of clarity on the wrongdoer control requirement was also commented by the UK Law Commission. The Commission emphasized that the law as to the meaning of control is unclear and its applicability in occasions, where the wrongdoers do not obtain control in the form of voting, is in doubt.[577] The recommendations of the Law Commission on that matter, constituted a considerable spur for the abolishment of that requirement in England and the reconstruction of the remedy on a clearer basis.[578] The same spur could be given to Cypriot legislators in

[576] (2006) 1 CLR 1263; (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[577] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 14.2
[578] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 185.

order to acknowledge the problematic nature of that requirement and consider the introduction of a new statutory remedy, which would not be based on the fulfillment of conditions with unclear terminology. Thereafter, the recommendations of the UK Law Commission on that issue, are valuable for Cyprus too, as Cypriot judges, until today, allow an aspect of the derivative action to remain badly applicable, portending an unattractive realm for shareholder protection.

3.2.3 "*The interests of justice*": Is it an attempt to escape uncertainty?

The unwillingness of Cypriot judges to interpret in clearer terms the fraud and wrongdoer control elements can also be attributed to the "interests of justice". In *Kouis*, Cypriot judges considered the embracement of the *'interests of justice'*.[579] English courts during the 1980s and 1990s avoided classifying the "*interests of justice*" as an exception to the *Foss v Harbottle* rule in its own right.[580] Controversial views have been expressed as to whether this concept constitutes a distinct exception itself. For example, the decisions in *Prudential*[581] and *Estmanco*[582] cases, on one hand were viewed as 'laudable' in the sense that justice was found for the claimants, but on the other hand were criticized as unhelpful in setting a sound legal background, upon which accurate explanations of the law could be given.[583] Furthermore, Sealy, commenting on relevant Australian case law, considered that this concept encloses the willingness of the judiciary to remedy a wrong, undistracted by any procedural or *locus standi* considerations.[584]

[579] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[580] Arab Reisberg, *Derivative Actions and Corporate Governance (*Oxford University Press, 2008) page 99.
[581] Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204
[582] Estmanco (Kilner House) Ltd v Greater London Council [1982] 1 WLR 2, at [10]– [11].
[583] N. Russell 'Liberalising the Derivative Action' [1982] New Zealand Law Journal 180, 182–3
[584] LS Sealy, 'The Rule in Foss v Harbottle: The Australian Experience' (1989) 10 Company Lawyer 52

The Cypriot courts have generally shown such willingness to grant a shareholder standing, where the justice so requires it. Particularly, in *Kouis*, the Court of First Instance underlined that it should be acceptable and fair to allow a derivative claim to proceed, even in cases where the wrongdoers may hold less than 50% of the company's shares, if the interests of justice necessitate such a decision.[585] The Cypriot court referred to the judgment of Jessel MR in *Russell v. Wakefield Waterworks Co*[586], in order to show that the derivative action can survive, even if one of the requirements on the '*fraud on minority'* exception cannot be met.[587] In specific, Sir George Jessel MR in *Russell* asserted that the prevention of a minority action under the *Foss* rule should not be considered as a universal rule, but it can be subject to exceptions.[588] According to his judgment the application of these exceptions depends not only on the necessity of the case, but also on the necessity of the court to award justice.[589]

Nonetheless, there is no conclusive indication on the part of Cypriot courts that a fifth exception, exists and should be applicable, when the circumstances of a case give rise to considerations that are based on the interests of justice. This exception is quite problematic in respect of its accuracy, as the precise circumstances that would allow its applicability are not indicated.[590] There is no clarity as to what kind of circumstances would fall within the ambit of the '*interests of justice'*. This problem concerned English courts too, creating a debate on whether a fifth exception actually existed.[591] This exception, if we can call it an exception, was firstly suggested by Sir James Wigram V-

[585] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[586] Russell v. Wakefield Waterworks Co (1875) L.R. 20 Eq. 474
[587] Anthony Boyle, 'A Liberal Approach to Foss v. Harbottle' (1964) 27 Modern Law Review 603
[588] (1875) L.R. 20 Eq. 474 at [480].
[589] Ibid.
[590] O. A Osunbor, 'A Critical Appraisal of "The Interests of Justice" as an Exception to the Rule in Foss v Harbottle' (1987) 36 International and Comparative Law Quarterly 1, 2.
[591] Ian M. Ramsay, Benjamin B. Saunders, 'Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action' (2006) Research Report, Centre for Corporate Law and Securities Regulation, The University of Melbourne, Research Paper No 250, 10 https://ssrn.com/abstract=914465 (accessed March 2020)

C in the course of his judgment in *Foss v. Harbottle.*[592] In detail, he stated that the interests of justice can supersede the rule, demanding action by the company itself, when it is inevitable that the wrong can only be remedied by an individual shareholder, suing in his private capacity.[593] Quoting the words of Sir Wigram V-C, the claims of justice were also encouraged in *Baillie v. Oriental Telephone & Electric Co Ltd*[594] by Swinfen Eady LJ, who stated that "in certain cases members may sue on behalf of the corporation if the interests of justice require it".[595] On the same scale of justice, Romer J in *Cotter v. National Union of Seamen*[596] pointed out that "[a]n action at the suit of individual members of an incorporated company is no doubt permissible where justice so requires".[597]

Even though the validity of this doubtful exception was questioned under English common law, the above cases approve its consideration. However, even in the words of Sir James Wigram V-C from which this concept originates, there is no suggestion that such a condition constitutes in itself a clear exception to the proper plaintiff rule.[598] Moreover, the Court of Appeal in *Prudential*, disapproved this ruling, as being a test of no practical significance.[599] Hence, it is unreasonable to believe that the encouragement of an ill-established concept in some relevant English case law would automatically set the keystone of a fifth exception that can be validly applicable by Cypriot courts. On the basis of this remark, it can be argued that reference of this exception by the Cypriot court in *Kouis*, reinforces the vagueness that the common law derivative action suffers

[592] [1843] 67 ER at [189]-[203].
[593] Ibid.
[594] Baillie v. Oriental Telephone & Electric Co Ltd [1915] 1 Ch. 503.
[595] [1915] 1 Ch. 503 at [518].
[596] Cotter v. National Union of Seamen [1929] 2 Ch. 58
[597] [1929] 2 Ch. 58 at [69].
[598] O. A Osunbor, 'A Critical Appraisal of "The Interests of Justice" as an Exception to the Rule in Foss v Harbottle' (1987) 36 International and Comparative Law Quarterly 1, 4.
[599] [1982] 1 All E.R. 437

in Cyprus and raises more questions for Cypriot judges to answer in the light of future similar cases. There is no doubt that Cypriot judges, by referring to this nebulous concept in *Kouis*, seek to extend the circumstances under which a derivative action could be raised. The problem is that they express their willingness to aid minority protection in a way that it is unlikely to achieve a desired result, as "*the interests of justice*" seems to be a superfluous consideration rather than a well-founded exception. As it was stated by the Court of Appeal in *Estmanco*, this concept constitutes an important reason, for making exceptions to the *Foss* rule, rather than being an exception itself.[600] Taking this statement into account, it could be argued that the Cypriot approach on the interests of justice, highlights the need of Cypriot judges to make exceptions to the proper plaintiff rule. Nonetheless, it is highly unlikely that derivative litigation would meet clarity, if the courts continue to produce unstable judgments, relying on uncertain exceptions.

3.2.4 Common Law Procedural Barriers on the Cypriot Derivative Claims

Except from the problems that arise in the interpretation of the fourth exception by English judges, the English common law remedy is quite problematic in terms of the procedural hurdles that sets to prospective plaintiffs. Under English common law, shareholders' uncertain prospects of success and meaningful recovery are not only limited to the exceptions of the rule in *Foss v Harbottle*, but they also extend to strict conditions that the plaintiff shareholder needs to meet.[601] In the old days of the English common law derivative action, English courts were susceptive to treat shareholders, who seek to initiate an action in the company's name, with suspicion, strictly monitoring their suitability and appropriateness in performing the role of instigator of

[600] Estmanco (Kilner House) Ltd v Greater London Council [1982] 1 WLR 2 at [10]-[11]
[601] William Kaplan and Bruce Elwood, 'The Derivative Action: A Shareholder's "Bleak House"?' (2003) 36 University of British Columbia Law Review 443, 450.

proceedings.[602] The English judiciary's uneasiness, is more than obvious, if someone looks at the decision of the Court of Appeal in *Prudential*.[603] Except from the useful insights of this particular case, a valuable record of other English cases[604] confirms that English judges have been habitually cautious with derivative litigation. Particularly, they were invited to mediate between the decision-making bodies and the corporate dispute in question.[605] The English judiciary was inclined to defer to the corporate will, erecting as many procedural hurdles as possible in the way of a minority applicant, who comes before the court as a litigant in a derivative claim.[606]

Unlike English courts, Cypriot courts have generally shown a willingness to grant a shareholder standing, with the most obvious point of their goodwill lying in the courts' tendency to embrace the *'interests of justice'*, as an additional consideration that would act in favor of the claimant's litigation effort. It is not clear whether Cypriot judges treat the *"interests of justice"* as an exception to *Foss v Harbottle* in its own right, but what can be said with certainty is that Cypriot judges do not express an intention to encumber the litigant shareholder with extra procedural barriers. As explained in Chapter 1, § 29(1)(c) of the Courts of Justice Law No. 14, 1960 provided that post-1960 English case law would be binding for Cypriot courts. Even though, the Cypriot derivative action is a descendant of the English common law, the Supreme Court of Cyprus clarified in relevant case law that English common law would have a persuasive rather than a binding effect in cases heard before Cypriot courts.[607] Hence, it seems that

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[602] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 76.
[603] Ibid.
[604] Smith v Croft (No.2) [1987] 3 All E.R. 909, Pavlides v Jensen and Others [1956] 2 All ER 518, Nurcombe v Nurcombe [1985] 1 WLR 370, Barrett v Duckett [1995] 1 BCLC 243
[605] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 94.
[606] Ibid, 101.
[607] Stylianou v. The Police (1962) 2 CLR 152; Antonis Mouzouris And Another v. Xylophaghou Plantations LTD. (1977) 1 CLR 287; Adamtsas LTD. (in voluntary liquidation) v. Republic (Minister of Finance and Another) (1977) 3 CLR 181; The Police v. Xydia (1992) 2 CLR 26.

Cypriot judges have shown an inclination to effectively 'brush aside' the procedural barriers that the English common law, so forcefully achieved to impose in the past decades. It is true that, Cypriot legislation is far from perfect, taking into account the unresolved issues of the fraud and wrongdoer control requirements. Nonetheless, the absence of these procedural considerations on the part of Cypriot judges in the two reported cases, reveals the adoption of a flexible and shareholder-friendly approach to derivative litigation that is not strongly affected by the hostility that English courts maintained against derivative actions.

The flexibility of the Cypriot law in allowing derivative claims would be better understood, by assessing the rigidity of the over-restrictive criteria that English courts considered in exercising their discretion to allow, or some alternatively would say to prohibit the initiation of derivative proceedings. Firstly, English case law had established that a full trial would be possible, if the representative plaintiff provides prima facie evidence that the defendants were in a position of control within the company and had perpetrated a fraud on the minority.[608] This means that, even though the right of a member to sue is considered to be an individual right in English common law, legal standing has to be established as a preliminary issue by evidence, showing a *prima facie* case. For example, in *Prudential* the Court of Appeal held that a derivative action could be raised only when the court determines whether the company was *prima facie* entitled to recovery and whether the wrongful action itself falls *prima facie* within the realm of the *Foss* exception for a claim to be allowed to proceed.[609] In the two Cypriot reported cases, analysed above, there is no clear suggestion that the litigants should bring a *prima facie* case, which the court should assess at a preliminary hearing

[608] G.R Sullivan, 'Restating the Scope of the Derivative Action' (1985) 44(2) Cambridge Law Journal 236, 239.
[609] Prudential Assurance Co v Newman [1982] 1 All E.R. 354

in order to allow the claim to proceed. The Cypriot court, in both cases, applied the '*fraud on minority'* exception, without raising further concerns of a "*prima facie*" character.[610] Nevertheless, it could be argued that, the facts of the two Cypriot cases demonstrate, on their own right, a *prima facie* case for the initiation of a derivative action and this might be the reason that such a consideration is blurrily sighted by Cypriot judges in their decision to allow a derivative action in both cases. The exclusion of this consideration by Cypriot judges in the two successful cases, seemed to be for the benefit of the litigant shareholders, relieving them from the burden of additional costs to search for evidence that cannot be easily found, especially when the wrongdoing directors are in control of the company and they can arbitrarily exercise their powers to block access of minorities to sensitive information. Finally, it is important to note the comments of the UK Law Commission on the "*prima facie*" concept, stating that it was causing significant delays and expenses at the preliminary stage, without any prospect of success.[611] In that sense, it can be argued that the Cypriot approach in *Kouis* and *Eliades* disencumbers the shareholder of the burden to prove an uncertain concept that it is unlikely to award him with a positive litigation outcome.

However, Cyprus Courts in the cases of *Ciara Quinn v Anglo Irish Bank Corporation Limited*[612] and in *Amstel Exploitatie BV v Dan Dvergsten and others*[613] voluntarily performed a prima facie examination, based on the English case of *Prudential*. In *Ciara,* the Cypriot Court rejected the claim on the basis of the preliminary examination, while in *Amstel*, the claim successfully passed the prima facie

[610] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136; (2006) 1 CLR 1263 (Civil Appeal No.11784, 24/11/2006)
[611] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 14.4
[612] Ciara Quinn v. Anglo Irish Bank Corporation Limited, CY: EDLEF:2012: A64
[613] Amstel Exploitatie BV v. Dan Dvergsten and others, CY:EDLEM:2015: A266

examination.[614] Hence, the approach of Cypriot courts to apply the prima facie requirement on an ad hoc basis and to remain silent on the determination of a "*prima facie*" concept, seems to create confusion to both courts and shareholders. As in English cases, following *Prudential*, there is no clarity as to what kind of evidence the representative claimant needs to show, in order to satisfy a "*prima facie*" concept, it is unlikely that the scarce application of the prima facie requirement by Cypriot courts in future cases, would make the remedy more readily accessible to Cypriot shareholders.

Another significant hurdle in the non-exhaustive list of English courts is the "*good faith*" requirement. English courts had looked at derivative claims from the perspective of whether the action was in the corporate interest and whether the claimant was the most appropriate person to start such an action.[615] There is no suggestion on the part of the Cypriot judiciary that the claims should have been brought "*bona fide for the benefit of the company*", as the Court of Appeal considered in the English case of *Barrett v Duckett*[616]. A question that could be raised at this point, is whether Cypriot courts are keen to encourage the continuation of a derivative claim, when the wrongful action falls within the boundaries of the *Foss* exception, regardless of the fact that the shareholder, who brings the action might has been motivated by a personal resentment against the defendant. This is a valuable consideration in *Kouis* case, as the two business partners, were also relatives and their relations were quite strained. On the basis of this observation, it could be assumed that, to some extent, Kouis might have been intrigued to pursue a derivative claim, due to his personal repulsion for the wrongdoer. So, if Cypriot judges were willing to follow UK's lead on *good faith*, they would have

[614] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62, 72.
[615] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 172.
[616] Barrett v Duckett [1995] 1 BCLC 243

questioned at this point whether such a repulsion was found to be in conflict with the interests of the company. Although, English common law did not provide further guidance on whether the collateral motives of the claimant, that do not conflict with the company's interests should trigger the judges to reject the initiation of a derivative claim.[617] Therefore, the remoteness of the Cypriot court from the consideration of the *good faith* criterion, may have been more productive of good than harm, as the term is not clear enough to guarantee that its interpretation by the judges would elucidate the matter of whether the claim should be permitted or not.

Moreover, another relevant consideration for English courts in allowing a claim to proceed, is the availability of an alternative remedy, which might not have a direct effect on the control that the wrongdoer exercised to perpetrate the fraudulent action.[618] In *Barrett*, the availability of the unfair prejudice remedy constituted an additional element in the Court of Appeal's decision to bar the initiation of the claim.[619] The decision in *Barrett* and particularly the judgment of Peter Gibson LJ[620], was strongly supported and applied in *Portfolios of Distinction Ltd v Laird*[621], where the Deputy High Court Judge, Launcelot Henderson QC, stressed that a successful claim could be achieved, only if there is no other adequate remedy available.[622] English courts viewed the availability of alternative remedies, as a clear bar to derivative litigation. In particular, they considered that the unfair prejudice remedy is a reasonable solution, which could replace the need of a plaintiff shareholder to resort to a derivative action.[623] However,

[617] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' (2006) 3 ECFR 69, 102.
[618] David Kershaw, 'The rule in Foss v Harbottle is dead: long live the rule in Foss v Harbottle' (2015) 3 Journal of Business Law 274, 280.
[619] [1995] 1 BCLC 243
[620] [1995] 1 BCLC 243 at [250]
[621] Portfolios of Distinction Ltd v Donald Ian Laird & Ors [2004] EWHC 2071 (Ch)
[622] [2004] EWHC 2071 (Ch)
[623] Bhullar v Bhullar [2003] EWCA Civ 424; Clark v Cutland [2003] EWCA Civ 810.

it would be unfair to say that such a view can be automatically supported by Cypriot courts, as the remedy of unfair prejudice has not been adopted in Cyprus. A viable alternative that Cypriot courts would be able to have regard to, is the oppression remedy. As, it will be explained below, the oppression remedy that Cypriot company law maintains cannot stand as an efficient method of shareholder protection, presenting a number of deficiencies. Subsequently, it would be unlikely that this remedy could operate as an effective substitute of the derivative action, which Cypriot judges would consider in an attempt to reject a plaintiff's derivative claim. It is remarkable to mention that in *Kouis* case, the defendant appealed to the Supreme Court of Cyprus, arguing that a derivative claim was wrongly raised and that the oppression remedy, which can be found in section 202 of the Cyprus Companies Law, Cap. 113, should have been applicable in the circumstances of that case.[624] The reluctant stance of the Cypriot Supreme Court in rejecting this argument, shows that the oppression remedy could not be accepted as a grounded consideration in the minds of Cypriot judges in determining the continuance of a derivative claim. Once again, the Cypriot approach makes the remedy more accessible to minority shareholders, developing some distance from the over-restrictive considerations of the English common law.

In addition, English courts, examined the views of independent members of the corporate organs. For example, in *Prudential* the court weighted the votes of the disinterested board not to pursue the litigation, in order to reach the same decision.[625] Also, Knox J in *Smith v Croft* (No.2), indicated that even if a wrong cannot be ratified, an independent body of shareholders can validly take the decision to prevent a minority shareholder's legal standing.[626] In other words, according to his suggestions, the ability

[624] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[625] [1981] Ch. 257
[626] [1988] Ch. 114 at [189].

of a minority shareholder to sue can be easily wiped out, regardless of whether or not the wrongful action falls within a ramifiability sphere.[627] Thus, English judges did not prevent shareholders from voting following a disfranchisement procedure, but they simply sought to exclude from their consideration those votes that had been casted by shareholders who are interested in the wrongful action.[628]

Even though, this concept of independence has some attraction in filtering unmeritorious claims, it also creates a number of practical difficulties.[629] In specific, English courts had not achieved to deploy particular means by which they would discover whether or not shareholders are actually interested in a particular vote. Of particular concern was the fact that an independent and disinterested board might reach unjust and irrational decisions to ratify a wrongdoer.[630] However, there is some evidence showing that English common law provided an explanation of how independence could be tested and be detected. The question is whether such an explanation was effective enough to determine "independence" and to assist the judicial effort in deciding the continuation or rejection of a derivative claim. In *Smith v Croft*, Knox J explained that the term "*independent*" refers to those shareholders that their decisions should be made for the benefit of the company and that there should not be a substantial risk that their votes would be casted for the improper purpose of protecting the wrongdoers.[631] Therefore, Knox J was concerned with the question of whether the decision has actually been taken for the company's benefit, delving into the complex world of the shareholders' intentions, while Vinelott J in *Prudential* adopts a different

[627] Jennifer Payne, 'A Re-Examination of Ratification' (1999) 58(3) Cambridge Law Journal 604, 616.
[628] Ibid, 621
[629] Ibid.
[630] Christopher A. Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2014) 34(4) Legal Stud. 582, 597.
[631] [1988] Ch. 114 at [189]

approach to the issue.[632] In contrast with Knox J, who investigated whether the members exercised their votes in a disinterested manner, for Vinelott J, the court should not focus on the way that voting has been exercised, but on detecting in general terms those members that are "interested" in the wrongful action and then simply disregard their votes.[633] It is evident that both considerations are too vague to find that a number of apparently independent shareholders are not, in fact, as disinterested as they might appear to be.[634]

Consequently, it is difficult to ascertain that a supposedly disinterested member would not vote contrary to the company's interests, if his relations with the wrongdoer are affected by a strong and long-standing colleague cooperation, or a friendship, or even by family bonds.[635] Especially, in medium sized companies, like the Cypriot ones, which are usually family-owned corporations, issues of independence complicate the judicial task in allowing a derivative claim. It is quite unlikely that the judges would be able to mitigate the risk of an interested vote to be casted as disinterested, when family relations are involved in members' decision to ratify a fraudulent transaction. Both Cypriot reported cases involve small businesses, in which the members had developed strong and long-lasting business and family relations. So, it is not surprising that Cypriot judges did not take into account the "*independence*" concept, as its consideration would complicate the performance of their specific task in evaluating the potential success of the derivative litigation. As a result, it can be concluded that English common law had left a gap in adequately translating the "*independent organs*" concept. The assessment of the motivations of disinterested shareholders, in voting in favor or

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[632] Jennifer Payne, 'A Re-Examination of Ratification' (1999) 58(3) Cambridge Law Journal 604, 621-622.
[633] [1980] 2 All E.R. 841 at [874] per Vinelott J
[634] Biala Property Ltd. v. Mallina Holdings Ltd. (No. 2) (1993) 11 A.C.S.R. 785
[635] Jennifer Payne, 'A Re-Examination of Ratification' (1999) 58(3) Cambridge Law Journal 604, 621.

against a derivative claim, seems to be an impractical and unhelpful process that cannot clearly determine whether the litigant shareholder can actually fulfill its representative role. For, that reason, it can be said that Cypriot judges wisely decided not to grapple with independence tentacles.

English law was developed to provide disincentives to prospective plaintiffs, but it seems that Cypriot law does not strictly follow the same over-deterrent approach. Facing all these practical complexities, it was almost impossible for a bona fide shareholder, who genuinely contemplates to bring a derivative action, to overcome all these procedural barriers.[636] On the contrary, the Cypriot approach could be seen as maintaining a flexible policy of favoring shareholders. An important remark, that enhances the perception on the inclination of the Cypriot judiciary to applaud the valuable role of derivative actions, is the fact that both Cypriot reported cases were heard by the same judges of the Supreme Court of Cyprus.[637] This means that, the Cypriot judiciary is keen to maintain a policy, which aims to offer a chance to "internally" develop English common law in a manner which would appear to be more beneficial for a potential plaintiff, without imposing further procedural limitations to the ability of a shareholder to justifiably fulfill his representative role.

The decision of the court in permitting the derivative claim in the two Cypriot cases reveals that the remedy is to some extent workable. However, a successful outcome in two reported cases cannot confirm that the remedy was not applicable by chance rather than by intention. The reality of the English common law foreshadows a problematic remedy. This means that even if Cypriot judges tend to exclude the consideration of

[636] Arad Reisberg, 'Theoretical Reflections on Derivative Actions in English Law: The Representative Problem' [2006] 3 ECFR 69, 99.
[637] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136; (2006) 1 CLR 1263 (Civil Appeal No.11784, 24/11/2006)

additional procedural hurdles in allowing a claim to proceed, the complexities of the "*fraud on minority"* exception suffice to deprive Cypriot shareholders from any prospects of success in future cases. Although, the outcome of the two Cypriot cases is positive, benefiting the litigant, the analysis above, has shown that Cypriot courts are not willing to give clear answers to specific questions emanating from the "*fraud on minority"* and "*wrongdoer control"* requirements, seemingly preferring to propagate the uncertainty that English common law had well-determined in the application of the remedy. The UK Law Commission stated that the possibility that the rule would be developed in a principled way to cover new situations is quite restricted.[638] This observation could be relevant for Cyprus too, as greater transparency in the requirements for a derivative claim seems to be an imperative need in an age of increased globalization of investment and growing international interest in corporate governance.[639]

3.3 The Cypriot oppression remedy: An ineffective alternative method of shareholder protection

As it was explained above, Cypriot law, having adopted the old English common law on derivative claims, offers a problematic solution for redress against corporate wrongdoing, while the English statutory derivative action provides for a more accessible mean of corporate relief for aggrieved shareholders. It seems that Cypriot legislators tend to adopt and maintain English law on shareholder remedies, that it is practically outdated. The same tendency is observed in relation to the Cypriot oppression remedy. The question that arises in this part of the Chapter, is whether the failure of the English oppression remedy to afford effective shareholder protection

[638] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 4.35
[639] The Law Commission Final Report 246, Cm 3769, October 1997, at para 6.9

reflects upon the Cypriot oppression remedy too. In order to answer this question, this part of the Chapter identifies the defects of the English oppression remedy and examine how these defects are reproduced in Cypriot law, leaving minority shareholders with no clue on how they can find their way out of oppression. But, firstly, it is important to trace back to the genesis of the oppression remedy and its evolution in English company law.

3.3.1 From "oppression" to "unfair prejudice": The History of the English unfair prejudice remedy

Under English Law the primary remedies available to a dissatisfied minority shareholder are the statutory derivative action, which can be found in Part 11 of the Companies Act 2006 and the unfair prejudice remedy which is contained in ss994-996 of the CA 2006. Before the codification of the statutory derivative action in England, the limited application scope of the fraud on minority exception, had not often provided for a timely and effective relief for the aggrieved shareholders.[640] In response to this problem, the statutory unfair prejudice remedy constituted an attractive alternative method of minority protection, capable of balancing the interests of majority and minority shareholders, and preventing shareholder oppression in corporate governance.[641]

The English unfair prejudice remedy is available, when the affairs of the company are being or have been conducted in a manner that is unfairly prejudicial to the interests of its members, allowing an aggrieved member to apply to the court for petition under s 994 of CA 2006, in order to be granted relief under s996 of CA 2006.[642] The feature

[640] K Wedderburn 'Derivative Actions and Foss v Harbottle' (1981) 44 MLR 202, 211, 212
[641] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 274.
[642] sections 994-996 of the UK Companies Act 2006

that defines the unfair prejudice remedy as flexible and broad in its scope and application is that the court is empowered to exercise wide discretion in order to determine what kind of conduct would fall within the ambits of unfairly prejudicial conduct and what remedy would be most appropriate to be given to the aggrieved member.[643]

However, the forerunner of the unfair prejudice remedy, the remedy for oppressive conduct was not so popular, pursued far less than the derivative action due to its onerous application standards and its inflexible interpretation by English courts.[644] The genesis of the unfair prejudice remedy traces back to the deliberations of the Cohen Committee on Company Law Amendment.[645] The Cohen Committee, considering the proper plaintiff rule, as the central background of its deliberations, observed that shareholders often seemed to be impotent in terms of challenging the conduct of the majority.[646] The only avenue for redress for an aggrieved shareholder, before the introduction of the unfair prejudice remedy, was to petition the court for a winding-up order in the face of flagrant violations of the principles of fairness.[647] The pursuit of such course of action was deterrent in its nature, as in many cases the winding up of the company was not beneficial for the aggrieved shareholders.[648] Particularly, if the break-up value of the assets of the company was quite low, or if the potential purchaser composed the majority, whose conduct led the minority to seek redress under the winding-up order, then it was unlikely that such an action would be a desirable option

[643] Davies P.L and Worthington S, Gower and Davies' Principles of Modern Company Law, (9th edn Sweet & Maxwell 2012) pages 512, 516.
[644] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L. Rev 40, 53.
[645] Alan Dignam & John Lowry, *Company Law*, 8th edition (Oxford University Press, 2014) page 214.
[646] Report of the Cohen Committee on Company Law Amendment (1945) Cmnd 6659
[647] Joseph E.O. Abugu, 'A comparative analysis of the extent of judicial discretion in minority protection litigation: The United Kingdom and United States' (2007) 18(5) I.C.C.L.R. 181, 190.
[648] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 7.7

for relief.[649] The Committee discerned that the hands of minority shareholders were tied, when directors overlooked to register a transfer of shares or when they received an excessive remuneration out of the company's profits, and setting aside a small proportion for distribution as a dividend.[650] Further, the Committee acknowledged that it was impossible to form a single recommendation that would cover each possible scenario of oppressive conduct by the majority.[651] So, taking this problem into account, the Cohen Committee sought to strengthen the vulnerable position of minority shareholders, by suggesting the introduction of a discretionary remedy which would give the court unfettered discretion to bring the matter in dispute to an end, by ordering any settlement that it considers just and equitable.[652] This alternative solution to a winding up order took the form of the "oppression" remedy within s210 of the UK Companies Act 1948. Section 210(1) of the Companies Act 1948 states that any member of a company who complains that the affairs of the company are being conducted in an oppressive manner to some part of the members may make an application to the court by petition for an order under this section.[653] This provision allowed minority shareholders to apply for relief from oppressive conduct by those in control of the company.[654] The remedy was designed to rectify oppression caused by the acts or omissions of the corporation.[655] In other words, it was established to relieve minority shareholders from the oppressive manner in which the business affairs of the corporation were being carried out and the oppressive way in which the directors were

[649] Ibid.
[650] Report of the Committee on Company Law Amendment (1945) Cmd 6659 at para. 58-59
[651] Ibid at para 60.
[652] Ibid.
[653] Section 210 of the UK Companies Act 1948
[654] Brian R. Cheffins, 'An Economic Analysis of the Oppression Remedy: Working towards a More Coherent Picture of Corporate Law' (1990) 40(4) The University of Toronto Journal 775, 776.
[655]Alex Fomcenco, Dave Deonarain, " 'A Bridge Too Far': A Critique of Canada's Oppression Remedy" (2018) 39(1) Business Law Review 12.

exercising their corporate powers.[656] Unfortunately, the drafting of the provision on oppressive conduct, was so narrow that only two English cases were successfully brought under s210 of the Companies Act 1948.[657]

The failure of the provision to find its way to effective shareholder protection, resulted in several considerations for statutory amendments by the Jenkins Committee. The Committee reviewed the problematic operation of the remedy, underlying its difficulties, and proposed the introduction of a remedy that would not only cover acts of actual illegality, but it would also answer to actions of unfairness that should not be necessarily illegal for a claim to be successful under the new provision.[658] This recommendation found its place in s 75 of the UK Companies Act 1980, which was consolidated as s459 of the UK Companies Act 1985.[659] This legal change replaced the term "oppression" with the "unfair prejudice", while further modifications in the 1989 Act, inserted the words "of its members generally" to broaden the scope of the provision, which today can be found in its updated form in ss994-996 of the UK Companies Act 2006.

3.3.2 The Cypriot Oppression Remedy: An imperfect descendant of the English oppression remedy

S 210 of the UK Companies Act 1948, was under-utilized and a successful petition for oppressive conduct was rarely brought, before the modification of the remedy from the "oppression" to the "unfair prejudice" scheme.[660] While the English oppressive conduct has been superseded by the more shareholder-friendly "unfairly

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[656] Ibid.
[657] Scottish Co-operative Wholesale Society Ltd v Meyer [1959] AC 324; Re HR Harmer Ltd [1959] 1 WLR 62
[658] Report of the Company Law Committee (1962) Cmnd 1749
[659] Alan Dignam & John Lowry, *Company Law*, 8th edition (Oxford University Press, 2014) page 215.
[660] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L. Rev 40, 53.

prejudicial conduct", s210 of the UK Companies Act 1948 continues to influence the Cypriot jurisdiction. Cyprus has not followed the modifications that English legislators initiated to alter the "oppression" remedy to an "unfair prejudice" one. On the contrary, Cypriot legislators decided to remain attached to the "oppression" concept. Section 202 of the Cyprus Companies Laws that incorporates the oppression remedy, as an alternative to a winding up order, is identical to the s210 of the UK Companies Act 1948. By adopting the exact essence of the old English oppression remedy, Cypriot law also adopts its inadequacies. The tendency of the English courts to confine section 210 to situations where the complainant could only demonstrate some sort of illegality was unquestionably the main reason that the remedy turned to be a complete failure in terms of providing adequate shareholder protection against oppressive behavior.[661] The question that arises in that respect, is whether the failure of the English oppression remedy to afford effective shareholder protection reflects upon the Cypriot oppression remedy too. In order to answer this question, it is important to identify the defects of the English oppression remedy and examine how these defects are reproduced in Cypriot law, leaving minority shareholders with no clue on how they can find their way out of oppression.

Oppressive conduct in England had most often been defined by interpreting section 210 of the 1948 Companies Act within English case law.[662] English courts attempted to set the limits, within which the oppressive conduct would be applicable, but their attempts have not been particularly rigorous in most cases.[663] The problem can

[661] D.D Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the Companies Act 1985' (1988) 8 Oxford Journal of Legal Studies 55, 77-79.
[662] Brian R. Cheffins, 'An Economic Analysis of the Oppression Remedy: Working towards a More Coherent Picture of Corporate Law' (1990) 40(4) The University of Toronto Journal 775, 779.
[663] Ibid.

be traced in both the wording of the provision itself and its interpretation by English judges.

First of all, by virtue of its drafting the English provision expressly stated that the remedy would be available to the petitioner only when the facts of the case justified a winding up order.[664] The manner in which the remedy is linked to a winding up order created a chain of continuous hurdles for the prospective applicant. Firstly, the applicant had to show that the company's affairs were conducted in a manner oppressive to some part of the members of the company.[665] However, the oppressive conduct that the applicant had to prove in order to be successful was not the only requirement that had to be met. Secondly, the applicant had to prove that the facts of the given case would justify a winding up order on the ground that it was just and equitable that the company should be wound up.[666] Thirdly, the applicant had to demonstrate that petition for oppressive conduct could succeed on the basis that the justified winding up in the relevant case would unfairly prejudice that part of the members, who had been oppressed, and therefore a petition for oppressive conduct should be preferable to a winding up order.[667] The exact same requirements can be found in s202 of the Cyprus Companies Laws.[668] The Cypriot Supreme Court in *Re Pelmako Developments Ltd*[669], interpreting s202, confirmed that a petition for oppressive conduct would be successful only if the requirements, contained in the provision, are satisfied. Notably, the UK Jenkins Committee that proposed the amendment of the oppression remedy, criticized the reference to the winding up order, contained in s210, and stated that such a difficult establishment by the petitioner should have not been an essential condition for the court

[664] s. 210 of UK Companies Act 1948
[665] s. 210(1) of the UK CA 1948
[666] s.210(2) (b) of the UK CA 1948
[667] Ibid.
[668] s. 202 of the Cyprus Companies Laws
[669] Re Pelmako Developments Ltd [1991] 1 CLR 246

to grant a remedy for oppressive conduct.[670] This consideration could be relevant for Cypriot law too. The strictness of s202 of the Cyprus Companies Laws, might be the primary reason that the oppression remedy is not popular at all, in Cyprus, as it is quite difficult for a petitioner to establish that a winding up order would be justifiable in his case, but at the same time that it would not be beneficial for the oppressed members, so that the oppression remedy could be granted. Cypriot case law evidences that Cypriot judges are more inclined to wind up the company rather than to seek for an efficient alternative to a winding up order. This is evident in the Cypriot case of *Karaoglanian v Karaoglanian*[671], where the Cypriot court stated that *"*The modern judicial trend of which Ebrahimi's case is an instance is that the courts are more than ready, where justice so requires, to remove the corporal veil of the company, go to its roots and if the substratum of the company has gone, demolish the company because in such circumstances so to do is both just and equitable*".*[672] In *Karaoglanian*, the petitioners failed to prove that their case would justify a winding up order on just and equitable grounds, and so the Cypriot court found that the oppression remedy, as an alternative to a winding up order could not be granted.[673] Hence, the complexity of s202, which is framed under the prism of the winding up jurisdiction, does not seem to offer Cypriot shareholders a powerful avenue to escape oppression.

It seems that Cypriot judges are reluctant in granting a remedy for oppressive conduct when the winding up order requirement is not satisfied. They decide to set aside a petition on the basis that the petitioner simply asked for an order, without making clear what kind of order the court should examine to bring the matter to an end. For

[670] Report of the Company Law Committee (1962) Cmnd 1749, para 201
[671] Bedros Karaoglanian & Sons Ltd and Others v. Hagop Karaoglanian and Another (1974) JSC 488
[672] Ibid.
[673] Ibid.

example, in *Pelmako*, the court dismissed the petition on the grounds that "The petitioners must state in their petition what orders they wish the court to make, however and a petition will not be held if it merely asks the Court to make an order regulating the company's affairs or such order as the Court thinks just."[674] The Cypriot judges referred to the successful outcome of the English case of *Meyer*[675], where the petitioner specified the remedy that he sought, when he raised a petition on the basis of the UK s210. They also quoted on the English case of *Re Antigen Laboratories Ltd*[676], where the Court of Appeal held that the petitioner must be specific in what he desires the court to do in respect of s210. Hence, the Cypriot court in *Pelmako* relied on these two cases in order to dismiss the petition on the basis that the petitioner asked for the court to intervene, without providing a detailed claim on what remedial solution could be achieved, by raising a petition under s202.

Another problematic element that the Cypriot provision borrowed from s210 of the UK Companies Act 1948 is the wording "*some part of the members*". Cypriot law allows courts to grant the remedy, only when "*some part"* of the members have been treated in an oppressive manner.[677] The phrase "some part" confirms how inflexible is the wording of the section, as the petitioner has to show discrimination.[678] In particular, the petition would only be successful, if the petitioner can prove that the oppressive course of conduct affected some of the members of the company. For instance, a breach of director's duty, in terms of failing to declare a dividend or awarding himself excessive remuneration, might affect all shareholders equally.[679] In most cases, a breach of directors' duties would not often harm some members, but it would probably affect

[674] [1991] 1 CLR 246
[675] SCWS v Meyer [1959] AC 324
[676] Re Antigen Laboratories Ltd [1951] 1 All ER 110 (Ch).
[677] s.202(1) of the Cyprus Companies Laws
[678] Alan Dignam & John Lowry, *Company Law*, 10th edition (Oxford University Press, 2018) page 215.
[679] Ibid.

all of them[680], and for that reason it is unlikely to fall within the ambit of s202. As a consequence, the wording of the provision, limits the situations within which a petition for oppressive conduct could be successfully brought. The general consensus of Cypriot legislators to maintain this particular wording within the provision, indicates that Cypriot judges are not prepared to interpret the provision in a way that the remedy refers to "members generally" as if the provision encompassed "the company as a whole". In other words, it seems that there is no intention on the part of Cypriot judges to avoid the belief that the conduct under issue should affect every membership interest independently. The fact that the remedy of s202 does not apply to the interests of the company as a whole, results logically in its inability to be applicable in actions where a derivative claim, with its multitude of stumbling blocks would previously have had to be brought.[681] Subsequently, in its current form the Cypriot oppression remedy cannot be clearly considered as an effective substitute of the Cypriot common law derivative action.

The problematic aspects of the English remedy cannot only be detected by virtue of its drafting within s210 of Companies Act 1948. A restrictive approach is also adopted by English judges towards the interpretation of the provision. The meaning of "oppression" was very narrowly construed in English case law. Specifically, in *Scottish Co-Operative Wholesale Society Ltd v Meyer*[682], Lord Simonds, attempting to define "oppression", stated that oppressive conduct was restricted to a course of action on the part of the majority that was *"burdensome, harsh and wrongful"*.[683] The Cypriot judges moved to a similar direction in *Pelmako* case, endorsing the definition of oppression

[680] Re Carrington Viyella plc (1983) 1 BCC 98,951; Re a Company (No 003070 of 1987) [1988] 1 WLR 1068
[681] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L. Rev 40, 53.
[682] SCWS v Meyer [1959] AC 324
[683] Ibid at [342], per Viscount Simonds LC.

that Lord Simonds provided in *Meyer*.[684] In order to provide a clearer interpretation of the meaning of oppression, they also quoted the words of Lord Keith of Avonholm in *Meyer*, who upheld that oppression relates to the "lack of probity and fair dealing in the affairs of a company to the prejudice of some portion of its members"[685]. In the first glance, these definitions seem to be clear enough for someone to understand what kind of conduct amounts to oppression of minority. The UK Jenkins Committee, commenting on the definition of *"burdensome, harsh and wrongful"* provided by Lord Simonds in *Meyer*, stressed that it seems to be a good one, as any other definition that someone would probably devise in relevant circumstances.[686] However, the Committee further observed that the above definition did not specify the degree of the required culpability to meet up with the element of "wrongfulness".[687] This means that English case law had not provided further clarifications as to whether oppression postulated actual illegality or invasion of legal rights or it can be established by conduct which is simply reprehensible, without being actually illegal.[688] The English judges in *Meyer*, expressed their intention to accept a broader view of the term and as the Committee stated, the successful outcome of the case in *Meyer* confirms that intention.[689] But, the same allegation cannot be made for the Cypriot judiciary, as in *Pelmako* the judges, by interpreting the wording *"burdensome, harsh and wrongful"* did not express a similar intention that the term should be viewed more broadly and the unsuccessful outcome of the case does not indicate their intention to do so.[690]

[684] Re Pelmako Developments Ltd [1991] 1 CLR 246
[685] [1959] AC 324 at [364] per Lord Keith of Avonholm
[686] Report of the Company Law Committee (1962) Cmnd 1749, para 203
[687] Ibid.
[688] Ibid.
[689] Ibid.
[690] Re Pelmako Developments Ltd [1991] 1 CLR 246

Accordingly, the concerns of the Jenkins Committee that there is no clarity as to which acts fall within the ambit of these definitions, reflect the uncertainty that surrounds Cypriot law too. The question that should be assessed by Cypriot judges is what kind of actions can be incorporated within the meaning of oppression in order to give minority shareholders direct access to the remedy of s202. Unfortunately, until now, this question remains unanswered, as it remained unanswered in English law, until the modification of the oppression remedy. The vague definitions provided by English judges failed to clarify what exactly they had in their minds, when interpreting the term "oppression".[691] So, it is unlikely that the Cypriot judiciary, by imitating the same vague terminology on oppression, would be able to properly describe what the term truly means within s202 of the Cyprus Companies Laws.

Furthermore, English case law, sought to exclude negligence and mismanagement from the types of conduct that could possibly fall within the definition of oppression.[692] A similar intention appears in *Pelmako*, where the Cypriot judiciary in order to dismiss the petition, referred to the English case of *Re Five Minute Car Wash Service Ltd*[693]. In *Re Five Minute*, the court rejected the petition on the grounds that mismanagement issues are insufficient to find a claim under the oppression remedy.[694] The judgment of Buckley J in this case, is of particular importance, as it reveals the narrowness that encompasses the English judicial interpretation of the term "oppression". In detail, Buckley J, dismissed the petition on the basis that the unwise, ineffective and careless performance of the duties of the director and chairman of the board of the company did not amount to oppression, because the director had not acted

[691] Brian R. Cheffins, 'An Economic Analysis of the Oppression Remedy: Working towards a More Coherent Picture of Corporate Law' (1990) 40(4) The University of Toronto Journal 775, 779.
[692] Pauline Roberts and Jill Poole, 'Shareholder remedies - efficient litigation and the unfair prejudice remedy' [1999] Journal of Business Law 38, 44.
[693] Re Five Minute Car Wash Service Ltd [1966] 1 WLR 745
[694] [1966] 1 WLR 745

"unscrupulously, unfairly, or with any lack of probity towards the petitioner"[695]. The judge also applying the words of Lords Simonds on the meaning of oppression, highlighted that the conduct in question could not be described as harsh or burdensome or wrongful towards any member of the company.[696] It is interesting to note that before the modification of the English oppression remedy, the Jenkins Committee, in its recommendations did not specify whether oppression should be assumed in cases of mismanagement.[697] So, it is not surprising that Cypriot judges have followed the same vague interpretation in *Pelmako* and have not clearly determined what kind of conduct would render the remedy of s202 available to minority shareholders, while the English case law on oppressive conduct and the recommendations of the Jenkins Committee, had not provided a clearer answer, until the modification of the remedy to an unfair prejudice one.

It is interesting that the interpretation of the term "oppression" by Cypriot judges is not exclusively based on English case law, but it extends to Scottish law too. Specifically, Lord Cooper in the Scottish case of *Elder v Elder & Watson Ltd*[698] embraced a wider interpretation of oppression, which was supported by the Cypriot judiciary. His Lordship, referring to the way that "oppression" should be perceived, stated that "the essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely"[699]. Referring to the meaning of oppression, the Cypriot court in *SGO Sibgasoil Investments Ltd*[700], quoted the words of Lord Cooper

[695] Ibid at [752]
[696] Ibid.
[697] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 7.9
[698] Elder v Elder & Watson Ltd [1952] S.C. 49
[699] [1952] S.C. 49, at [55]
[700] SGO Sibgasoil Investments Ltd, petition 375/2013 (Distinct Court of Nicosia)

in *Elder v Elder & Watson Ltd.* This quoting, brings up the question of whether Cypriot judges express an implied intention to interpret "oppression" in a broader spectrum. The view of the UK Jenkins Committee could be useful on that matter. The Committee underlined that the statement of Lord Cooper in *Elder* gives the impression that the UK section 210 of CA 1948 was not structured only with the intention to cover complaints that narrowly fall within cases where the affairs of the company were being conducted in an oppressive manner to the members concerned.[701] On the contrary, the Committee, added that, the remedy as originally framed, intended to cover complaints that broadly fall within those cases, where the affairs were being conducted in a manner unfairly prejudicial to the interests of those members.[702] Therefore, if we assume that the allegation, made by the Committee is true, then it could be argued that the same allegation applies to the way that Cypriot courts interpret s202. To explain this further, it can be said that, by quoting the Lord Cooper's statement in *SGO Sibgasoil Investments Ltd*, the Cypriot judges might have expressed an implied intention to extend sphere of complaints, which would give rise to a petition for oppressive conduct.

However, the above argument seems to be a rebuttable presumption rather than a proof of Cypriot court's flexibility in interpreting s202. Even though, the reference to this statement by the Cypriot court implies the approval of a wider interpretation of the term "oppression", there is still no clear indication by the Cypriot judges on what oppressive conduct means for the purposes of granting relief under s202. In practice, the unsuccessful outcome of the *SGO Sibgasoil Investments Ltd* case, confirms the strictness of the Cypriot judiciary in interpreting s202, regardless of any implied intention to the contrary.

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[701] Report of the Company Law Committee (1962) Cmnd 1749, para 204
[702] Ibid.

Another restrictive component, on the way that oppressive conduct is interpreted within English case law, relates to the continuing effect that the act should have in order to constitute "oppression". This means that the oppressive conduct should indicate a course of action as distinct from an isolated act.[703] As the Jenkins Committee explained, "oppression" is too powerful, as a word, to enclose a wide range of situations in which the petitioner might be held entitled to relief under s210.[704] For that reason, English courts limited its power to the extent that the act complained of would be of a continuous nature.

In a valuable record of English cases, the court dismissed the petition due to the fact that a single act could not enter the realm of "oppression". For example, in *Re Harmer Ltd*[705] the court held that s 210 of the Companies Act 1948 applies to conduct of a continuing nature and not to isolated acts of oppression, which have no actual effect at the time that the petition is presented.[706] In addition, in *Re Westbourne Galleries*[707] the court found that, the director's action to improperly override a resolution of the shareholders, properly passed in the general meeting in order to sell a lease that the corporation possessed, was regarded as an isolated event of no continuing effect up to the date of the petition. The English court in *Re Jermyn Street Turkish Baths Ltd*[708] moved on the same direction, as the allegation that the directors had improperly allotted shares to themselves was not a sufficient ground to justify an order under s210, as the oppressive conduct complained of was not operative at the time that the petition was filled. The Cypriot court by quoting the English case of *Re Jermyn Street Turkish Baths Ltd* in *SGO Sibgasoil Investments Ltd,* depicts its intention to treat isolated acts, as a

[703] Report of the Company Law Committee (1962) Cmnd 1749, para 202
[704] Ibid.
[705] Re Harmer Ltd [1959] 1 WLR 62
[706] [1959] 1 WLR 62
[707] Re Westbourne Galleries [1970] 1 WLR 1378 (Ch.)
[708] Re Jermyn Street Turkish Baths Ltd [1971] 1 WLR 1042

barrier to a successful petition within s202.[709] This means that Cypriot courts would not appear willing to grant the remedy in similar future cases, where directors might appoint themselves to paid posts with the company at excessive rates of remuneration, thus depriving the complaining members of any dividend, or at least an adequate dividend, on their shares. The same restrictive attitude on the interpretation of s202 is illustrated in *Pelmako*. The Cypriot court in *Pelmako,* referred to the English case of *Re Harmer Ltd*, which as noted above, supported the view that the act should be of a continuing nature in order to fall within s210.[710] Thus, it can be argued that Cypriot judges in *Pelmako,* by interpreting s202 in the same way that English judges interpreted s210 in *Re Harmer Ltd,* express an implied intention to restrict the availability of the remedy only to complaints of a continuing nature.

Subsequently, it can be concluded that the Cypriot remedy is narrow enough to exclude situations in which action under section 202 might be possible. Before the modification of the English oppression remedy, the UK Jenkins Committee recommended that the section 210 should be re-structured, so that it allows isolated acts, such as excessive remuneration policies, issuing of shares by directors, to be named as oppressive actions.[711] This recommendation should be relevant for Cyprus too, as it verifies the presumption that the Cypriot oppression remedy, following the UK's lead on s210, is framed so narrowly, that it is almost impossible for a minority shareholder to get relief from oppression, when his case falls within actions that are considered to be isolated.

Finally, another major problem that can be identified within the Cypriot oppression remedy is the absence of an express provision, entitling personal

[709] SGO Sibgasoil Investments Ltd, petition 375/2013 (Distinct Court of Nicosia)
[710] [1991] 1 CLR 246
[711] Report of the Company Law Committee (1962) Cmnd 1749, para 212.

representatives to present a petition under s202. In order to understand the strictness of the Cypriot law on that matter, firstly, it is useful to have regard to the English approach under s210 of the Companies Act 1948. Section 210 had not introduced, a clear provision until the amendment of the oppression remedy to an unfair prejudice one.[712] This absence increased the risk that the directors, who were empowered under the articles of association to refuse to register personal representatives, would force these representatives to sell their shares at an inadequate price.[713] The same problem would be relevant for Cypriot law too, as a provision on personal representatives is also absent from s202 of the Cyprus Companies Laws.[714] The UK Jenkins Committee apprehended the risks that came along with the absence of a provision on personal representatives. For that reason, the Committee proposed the introduction of a clear statement within the UK s210, which would authorize the legal personal representatives to present a petition, even if they are not registered as members of the company, such as in cases of trustees, who are not registered as members, but to whom shares have been transmitted by operation of the law.[715]

It is interesting that, prior to the reform of the remedy, the English case law interpreted s210 flexibly and the question, as to whether personal representatives should be allowed to present such a petition, remained open for consideration. Particularly, the English court in the case of *Re Jermyn Street Turkish Baths Ltd*[716], supported that "A petition for relief from oppression may also be presented by the personal representatives of a deceased member, whether they have themselves been registered as members or not, and they may complain of oppression of the deceased during his lifetime or of

[712] s.210 of the UK CA 1948; s994 of the UK CA 2006.
[713] Report of the Company Law Committee (1962) Cmnd 1749, para 205.
[714] s.202 of the Cyprus Companies Laws
[715] Report of the Company Law Committee (1962) Cmnd 1749, para 209.
[716] Re Jermyn Street Turkish Baths Ltd [1970] 3 A11 ER 57

themselves since his death"[717]. It is interesting that, even though s210 did not expressly covered personal representatives, this case demonstrates that the English judges are more than willing to offer them a chance to represent a deceased member in a petition within s210. On the contrary, Cypriot law seems to be stricter on that matter, if someone looks at s27 of the Cyprus Companies Laws, which provides for the definition of the "member" of a company. As section 27(1) and 27(2) states "The subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration shall be entered as members in its register of members. Every other person who agrees to become a member of a company, and whose name is entered in its register of members, shall be a member of the company."[718] This provision witnesses the necessity of the petitioner to be registered as a member of the company, in order to file a petition for oppression. In contrast to the English approach, where the judges expressed their willingness to endorse the concept of personal representatives for the purposes of s210, there is neither relevant case law in Cyprus, which would display a similar intention on the part of the Cypriot judiciary nor any intention to follow the recommendations of the UK Jenkins Committee to amend s202, in order to include personal representatives.

It is particularly disappointing that the above analysis renders the Cypriot legal framework on shareholder remedies, completely inadequate to safeguard the interests of minority shareholders in cases of oppression. Except from the inadequacy of the Cypriot derivative action to give minority shareholders a better prospect of protection against misconduct, the Cypriot oppression remedy has proven to be another failure of Cypriot corporate law to defend not only the rights but also the interests of minority

[717] [1970] 3 A11 ER 57
[718] s.27(1) , s27(2) of the Cyprus Companies Laws

shareholders in cases where these have been oppressed by those in control of the company. Apparently, the Cypriot judiciary has failed to specify the actions that would actually allow a minority shareholder to file a petition for oppressive conduct. The vagueness surrounding the interpretation of s202, creates confusion not only to Cypriot judges who are not in a position to clearly set the limits of oppressive conduct, but also to minority shareholders, who need to comply with the strict drafting of the section, satisfying the winding up requirement for the petition to proceed. It seems paradox that the petitioner must prove that his case would satisfy a winding up order and at the same time that it falls within the limits of oppressive conduct, while the Cypriot judges cannot assure what kind of conduct this concept needs to satisfy for a petition to attract their attention for examination. Considering that, the applicant personally receives the benefit of the relief provided under the oppression remedy, it seems easier for a Cypriot shareholder to rely on the oppression remedy than proving a breach of a corporate right, facing a number of insuperable procedural hurdles, which would give him indirect recovery under the initiation of derivative proceedings.[719] However, there is no reported record of successful cases under s202, and so this inactivity allegedly implies that access to the Cypriot oppression remedy is not as easy as it seems.

Therefore, it can be argued that the absence of successful petitions under s202 indicates that the Cypriot oppression remedy might be an even more ineffective remedial tool than the Cypriot derivative action, as the later has been successfully applicable twice in the shareholder litigation history of Cyprus. The UK Jenkins Committee suggested that if s210 of the UK Companies Act 1948 is to afford effective protection, it is necessary to extend its application to cover elements of unfairness rather

[719] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 275

than just illegality.[720] Based on this suggestion, it is logical that that s202 of the Cyprus Companies Laws, as a successor of the English remedy, cannot be regarded as a workable alternative remedy for Cypriot shareholders, if its application continues to rotate only around the concept of actual illegality.

3.3.3 The Availability of the Cypriot oppression remedy as an alternative to a derivative claim: Evidence from case law

As discussed in Chapter 2, before the codification of the English statutory derivative action, the English courts considered the availability of the unfair prejudice remedy, as a barrier to the continuance of a derivative claim.[721] In specific, if the wrong at issue could had been redressed with the application of the unfair prejudice remedy, the English judges were keen to restrict access to the derivative claim. The case of *Barrett v Duckett* evidences the tendency of the English courts to consider the presence of the unfair prejudice remedy, as a factor that could block the claimant's access to litigation proceedings on behalf of the company.[722] However, the same consideration was not applicable in the case of the Cypriot oppression remedy, as the Cypriot judges had not viewed the oppression remedy as a reasonable solution, which could replace the need of a plaintiff shareholder to resort to a derivative action. Particularly, in both Cypriot cases, where the derivative claims had been successfully brought, the Cypriot judiciary did not consider the availability of the oppression remedy as a barrier to the bringing of the derivative claim. The intention of the Cypriot judges to exclude from their consideration the oppression remedy, as an alternative solution that could bar the derivative claim, implies that the judges recognize the problematic nature of the oppression remedy and prefer to reject a s202 petition rather than a derivative action.

[720] Report of the Company Law Committee (1962) Cmnd 1749, para 203
[721] [1995] 1 BCLC 243
[722] Ibid.

This is evident in the case of *Kouis*, where the defendant appealed to the Supreme Court of Cyprus on the basis that the appropriate remedy that should have been sought by the claimant was the oppression remedy and not a derivative action.[723] On the notion of this appeal in *Kouis*, it can be argued that the Cypriot courts could have grasped the opportunity to establish the oppression remedy, as a grounded consideration in determining the continuance of a derivative claim. But, the Supreme Court of Cyprus chose not to apply any consideration on this matter.

As a result, the rejection of this appeal in combination with the reluctance of the Cypriot judges to include the oppression remedy within the range of considerations that could possibly bar the initiation of a derivative claim, leads to the conclusion that they do not value the remedy, as a suitable alternative mechanism of shareholder protection. The reality of the Cypriot case law confirms that the oppression remedy does not find admirers not only on the part of the petitioners but also on the judiciary's part that disregards its existence in deciding whether or not to grant a derivative claim. So, having no effective alternatives in the table of shareholder remedies, it seems that the only way forward is an updated and effective statutory derivative action, which would be able to offer advantages that should ensure that it remains the remedy of choice among Cypriot shareholders.

3.4 Concluding Remarks: How well has Cypriot company law done in achieving effective shareholder protection?

The existing framework on shareholder protection, has shown that Cypriot law lacks readily accessible methods of shareholder protection, giving Cypriot shareholders no effective remedy to count on. Cypriot law maintains two restrictive and cumbersome

[723] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136

remedies to invoke. It is unlikely that Cypriot shareholders could rely on the "*fraud on minority*" exception to ascertain the bringing of a successful claim in future cases. A potential future plaintiff might get trapped somewhere between the difficulty of proving the badly determined concepts of fraud and wrongdoer control, if the issue is not left to the problematic fifth exception of the "interests of justice".[724] In general, the limited record of Cypriot case law reveals that the Cypriot judiciary did not strive to identify the defective aspects of the forth exception to the *Foss* rule, as it simply implemented both elements in a wider sense, but it was never concerned with the question of what this wider sense in its meaning stands for. The analysis illustrated that the Cypriot derivative action is inadequate, as it cannot protect the interests of minority shareholders effectively. Furthermore, the examination of the Cypriot oppression remedy showed that the alternative to a winding up order, is wrongly named as an alternative, because it is not in a position to rectify corporate wrongdoing and it cannot compensate for the ineffectiveness of the Cypriot derivative action.

It is true that the oppression remedy plays a valuable role in relation to closely-held corporations.[725] The defects of the Cypriot oppression remedy, that have been examined above, demonstrate that Cypriot shareholders remain completely unprotected, when they decide to risk more than just their share capital in the company. This means that, when the minority shareholders are also involved in the company, by taking part in the management, as directors, their involvement may be easily terminated by the majority in case of a dispute, thereby depriving the minority shareholder of remuneration.

[724] K. W. Wedderburn, 'Shareholders' Rights and the Rule in Foss v. Harbottle (Continued)' (1958) 16(1) The Cambridge Law Journal 93, 106.
[725] Ian Ramsay, 'An Empirical Study of the Use of the Oppression Remedy (1999) 27 Australian Business Law Review 23, 25.

The reality of Cypriot case law has demonstrated that the common law derivative action is more popular than the oppression remedy in Cyprus. Cypriot judges remain apathetic in considering the oppression remedy as a viable alternative mechanism of shareholder protection that could discourage the bringing of a derivative claim. This apathy confirms the problematic nature of the oppression remedy that stems from both its drafting and interpretation. Apparently, Cypriot courts are more inclined to apply derivative claims, without examining the availability of alternative remedies. This preference implies that they value the role of the derivative action as a protection mechanism for minority shareholders and as a deterrent mechanism for the wrongdoing directors. As such, it is fair to argue for a legal reform that would embody the best elements of a classical model, keeping those that remain relevant and discarding the anachronistic ones. This attempt to provide a remedial tool, well enough equipped to cope with the demands that modern corporate reality places upon Cypriot companies, will be discussed in Chapter 5. The next Chapter (Chapter 4) provides a conceptual analysis of how an effective derivative action should be understood from a corporate governance perspective and presents the model upon which the Cypriot reform should be framed. The thesis refers to this model, as the Platonian Remedial Model (PRM), explaining its relevance with the Plato's allegory of cave.

Chapter 4

A Platonian Approach to Shareholder Derivative Litigation: The Way Out of the Corporate Cave

4.1 Introduction

The Chapter explores what is the key consideration for those who are charged with the task of drawing up a competitive corporate regulatory framework that seeks to promote investor protection and good corporate governance practices? The Chapter provides a theoretical approach to this question, introducing the framework upon which the proposals for the reform of the Cypriot derivative action would be founded.

The answer would be given through the use of the most famous of Plato's similes, The Allegory of the Cave, which commences the 7th book of the Republic written around 380 BCE. Plato's simile of the cave has occasioned many interpretations. Due to Plato's metaphorical language, it has seemed almost impossible to find one single interpretation that is perfectly coherent on philosophical and philological grounds.[726] This study deploys the political interpretation of Plato's simile. The examination of the allegory through political lens offers a deep understanding of the impact that wrongful political decision-making has over the interests of the public.[727] On that basis, the analysis of the allegory in this Chapter, offers a better understanding of the impact that wrongful or negligent corporate decision making has on the interests of minority shareholders. The Chapter develops an allegorical analysis to examine how

[726] Vassilis Karasmanis, 'Plato's Republic: The Line and the Cave' (1988) 21(3) Apeiron 147 - 171.
[727] Ibid.

mismanagement is understood from a corporate governance perspective and what role the derivative action can play to ensure responsible corporate governance practices. Except from providing a conceptual framework on how corporate misconduct is understood within a corporate structure, the Chapter uses the allegory of the cave to explain how important are flexible legal criteria to enable minority shareholders to bring a derivative claim. The Chapter argues that the rules governing the circumstances in which such an action may be brought should be made more accessible to minority shareholders so that, the commencement of a derivative claim would be regarded as a remedy, worth pursuing in exceptional conditions of mismanagement. The Chapter concludes that the ability to access the remedy is the keystone for the creation of an effective derivative action. Only then, it can function as a deterrent of mismanagement and assume a compensatory role in corporate governance. The Thesis applies this framework in Chapter 5 to make a careful selection of the English and German procedural rules that will compose the regulatory design of the statutory derivative action in Cyprus. The Chapter does not intend to embark on a lengthy discussion of the theory underpinning the rationale of the derivative actions as that has been extensively analysed in relevant authoritative sources.[728] However, the allegorical text itself, paves the way for the Chapter to briefly explain how the functions of the derivative action have the potential to ensure responsible corporate governance practices.

4.2 Plato's Allegory of the cave: The political interpretation

Plato's allegory of the cave, is written in the form of a dialogue between his mentor Socrates and his brother, Glaucon.[729] Plato provides a description of a cave to present

[728] For instance, see A. Reisberg, 'Shareholder remedies: the choice of objectives and the social meaning of derivative actions' (2005) 6 EBOR 227.
[729] Plato, *Republic*, 514a- 518d, Trans. Ιωάννης Γρυπάρης, Πολιτεία, (MATI, 2004)

the corruption of the prevailing political system in the ancient Athenian society.[730] Particularly, he describes the picture of a cave, in which people are chained in a way that does not allow them to look around the cave and gain access to the entrance behind them. The chains force the prisoners to face only the wall in front of them. Behind the prisoners there is a fire and between the prisoners and the fire there are people carrying objects. The fire casts light on the wall and the prisoners can only see the shadows of these objects.[731] Considering the allegory through political lens[732], Plato symbolizes the corrupted political class that presided in the democratic republic of ancient Athens. Specifically, the cave pictures the failed political system, in which corrupted politicians and ambitious demagogues, induced the citizens to approve wrong political decisions, in order to promote their own interests and not the public interest.[733] In his attempt to criticize the formation of the Athenian democracy in his time, Plato, uses the allegory to describe the citizens as chained prisoners and the corrupted politicians, who abuse the public, as the people behind the fire who carry the objects.[734] The bounds of the prisoners symbolize the lack of education and its effect on the promotion of the citizens' interests, while the people that carry the objects depict the abusive practices of the ambitious politicians, who manipulate the public for the promotion of their personal interests.[735] So, the allegory demonstrates that the citizens, being ill-educated are unable to confront these abusive practices and to protect their interests against the wrongful decision making of corrupted rulers.[736] Finally, Plato supposes that one of the prisoners is released from his bounds and looks out of the cave.[737] According to Plato,

[730] Nicholas Pappas, *Plato and the Republic*, (Routledge Philosophy Guide Books, 1995) pages 191-200.
[731] Plato, Republic, 514a- 515b, Trans. Ιωάννης Γρυπάρης, Πολιτεία, (MATI, 2004)
[732] Gabriel Zamosc, 'The Political Significance of Plato's Allegory of the Cave' (2017) 66 (165) Ideas Y. Valores, 237-265.
[733] Plato, Republic, 514a- 521a, Trans. Ιωάννης Γρυπάρης, Πολιτεία, (MATI, 2004)
[734] Plato, Republic, 520a- 521a, Trans. Ιωάννης Γρυπάρης, Πολιτεία, (MATI, 2004)
[735] Ibid.
[736] J. Ferguson, 'The Sun, Line and Cave Again' (1963) 13 Philosophical Quarterly 188-193.
[737] Plato, Republic, 515c- 519c, Trans. Ιωάννης Γρυπάρης, Πολιτεία, (MATI, 2004)

the prisoner be freed from the cave and having access to education, and returns back to the cave to help his fellow cave dwellers to set free from their bonds.[738] According to Plato, the freed prisoner, is the philosopher, who returns back to the cave to educate the citizens.[739] Through this assumption, Plato provides the solution to the problem of this corrupted political system, which is not other than the citizens' access to education, so that they can prevent wrongful decision-making and ensure that the politicians would act for the interests of the republic as a whole.[740]

4.3 The relevance of Plato's allegory of the cave in corporate governance: A corporate cave

Picture 4.1: *Corporate Cave*

[738] Plato, Republic, 519c- 521a, Trans. Ιωάννης Γρυπάρης, Πολιτεία, (MATI, 2004)
[739] Ibid.
[740] A. Bloom, The Republic of Plato: Translated with Notes and an Interpretative Essay (New York: Basic Books, 1991) pages 307-310

4.3.1 Inside the corporate cave: Management and Control

The modern corporate reality is characterized by a delegated and centralized management structure.[741] The shareholders, as members of the company, do not practically control the company's operations, but they cede the task of the company's administration to the board of directors. It is widely accepted that companies should operate for the collective benefit of shareholders, which is not other than value maximization of the company.[742] The shareholders, as the principals who have stakes in the company entrust the promotion of their interests and the protection of their shareholding to their corporate agents, the directors.[743] Berle and Means in "The Modern Corporation and Private Property"[744] argued that the board of directors control and dominate the affairs of the company. The sizeable power of the management in controlling corporate wealth comes along with a number of tempting opportunities. In a corporate structure, where ownership is concentrated and separated from control, it is common that the directors may take advantage of these opportunities and decide to neglect their duties or to engage in disloyal transactions.[745] Such opportunistic behavior evidences that the directors are not saints and they do not act for the benefit of the company because of their genuine intentions to do so.[746] The significant discretion of the managers in the running of the business, is expected to lead at some point to corporate abuses by directors and officers, whose decisions in certain occasions are more likely to be aligned with their enrichment rather than the promotion of

[741] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 33
[742] David Gibbs-Kneller, and Chidiebere Ogbonnaya, 'Empirical analysis of the statutory derivative claim: de facto application and the sine quibus non' (2019) 19 (2) Journal of Corporate Law Studies 303.
[743] Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 J. Financial Econ. 305, 308.
[744] AA Berle and GC Means, *Modern Corporation and Private Property* (Harcourt 1968)
[745] R. Sitkoff, 'The Economic Structure of Fiduciary Law' (2011) 91 Boston University Law Review 1039, 1042.
[746] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 35

shareholders' interests.[747] The divergence of pursued interests in the agency relationship between the management and the shareholders is known as the agency problem.[748] This conflict of interests between the managers and the shareholders raises agency costs. Two types of costs normally arise as a result of the agency problem.[749] These are related to expenses made by the shareholders to ensure that the management is acting to promote the members' interests and expenses incurred by the management to reassure the shareholders that their interests are effectively safeguarded.[750] The agency cost problem usually appears when the management acts negligently or in cases of breaches of directors' fiduciary duties.[751]

However, the agency problem is not only relevant to the relationship between managers and shareholders, but tends to affect the relationship between majority and minority members. The majority shareholders play a decisive role in the administration of the company, as a significant stake of their private investment is attached to company's wealth.[752] It is quite common for majority shareholders to hold a powerful management position in the board of directors, especially in corporate structures, where ownership concentration is considerably high.[753] However, it is not expected that majority shareholders would always act for the benefit of the company as a whole. Their advantageous directorial position is presented with opportunities to extract private

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[747] PL Davies, *Introduction to Company Law*, (OUP, 2002) page 137

[748] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, *The Anatomy of Corporate Law A Comparative and Functional Approach*, 2nd edition, (OUP 2009) pages 21–23.

[749] Ian Ramsay 'Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Derivative Action' (1992) 15 University of New South Wales Law Journal 149, 151.

[750] M. Jensen and W. Meckling 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305.

[751] Harald Baum and Dan W. Puchniak, *The Derivative Action in Asia: A Comparative and Functional Approach*, (Cambridge University Press, 2012) page 13

[752] Martin Gelter and Geneviéve Helleringer, 'Lift not the veil! To whom are directors' duties really owed?' [2015] U. Ill. L. Rev. 1069, 1117

[753] Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) 52 The Journal of Finance 737.

benefits to the detriment of the minority shareholders, who hold a very limited portion of shares that does not justify higher ambitions in terms of involvement in the company's management.[754] Subjugating the board to their wishes, they can anticipate the alignment of the board's actions with their opportunistic motives. In such cases of opportunism, the ones primarily harmed by such tactics, and subsequently have the incentives to prevent them, are minority shareholders.

The description of Plato's cave seems to be the appropriate text to develop considerations on how the company operates when wrong has been perpetrated against it. Specifically, Picture 4.1 is an illustration of the agency problem either between the management and shareholders or between the majority and minority shareholders, or both scenarios, depending on the given corporate ownership context. It is interesting to examine how the symbols in the allegory can be linked to the agency problem.

In analogy to the corrupted society of Plato, it can be assumed that the cave symbolizes a corrupted corporate structure. The agents are supposed to represent the principals and promote their interests.[755] Picture 4.1 displays the practical reality of the relationship between the principals and agents, which has proven problematic, when the increasing autonomy of the agents, results in opportunism and the promotion of their personal agenda instead of promoting the interests of the principals. In specific, it depicts a corporation, in which the minority shareholders, deprived from any effective means of shareholder protection, are subjected to the abusive behavior of those in control, who seek to promote their personal interests to the detriment of the company's interests. The chained prisoners symbolize the shareholders, who are ill-equipped to cope with mismanagement due to the absence of effective and accessible means of

[754] J. Dine, M. Koutsias, *"The Nature of Corporate Governance: The Significance of National Cultural Identity"* (Edward Edgar Publishing Limited, 2013) page 95
[755] Ibid, page 94

shareholder protection. Particularly, it could be assumed that the bounds symbolize the absence of information rights on the part of shareholders. The information asymmetry stands at the centre of the agency problem.[756] So, the bounds symbolise the lack of access to the same level of information between the shareholders and the management about the ongoing decision-making in the corporate context. In analogy to the allegory, the people, carrying the objects, whose shadows are reflected on the wall, illustrate those in control, who, pretending to act for the benefit of the company, seek to enrich themselves to the company's detriment. In detail, it can be said that the description of the people carrying the objects, symbolizes the wrongful or negligent decision-making of the management, while the shadows of these objects that chained prisoners can see, portray how the shareholders can be subjected to the deceitful behavior of the management. Even the position of the figures in Picture 4.1 demonstrates the waning of links between the agents and principals. In particular, Picture 4.1 shows the group of agents standing on an advantageous position inside the cave, controlling the company affairs, while the shareholders are placed, chained, on the ground, incapable of holding the directors accountable for their actions. This is a deliberate choice of the researcher to show how "bad" corporate governance is understood, with a symbolic effect. Furthermore, the wording "those in control" is intentionally, deployed above, as the illustration of Picture 4.1 aims to include not only the directors but also majority shareholders. In specific the corporate cave, shows the control of the company generated at board level, but also the effects that the conflict of interest between those in control and the company may have on the company in general, irrespective of whether these effects derive from the pursuit of private benefits by the board or majority shareholders or both.

[756] Ibid.

4.3.2 Outside the corporate cave: Corporate Accountability and Access to Derivative Claims

The efforts to address the agency problem are directed towards mechanisms of corporate accountability, intended to ensure that management acts in the best interests of the shareholders.[757] The agency problem is closely related to the derivative action. The imposition of legal rules and standards of proper corporate behavior upon the decision-making bodies is vital in reducing the agency costs.[758] The derivative action, as a private enforcement mechanism, assumes a primary role in the reduction of agency costs.[759] The rules enforced by the initiation of the derivative action are designed to mitigate the agency conflicts inherent in the company. Considering that a derivative suit does not necessarily require the cooperation of shareholders, it is reasonable to argue that the availability of the remedy reduces the monitoring costs that would have been inevitably incurred, if the shareholders were involved in collective actions.[760] Derivative actions relate to the steps being taken on behalf of shareholders to redress the imbalance in the modern company form between control exercised by directors and that exercised by shareholders.[761] Similarly to the corrupted political system that Plato presented through the allegory, the picture of the corporate cave displays a corrupted corporate entity, in which the absence of an effective derivative action, restricts the minority shareholders from safeguarding their interests against directors' wrongdoing. So, except from lack of access to corporate information, the chains could also be a symbol of lack of incentives that prevent meritorious shareholders from bringing a

[757] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, *The Anatomy of Corporate Law A Comparative and Functional Approach*, 2nd edition, (OUP 2009) pages 39-40.
[758] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 23
[759] Ibid.
[760] Ibid, page 24
[761] D McDonough, 'Proposed New Statutory Derivative Action—Does It Go Far Enough?' (1996) 8 Bond Law Review 47

claim on behalf of the company to protect their interests against managerial misconduct. The question that is raised in relation to this modern corporate cave, is how the minority shareholders will be able to deal with mismanagement issues, when the derivative action as corporate governance mechanism, capable of deterring the directorial wrongdoing and compensating the company, is not accessible to them? The answer is given through Plato's allegory that brings to the spotlight the necessity of introducing an effective and accessible derivative action.

The allegory itself, in the first glance provides a realistic consideration to the problem of managerial misconduct. If one of the prisoners manages to free himself from the bounds and look out of this corporate cave, he may eventually drive the other prisoners out of the cave. The wording of the allegory itself, is forward looking and underlines the cumulative effect of the derivative action, as a corporate governance mechanism. In detail, it suggests that minority shareholders should have better access to the procedural requirements that accompany the initiation and settlement of the derivative action, in order to recover not only the loss in their shareholding, but also the losses that the company suffered as a whole. Analogically to the Plato's corrupted political society, where the ill-educated citizens needed access to education in order to protect their interests against corrupted politicians, in this corrupted corporate cave, the ill-equipped minority shareholders need better access to the remedy to ensure that their interests are effectively safeguarded. Hence, the allegory of the cave is used to explain how shareholders could deal with the corrupted approach of a powerful managerial body, especially when that approach is adopted to the detriment not only of shareholders, but also to the society as a whole.

Given the strong communitarian thrust of Plato's ideal republic[762], the access to education is not primarily intended only for the philosopher's benefit but rather for the society's own good and any benefit the individual philosopher receives is indirect.[763] These considerations lead by necessity to the compensatory rationale that underlies the derivative action, which serves as a principal means of the company's financial redress. The remedial effects of the remedy lie on the compensation that is awarded directly to the company as a whole and indirectly to the litigant shareholder and its fellow shareholders ex post.[764] This means that the benefits of this representative action become evident after the claim has been initiated and ends up to be successful. The benefit that the remedy grants to the shareholders reflects the loss that each and one of them suffers in the value of their shareholding. However, the compensatory function of the derivative action is not without limitations. In certain occasions, it is likely that the costs of continuous litigation would equate or exceed the expected financial recovery.[765] The monetary compensation might be trivial, if it is compared to the time and the funds that the plaintiff shareholder speared to pursue such an action.[766] The worse scenario that a plaintiff shareholder could face, is the case, where he might have already sold his shares by the time that the courts orders the expected recovery, while he have owned those shares at the time that the wrongful act occurred.[767] As a result, the plaintiff shareholder would compensate the company, as the direct beneficiary of the claim, but he would have no personal gain, considering that he no longer owns any shares to be reflectively remedied. On the contrary, the incoming members would enjoy the

[762] Julia Annas, *An Introduction to Plato's Republic*, (Oxford University Press, 1981) pages 170-189.
[763] Plato, Republic, 520a- 521a, Trans. Ιωάννης Γρυπάρης, Πολιτεία, (MATI, 2004)
[764] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) pages 51-52.
[765] Ibid, 57.
[766] Roberta Romano, 'The shareholder suit: litigation without foundation?' (1991) 7(1) Journal of Law, Economics, & Organization 62.
[767] John Coffee and Donald Schwartz, 'The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform' (1981) Columbia Law Review 261, 302-309.

financial benefit of the action in their shareholding, without having their interests harmed at all.[768] These limitations show that the likelihood of financial recovery is insufficient to encourage the bringing of a derivative action. Similarly, to Plato's allegory, the return of the freed prisoner (individual shareholder) to the corporate cave to release the other shareholders from the bounds, reflects the idea that the derivative claims aim to protect shareholders collectively, avoiding the pitfall of safeguarding the interests of some equity holders to the detriment of others.

The return of the freed prisoner back to the cave and the release of his fellow-dwellers, advances Plato's conception of political justice.[769] The return to the cave and the release of the rest of the prisoners, illustrates the way that education for all citizens can benefit the society in general. In more detail, the philosopher, that returns back to the cave to educate the citizens, serve a public purpose, which is not other than the restructuring of the political society, in which well-educated citizens would be able to combat corruption and consequently to direct the ideal Republic of Plato to its prosperity.[770] Analogically, the return of the individual shareholder back to the corporate cave to release the other members of the company, is a symbolic representation of the social benefit that the remedy delivers that takes effect both ex ante and ex post. The right of the minority shareholder to raise a claim, serves the purpose of revealing corporate abuse, punishing improper corporate conduct and awarding justice when intra-corporate mechanisms fail to do so.[771] This action, is thus

[768] Ibid.
[769] Richard Kraut, 'Return to the Cave: Republic 519–521', in Plato 2: Ethics, Politics, Religion, and the Soul', (Oxford University Press, 1999), pp. 235–54.
[770] Plato, Republic, 519e- 521d, Trans. Ιωάννης Γρυπάρης, Πολιτεία, (MATI, 2004)
[771] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62, 81.

a public good provided by regulation which otherwise would not be, if left to private bargain.[772]

So, except from its financial benefit, which is delivered after the action is brought, the derivative action integrates a deterrent function within its substance, which is assumed to be even more significant than its monetary benefit and confirms its importance in improving corporate governance practices.[773] In specific, the derivative action provides non-monetary relief to the company through a court order for the termination of self-dealing, fraudulent and negligent transactions, penalizing the wrongdoers for their corporate violations and preventing further loss to the company. The deterrent effect of the remedy is also workable ex ante.[774] A successful derivative claim does not only hold the wrongdoer accountable for his misdeeds, but it also provides a powerful disincentive for those who seek to engage in similar practices.[775] In other words, each successful derivative action could be understood as a public warning to potential corporate managers and dominant shareholders, giving them a valuable reason to abstain from wrongdoing.[776] In fact, even the threat of expected liability is sufficient to deter potential corporate misconduct. As Reisberg argues, the bringing of derivative claims should not be understood as a process of balancing a private conflict of financial interests. Instead, it should be perceived as a social condemnation of corporate misconduct.[777] Hence it would be unreasonable to assume

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[772] I.H. Chiu, 'Contextualising Shareholders' Disputes—A Way to Reconceptualise Minority Shareholder Remedies' [2006] JBL 312.
[773] I. Ramsay 'Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Derivative Action' (1992) 15 University of New South Wales Law Journal 149, 156.
[774] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 65.
[775] JC Coffee 'New Myths and Old Realities: The American Law Institute Faces the Derivative Action' (1993) 48 Business Lawyer 1407, 1428.
[776] Harald Baum and Dan W. Puchniak, *The Derivative Action in Asia: A Comparative and Functional Approach*, (Cambridge University Press, 2012) page 14.
[777] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 73.

that derivative claims are brought only for the purpose of offering financial relief to the company and its members. The complex form of the remedy itself, the time and resources spent for the claim to be brought, imply that this regulatory mechanism serves a social purpose which is strongly connected to its deterrent value.[778] So, the allegory itself seems to be the most suitable representation of how an effective derivative action can assert an important compensatory and deterrent role in corporate governance, a role that that goes beyond shareholder protection and becomes, essentially, a public good.

4.4 Looking out of the cave: A Platonian approach to derivative litigation - The Platonian Remedial Model (PRM)

Having established the need and the methodology for redefining the way that the law on derivative claims should be formulated, it crucial to bring the content of this conceptual framework into a new model for derivative litigation. So, the thesis proposes the adoption of a *Platonian Remedial Model (PRM)* for the introduction of an effective derivative action. The key objective of the Platonian Remedial Model (PRM) is to improve the accountability of the corporate executives.[779] Intertwining the above conceptual observations into a cohesive model of derivative actions, the model conceptualizes the derivative action, as an accessible corporate governance device, which can offer both pecuniary and non-pecuniary benefits to the company, in the exceptional occasion that the company itself is incapable of inducing those in control to act in the company's interests.

The PRM puts forwards the policy of promoting the use of the derivative action, as follows: Firstly, the PRM highlights the importance of the deterrent and

[778] S. Shavell 'The Social versus the Private Incentive to Bring Suit in a Costly Legal System' (1982) 11 JLS 333.
[779] BR Cheffins 'Minority Shareholders and Corporate Governance' (2000) 21 Company Lawyer 41.

compensatory functions of the derivative action. The extended metaphor on the corporate cave itself emphasises that the effectiveness of the remedy is strongly linked to the performance of its prime functions.[780] Secondly, the model acknowledges that shareholders should not be denied of any reasonable access to the remedy solely on the basis of lack of legal standing. This policy, is reflected in the symbolic scene of the allegorical text, where one of the prisoners is released from the bounds and looks out of the corporate cave. Thirdly, the PRM, by placing the individual shareholder to return back to the corporate cave to release the other members from their bounds, acknowledges the collective effect of the remedy. On that basis, the model recommends that the procedural safeguards that the court considers during the screening process to prevent undesirable litigation, should focus on the question of whether the bringing of the derivative claim serves the interests of the company as a whole and adds both economic and social value to the company. Finally, the PRM, seeks to introduce strategies to simplify the litigation process and to create a more accessible litigation environment for minority shareholders; these are related to better access to information rights, the development of a shareholder-friendly cost allocation scheme and the broadening of causes of action that would give rise to the bringing of a derivative claim.

4.5 Concluding Remarks

Apparently, any legal change that would open the floodgates of corporate litigation would not be welcomed.[781] The PRM does not aim to encourage undesirable litigation, but instead to ensure that the access of a bona fide shareholder to derivative litigation would not be discouraged. By creating a more shareholder-friendly litigation environment, the PRM increases the scope of shareholder engagement in derivative

[780] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 184.
[781] Ibid, 191.

litigation, in the light of strengthening corporate accountability. The model supports the necessity for procedural conditions to minimize risk of counter-productive litigation, as long as these conditions, filter the ability of the claim to serve the corporate interests and not necessarily the ability of the shareholder to bring the claim. So, the PRM by giving better access of minority shareholders to the remedy, ensures that the derivative action has a fair chance of exercising effectively its compensatory and deterrent functions, to reach its potential and to promote good corporate governance practices.

The use of Plato's allegory of the cave, provided a theoretical approach on how a company appears to be, when wrong has been perpetrated against it, and the derivative action is called to play its deterrent and compensatory role. This allegorical analysis was useful for two different reasons. Firstly, it has illustrated the problems that arise, when the law on derivative claims is dysfunctional in many respects of the statutory process, and secondly it pointed out the accessible way in which the rules on derivative claims should be formed to attain higher levels of minority shareholder protection. The useful insights that the allegory provides, constitute the theoretical background upon which the reformed proposals on the introduction of the Cypriot statutory derivative action, would be framed. In this regard, Chapter 5 of the thesis, suggests that the Cypriot legislators should not only borrow the flexible provisions that both jurisdictions have to offer, but they should set up a remedial device, based on the accessible grounds upon which all procedural rules of the English and German law should have been formed, in order to increase the levels of minority shareholder protection.

Chapter 5

Strengthening Shareholder Protection in Cyprus: Reform Proposals for the Introduction of an Accessible Derivative Action and Strategies for the Improvement of Existing Alternative Methods of Minority Shareholder Protection

5.1. Introduction

The comparative analysis of the common law derivative actions in England and Cyprus, has demonstrated that the Cypriot approach is slightly more flexible than the old English common law regime. The analysis of the two Cypriot reported cases[782] on derivative claims in Chapter 3, has revealed that the Cypriot judges have flexibly interpreted some of the procedural requirements of the English common law remedy in allowing the derivative claim to proceed. However, there is no scholarly analysis that proves whether the flexibility of Cypriot courts is intentional or it simply lies on the fortuity of unambiguous cases, where the application of the remedy is self-evident and there is no need to consider and interpret in depth all the complex English procedural rules. Whatever the case maybe, the questions that have concerned English courts for decades regarding the interpretation of uncertain common law procedural conditions, such as "the fraud on minority" and "wrongdoer control", remain challenging for the Cypriot judges too, rendering the Cypriot remedy ineffective in many respects.

[782] (2006) 1 CLR 1263 (Civil Appeal No.11784, 24/11/2006); (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136

This Chapter aims to introduce a legal framework in Cyprus, which will be more protective than the current one. To achieve this, it puts in place reform proposals that would be focusing on the policy premises that the PRM introduced in Chapter 4. The allegorical analysis in Chapter 4, demonstrated that the keyword that the legislator should be concerned with, in introducing an effective derivative action is "accessibility" to all the constituent elements of the remedy. Following this conceptual consideration, each of the proposed rules on the reformed derivative action in Cyprus is formed on the basis of how accessible each procedural condition is to minority shareholders. The Chapter firstly, provides a legal map of the suggested reforms, which are based on the application of the Platonian Remedial Model (PRM). Following the outline of the main pillars upon which the new remedy is developed, the Chapter thoroughly examines which legal elements of the English and German law on derivative claims, should be included in the new remedy and which ones should be avoided. Specifically, the legal aspects of the English and German statutory derivative actions that were examined in Chapter 2, will be implemented in this Chapter to develop the recommendations for the reform of the Cypriot common law derivative action. The legal aspects of the two statutory remedies are examined on the basis of their alignment with the PRM. In other words, the Chapter explains which English and German law elements seem to be more closely connected to the purposes of the PRM, and which ones fail to assert the accessibility that the PRM intends to bring to the new Cypriot remedy.

Furthermore, the Chapter provides some additional recommendations for the improvement of existing alternative methods of minority shareholder protection. As explained in Chapter 3, the application of the oppression remedy in the Cypriot jurisdiction, as an alternative mechanism of shareholder protection is outdated and completely inadequate to secure the interests of minority shareholders, compared to the

well-established English unfair prejudice remedy. The Chapter argues that Cypriot legislators should prioritise the reform of the derivative action, since the nature of the remedy itself, fits with the closely held character of Cypriot companies

By way of disclaimer, it should be clarified that given the objectives of this study, the Chapter does not consider the theories and rationale underlying the unfair prejudice remedy in any detail and is not concerned either with specific proposals to reform the Cypriot oppression remedy. It simply, aims to provide some additional recommendations on legal amendments that could follow the reform of the derivative action and are likely to strengthen the overall picture of shareholder protection in Cyprus. The Chapter examines the aspects of the English unfair prejudice remedy that could improve the Cypriot law on oppression. The Chapter argues that an amended oppression remedy, based on the English model, is a welcome development. The Chapter also identifies the challenges that a Cypriot shareholder may face in using an amended oppression remedy. The Chapter further argues that the reform of the derivative action should remain the main priority for the Cypriot legislator, since any legal changes on the alternative methods of shareholder protection in Cyprus, are not adequate to reach the same level of protection that an effective derivative action can offer.

5.2 The Synthesis of the New Statutory Derivative Action in Cyprus: Applying the Platonian Remedial Model (PRM) to Cypriot Company Law

Following the allegorical analysis of Chapter 4 on how significant is accessibility to the derivative action for minority shareholders, in cases of managerial wrongdoing, it is important to examine the applicability of the PRM to the reform proposals for the introduction of a statutory derivative action in Cyprus. Based on the allegory, the key

consideration for the Cypriot legislators, regarding the creation of a statutory remedy, should be the extent to which the constituents of the new remedy are accessible to minority shareholders. It is noteworthy, though, that a balance needs to be maintained, between investor protection and managerial freedom.[783] The comparative analysis of the English and German approach on derivative actions in Chapter 2, has shown that such a balance has not been achieved to a great extent, as both laws are more responsive to non-interference with the decision-making rather than to minority shareholder protection. So, the reform's success is deemed to fail, if the Cypriot legislators simply include within the Cypriot law, some of the English and German provisions, as they are presented in the statutory procedures of the UK Companies Act 2006 and UMAG respectively. For that reason, the reform proposals that the thesis puts in place in this Chapter would not be solely based on the current form of the English and German law, but they will aim at creating an accessible remedy in Cypriot law. It has been argued that the absence of derivative suits and the lack of minority shareholder protection is not explained through the strictness of one single procedural requirement, but with a whole range of legal conditions, which are made inaccessible to minority shareholders.[784] Thus, on the basis of the Cypriot reform, it would be of little practical importance to add one or two factors that are flexible outright in the English and German law, disregarding the revision of the rest mandatory legal provisions. The legal elements of the remedy are assessed in this part of the Chapter, so that the recommended rules could assert the accessibility and effectiveness that the remedy intends in order to

[783] Law Commission, Shareholder Remedies: A Consultation Paper (Law Com No. 142, 1996) para 1.13; Brian R. Cheffins, 'Reforming the Derivative Action: The Canadian Experience and British Prospects' (1997) 2 Company Financial and Insolvency Law Review 227, 233.
[784] Martin Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 Brook. J. Int'l L. 843.

protect the Cypriot shareholders, in the exceptional occasion that the company takes the form of a corrupted corporate cave.

The key aspects of the PRM, discussed in Chapter 4, will be placed on a set of practical recommendations and they will be included in the proposal for the reform of the common law derivative action in Cyprus. It should be noted though, that the application of the PRM in Cypriot company law, does not aim at creating a policy that fundamentally re-shapes the derivative litigation process, but it aims at identifying and reviewing the major flaws of the common law remedy. The outline of the proposal is structured as follows:

Based on the PRM policy, the individual shareholder should not be denied any access to the remedy on the basis of lack of legal standing. Any shareholder, with a membership status assumes that the company functions lawfully and in a way that promotes its interests. The PRM highlights that the right to sue on behalf of the company, belongs to the company itself, and so every shareholder should have the right to raise a derivative action on behalf of the company. On that basis, the thesis proposes that Cypriot law should enforce the individual minority right to sue on behalf of the company, as part of the new statutory derivative action.

As it was explained in Chapter 4, the PRM recommends that the rules governing the derivative action should not restrict access to the remedy. The types of causes of action which give rise to the commencement of derivative litigation should be as wide as possible to allow shareholders, in appropriate circumstances, to utilize this remedy.[785] For that matter, Cypriot law should not place any explicit limits on the type of conduct which can give rise to a derivative claim. Considering that better access to

[785] BR Cheffins 'Reforming the Derivative Action: The Canadian Experience and British Prospects' (1997) 2 CFILR 227, 241–3

litigation is pertinent to the effective use of the remedy, it is suggested that Cypriot company law should abolish the wrongdoer control and fraud on minority requirements. As explained in Chapter 3, these two elements restrict the availability of the remedy to minority shareholders, since their interpretation by Cypriot courts is quite restrictive and vague, leaving many gaps in the understanding of what kind of conditions fraud and wrongdoer control represent. The new regime will allow a broader range of claims to be brought more easily than is presently the case at Cypriot common law, especially breaches of the director's duty of care, which are excluded currently from the scope of the common law derivative action. Also, given the discussion in Chapter 3 as to what kind of breaches may be ratified by shareholders, it is further suggested that ratification should be removed from the list of deciding factors that bar access to the remedy. Cypriot law is considerably unclear on that matter, and so it is proposed, that shareholders should be able to apply for leave of the court irrespective of whether a breach is ratifiable or whether ratification has taken place.[786]

Furthermore, it is suggested that the new remedy should include a judicial screening procedure, under which the Cypriot judges would examine the admission or refusal of leave, so that the claimant shareholder can proceed with the derivative claim. Under the proposed rule, Cypriot judges should assess whether the claim would increase the economic and social value of the company. This screening mechanism seeks to replace overbroad and restrictions related to a claimant's standing to sue with a judicial tool that would be able to assess the merits of the case in question, based on the inquiry of whether the claim serves the company's interests. The reason for such a judicial ground, is based on the PRM, which highlights that the derivative claim is equivalent to a claim made by the company itself and as a result, the conduct of the

[786] A. Boyle Minority Shareholders' Remedies (Cambridge University Press 2002) pages 76–8

claimant shareholder should be of secondary importance in the court's assessment of whether the action would yield any monetary and social benefits to the company, if it is permitted.[787]Also, the PRM highlights the importance of introducing strategies that would resolve problems relating to litigation costs and information asymmetry, so that access of minority shareholders to litigation could be facilitated. On that basis, reforms are also proposed in relation to the cost allocation system and the information disclosure scheme that currently apply in Cyprus. These recommendations are explained in greater detail in sections 5.2.7 and 5.2.8.

Finally, the PRM acknowledges that accessibility to the remedy would be achieved by introducing measures that simplify the litigation process. Taking this policy into account, it is proposed that a well-structured statutory procedure to derivative litigation, which provides transparent legal criteria for permission to be granted, is clearly filled with more certainty than the complexities of the fraud on minority and wrongdoer control requirements that the Cypriot common law maintains until today. The proposed statutory model in Cyprus would be formed as follows; Firstly, an admission stage, will include all the legal criteria, which the claimant shareholder will need to satisfy, so that the court will allow the claim to proceed to the main trial. In this admission stage, all the legal conditions would be considered by the court, in order to decide whether the bringing of the claim would serve the corporate interests and whether the claimant should be allowed to litigate on the company's behalf. If the claimant succeeds in the admission stage, the court should give permission to the claimant to proceed to the main trial. In the main proceedings, the merits of the case will be examined by the court and the claimant will be able to obtain a court order for the company's redress, if successful. It should be noted, that the Chapter does not aim to discuss all the deciding factors that

[787] Jennifer Payne 'Clean Hands in Derivative Actions' [2002] CLJ 76, 77-81.

the court should have regard to, in allowing the claim proceed. Some of these factors, including the good faith requirement, the demand rule, the "corporate interests" criterion and the views of disinterested members, are discussed in greater detail in parts 5.2.4, 5.2.5, 5.2.6, to assess whether their consideration can provide a more efficient and accessible method by which the Cypriot courts can fairly decide on the continuance or discontinuance of derivative proceedings. Specifically, the Chapter argues in favour of the inclusion of the 'corporate interests' criterion, since its consideration by the Cypriot judges in allowing the claim to proceed, is reflective of the remedy's nature that it should be used for the benefit of the company. It further argues that the 'good faith' criterion should not be considered separately from the 'corporate interests' criterion, but the Cypriot courts should assess the good faith of the litigant on the basis of whether the claim serves the corporate interests. Finally, the Chapter suggests that the Cypriot courts in exercising their discretion to allow or reject a derivative claim, should have regard to the views of disinterested members, as long these views are treated as a mere consideration by the Cypriot courts and not as conclusive evidence on their final decision, since it is a challenging task for the courts to predict whether and to what extent a member is interested or disinterested in the respective claim.

Having identified the main pillars of the Cypriot reform, the following parts starting from 5.2.1 to 5.2.8, discuss in more detail these recommendations with reference to the English and German approach on derivative claims. Specifically, the following analysis identifies which common and civil law elements constitute valuable lessons for Cypriot legislators in introducing a reform of the common law derivative action and which ones should be avoided, as inaccessible measures that would provide a less effective method of commencing derivative litigation.

5.2.1A Legal Standing: Preserving the Individual Minority Right

The right to sue can be conferred to minority shareholders in two ways. In the context of the first approach, this right is granted only to a qualified group of members, who satisfy a particular ownership threshold, as it is prescribed by the relevant law. As explained in Chapter 2, this approach has been adopted by Germany and in most of the civil law jurisdictions in derivative proceedings, viewing the percentages on the share ownership requirement to vary between the 1% to 10%, depending on the flexibility of the law in each jurisdiction.[788] In the context of the second approach, an individual right is conferred on a minority shareholder to sue on behalf of the company in their capacity as members of the company, holding shares. The latter approach, being the most favorable for the litigant, is adopted in England, since the establishment of the previous common law on derivative claims.[789] The individual minority shareholder right to sue on behalf of the company is well-maintained within the UK Companies Act 2006 until today.[790]

Cypriot law adopts the English common law approach on this matter; Cypriot shareholders can raise a derivative action in their capacity as shareholders. It is suggested that Cypriot legislators should consolidate this right by giving it a statutory basis. This approach is more appropriate for the reformed Cypriot derivative action than the civil law position. As it was previously explained, Cyprus is a country with a mixed legal system, so it is reasonable to be influenced by both civil and common law elements. The question is whether the common or the civil law approach is more closely connected to the accessibility that the new remedy seeks to achieve.

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[788] Martin Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe?' (2012) 37 Brook. J. Int'l L. 843, 859.
[789] Seaton v. Grant (1867) LR 2 Ch App 459; Birch v. Sullivan [1957] 1 WLR 1247.
[790] s.260(5) of the UK CA 2006

The German approach sets 1% threshold of the registered share capital.[791] So, the imposition of 1% ownership threshold of the registered share capital in Cyprus, similar to the one that applies in the German measure, governing derivative actions, would further block access of Cypriot shareholders to the remedy. Individual members with less than 1% of nominal share value, will be deprived of the right to sue and if they attempt to communicate with fellow members start a collective a action, they might be trapped in the lengthy and costly proceedings of finding members willing to engage in litigation and to protect the corporate interests.[792] The adoption of the German approach within the Cypriot company law on that matter would deprive loyal shareholders, who hold minimal stakes in the company, from a realistic access to the remedy that according to the PRM, should not be associated with any lack of legal standing.

The most persuasive argument in favour of the qualified minority right, rests on the idea that the interests of members with a significant stake in the company are in alignment with the company's interests, and so these members have a optimum reason to exercise this right, as long as their substantial share contribution bears more risks.[793] Even though, this argument seems solid, it is subject to a variation of probabilities. This means that it is not certain that every shareholder with a substantial stake in the company would be interested in pursuing a claim on behalf of the company, especially, if we take into account the passivity of institutional investors in European jurisdictions.[794] The fact that majority members, have made a strong investment in the company does not automatically incentivize them to serve the corporate interests and

[791] s.148(1), sentence 1 of the AktG (the UMAG)
[792] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 83
[793] Ibid page 175.
[794] Roman Tomasic and Folarin Akinbami, Shareholder Activism and Litigation against UK Banks in Joan Loughery (ed) Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis, (EE 2013), 143-172.

bear the risk of litigation.[795] On the contrary, in certain occasions, it is likely that members with better access to share capital, would use the threat of a derivative claim, as an extortion mechanism, in order to force the management to abide by their wishes.[796] In other words, these members are more inclined to come to an agreement with the wrongdoing directors so as to avoid derivative proceedings, if the management consents to operate in a considerable way that solely benefits their interests. As it was explained in Chapter 4, through the allegorical analysis of the corporate cave, the derivative action has not been created to protect the dissident minorities with significant voting power, but to protect the company as a whole from maladministration. The PRM highlights deterrence of mismanagement as one of the main rationales behind the use of the remedy. It seems that to some extent the imposition of ownership thresholds in the bringing of derivative claims alters that purpose, encouraging a corporate culture, which conceals corporate misconduct in return of the promotion of the interests of a particular group of members. It is likely that the imposition of ownership thresholds in Cyprus would create such a corporate culture in which derivative actions could be brought only by a limited number of closely held companies, where the dissenting decision-making approaches of majority members would be resolved in litigation.

In the absence of other efficient safeguards against malicious shareholders, quorum thresholds might have been regarded as a reasonable option to accommodate the law on derivative claims with managerial freedom in decision-making.[797] However, as it was

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[795] J. Dine, M. Koutsias, *"The Nature of Corporate Governance: The Significance of National Cultural Identity"* (Edward Edgar Publishing Limited, 2013) page

[796] K. Grechenig and M. Sekyra, "No Derivative Shareholder Suits in Europe –A Model of Percentage Limits, Collusion and Residual Owners", (2007) The Center for Law and Economic Studies Columbia University School of Law, Working Paper No. 312 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=933105> accessed August 2020

[797] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 104.

explained in Chapter 4 with the development of the PRM, the ability of a member to sue, should play a backseat role in the decision of the court to allow the claim to proceed. Predatory shareholders should not be assessed by the court on their inability to qualify as holders of specific ownership thresholds. Instead, the procedural safeguard should be focused on whether the claim, sought to be brought by this member, is contrary to the company's interests, and so it should be dismissed.[798] The qualified minority requirement is designed to prevent predatory shareholders from bringing a derivative claim. However, as it was discussed on the analysis of the German law on derivative claims in Chapter 2, the qualified members with significant stake in the company, might turn into the most inappropriate and undesirable litigants, since they can be easily corrupted by the wrongdoers to safeguard their substantive investment rather than engaging in derivative litigation which might involve a prospect of failure; a situation that can turn the company into a corporate cave, as this is illustrated in Picture 4.1 of Chapter 4. If corporate interests are to be protected through the initiation of the derivative action, minority members, with minor stakes in the company, should not be excluded from being entrusted with the representative role of starting derivative proceedings, as their incentive to act for the benefit of the company might be stronger than the qualified minority's one in certain instances. So, it is difficult to perceive why a particular minority group should be excluded from seeking accountability for the wrongdoers, simply for the reason that their investment is considerably low compared to his fellow members.[799] As it was explained above, low investment does not necessarily amount to lack of incentive in protecting the corporate interests. Consequently, it seems quite unnecessary for Cypriot legislators to doubt and withdraw

[798] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 174.
[799] Ibid, page 176.

the individual right of every minority shareholder to sue on behalf of the company, while for many decades the Cypriot company law, was embracing the preservation of this individual right through the interpretation and application of the UK Foss v Harbottle exception.

5.2.1B The contemporaneous and continuous ownership requirement

The contemporaneous ownership rule requires that the claimant should be a member of the company at the time that wrongful act occurs, while the continuous ownership rule requires the claimant to become a member before and at the whole duration of the litigation process. As it was explained in Chapter 2, the German law bars the accessibility of the remedy to incoming and former members, taking into account the point in time in which the claimant became a member.[800] This policy aims at filtering unmeritorious claims.[801] The rationale for the existence of the aforementioned requirement lies on the idea that current members might have a better prospect of having their interests closely connected with those of the company than former or incoming members.[802] However, this assumption is not accompanied by any conclusive evidence on the effectiveness of this measure in preventing predatory claimants.[803] The imposition of such a threshold does not doctrinally reflect all claimants' motives in bringing a derivative claim.[804] In other words, it is not universally accepted that an incoming member would exclusively buy his shares for the sole purpose of bringing the company in litigation. It is unreasonable to assume that an incoming member's interests are less aligned with the corporate interests than those of

[800] s.148(1), second sentence, no 1 of the AktG (the UMAG)
[801] H. Fleischer, 'Act on Corporate Integrity and Modernization of Rescission Law' [Das Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts] [2005] NJW 3525, 3526.
[802] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 177.
[803] Ibid.
[804] Fang Ma 'The deficiencies of derivative actions in China' (2010) 31(5) Comp.Law. 150, 152.

a long-registered member, with the justification that he was not a member of the company when the wrong occurred to the latter. Incoming shareholders should be rightfully entitled to sue on behalf of the company, as they benefit from future business decisions and at the same time suffer from the badly made managerial decisions of the past.[805] On the contrary, it is not surprising to see a long-term shareholder bringing an action which is inconsistent with the corporate interests, in order to meet his personal ambitions.[806]

Section 260(4) of the UK Companies Act 2006 states that a derivative claim may be brought by a member in respect of wrongs committed prior to his becoming a member.[807] The English approach acknowledges that the deterrence of the wrongdoers and the financial recovery of the company are not issues that should be left only to long-lasting members. This policy does not constitute an innovation in the introduction of the English statutory remedy, but has its roots in the previous English common law regime.[808] So, considering that Cyprus maintains the English common law approach on derivative claims, this policy can remain in force in the light of a Cypriot statutory remedy. If Cypriot legislators aim to promote the multi-functioning role that the derivative action has to play in promoting good corporate governance practices, it is necessary to perceive that the remedy essentially enforces rights belonging to the company and not to the members[809], a policy that is highlighted in the advancement of PRM. As such the point in time that the claimant became a member should be

[805] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 346.
[806] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 177.
[807] s.260(4) of the UK CA 2006
[808] Seaton v. Grant (1867) LR 2 Ch App 459; Birch v. Sullivan [1957] 1 WLR 1247.
[809] Travis Laster, 'Goodbye to the Contemporaneous Ownership Requirement' (2008) 33 Del. J. Corp. L. 673-694.

immaterial for the initiation of derivative proceedings.[810] This requirement has been a matter of debate in England during the formation of the statutory remedy, out of fear that it might encourage undesirable litigation.[811] Nonetheless, the historically established common law position on that matter has not changed after the enactment of the 2006 Act.

There is no doubt that a loss suffered by the company is usually a loss suffered by the shareholders too.[812] Naturally, a connection can be found between the reflective losses that the members suffer and the losses that the company suffers from the wrongdoing, otherwise the members would be disinterested in raising a derivative claim.[813] However, it seems unreasonable to render the reflective loss that the individual member suffered, a legal condition for the bringing of the derivative action, while the remedy itself, is not a personal one. The claimant serves as a representative organ of the company that seeks to recover directly the losses suffered by the company and indirectly any losses in his shareholding. So, it is important for Cypriot legislators to comprehend the representative nature of the remedy by following the flexible English approach on that matter, and not exclusively select long standing members to exercise a legitimate right that belongs to the company as a whole. Finally, impact of widening the classes of people, to include former members, might not be useful, since the vast majority of claims, even in jurisdictions that the law includes wider classes of people, are brought by current members.[814] Evidence from the Canadian jurisdiction, where the

[810] Arab Reisberg, 'Derivative claims, the UK companies act 2006 and corporate governance: A roadmap to nowhere?', in Choi, J. and Dow, S. (eds.) Institutional Approach to Global Corporate Governance (Emerald Group Publishing, 2008) 9 International Finance Review 337, 346.
[811] Hansard, HL, Vol.679 Official Report, 27/2/2006; col. GC12-13 (Lord Grabiner).
[812] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 179.
[813] Ibid.
[814] BR Cheffins 'Reforming the Derivative Action: The Canadian Experience and British Prospects' (1997) 2 CFILR 227, 241–3

legislation confers a prima facie right to former members to raise a claim[815], indicate that applications for leave made by former shareholders have been rejected on the basis that the member lacked sufficient interest in the claim's outcome.[816] Taking this into account, it is suggested that the reformed Cypriot law on derivative claims, should allow present and incoming members to bring an action on behalf of the company.

5.2.1C The majority's shareholder right to sue on behalf of the company

The derivative action has been designed to protect minority shareholders from the abusive practices of the controlling members and place the company back to the position that it would have been, if the wrong has not been occurred.[817] Traditionally, the minority shareholders constitute a vulnerable corporate group, as they have minimum voting power and subsequently less control over wrongful decision-making. Hence, it seems reasonable for a minority shareholder, whose voting power is trivial, to serve as a representative of the company's action in order to protect his interests and deter the deceitful behaviour of the controlling wrongdoers. The question that concerns this part of the Chapter, is how a majority member, who has control over the company can ever benefit from the remedy which is designed to protect the minorities.

This question concerned England in post-Act 2006 case law. In *Cinematic Finance Ltd v Ryder,* a creditor and majority shareholder of the respondent corporations, applied for permission to continue a derivative claim against the respondents under s.261(3) on the basis of a breach of fiduciary duty.[818] The claimant argued that his majority membership status should not be considered as a procedural barrier to the bringing of the derivative claim. The court refused the claimant's application for permission, stating

[815] Arab Reisberg, 'Promoting the Use of Derivative Actions' (2003) 24 *Company Lawyer* 250
[816] Jacobs Farms Ltd v Jacobs (1992) OJ No 813 (Ont Gen Div)
[817] Edwin C. Mujih, 'The new statutory derivative claim: a paradox of minority shareholder protection: Part 2' (2012) 33(4) Company Lawyer 99,106.
[818] Cinematic Finance Ltd v Ryder & Ors [2010] EWHC 3387

that permission to a majority shareholder should be granted in very exceptional cases, but the English judges found it difficult to envisage and determine what kind of circumstances would make the right to sue, a majority right.[819] The answer to the above question has been given by the Cypriot case law. As it was explained in Chapter 3, in the case of *Kouis*, the successful derivative claim was brought by a majority shareholder, who was holding 50% of the company's share capital, while the rest 50% was held by the wrongdoer.[820] Principally, in this particular condition that the company's shares are held by only two members on a fifty-fifty (50-50) basis, no derivative action can be brought, as there is no minority member in the company to assume the representative role of shareholder-claimant. The problem that arises in such cases, concerns the inability of the claimant to raise a derivative claim, firstly because of his majority membership status and secondly because the member controlling the other half of the company's shares can always use his voting power to conceal his disloyal transactions and prevent the bringing of a derivative action against him.

It is unsurprising that Cypriot courts allowed a claim to be brought by a majority member, if we take into account the particular condition under which such permission was given. It is likely that cases of this nature might come before Cypriot courts in the future, considering the concentrated ownership structure and the family-held character of the Cypriot companies. Therefore, the flexible approach that Cypriot courts adopted in *Kouis,* regarding the range of applicants that can access the remedy, could be incorporated in the proposed statutory procedure, since it fits well with the corporate reality of Cypriot companies. Such a legal provision would provide legal certainty within Cypriot company law and more clarity in relation to the conditions that can give

[819] Ibid.
[820] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136

rise to the initiation of a derivative action. Allowing a majority shareholder to bring a claim in *Kouis*, Cypriot judges seem to comply with the policy of the PRM, by paying more attention to the deterrence of the actual wrong, which is one of the primary objectives of the remedy, rather than to the capacity of the member to fulfill this objective. On that basis, it is proposed that Cypriot legislators should consider the extension of the right to sue to majority shareholders in the exceptional case of a fifty-fifty share ownership structure.

5.2.2 The proposed statutory procedure in Cyprus: The introduction of a single admission process

The comparative analysis of the English and German statutory procedures for the bringing of derivative claims, demonstrated that each jurisdiction deploys different mechanisms to restrain unmeritorious claims. As it was illustrated in Chapter 2, the law of each of the examined jurisdictions appears to be shareholder-friendly in different aspects of the derivative proceedings. A similar pattern was observed in relation to the variety of procedural obstacles that each jurisdiction sets in order to prevent undesirable litigation. Although, one common tool that both jurisdictions have adopted in order to protect the management from predatory litigants, relates to the two-stage process that the claimant shareholder(s) need to overcome in order to have a chance of being successful with the claim.[821] The question that concerns this part of the Chapter, is whether a multi-stage procedure is a desirable option for a reformed statutory derivative action in Cyprus.

[821] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 107.

As it was explained in Chapter 2, the preliminary stage of the statutory derivative action, which can be found in both the English and German law, serves as a filtering mechanism, by which the facts of the case are assessed. The examination of the merits of each case by the court at the preliminary stage, operates as a protective cloak against the continuation of frivolous suits. So, the courts might have been more suspicious on whether the facts of a case should allow the claim to proceed, if there were no preliminary criteria to endorse the commitment of the wrongful action against the company and the credibility of the claimant-shareholder in bringing the action.[822] It can be argued that the first stage of the statutory process amounts to an affirmative statement of the court that the claimant shareholder rightfully seeks redress on the company's behalf.[823] If the claimant satisfies the requirements of the preliminary stage, it seems that the wrongful action becomes subject to public condemnation and as a result the social value of the remedy can be more easily understood.[824] In this regard, it can be said that a two-stage procedure, is a socially desirable constraint which adds value to the deterrent function that the remedy intends to play.[825]

Nevertheless, the experience from the English post-Act case law[826] has shown that it is unlikely that the above arguments are strong enough, to encourage Cypriot legislators to adopt a dual admission process in the introduction of a more accessible derivative action. In the first stage of the English statutory procedure, the applicant needs to provide a prima facie case.[827] Even though, this "prima facie case" stage was heavily criticised by the UK Law Commission, as an unnecessary addition to the

[822] J Cox 'The Social Meaning of Shareholder Suits' (1999) 65 Brooklyn Law Review 3, 24
[823] Arab Reisberg, 'Shareholders' remedies: the choice of objectives and the social meaning of derivative actions' (2005) 6(2) European Business Organization Law Review 227, 262
[824] Ibid.
[825] Ibid.
[826] Franbar v Patel, [2008] EWHC 1534 (Ch); [2008] BCC 885 [24] (Trower QC)
[827] s.261(2) of the UK Companies Act 2006

admission procedure, the Parliament finally decided in favour of its inclusion in the statutory process.[828] The UK Law Commission disapproved such an inclusion, arguing that it could lead to a time consuming and expensive mini-trial on the merits of the case.[829] Post-Act 2006 case law has confirmed the fear of the UK Law Commission, as the claimant-shareholder in order to demonstrate a prima facie case, had to meet criteria, which were supposed to be subsequently considered in the second stage.[830] Also, post-Act 2006 case law, has proved that the "prima facie case" requirement might be subject for consideration by the courts even in the latter stage.[831] Given these findings, it is suggested that the inclusion of a preliminary stage in the new Cypriot derivative action would be nothing but an unnecessary hurdle. Such a hurdle would act to the detriment of meritorious claims, as the significant time and resources, that the claimants would need, to meet the requirements of this initial stage, might disincentivize them to start proceedings in the first place.[832]

The same problems appear in the German statutory process, as in both stages the claimant shareholders need to ask the company to take over the proceedings.[833] It is true that the repetitive application of the procedural rules in the statutory processes of both jurisdictions is well-intentioned, aiming at preventing the opening of litigation floodgates.[834] However, this approach seems to be less shareholder-friendly, as it is

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[828] Andrew Keay and Joan Loughrey, 'An assessment of the present state of derivative proceedings' Joan Loughrey (ed), Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis, (EE, 2013) 194

[829] Hansard, HL, Vol.681 Official Report, 27/2/2006 col.883.

[830] Andrew Keay and Joan Loughrey, 'An assessment of the present state of derivative proceedings' Joan Loughrey (ed), Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis, (EE, 2013) 195; Bridge v Daley; [2015] EWHC 2121 (Ch) [8], [75]-[76] (Hodge QC).

[831] Stainer v Lee, [2010] EWHC 1539 (Ch) at [29] (Roth J).

[832] Julia Tang, 'Shareholder remedies: demise of the derivative claim?' (2012) 1(2) UCL J.L. and J. 178, 186.

[833] s.148 (3) sentences 1, 2 of the AktG (the UMAG); s.148(1), second sentence, no 2 of the AktG (the UMAG)

[834] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 108.

likely to bar meritorious litigation.[835] In Germany, it is difficult to determine whether a dual procedure renders the remedy accessible to minority shareholders, as there is no relevant case law to evidence the application of this two-stage process in judicial practice.[836] On the contrary, some of the UK post-Act 2006 cases, which were examined in Chapter 2, illustrated the court's intention to bring the two stages into one, bypassing or telescoping the prima facie case stage, when the facts of the case can easily amount to a prima facie case.[837] This seems to be the approach that was followed by Cypriot courts in *Kouis* and *Iliades,* where the prima facie requirement was not considered at all.[838] The successful outcome of both cases implies that a prima facie case was established from the outset and it is likely that the Cypriot judges considered a further examination of the requirement unnecessary.

It is worth-mentioning that English courts interpreted the prima facie requirement in a flexible manner. Particularly, in a list of six post-Act 2006 cases, all of them satisfied the criterion of the first stage and moved to the second stage of the derivative proceedings.[839] Based on that evidence, if this requirement is not truly an obstacle for meritorious claimants, then it is questionable that it needs to compose a separate stage in the derivative proceedings, making the whole procedure long-lasting. British scholarship has raised arguments that the first stage of the English statutory procedure is likely to be disregarded in future cases[840], relieving the claimants from the complexity

[835] Ibid.
[836] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 122.
[837] Franbar v Patel, [2008] EWHC 1534 (Ch); [2008] BCC 885 [24] (Trower QC);
[838] (2006) 1 CLR 1263 (Civil Appeal No.11784, 24/11/2006) (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[839] David Gibbs, 'Has the Statutory Derivative Fulfilled its Objectives? A Prima Facie Case and the Mandatory Bar: Part 1' (2011) 32 Company Lawyer 41, 43; [2008] EWHC 1339 (Ch), [2008] BCC 866; [2008] EWHC 1534 (Ch), [2008] BCC 885.
[840] Andrew Keay and Joan Loughrey, 'An assessment of the present state of derivative proceedings' Joan Loughrey (ed), Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis, (EE, 2013) 195.

that the dual procedure entails. It seems that this argument has already found its supporters in Cypriot common law, where the prima facie requirement is disregarded, as a condition that can be easily satisfied, when the claimant brings a strong case of misconduct before the Cypriot courts, as happened in *Kouis* and *Iliades* cases.

Based on the recommendations of the UK Law Commission, the judicial interpretation of the "prima facie case" stage in UK post-Act 2006 case law and the aforementioned arguments from English academic commentaries, it is suggested that the Cypriot proposed model should be formed upon a single admission stage. In this stage, the court will consider the prima facie requirement along with all other legal criteria that would allow the claimant to go to the main trial, if the admission stage is successfully passed. This proposed model brings all the procedural grounds for the bringing of the derivative claim in one stage, removing the complexity that both the English and German law places upon their statutory schemes, by applying twice the same legal criteria in the duration of the 2-stage admission process.

5.2.3 Extending the Cause of Action

As it was explained in Chapter 2, the German approach restricts the admissibility of derivative actions to cases of corporate criminality and gross violations of the law or serious violations of the company's constitution.[841] This restrictive approach coincides with the current Cypriot framework, which endorses the English common law exception of "fraud on minority". It is likely that the strict approach of German law on the scope of actions might be one of the factors that render the bringing of derivative claims in Germany a rare phenomenon.[842] In any case, the lack of derivative litigation

[841] s.148 (1) sentence 2 no. 3 of the AktG (the UMAG)
[842] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 185-186.

in Germany seems to be a warning sign for Cypriot legislators to remove strict provisions, related to the scope of misfeasance, in an attempt to increase the levels of minority shareholder protection in Cypriot companies.

However, as it was discussed in Chapter 2, the English statutory remedy amended this restrictive approach to the cause of action and extended the range of actions to any breach of duty, including directors' negligent conduct.[843] The main question that Cypriot legislators should consider, is whether a reformed derivative action would become more accessible to Cypriot shareholders by maintaining the previous English common law to the cause of actions or by extending the scope of misfeasance, following the UK Companies Act 2006 modifications? In other words, it is important to consider whether a filtering mechanism in the cause of actions such as the one that German law imposes, is a necessary measure to avoid the abuse of the Cypriot remedy in future cases.

Excluding negligent board decisions from the cause of action and imposing high standards of wrongdoing, frustrates the deterrent and compensatory function of the remedy. The derivative action is not designed to redress only intentionally fraudulent acts, and applaud the negligent decisions of the board that might lead to massive corporate scandals.[844] As it was explained in Chapter 4, through the allegory of the cave, the derivative action is meant to remedy a corporate wrong, in the exceptional occasion that the company itself is trapped within a corporate cave, unable to remedy the wrong itself. Hence, it is unclear why directors' wrongdoing falling within the boundaries of negligent conduct should be excused from liability in these exceptional

[843] s. 260(3) of the UK Companies Act 2006
[844] Joan Loughrey, 'The director's duty of care and skill and the financial crisis', in Joan Loughrey (ed), Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis, (EE, 2013) 12-14, 33-40.

circumstances, when that wrong has truly harmed the company's proper functioning and cannot be redressed by the company itself. In other words, if accountability is to be assumed only for gross violations, it is difficult to imagine how the directors would be prevented from exercising bad corporate governance practices. Given this rationale, it is proposed that the fraud and wrongdoer control requirements should be abolished and the new remedy should follow the English approach, extending the cause of action to cover cases of negligence too.

Even though, the English legislation does not raise a barrier similar to the German provision of s148 sentence 1(3), it constrains access to the remedy in a different way. The English ratification concept seems to have the same restrictive effect to the availability of the remedy. As, it was discussed in Chapter 2, the UK Act provides a barrier to the bringing of derivative actions, if the wrong can be ratified.[845] Also, the ratification condition appears as another consideration for the court to decide on whether a claim should be allowed to proceed.[846] As it was previously mentioned, there is only one case, in which the court considered the ratification concept, after the enactment of the UK Companies Act 2006 and in this case the court acknowledged that the ratification provisions simply repeat the mistaken and heavily criticized English common law position on ratifiable wrongs.[847] The absence of the ratification concept from the considerations of the court in granting permission in post-Act 2006 cases, implies that English judges are quite reluctant in applying these provisions either as a barrier or as a consideration for giving permission. The rationale behind this reluctance lies on the fact that they are unprepared to face the dilemma of what kind of wrong is ratifiable in every case of that comes before them, while previous judicial practice had

[845] s.263(2)(2) of the UK CA 2006
[846] s.263(3)(c) (ii) of the UK CA 2006
[847] Franbar Holdings v Patel [2008] EWHC 1534 (Ch); [2008] B.C.C. 885 at [897].

no clear answer to that question.[848] Considering that Cypriot law maintains the English common law approach on derivative claims, Cypriot legislators can be easily influenced by the mistakes of the UK Government and re-introduce the ratification concept into a new statutory derivative action. If Cyprus decides to follow UK's lead on that matter, it seems unlikely that the Cypriot judges will be able to effectively apply this provision, since the English judges are still struggling to remove the uncertainty that the concepts entails. The fact that British scholarship has argued against this concept[849], should work as a warning for the Cypriot legislators. Thus, it is proposed that Cypriot legislators should remove the ratification element in the introduction of a more accessible remedy, learning from the mistakes of the UK Government that decided to incorporate the previous common law ratification concept within the new statutory derivative action, disregarding the fact that English courts had no guidance as to how this concept should be interpreted in order to fit well with the purposes of the remedy. Thus, it is suggested that the new remedy should give Cypriot shareholders access to a wider range of actions, so that directors' negligent and wrongful decision-making that does not amount to "fraud" would be monitored and estopped, if needed.

Finally, the concentrated ownership structure of Cypriot companies, increases the possibilities of the controlling majority causing damage to the company by exercising their excessive voting powers over the board.[850] Given the current structure of the Cypriot companies, this abusive practice can escape the enforcement of accountability in two ways; either because the wrong committed would not be of a fraudulent nature

[848] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 81; Rolled Steel Products (Holdings) Ltd v British Steel Corp [1986] Ch 246 at [296] per Slade LJ.
[849] A. Boyle, '*Minority Shareholders' Remedies*' (Cambridge University Press 2002) pages 76–8; BM Hannigan 'Limitations on a Shareholder's Right to Vote—Effective Ratification Revisited' [2000] JBL 493; J Payne 'A Re-examination of Ratification' (1999) 58 CLJ 604, 614.
[850] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 191.

to fall within the boundaries of the remedy and be redressed as such, or because it might be considered by the courts as a ratifiable one. In any case, the formation of the law deprives minority shareholders from protection of interests that have not been grossly violated. For all these reasons, it is suggested that a flexible strategy on the scope of remediable wrong, constitutes an imperative objective of the Cypriot law on derivative claims.

5.2.4 Filtering Undesirable Claims: The corporate interests in derivative litigation

A common criterion that both English and German courts examine in granting leave relates to the question of whether the action promotes the corporate interests. As it was explained in Chapter 2, the UK Act 2006, places the English judiciary in the position of a managing director to adjudicate the desirability of the claim based on the long-term prosperity standards that the management would have considered, if it was the one to make the decision on the admissibility of the claim.[851] The German approach sets a similar consideration for German courts, calling the judges to consider whether the company has any predominant interests, which would make the bringing of the derivative action, an undesirable option for the company.[852] As it was previously argued, the wording of the German provision seems to provide a more flexible criterion for the German judges to interpret, since it does not place the courts in the position of the directors to decide on the importance of the claim under a hypothetical director test. However, it is hard to see how the German judges would assess whether the company needs to safeguard interests that supersede the enforcement of the derivative claim, if they do not place themselves in the position of the corporate decision-maker, who is the

[851] s.263(3)(b) of the UK CA 2006
[852] 148(1), second sentence, no 4 of the AktG (the UMAG)

most appropriate person to assess what kind of actions promote the company's interests and what kind of actions are detrimental to those interests. In one way or another, the wording of both provisions does not alter the purpose for which this criterion is established, which is not other than to ensure that the floodgates of litigation would remain closed, in any case that the use of the remedy does not serve the corporate interests.[853]

It is worth-mentioning that this consideration can be found in the legislation of many common law jurisdictions, such as Canada, Australia and New Zealand.[854] The fact that this criterion has been tested as a method of filtering unmeritorious claims in both civil and common law countries, render it a welcome development for a country with a mixed legal system, such as Cyprus. Also, the UK Law Commission confirmed the necessity for the existence of such a criterion in its recommendations for the introduction of the English statutory derivative action. Particularly, the Commission argued that this legal condition should be considered by the courts in any jurisdiction, regardless of whether the consideration is incorporated into the statute or not.[855] This argument coincides with the PRM that conceptualizes the derivative action, as a remedy that should be used on behalf of the company and for its benefit. So, considering that the judges perceive the very essence of the derivative action, it would be illogical to admit the continuance of a claim, that is contrary to the company's interests and solely seeks to put pressure on the management.

As it was discussed in Chapter 2, the English courts consider this criterion in most of the UK post-Act 2006 cases. The interpretation of this criterion by the judges in both

[853] Chapter 2
[854] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 192.
[855] Law Commission, Shareholder Remedies: A Consultation Paper, (Law Commission Consultation Paper No 142, 1996) at para 16.33

of the examined jurisdictions, assist their challenging task of deciding whether derivative litigation in each case that comes before them, serves the main purposes for which the remedy is used.[856] Particularly, the judges are called to assess whether the action would bring a desirable financial benefit to the company and its members as well as the deterrence of the current and future wrongdoing.[857] As it is argued in British scholarship, the deterrent effect of litigation, is difficult to be predicted by the courts, through the interpretation of this provision.[858] However, the Cypriot judges should acknowledge that despite the low financial recovery that an action might immediately offer in some instances, deterrence could ultimately promote good corporate governance practices and offer a long-term benefit to corporate entities, in which the corrupted directorship seeks to engage in disloyal transactions.

The analysis of the post-Act 2006 case law on Chapter 2, witnesses that the judges are cautious in intervening in the corporate decision-making. The interpretation of the "interests of the company" condition in English cases illustrated that the courts are quite reluctant in making commercial decisions, such as adjudicating on the importance that a director would attach to the continuation of a derivative claim.[859] This is evidenced in the case of *Iesini*, where Lewison J enumerated a list of features that should be taken into account, when the court assesses whether the claim is in the company's interests; size and the strength of the claim; the cost of proceedings; the company's ability to fund the action; the ability of the potential defendants to satisfy a judgment; the impact on the company, if the action is unsuccessful and results in the payment of the defendant's

[856] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 193.
[857] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 210.
[858] Ibid.
[859] Iesini v Westrip Holdings Ltd [2010] BCC 420, at [441]- [442]; Franbar v Patel [2008] EWHC 1534 (Ch); [2008] BCC 885 [27]-[29] (Trower QC), Wishart v Castlecroft Ltd & ors [2009] CSIH 65 [43] (Lord Nimmo Smith Lord Reed Sir David Edward, QC);

costs too; any disturbance on the company's daily business affairs, while the claim is pending; whether the prosecution of the claim would harm the company in any other way.[860]

It seems that English judges provide valuable guidelines in the way that the provision could be interpreted to ensure consistency with the very essence of the remedy. This list of factors provides useful insights on how a relevant provision could be interpreted in Cypriot company law. It is hard to see though, how the provision itself is flexible, as it involves the consideration of many different factors in relation to the desirability of the claim. It seems that the flexibility lies on the way that Cypriot judges will interpret this provision and their willingness to do so, substituting the board's role, when the latter seems to be corrupted. Hence, it is suggested that Cypriot legislators should include a similar provision in the new statutory derivative action. It is further suggested that, in this exceptional occasion of corporate misconduct, the Cypriot courts should not be reluctant to intervene in the company's business affairs, for the reason that they do not obtain the business background, required to make a commercial decision on whether the claim serves the corporate interests.[861] Especially, in cases where the conduct involved is of a fraudulent, dishonest or negligent nature they should be less hesitant to make such a decision.[862] The law itself in both of the English and German jurisdictions provides the courts with wide discretion to decide on this matter. A similar legal roadmap could be drafted for the Cypriot judges, inviting them to be less cautious in placing themselves in the position of the corporate decision-maker, when the Parliament itself through the enactment of the relevant provision, call them to

[860] Iesini v Westrip Holdings Ltd [2009] EWHC 2526 (Ch), [2010] BCC 420 at [422] (Lewison J)
[861] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 195-196
[862] Ibid.

closely examine and decide upon conventional business issues, that have been subjected to the deceitful conduct of the management.[863]

5.2.5 Filtering Undesirable Claims: The good faith criterion

Some might argue that "the interests of the company" as a filtering mechanism would not suffice to block disloyal litigants. One of the considerations for the court to give permission that already applies in Cypriot law, as part of the previous English common law scheme, is the applicant's good faith. This criterion can also be found in most of the common law jurisdictions[864], including the English statutory discretionary factors of s 263.[865] As it was explained in Chapter 2, the interests of the company and the good faith requirements are interrelated, as the court in post-Act 2006 cases assessed the good faith of the litigant on basis of whether the action promotes the interests of the company.[866] The previous English common law insisted on rejecting the initiation of the derivative claims, when the claimant has ulterior motives for bringing the claim.[867] However, the judges in the UK post-Act 2006 cases, considered that the ulterior motives of the claimant do not amount to bad faith, if the claim benefits the company.[868] So, it seems that the English interpretation of the good faith requirement repeats to a large extent the discretionary factor of whether the claim serves the corporate interests.

This flexible approach appears in Cypriot case law too. Considering that the Cypriot law maintains the previous English common law approach on derivative claims, it is expected that the Cypriot judges would support the view that the claimant's ulterior motives should suspend the bringing of the claim. Even though, the judges have

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[863] BR Cheffins, *Company Law, Theory Structure and Operation* (OUP 1997) 316–19
[864] ss. 236–42 of the Australia Corporations Act 2001; s. 239(2) (b) of the Canada Business Corporations Act (R.S.C., 1985, c. C-44)
[865] s.263(3) (a) of the UK CA 2006
[866] Chapter 2, section 2.3. A5
[867] Barrett v Duckett [1995] 1 B.C.L.C. 243 CA (Civ Div).
[868] Chapter 2, section 2.3. A5

not expressed a clear opinion on that matter, the successful derivative action in *Kouis* case[869], reveals their intention to provide a shareholder-friendly interpretation of the good faith requirement, similar to the way that English judges interpret this requirement in post-Act 2006 cases. As it was argued in Chapter 3, the facts of the case, presented a close relation between the two parties and the claim might have also been brought by the claimant as a result of their personal controversy. However, the possibility of the claim being avenging, did not prevent the court from allowing the claim, since the claim was serving the corporate interests. So, it is suggested that this implied intention of the Cypriot courts to flexibly interpret the good faith requirement should be preserved. There is no reason for Cyprus to move back to the strict previous English common law position. It is not surprising that the closely-held nature of Cypriot corporations, would give rise to the creation of some personal vendettas, especially in cases of family-held companies. If Cypriot courts were inclined to refuse leave every time that the claim was benefiting the company as a whole, but a personal repulsion was present, the remedy would not have been practically applicable in Cyprus and the *Kouis* case might have been unsuccessful, as a result of the applicant's bad faith. The strict interpretation of the good faith criterion, imposes unrealistic expectations on the claimant-shareholder, who should not be an "angel" to achieve the company's redress.[870] As long as the claim is consistent with the company's interests, there should be no further inquiry into the applicant's good faith by Cypriot judges. Arguably, the protection of innocent directors from the illegitimate motives of the claimant-shareholder is essential and justifies the refusal of leave, when these motives attract claims that harm the company's interests.[871] Hence, as the PRM indicates, turning the focus of the claim to the company and not to

[869] (Civil Appeal No. 11387, 23/01/2004) 1A SCJ 136
[870] Samantha S. Tang, 'Corporate avengers need not be angels: rethinking good faith in the derivative action' (2016) 16(2) Journal of Corporate Law Studies 471, 478
[871] Ibid.

the claimant-shareholder, seems to be the most appropriate way for Cypriot judges to interpret filtering criteria and subsequently to interpret the good faith requirement, as such interpretations fits well with the overarching purpose of the remedy.[872]

5.2.6 Filtering Undesirable Claims: The views of disinterested members

The double demand rule that appears in the German law on derivative actions, ensures that the company is not deprived of its right to sue the wrongdoers.[873] The fact that the claimant shareholders need to request the company to take over the proceedings demonstrates that German law assumes that the company should always be the first option in initiating litigation proceedings.[874] Despite the ability of the demand rule to screen out frivolous claims, it is crucial to avoid the possibility that the company would bring the claim in bad faith, preventing diligent members to pursue derivatively the company's redress.[875] Considering the concentrated ownership structure of Cypriot companies, it is not surprising to see the controlling wrongdoers taking advantage of a potential demand rule, incorporated within a reformed statutory remedy, in order to take over the proceedings and protect themselves from the exposure of their wrongdoing.[876] The effect of the demand requirement might prove to be damaging for meritorious claimants rather than preventive for the unmeritorious ones. The German demand rule, has proven to be of no practical importance for the litigants in the German derivative litigation history, while suggestions have also been made for the abolition of the provision from the German statutory remedy.[877] Given these findings, it is proposed

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[872] Ibid.
[873] s.148(1), second sentence, no 2 of the AktG (the UMAG), s.148 (3) sentences 1, 2 of the AktG (the UMAG)
[874] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 201.
[875] Ibid.
[876] Ibid, page 200
[877] Martin Peltzer 'Das Zulassungsverfahren nach § 148 AktG wird von der Praxis nicht angenommen! Warum? Was nun?', in Ulrich Burgard, Walther Hadding, Peter O. Mülbert, Michael Nietsch & Reinhard Welter (eds) *Festschrift Für Uwe H. Schneider zum 70. Geburtstag* (Otto Schmidt 2011), 763, 959

that Cypriot legislators should avoid the inclusion of a demand rule within a reformed remedy.

The proposed framework, aiming at the accessibility that shareholders need to combat managerial wrongdoing, asserts that the English approach, which emphasizes on the views of disinterested members on prospective litigation, seems to be more shareholder-friendly than the German universal demand requirement. Allowing the majority to preclude a claim from being brought at any time of the derivative proceedings, seems an unfair option for potential litigants, while it cancels the function of the remedy itself.[878] On the contrary, the views of disinterested members, as a condition taken into account by the court, can assist the task of the Cypriot judges in exercising their discretion to decide on whether the claim is truly brought in good faith and for the benefit of the company.[879] The application of this criterion though, entails some risks. Considering the closely-held character of Cypriot businesses, it is difficult to ascertain how disinterested a member could truly be in the alleged misfeasance.[880] The English legislation provides little guidance on the definition of the "connected person" to the wrongdoing.[881] So, the uncertainty that surrounds this condition, may lead the Cypriot judges to unfair decisions for both the company and its aggrieved minority members, if these decisions are mainly influenced by uninformed views of allegedly "disinterested" members.

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[878] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 203.
[879] C. Hirt, 'Ratification of Breaches of Directors' Duties: the Implications of the Reform Proposal Regarding the Availability of Derivative Actions' (2004) 25 Company Lawyer 197, 211.
[880] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 181.
[881] ss.252 –256 of the UK CA 2006; R. Cheung, 'The New Statutory Derivative Action in Hong Kong: a critical examination, Part 2' (2008) 29 Company Lawyer 313, 320

Another problem that renders this requirement an unnecessary procedural layer in the initiation of derivative litigation[882], relates to the reluctance of the English judges to decide on corporate issues, and so they can easily abide by the views expressed by disinterested members on the proposed litigation.[883] Similarly, if Cypriot judges adopt the same reluctant approach in reviewing management decisions, then the decision to litigate might no longer be subjected to their discretion, but it might be determined by the views of members, who would be (un)doubtfully disinterested in the wrongdoing. Nonetheless, the incorporation of such a provision in the proposed remedy, could be workable, if Cypriot judges review business decisions, without taking the disinterested members' views, as conclusive evidence on their decision to allow or refuse shareholder-initiated litigation.[884] It is suggested that the Cypriot judges should not act out of fear in adjudicating on corporate issues, leaving the proposed litigation in the views of a corrupted board, but they can use the opinions of experienced corporate insiders in order to make informed and fair decisions. On that basis, the incorporation of a relevant provision in the proposed remedy, similar to the English provision of s263(4), could restrict the number of vexatious claims in the future.

5.2.7 The Introduction of a New Cost Allocation System in Cypriot Company Law

This part of the proposed framework introduces a more accessible scheme on the allocation of derivative litigation costs in Cyprus. The analysis of the Cypriot derivative action in Chapter 3, showed that Cypriot judges seem to be more flexible in the interpretation of the English common law principles on derivative claims. However,

[882] Hans C. Hirt 'The enforcement of directors' duties pursuant to the Aktiengesetz: present law and reform in Germany: Part 2' (2005) 16 ICCLR 216, 349ff.
[883] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 200.
[884] Ibid, page 199.

there is no evidence on the approach that they have followed in relation to the indemnification of derivative action claimants. Considering that the records of Cypriot cases are silent on that matter for the time being and there is no relevant provision in the Cyprus Companies Laws or the Cyprus Civil Procedure Rules on how derivative litigation costs are paid, it is reasonable to assume that Cypriot judges apply English common law, relying on the losers-pay principle[885]. On that basis, the Cypriot judges could use the "Wallersteiner order" to indemnify derivative claimants. However, in corporate structures, such as cozy quasi-partnerships, which are quite common in Cyprus, minority shareholders may prefer to disregard a breach of duty rather than to challenge the prevailing position of executive directors, as a claim against them to vindicate the company's rights may not bring the desired result neither to the claimant shareholder nor to the company in general. In that case, the defendant director is in a stronger position to continue wrongdoing, having in mind that the cost hurdle completely discourages minorities from pursuing the action. Therefore, it can be argued that the English common law approach on cost allocation that Cyprus underpins within its own common law system, produces an uncertain benefit to minority shareholders due to the courts' control over reimbursement.[886]

In the light of a statutory reform of the Cypriot derivative action though, Cypriot legislators should consider the codification of English common law principles on litigation costs, so that the law would be clearer for both the courts and the claimant-shareholders. Considering that the reform proposals, introduced in this Chapter, contain amendments in many different aspects of the remedy, the issue of cost allocation should not be disregarded. Currently, the unclear position of Cypriot judges on that matter,

[885] Wallersteiner v Moir (No2) [1975] QB 373

[886] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 56.

may become a great disincentive for future applicant-shareholders. It would not be unreasonable to assume that this lack of clarity on litigation costs might be one of the reasons for the time of scarcity that derivative claims currently experience in Cyprus. Thus, the unclear strategy that Cypriot courts follow on litigation costs, can be partly accountable for the doctrinally problematic remedial scheme that applies within Cypriot company law.

The codification of the English common law rules on litigation costs within Cypriot company law, in the form of a legal provision within the reformed statutory remedy or in the form of an order under the Cyprus Civil Procedure Rules, as it can be found in the UK CPR, seems to be a way towards legal certainty on questions relating to the allocation of derivative litigation costs. However, the English case law, has shown that the codification of the common law rules on litigation costs, has not changed the cautious approach of the English courts in granting indemnity costs orders.[887] The analysis of relevant case law on Chapter 2, demonstrated that English judges follow a rather strict approach on the indemnification of the shareholder-claimant in fear that the claim might have been initiated to that end. The flexibility of the English law, in granting judges wide discretionary powers to decide on cost indemnity orders, resulted in judicial interpretations, which are nothing but flexible in relieving predatory claimants from excessive litigation costs.[888] If the codification of the English rules on litigation costs brings about a similarly cautious attitude on the part of Cypriot judges, it seems unlikely that the remedy would be characterized as a cost-efficient one.

To avoid the possibility of Cypriot judges repelling meritorious claims, by adopting the UK's restrictive interpretative tactics, this part of the Chapter proposes an

[887] Ibid 56-58
[888] Ibid.

amendment of the cost allocation system in Cyprus, which will be inspired by the German jurisdiction. The German provision of s148(6) states that in case that the claim is unsuccessful, the claimants will be indemnified not only for the costs of the main proceedings but also for the costs incurred at the preliminary stage.[889] This provision places the German courts to exercise their discretion in granting an indemnity order at the admission stage of the litigation process. If the action is admitted, this means that the court has assessed the claim, as one being in the interests of the company, and so indemnification from that point on is secured regardless of the main trial's outcome.[890] German legislators seem to perceive that the question of whether the claimant-shareholder(s) would be reimbursed, should be answered at the admission stage, as this is the stage, where the court also considers whether the claimant acts in accordance with the corporate interests in bringing the claim. Once more, "the corporate interests" criterion is considered to be of particular importance for the prevention of vexatious claims.

So, it is suggested that Cypriot legislators should introduce a new provision similar to the German rule of s 148(6), under which the Cypriot judges will be able to decide on the claimant's indemnification by answering the question of whether the claim is consistent with the company's interests. A positive answer to this question at the admission stage of the derivative procedure should provide minority shareholders with a ticket to reimbursement. This degree of predictability of the law on litigation costs embraces the PRM policy that the rights being enforced are those of the company, and so the company should bear any massive litigation costs incurred during the litigation process. Furthermore, the Cypriot legislators should consider to incorporate within the

[889] s.148 (6) fifth sentence of the AktG (the UMAG)
[890] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 206.

new provision, the excepted situation under which the indemnification would not be granted. Similarly to the German law, the Chapter proposes the introduction of a sentence within the new provision on indemnification, which will enable the court to refuse the granting of an indemnity order, when it is proven that the claim is brought as a result of an intentional or grossly negligent application.[891]

Even though the English insights on cost allocation offer useful guidelines to Cypriot judges in granting indemnity cost orders, the German position seems to be closer to what the remedy needs, in order to become more accessible to minority shareholders. There is no reason why the consideration of granting an indemnity order should be made at a latter stage of the derivative proceedings, once the court is convinced that the claim was honestly brought for the protection of the company's interests.[892] Finally, it should be noted that the generosity of the law to minority shareholders in relation to litigation costs, cannot be found only in the German jurisdiction. Common law countries, such as New Zealand, follow a similar approach on that matter.[893] So, it is likely that the introduction of a similar provision in Cyprus would fit well with the mixed nature of its legal system, considering that the new law would comprise both civil and common law elements. The generous scheme that presides in New Zealand might be the reason for the remedy's more frequent use compared to other common law jurisdictions, such as England.[894] In an attempt to avoid the opening of litigation floodgates, it is reasonable for Cypriot legislators to discourage the adoption of such a flexible approach on litigation costs. Arguably though, Cypriot legislators should not be concerned with any additional filtering mechanisms or other

[891] Ibid.
[892] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 57-58.
[893] s.166 of the New Zealand Companies Act 1993
[894] Andrew Keay, 'Assessing and rethinking the statutory scheme for derivative actions under the Companies Act 2006' (2016) 16(1) Journal of Corporate Law Studies 39, 59.

restrictive measures in introducing new law on indemnification, as the filter is already applicable by the use of the remedy itself, which offers a minor and short-term financial benefit only to successful litigants.[895]

The analysis of Cypriot common law Chapter 3, has shown that Cypriot courts are quite flexible in the interpretations of the English common law requirements for the bringing of derivative claims. So, the attitude of Cypriot judges, in providing flexible interpretations of the strict English common law rules on derivative claims, does not justify the absence of derivative suits in Cyprus. Considering that there is no evidence on the approach of the Cypriot courts in granting indemnity cost orders, someone would wonder, whether Cypriot judges are keen to follow the cautious English approach on cost allocation. If this is the case, then the combination of scant information rights that are granted under Cypriot company law and the reluctance of Cypriot courts in granting indemnity cost orders, could reasonably justify the absence of derivative litigation in Cyprus, regardless of the flexible interpretations that Cypriot judges have adopted in relation to the other English common law criteria on derivative claims. Even if, Cypriot judges continue to adopt flexible interpretations of the English common law rules, and the rules on costs and claim-related information rights do not become more accessible to minority shareholders, then in most cases of misfeasance, it would be unlikely for the claimant-shareholders to work towards holding the wrongdoers accountable for their misbehavior, since "their hands would remain tied". After the recommendations for a more accessible cost allocation scheme, part 5.2.8 discusses proposals for a more accessible information disclosure scheme.

[895] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 208.

5.2.8 Access to information rights

Another critical issue, that will determine the accessibility of the proposed remedy to minority shareholders relates to their access to information rights. Shareholder access to corporate information at pre-action stage is regarded as a key issue for the initiation of derivative proceedings.[896] If the documents containing evidence of directors' breaches of duty were available only to the wrongdoers, it would have been impossible for minority shareholders to uncover any kind of managerial wrongdoing. For the time being, EU law and particularly the Shareholder Rights Directive II, which has been implemented within the Cypriot company law has not facilitated the access of minority shareholders to information rights[897], reducing information asymmetries and giving access to documents that can deter managerial wrongdoing, if they are appropriately used in the course of the preliminary litigation stage. The Directive mainly focuses on information rights, which are related to the facilitation of the General Meeting.[898] For that reason, this part of the chapter resorts to national legislation, firstly, examining what kind of information rights are available to minority shareholders under Cypriot company law and whether these rights are adequate to give minority shareholders better access to the remedy. Secondly, this part provides a comparative analysis of the German, English and Cypriot disclosure regimes and argues that in all three jurisdictions shareholders enjoy limited information rights. Finally, this part of the Chapter forms some recommendations for small changes upon the currently applicable disclosure regime in Cyprus.

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[896] D. Latella 'Shareholder Derivative Suits: A Comparative Analysis and the Implication of the European Shareholders' Rights Directive' ECFR (2009) 322; S. Kalss 'Shareholder Suits: Common Problems, Different Solutions and First Steps towards a Possible Harmonisation by Means of a European Model Code' ECER (2009) 341

[897] D. Latella 'Shareholder Derivative Suits: A Comparative Analysis and the Implication of the European Shareholders' Rights Directive' ECFR (2009) 322

[898] Georgios Zouridakis, *Shareholder Protection Reconsidered: Derivative Action in the UK, Germany and Greece* (Routledge, 2020) page 209

Access to corporate information under Cypriot company law at pre-action stage can be sought through a company investigation under sections 158-159 of the Cyprus Companies Laws. These provisions are identical to ss 431-432 of the UK Companies Act 1985, which have not been incorporated to the new 2006 Act. Under section 158 of the Cyprus Companies Laws, the power to appoint inspectors is exclusively vested in the Council Ministers, similarly to the abolished UK provision of section 431, which empowered only the Secretary of State to initiate an investigation process.[899] In analogy to the UK Act 1985, the Council of Ministers under s 158 of the Cyprus Companies Laws Cap 113 can make an appointment of inspectors for investigation of the company's affairs, "(a) in the case of a company having a share capital, on the application either of not less than two hundred members or of members holding not less than one-tenth of the shares issued; (b) in the case of a company not having a share capital, on the application of not less than one-fifth in number of the persons on the company's register of members".[900] Furthermore, an investigation can be initiated "if- (i) the company by special resolution; or (ii) the Court by order, declares that its affairs ought to be investigated by an inspector appointed by the Council of Ministers."[901]

Also, under s159, the Council of Ministers will appoint one or more inspectors for corporate investigation, if it is satisfied that the circumstances of the case suggest that "that its business is being conducted with intent to defraud its creditors or the creditors of any other person or otherwise for a fraudulent or unlawful purpose or in a manner oppressive of any part of its members or that it was formed for any fraudulent or unlawful purpose; or that persons concerned with its formation or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other

[899] s. 431 of the UK CA 1985
[900] s.158 (1), (a), (b) of the Cyprus Companies Laws Cap 113.
[901] s. 159(a),(i),(ii) Cyprus Companies Laws Cap 113.

misconduct towards it or towards its members; or that its members have not been given all the information with respect to its affairs which they might reasonably expect." [902] If the appointment is requested by the company itself or of its members, then "the application shall be supported by such evidence as the Council of Ministers may require for the purpose of showing that the applicants have good reason for requiring the investigation, and the Council of Ministers may, before appointing an inspector, require the applicants to give security, for such amount as the Council of Ministers may determine, for payment of the costs of the investigation". [903] The Cypriot law provides wide investigation powers to the inspectors that are appointed by the Council of Ministers. In particular, under s 161(1), all officers and agents of the company are in duty to provide the inspectors with all books and documents relating to the company and also to provide the inspectors with all assistance that could reasonably be offered in the course of the investigation procedure.[904]

The adequacy of information rights enjoyed by the minority shareholders in both the German and English jurisdictions is particularly limited.[905] As it was explained in Chapter 2, the German law provides for a special audit procedure, which the legislators intended to introduce in order to simplify shareholders' access to corporate information and consequently to the remedy itself. Specifically, the UMAG aligned the prerequisites for the commencement of a special investigation, with the requirements that the litigants need to satisfy at the preliminary stage of the derivative proceedings.[906] The German special audit procedure does not seem to be very different from Cypriot investigation

[902] s. 159(b)(i), (ii), (iii) Cyprus Companies Laws Cap 113.
[903] s. 158(2) of the Cyprus Companies Laws Cap 113.
[904] s. 161(1) of the Cyprus Companies Laws Cap 113.
[905] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 111.
[906] Ibid.

process of ss158-159 of the Cyprus Companies Laws Cap 113. The Cypriot law places quorum requirements of not less than 200 shareholders or a shareholding of not less than 10% for the commencement of an investigation.[907] These quorum requirements are higher than the German pre-conditions for the appointment of special auditors.[908] At least, in Germany, the quorum requirements are proportionate between the special audit procedure and the derivative action. On the contrary, the imposition of such a quorum requirement under Cypriot law, seems to be unreasonable, if we consider that a quorum pre-condition for the commencement of a derivative claim is not required at all under Cypriot common law. In this paradoxical condition, it is hard to imagine how a Cypriot minority shareholder can exercise his individual right to sue on behalf of the company, if he does not have access to the relevant disclosure regimes in his capacity as a member of the company. The fact that the shareholder needs to find allies in order to access the information needed for his claim, might discourage minority shareholders from starting a claim in the first place.[909] Considering the closely-held character of Cypriot companies, it seems difficult for a minority shareholder to fulfil by himself the aforementioned pre-requisites in the course of applying for the appointment of inspectors. So, under the Cypriot disclosure regime, if a claimant-shareholder does not already obtain evidence, showing a prima facie case for the initiation a derivative action, it is unlikely that he will apply for appointment of inspectors under ss 158-159. Except from the procedural obstacles that the quorum conditions place, the shareholder may also be liable for the costs of the investigation, which in some cases might reach

[907] ss. 158-159 of the Cyprus Companies Laws Cap 113.
[908] s.142(2), first sentence of the AktG (the UMAG)
[909] Suzanne Kalss, 'Shareholder Suits: Common Problems, Different Solutions and First Steps towards a Possible Harmonisation by Means of a European Model Code' (2009) 6 ECFR 324, 342.

millions of euros.[910] In contrast with the Cypriot law, the German provision on special audit, seems to be more generous on that matter, as it places the burden of costs on the company.[911] So, if it would ever be possible for a minority shareholder to bring a claim successfully, the disclosure regime that Cypriot law provides, at the moment, does not increase the prospects of that success.

Lastly, having asserted that information rights should be easily accessible to shareholders to facilitate the litigation process, this part of the chapter proposes some amendments to the existing Cypriot disclosure mechanism of ss158-159. In order to make the investigation process more accessible to the prospective claimants, the Cypriot legislators should consider the removal of the quorum requirements, which seem to be disproportionate to the individual right of the member to bring derivative proceedings. This amendment would harmonize the investigation process with the purposes of the derivative action, strengthening the coherence and clarity of the law in the respective procedures. Also, Cypriot legislators should learn from the German approach on cost allocation, and amend accordingly s158, so that the financial burden of the investigation process would be carried by the company, when the application for the appointment of inspectors is not fraudulently or negligently submitted.[912] The rationale for this reform proposal rests on the PRM which highlights that the purpose of the remedy is to enforce rights belonging to the company, so the costs for the information needed to enforce those rights should be paid by the company along with other litigation costs.

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[910] Carsten A. Paul, 'Derivative Actions under English and German Corporate Law Shareholder Participation between the Tension Filled Areas of Corporate Governance and Malicious Shareholder Interference' (2010) 7 ECFR 81, 112.
[911] Ibid.
[912] s.146, first and second sentence of the AktG (the UMAG)

In contrast with the German and Cypriot approach, English law does not provide any right to minority shareholders for appointing auditors or inspectors, since the identical provisions of ss 431-432 of the UK Companies Act 1985, that Cypriot law adopted, are not present in the UK Act 2006. The fact that an investigation procedure is already included within Cypriot company law, does not mean that Cypriot legislators should preclude the possibility of incorporating equivalent alternative disclosure mechanisms within the legislation to enhance shareholders' access to corporate information. Even though, the discovery order does not provide for an extensive investigation into the company's affairs, it can become a valuable tool in the hands of minority shareholders, who need access to documents that would enlighten their evaluations on the merits of their presented case. The English pre-action disclosure scheme of the CPR 31.16[913], could be a valuable addition to the list of disclosure mechanisms that could become available under Cypriot company law, as it would enable minority shareholders to support their allegations by gathering the necessary information, without the need to satisfy any quorum requirements. As it was discussed in Chapter 2, the English case law has demonstrated that English courts are cautious in granting a discovery order, and their discretion usually leans on the acceptance of the order, when the disclosure of documents sought, is precise and focused.[914] It is suggested that, a pre-action disclosure order would be a welcome development within the Cyprus Civil Procedure Rules. It remains to be seen, what would be the approach of Cypriot judges, as this cannot be predicted. In any case, the English case law offers some lessons that could guide the way that Cypriot judges would exercise their discretion in granting an order.

[913] UK Civil Procedure Rules 31.16
[914] Chapter 2

5.3 Additional recommendations to strengthen minority shareholder protection in Cyprus

As it was examined in Chapter 3, the Cypriot oppression remedy maintains shareholder protection in considerably low levels. The decision of Cypriot legislators to adopt and maintain a remedy that England abolished decades ago is unwise, as it does not allow proper shareholders' monitoring of a bad management. Once again, Cyprus falls many steps behind the UK's legislative changes, which rejected the concept of oppression and introduced the unfair prejudice remedy in an attempt to increase the protection afforded to minority shareholders. Part 5.3.1 identifies the benefits that English law on unfair prejudice petitions can confer on Cypriot law to improve the overall level of minority shareholder protection in Cyprus. Part 5.3.2 provides some useful guidelines on the flexible way that the oppression remedy is applicable in other common law jurisdictions, including Canada, Australia and New Zealand. Finally, Part 5.3.3 addresses the challenges that Cypriot legislators and courts would confront in replacing the oppression remedy, with an unfair prejudice remedy, similar to the English one. These challenges relate to the difficulties that the petitioner might face in satisfying the judicial requirements that the English remedy places, but also focus on the interaction between the two remedies, and specifically to the aspects of an amended oppression remedy that might affect the viability of the proposed statutory derivative action.

5.3.1 The English unfair prejudice remedy: a valuable insight for Cyprus

Compared with the previous English oppression remedy, the statutory unfair prejudice remedy abandoned the narrowness of the term "oppression".[915] The range of

[915] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L. Rev 40, 53.

conduct covered and the flexibility of the relief offered provides the rationale for the remedy's popularity.[916] The English legislators, applying the recommendations of the Jenkins Committee, removed the winding up threshold that minority shareholders had to meet in order to obtain the remedy.[917] However, the flexibility of the remedy does not derive only from its statutory footing in the CA 2006. The innovative feature of this new remedy lies on the common law developments that broadened the interpretation of the unfairly prejudicial conduct.[918] In particular, the courts considered that a petition on unfair prejudice could arise, not only in relation to the rights of the shareholders, as these are determined within the articles of association, but also in relation to their interests under reasonable expectations.[919] The main elements of the English remedy are examined in parts 5.3.1A, 5.3.1B, 5.3.1C and 5.3.1.D. This examination aims to show that English law has to offer valuable lessons to the Cypriot jurisdiction that is in need of better law on minority shareholder protection.

5.3.1A Conduct of the company's affairs

Section 994(1)(b) states that the petitioner must establish that that "an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial".[920] In contrast with the Cypriot oppression remedy, this section does not necessitate a continuous course of conduct for the remedy to be applicable. This means that the petitioner would not only be allowed to seek relief, when the unfairly prejudicial conduct is continuous, but also when the conduct is completed by the time of the presentation of the petition.[921] The English courts, by

[916] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 276
[917] s.994 of the UK CA 2006
[918] Zhengyang Fan, 'Unfair prejudice in United Kingdom Company Law' (2021) 9(1) Asian Journal of Humanities and Social Studies 27, 36
[919] P. Paterson, 'A criticism of the contractual approach to unfair prejudice' (2006) 27 Comp Law 204.
[920] s. 994(1)(b) of CA 2006
[921] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 9.3

interpreting the unfair prejudice provision, endorsed the inclusion of isolated acts and omissions. This flexible approach has been adopted in a variety of English cases. For example, in *Re Norvabron Pty Ltd*[922], the court manifested that an isolated act or omission, depending on the circumstances of the particular case, would be sufficient to give rise to a petition on unfairly prejudicial conduct. Also, in *Re a Company (No 001761 of 1986)*[923], Harman J explained that an unfair prejudice petition should not be barred on the basis that "the conduct of which complaint is made has ceased six months before the petition was presented".[924] Similarly, in *Lloyd v Casey*[925], the court permitted the petition to proceed on allegations relating to conduct which took place before the petitioner became a registered member in the company.[926] This decision rested on the fact that, the past tense in the wording of the provision accepts an action as unfairly prejudicial, even when it has occurred before the presentation of the petition.[927]

However, the English courts have set a fixed limit between the occurrence of the unfairly prejudicial event and the time that it is allowed up until the aggrieved member can raise a petition. Remarkably, Peter Gibson J in *Re DR Chemicals Ltd*[928] suggested that unreasonable delays in making a petition on the grounds of s994 may lead to the petition' s rejection, if such a delay is completely inexcusable.[929] Obviously, this limit is formed in a lenient way, so that it does not deprive a minority shareholder from bringing a petition on unfair prejudice, when the conduct of which he complains, was clearly an event belonging to the past and it does not affect the petitioner's interests at

[922] Re Norvabron Pty. Ltd. [1987] 5 ACLC 184
[923] Re a Company (No 001761 of 1986) [1987] BCLC 141
[924] [1987] BCLC 141 at [143]
[925] Lloyd v Casey [2002] 1 BCLC 454
[926] [2002] 1 BCLC 454
[927] Alan Dignam & John Lowry, *Company Law*, 10th edition (Oxford University Press, 2014) page 216
[928] Re DR Chemicals Ltd [1989] BCLC 383
[929] [1989] BCLC 383 at [397]-[398].

the time of the petition.[930] The flexibility of both the wording of the provision and its interpretation by English judges, cannot be found in the Cypriot approach, as Cypriot shareholders cannot raise a petition for oppressive conduct, if at the time of the petition the oppressive conduct is not ongoing.

5.3.1B Interests qua member

S994 states that the petitioner must prove that his interests, in his capacity as a member, should have been unfairly prejudiced due to a particular course of conduct on the part of the company. It is not possible to determine what kind of conduct would fall within the words "unfair prejudice", if, firstly, we do not consider what kind of members' interests, when these are violated by the majority of the company, would satisfy an unfairly prejudicial conduct. So, it is obvious that there is a strong interaction between the identification of the members' interests and the determination of "unfair prejudice" for the purposes of s994.[931] It is necessary to examine both elements, in order to unfold the wide range within which the remedy operates. The connection between these two elements becomes even clearer, if someone looks at the words of Peter Gibson J in *Re a Company (No 005685 of 1988)*[932], who declared that both elements need to be satisfied for a petition to succeed. In specific, he stated that the conduct complained cannot be unfair without being prejudicial to the member's interests and accordingly it cannot cause prejudice to the relevant interests without being unfair.[933]

The innovative feature of the English unfair prejudice remedy, which the Cypriot oppression remedy is lacking, is the term "interests" that has been inserted in s994. The wording of the provision evidences the intention of the English courts to give an

[930] Alan Dignam & John Lowry, *Company Law*, 10th edition (Oxford University Press, 2014) page 215
[931] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 9.17
[932] Re a Company (No 005685 of 1988) [1989] BCLC 427
[933] [1989] BCLC 427

expansive effect on the scope of the remedy, thereby seeking to approve the petition, not only when the members' legal rights have been unfair prejudiced, but also when their interests may suffer from unfairly prejudicial behaviour on the part of the company.[934] This intention is confirmed in a variety of cases, such as in the statement of Peter Gibson J in Re Sam Weller & Sons.[935] The judge, particularly, held that "interests" are wider than "rights" and the presence of interests within the section expresses the intention of both the English legislators and courts to recognize that shareholder may have different interests that would fall within the provision and may be unfairly prejudiced, even if their rights as members are usually the same.[936] The same view was expressed by Hannigan, who pointed out that there is not one single checklist of members' interests that would universally fall within the ambits of the provision.[937] Firstly, the term "interests" covers the legal rights of the members, as these are defined within the articles of association.[938] Before the creation of the unfair prejudice remedy, the oppression of legal rights also formed the basis of the application of the English oppression remedy, in which "rights" were seen to be solely as those entrenched in a company's constitution.[939] But, the new provision aims to go beyond the restrictive approach that Cypriot law preserves and had so thwarted the development of the English oppression remedy. The value of the term interests within s994 is exemplified by its potential to protect the interests of minority members, who conclude shareholders

[934] Alan Dignam & John Lowry, *Company Law*, 10th edition (Oxford University Press, 2014) page 219-220
[935] Re Sam Weller & Sons Ltd [1990] Ch 682
[936] P. Paterson, 'A criticism of the contractual approach to unfair prejudice' (2006) 27(7) Comp Law 204
[937] B. Hannigan, 'Section 459 of the Companies Act 1985 - A Code of Conduct for the Quasi-Partnership?' [I9881] LMCLQ 60.
[938] Christopher A. Riley, 'Contracting Out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts' (1992) 55 The Modern Law Review 782, 793-794.
[939] Ibid.

agreements that have not been recorded in written understandings or have not been incorporated within the constitution of the company.[940]

The rationale that the unfairly prejudicial conduct itself must adversely affect the interests rather than just the rights of the petitioner, was explained by Lord Grantchester QC in *Re a Company (No 004475 of 1982)*[941]. The judge held that it is expected that in small private companies, the capacities of an individual, as a shareholder, director or employee would obviously be treated separately.[942] But, this legalistic approach on segregating these capacities, does not mean that a dismissal of that individual from the board or from employment would not inevitably affect the value of his interest, as a shareholder in the company.[943] Consequently, the court's jurisdiction under s994 protects not only the rights of the members under the company's constitution, but extends to the protection of other interests of the members, such as the expectation of that individual to participate in the management of the company. The concept of legitimate expectations that was recognized as falling within interests that might have been unfairly prejudiced, is presented by Hoffmann J in *Re a Company (No 4377 of 1986)*[944]. The judge considered that the language of s994 should allow a member to raise a petition, when the petitioner has a legitimate expectation, that he will continue to contribute to the management as a director and his removal from office could give rise to unfairly prejudicial conduct against his interests not as a director, but as a member of the company.[945]

[940] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 9.25
[941] Re a Company (No 004475 of 1982) [1983] 2 All ER 36
[942] Ibid at [44]
[943] Alan Dignam & John Lowry, *Company Law*, 10th edition (Oxford University Press, 2014) page 222
[944] Re a Company (No 4377 of 1986) [1987] 1 WLR 102
[945] [1987] 1 WLR 102

The broad scope of the application of the remedy becomes evident in small private companies rather than in public ones. This observation was made by the UK Law Commission, which in its analysis of recent case law on s994 concluded that shareholders in smaller-owned managed companies are more likely to gain relief under s 994petition than the shareholders, investing in larger companies.[946] To explain this further, in the case of a large public company it is easier to distinguish the director's interests in his capacity as a director from his interests, as a holder of a small proportion of the company's shares. This distinction is more difficult in the case of small private companies, especially in quasi-partnerships, where two or three members have invested all their capital, by subscribing shares for the company on the notion that each will gain his living by contributing to the management of the company, as a director.[947] This observation seems to be relevant for Cypriot companies, which are mainly small family-based businesses. If the Cypriot oppression remedy was interpreted in the way that the English unfair prejudice remedy does, the Cypriot shareholders would have actually been able to protect their interests more effectively, including within the ambit of these interests their legitimate expectation to take part in the management. Thus, a potential dismissal from office would amount to oppressive conduct to their interests as members, considering that they would have ventured their whole capital for the operation of the business. Unfortunately, the Cypriot judiciary is not inclined until today to extend the interpretation of the oppression remedy to recognize the "legitimate expectations", as falling within the interests that might be oppressed. Hence, it is disappointing that Cypriot law, in situations involving small companies and there is a

[946] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 9.53
[947] Re a Company (No 00477 of 1986) [1986] BCLC 376

breakdown in shareholder relations, there is no satisfactory mechanism to resolve the dispute.

Academic commentary on early s994 case law observed that the English judiciary tended to reign in the "legitimate expectations" concept.[948] Legal scholars viewed that the broad scope of the remedy entailed the risk that the remedy might be abused by the aggrieved members opening the floodgates of litigation.[949] This view was also supported by Hoffmann J in *Re a Company (No.007623 of 1984)*[950], who stressed that "the very width of the jurisdiction means that unless carefully controlled it can become a means of oppression"[951] It is not possible that the removal of a member from a management position would always find the grounds to an unfairly prejudicial conduct.[952] For instance, in *Jackman v Jackets Enterprises Ltd*[953], the court dismissed the petition on the basis that no expectation was found on the part of the petitioner to participate in the management of the company, as she acquired her shares by way of a gift.

Despite these concerns, the English courts followed an unconstrained approach to the concept of "legitimate expectations".[954] This state of uncertainty that endangered the bringing of unmeritorious petitions, was somewhat restricted by the landmark judgment of Lord Hoffmann in the case of *O' Neill v Phillips*[955]. His Lordship doubted that the adoption of the phrase "legitimate expectations" is the appropriate one. For that

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[948] John Lowry, 'The Pursuit of effective minority shareholder protection: s. 459 of the Companies Act 1985' (1996) 17 Company Lawyer 67
[949] L.S. Sealy, 'Shareholders' Remedies in the Common Law World' [1997] C.F.I.L.R. 172, 173
[950] Re a Company (No.007623 of 1984) [1986] B.C.L.C. 362
[951] [1986] B.C.L.C. 362 Ch D at [367].
[952] R. Cheung, "The Statutory Unfair Prejudice Remedy in Hong Kong" (2008) 29(11) Company Lawyer 346, 348.
[953] Jackman v Jackets Enterprises Ltd [1977] 4 B.C.L.R. 358 (S.C.)
[954] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 183.
[955] O'Neill and Another v. Phillips and Others [1999] UKHL 24

reason, he overturned his own establishment and introduced the term "equitable restrains", which would give rise to a petition when these equitable considerations would make it unfair for the petitioner to exercise his rights under the articles.[956] The same approach was adopted in *Re Said D Harrison & Sons Plc*[957] , where Lord Hoffmann effectively closed down the categories of what kind of interests would fall within the unfairly prejudicial conduct that a s994 petition requires.[958] The Court of Appeal dismissed the petition and Lord Hoffmann in his analysis stated that if the conduct complained of is in accordance with the articles of association, it would not be considered as unfairly prejudicial, since there would be no legitimate expectation that the board and the company in general would have not exercised its powers, as these have been given by the articles of association.[959] In order to avoid interference with the corporate affairs, it seems that the English judges are anxious to temper the width of the remedy, which is broad in both its drafting and its interpretation.[960] Despite their attempts to set some limits to the categories, which would allow a s994 petition to succeed, their intention in interpreting the remedy broadly remains unchanged.[961] This is the main reason that the remedy remains so popular amongst English shareholders, because it covers a wide range of situations, within which a member might fall, and it fades out the possibility that the member would remain unprotected, if his interests or rights fall within the categories which the judges have established.[962] The same conclusion cannot be reached for the Cypriot oppression remedy, which does not accept the removal of a director from office, as oppressive conduct. Notably, the wording of

[956] Ibid.
[957] Re Saul D Harrison & Sons plc [1995] 1 B.C.L.C. 14
[958] [1995] 1 B.C.L.C. 14 at [19]
[959] Ibid.
[960] Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic' (1999) 30 Cambrian L. Rev 40, 54.
[961] D. Cabrelli, 'Derivative Actions: Part of Minority Shareholder's "Forensic Arsenal" in Scotland (2003) Scots Law Times 73, 75
[962] Ibid.

s202 does not refer to the term "interests" at all, and so the Cypriot judges remain attached to the rigid perception that only the oppression of strict legal rights conferred by the company's constitution would give rise to a petition under s202.

5.3.1C Unfairly prejudicial conduct vs Oppressive conduct

S994 does not offer any express definition of what conduct ought to be regarded as unfairly prejudicial. The boundaries of this concept are left to the English courts to decide.[963] Specifically, English judges viewed the unfairly prejudicial conduct, as a concept that could be objectively determined.[964] The objective element of the unfairness test was established by Slade J in *Re Bovey Hotel Ventures Ltd*[965], where the judge stated that a conduct would be regarded as unfairly prejudicial when a reasonable bystander, observing the actual consequence of this conduct, would regard it as unfairly prejudicial to the petitioner's interests.[966] This ruling was also endorsed in other relevant cases, such as in *Re RA Noble & Sons (Clothing) Ltd*[967], in *Re Sam Weller*[968], in *Re Marco (Ipswich) Ltd*[969], showing the court's willingness to follow a principled approach in the interpretation of the term "unfair prejudice". However, the focal point on the test of unfairness was determined by Hoffman LJ in Re Saul D Harrison[970], who stated that, in order to discover what conduct would be characterized as unfairly prejudicial, attention should be given to the impact of the act and not in its nature.[971] This means that the objectiveness of the test reveals that unfairly prejudicial conduct

[963] Christopher A. Riley, 'Contracting Out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts' (1992) 55 The Modern Law Review 782, 793,794
[964] Alan Dignam & John Lowry, *Company Law*, 10th edition (Oxford University Press, 2014) page 226
[965] Re Bovey Hotel Ventures Ltd unreported but quoted and followed in Re R A Noble & Sons (Clothing) Ltd [1983] BCLC 273
[966] [1983] BCLC 273, at [290]-[291] per Nourse J
[967] Ibid.
[968] Re Sam Weller & Sons Ltd [1990] Ch 682 (Ch)
[969] Re Macro (Ipswich) [1994] 2 BCLC 354
[970] Re Saul D Harrison [1995] 1 B.C.L.C. 14
[971] [1995] 1 B.C.L.C. 14 at [19] per LJ Hoffmann

extends beyond unlawful conduct.[972] Even though, a breach of shareholders' rights is sufficient to provide the grounds of an allegation for unfairly prejudicial conduct, the English judges, applying this test confirmed that there is no need for a course of action to be unlawful in nature, so that it reaches a level of unfairness.[973] In other words, a particular act or omission may satisfy the grounds for a petition on unfair prejudice, even if in the first glance appears to be legally proper, but its impact is unfair to the petitioner.[974]

However, the general wording of s994 does not clarify what kind of acts would actually enter the realm of unfairness. The UK Law Commission pointed out that, it is difficult to classify the actions that might fall within the limits of s994, but at the same time the Commission attempted to broadly define the allegations, which might give rise to a petition for unfair prejudice. For instance, the exclusion from management[975], failure to provide information[976], increase of issued share capital[977], non-payment of dividends[978], excessive remuneration of directors[979], mismanagement[980], alteration of the articles of association[981], diversion of company business and misappropriation of assets[982], are some of the situations that the UK Law Commission underlined, as factual conditions that might lead to a successful petition. Nonetheless, these practices are not of general application to all petitions, considering that different types of allegations

[972] Fang Ma, "A Challenge for China: Is it Possible to Introduce Unfair Prejudice Remedies? (Part 1)" [2009] I.C.C.L.R. 417.
[973] Khurram Raja, 'Majority shareholders' control of minority shareholders' use and abuse of power: a judicial treatment' (2014) 25(5) I.C.C.L.R 162, 182.
[974] D.D Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the Companies Act 1985' (1988) 8 Oxford J Legal Stud 55, 79
[975] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 9.34
[976] Ibid, at para 9.35
[977] Ibid, at para 9.36-9.38
[978] Ibid, at para 9.41-9.43
[979] Ibid.
[980] Ibid, at para 9.44-9.48
[981] Ibid, at para 9.39
[982] Ibid, at para 9.40

apply to different petitions and that one petition might include more than one allegation.[983] For example, it is interesting that in the recent case of *Rahman v Malik*[984], the court examining the issue of unfairness for the purposes of section 994, took into account some cultural perceptions deriving from the Bangladeshi community. This enlightened approach[985], in interpreting what type conduct could be treated as unfairly prejudicial, definitely falls outside the categories provided by the UK Law Commission. The rationale for this approach lies on the breadth and the flexibility of the remedy, which is capable of adapting its application to a variety of situations that create new perspectives for effective shareholder protection.[986]

In contrast with this flexible English approach[987], the tendency of the Cypriot courts to confine section 202 to situations where the complainant could only demonstrate some independent illegality evidences that the Cypriot law accepts only that the unlawful conduct can be an oppressive conduct. However, this is a very unrealistic assumption, as the requirement to prove an independent illegality, implicitly raises allegations that the company's articles and the memorandum incorporate all the inter-shareholder arrangements.[988] Of course, this is not true, especially in small private companies, where there are many inter-shareholder agreements, which are not encapsulated within the articles of association and might be oppressive to the minority. As a result, it seems almost impossible for a minority shareholder to file a petition for oppressive conduct, considering that the violation of such an agreement cannot be

[983] Ibid, at para 9.33
[984] Rahman v Malik & Ors [2008] EWHC 959 (Ch)
[985] D. Milman, 'Shareholder rights: analysing the latest developments in UK law' (2010) Company Law Newsletter 1, 3.
[986] Ibid.
[987] S. Griffin, 'Negligent Mismanagement as Unfairly Prejudicial Conduct' (1992) 108 L.Q.R. 389
[988] D.D Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the Companies Act 1985' (1988) 8 Oxford Journal of Legal Studies 55, 78-79

characterized as illegal[989], and subsequently oppressive by the Cypriot courts, on the basis that it is not an unlawful continuous act that infringes the rights of the petitioner, as these are defined in the company's constitution. For that reason, the Cypriot oppression remedy is not, to say the least, an attractive pole for aggrieved shareholders who seek relief against oppression.

5.3.1D Part of members or members generally

Another benefit of the English unfair prejudice remedy relates to the wording of s994, which states that the conduct of a company's affairs should be unfairly prejudicial to the interests of any of its members.[990] The Cypriot oppression remedy includes only the words "part of its members", a phrase that implicitly alleges an exclusion of a breach of director's duty from the categories which might fall within the meaning of s202. So, the Cypriot law restricts the ability of a minority shareholders to seek a personal remedy under s202, when a breach of director's duty oppresses their interests. On the contrary, s994 of the UK CA 2006 implies that the unfairly prejudicial conduct would include matters which might be wrongs to the company, as well as matters affecting all shareholders equally.[991] It is remarkable that a breach of director's duty does not give rise only to an unfair prejudice petition, but also to the bringing of a derivative claim. In other words, the unfair prejudice remedy, by inserting these words "member as a whole" offers the petitioner the advantage of choosing whether he wishes to receive the direct benefit from the s994 proceedings rather than simply bringing a derivative action, the benefit of which is attributed to the company as whole and not immediately to the petitioner.[992] Unfortunately, this is not an advantage that can be offered to Cypriot

[989] D.D. Prentice, 'Protection of Minority Shareholders' (1972) 25 CLP 124, 140-141.
[990] Law Commission, Shareholder Remedies: Consultation Paper, 1997, at para 9.31
[991] Ibid, at para. 9.32
[992] Ibid.

shareholders. The restrictive wording of the Cypriot oppression remedy implies that a minority shareholder would have no means of redressing a breach of duty on the basis that firstly, the oppression remedy would not cover such a breach and secondly, that the procedural obstacles of common law derivative action would probably bar the claimant's access to redress, even if he achieves to show that the director has acted in breach of duty. Sadly, the rigid formation of both Cypriot remedies alleges that the petitioner would somehow be estopped from receiving adequate relief and that he would remain completely exposed to corporate wrongdoing.

5.3.2 The oppression remedy: A comparative perspective from the Commonwealth

Evidence from other common law jurisdictions provide some guidance on the importance of preserving a statutory derivative claim and its interrelationship with the oppression remedy. Similarly, to the Cypriot approach, the Canadian company law preserves an oppression remedy[993], which is inspired by the old English oppression remedy of s210 of the CA 1948. However, the Canadian oppression remedy is far more attractive than the Cypriot one. The difference between the two jurisdictions lies on the fact that Canadian legislators have adopted the recommendations of the UK Jenkins Committee and created a broad oppression remedy that is parallel to the English unfair prejudice remedy, removing the drastic consequences of the winding up requirement and the restrictive language that the old UK model maintained.[994] The Canadian approach, following the English law on unfair prejudice, should be considered by Cypriot legislators, as a way to remove the strictness that the current oppression remedy undergoes. The above analysis on the wording and interpretation of the English unfair

[993] s. 241 of the Canada Business Corporations Act (R.S.C., 1985, c. C-44)
[994] L. Griggs and J. Lowry 'Minority Shareholder Remedies: A Comparative View' [1994] JBL 463, 475

prejudice remedy, has shown that the wider spectrum within which the English unfair prejudice remedy operates, provides a useful roadmap for Cypriot legislators to strengthen minority shareholders protection.

Also, the derivative action in Canada retains a statutory formation, and so the interrelationship of the two statutory remedies has raised the question of whether both personal and corporate claims could find their place within the Canadian oppression remedy.[995] The Dickerson Committee viewed that the two remedies serve different purposes.[996] In particular, the Committee considered that the objective of the derivative action is to remedy wrongs that harm the corporation as a whole, while the oppression remedy should respond to personal wrongdoing against minority shareholders in small corporations.[997] Although, the Committee acknowledged that in cases, where a wrongful action causes both personal detriment to the minority shareholders and harms the company as a whole, the court should exercise broad discretion to make a decision based on standards of fairness and allow the aggrieved shareholder to choose the remedy that is more suitable to resolve the dispute.[998] Therefore, the Committee found that the two statutory remedies can operate side by side, but still there is no clear indication that the Canadian oppression remedy can, by any means, replace the derivative action.[999] Similarly, it can be argued that a statutory derivative action, as this is proposed in this Chapter, and an amended oppression remedy, following the English model, could operate side by side to give minority shareholders the right to choose

[995] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 292
[996] RWV Dickerson JL Howard and L Getz Proposals for a New Business Corporation Law for Canada (Ottawa 1971).
[997] P. Anisman 'Majority–Minority Relations in Canadian Corporations Law—An Overview' (1986–1987) 12 Canadian Business Law Journal 473, 476.
[998] RWV Dickerson JL Howard and L Getz Proposals for a New Business Corporation Law for Canada (Ottawa 1971) at para 484.
[999] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 292

between two viable and effective options, and not between two problematic ones, as these are currently presented within the Cypriot legal framework.

On the contrary, there is evidence in Canada[1000] and more recently in Australia[1001], revealing that the statutory derivative action is more popular than the oppression remedy in cases involving closely-held corporations. This is a surprising practice, as the Australian government reports viewed that the statutory derivative action was intended to find its place in large public companies.[1002] This presumption was based on the notion that the remedy would operate, as a mechanism of maintaining investor's confidence and that the shareholders by using this mechanism would act as watchdogs on their investment, in order to safeguard it against mismanagement.[1003] Practically, though, the statutory derivative action in both Canadian and Australian jurisdictions found its place more often in small private companies to solve internal disputes rather than in large ones.[1004] So, the view of the Dickerson Committee that only the oppression remedy could be linked to wrongs done in closely-held corporations, was practically rebutted.

Hence, the Canadian and Australian jurisdictions have shown that the statutory derivative action has proven to be not only theoretically but practically more popular than the oppression remedy in closely-held companies. This observation should be relevant for Cyprus too, if we consider that in Cyprus, small private companies constitute the vast bulk of companies and accordingly that the two successful derivative

[1000] BR Cheffins & J. M. Dine, 'Shareholder Remedies: Lessons from Canada'(1992) 13 Company Law. 89, 92.
[1001] I. Ramsay and B. Saunders 'Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action' (2006) 6 JCLS 397, 420
[1002] CLERP Proposals for Reform, Directors' Duties and Corporate Governance: Facilitating Innovation and Protecting Investors (Paper No 3 1997) 8
[1003] Arab Reisberg, Derivative Actions and Corporate Governance (Oxford University Press, 2008) page 292
[1004] Ibid.

action cases of *Kouis* and *Iliadis* derived from the private end of the company spectrum. Also, the analysis of the Cypriot case law in Chapter 3, demonstrated that the Cypriot judges do not value the use of the oppression remedy and they do not consider it as a decisive factor to disapprove the initiation of a derivative claim.[1005] So, based on these findings, it is suggested that the introduction of a statutory derivative action in Cyprus should be the primary concern of the Cypriot legislator to increase the levels of shareholder protection. In any case, amendments to the Cypriot oppression remedy should be welcomed, but, carefully, considered to further enhance shareholder protection and give shareholders a better prospect of redress, when the wrong suffered is a personal one.

5.3.3 Risks and Challenges in Replacing "oppression" with "unfair prejudice" in Cypriot company law

It is true that after the abolishment of the term "oppression" and the introduction of the UK unfair prejudice remedy, the amended form of the statutory remedy under s459 of CA 1985, as consolidated in s994 of CA 2006, has proven to be very popular, especially in its application to small private companies.[1006] It is also true that the range of the conduct covered and the flexibility of the relief offered within s994 petitions gradually turned the remedy to the most attractive solution for dissatisfied shareholders in England.[1007] Considering that in Cyprus the oppression remedy does not appear as a viable alternative, it could be argued that a legal reform inspired by the English model on unfair prejudice, is more than welcomed.

[1005] Chapter 3
[1006] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 277
[1007] Ibid.

As a matter of law, the English unfair prejudice remedy is a remedy for shareholders, who have suffered personal harm due to unfairly prejudicial conduct.[1008] On the contrary, the derivative action is a different creature, aiming to redress corporate wrongs, by allowing, in limited circumstances, a minority shareholder to pursue an action on the company's behalf.[1009] The overreliance on the unfair prejudice remedy could create imbalance in the enforcement mechanisms of corporate governance.[1010] As explained in Chapter 2, the English case law presents a number of situations where the minority shareholders relied on the unfair prejudice remedy as a means of exercising enforcement rights belonging to the company. However, English legislators had no intention to create a remedy that would allow the minority shareholders to supersede the restrictions of the rule in *Foss v Harbottle* by presenting an unfair prejudice petition.[1011] As explained by Auld LJ in *Phoenix Office Supplies Ltd v Larvin*, 'it is important to keep in mind that s 459 [now CA 2006, s 994] is designed for the protection of members of companies'.[1012] This observation is significant for Cypriot legislators too, as the possibility of adopting an amended oppression remedy, similar to the English unfair prejudice remedy should not undermine the policy on which the rule in *Foss v Harbottle* is based.[1013]

Cypriot legislators should be particularly cautious in introducing legal changes, based on the English model, due to the difficulty of the petitioner in proving his case

[1008] L.S. Sealy, "Shareholders' Remedies in the Common Law World" (1997) 2 C.F.I.L.R. 172
[1009] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 282
[1010] Ibid.
[1011] Han-Christoph Hirt, 'In What Circumstances Should Breaches of Directors' Duties Give Rise to a Remedy under ss.459–61 of the Companies Act 1985?' (2003) 24(4) The Company Lawyer 100, 103; JE Parkinson, *Corporate Power and Responsibility—Issues in the Theory of Company Law*, (Clarendon Press 1993) pages 258–9
[1012] Phoenix Office Supplies Ltd v Larvin [2002] EWCA Civ 1740, per Auld LJ at [27]
[1013] Han-Christoph Hirt, 'In What Circumstances Should Breaches of Directors' Duties Give Rise to a Remedy under ss.459–61 of the Companies Act 1985?' (2003) 24(4) The Company Lawyer 100, 110.

with regard to a breach of directors' duties under an unfair prejudice petition.[1014] In specific, under English law, a petitioner should prove that his interests as a member are unfairly prejudiced, as a result of the presence of two elements.[1015] Firstly, the petitioner should prove the director's breach of duty and secondly, he should also prove the majority's 'wrongful' failure to initiate or prevent litigation against the wrongdoer in circumstances where a derivative action is not available.[1016] It has been argued that it is almost impossible for the petitioner to satisfy the second element, when the wrongdoer director is the controlling majority of shareholders.[1017] For that reason, it has been suggested that the application of the remedy on the basis of directors' breaches would be more likely to succeed in companies, which are composed of a small number of members.[1018] Even this suggestion might not be applicable, if Cypriot law introduces an unfair prejudice remedy. To explain this further, it is useful to consider the Cypriot case of *Kouis*, which involved a small private company, composed of only two members, who were also the managing directors. If the case of *Kouis* was posited on the basis of an unfair prejudice petition, it would have been impossible for the claimant to prove that the controlling shareholder wrongfully failed to initiate derivative proceedings, as the claimant also formed part of the controlling majority. Despite its wide range of application, it seems that the unfair prejudice remedy is not suitable in all cases involving corporate misconduct and in the light of a future case similar to

[1014] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 284
[1015] Han-Christoph Hirt, 'In What Circumstances Should Breaches of Directors' Duties Give Rise to a Remedy under ss.459–61 of the Companies Act 1985?' (2003) 24(4) The Company Lawyer 100, 110.
[1016] Ibid.
[1017] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 284
[1018] Han-Christoph Hirt, 'In What Circumstances Should Breaches of Directors' Duties Give Rise to a Remedy under ss.459–61 of the Companies Act 1985?' (2003) 24(4) The Company Lawyer 100, 110

Kouis, a potential unfair prejudice remedy would not be as beneficial as a statutory derivative action against a breach of director's duty.

Moreover, it should be pointed out that the popularity of the English unfair prejudice remedy carries a number of difficulties that do not render it a suitable remedial tool for the minority shareholders in certain circumstances.[1019] The unfair prejudice remedy is in essence an exit remedy[1020], which ensures that an aggrieved member can leave the company, after receiving proper reimbursement for the loss that he has suffered.[1021] So, the problem appears, when this exit option that the remedy offers is not always the desired solution for shareholders, who do not wish to run away from the company.[1022] Especially, if we consider a case, where the wrongful action has caused diminution in share value, the exit right that allows the aggrieved member to sell his shares and leave the company, does not seem to be a satisfactory option.[1023] On the contrary the derivative action, is a remedy that does not force the aggrieved member to abandon his active role, as a shareholder in the company.[1024] So, it can be said that the derivative action is preferable in certain circumstances, as there is no reason to force into a buyout order, a claimant who prefers to remain as a shareholder in the company and the claim sought is based on a breach of fiduciary duty by a director.[1025]

Another reason that Cypriot legislators should be particularly cautious in amending the oppression remedy to an unfair prejudice one, relates to the concerns of the UK Law Commission in respect of the disadvantages that surround the relatively wide scope of

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[1019] Jennifer Payne, "Bigger and Better Guns for Minority Shareholders" [1998] C.L.J. 36
[1020] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 288
[1021] s.996(2) of the UK CA 2006
[1022] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 288
[1023] Ibid.
[1024] Ibid.
[1025] L. Kosmin 'Minority Shareholders' Remedies: A Practitioner Perspective' (1997) 2 CFILR 201, 213

the unfair prejudice remedy. The concerns of the UK Law Commission were not directed towards the real substance of the unfair prejudice remedy, but the problem was detected on the impact that the length and costs of s994 proceedings had on small private companies.[1026] In order to highlight this problem, the Commission referred to the cases of *Re Elgindata Ltd*[1027], where the 43-day hearing costed 320,000 pounds, and the value of the shares fell from about originally purchased price of 40,000pounds to 24,600pounds and the case of *Re Marco (Ipswich) Ltd*[1028], where the hearing lasted 27 days and the costs claimed reached the amount of 725,000pounds.[1029] Hence, it is logical that cases on unfair prejudice would occupy a considerable amount of time and costs, as the court's review is not limited only to the articles of association, but extends to the examination of the legitimate expectations of the petitioner and the unfairness of the respondent's conduct. Except from this problem, Vinelott J in *Re a Company ex p Burr*[1030], explained that the presentation of the petition may have a detrimental effect to the reputation of the company too.[1031] Furthermore, the Law Commission pointed out that the broad scope of the remedy enables petitioners to bring before the courts any facts that may distantly relate to the claim for relief under s996 and such freedom may lead to "complex, often historical, factual investigations and costly, cumbersome litigation".[1032]

It should also be noted that the UK Law Commission rejected the amalgamation of the two remedies and suggested that two distinct remedies should be preserved, arguing that if claims for wrongs to the company are combined with personal claims in

[1026] Alan Dignam & John Lowry, *Company Law*, 10th edition (Oxford University Press, 2014) page 248
[1027] Re Elgindata Ltd [1991] BCLC 959
[1028] Re Macro (Ipswich) [1994] 2 BCLC 354
[1029] Pauline Roberts and Jill Poole, 'Shareholder remedies - efficient litigation and the unfair prejudice remedy' [1999] JBL 38, 41.
[1030] Re a Company ex p. Burr [1992] BCLC 724, at [735]
[1031] [1992] BCLC 724, at [735]
[1032] Law Commission, Shareholder Remedies, Consultation Paper, No 142 (1996) para. 14.5.

an unfair prejudice petition, the proceedings will lack a clear focus from a case management point of view.[1033] This is a useful consideration for Cypriot legislators, who need to acknowledge the functional equivalence that the adoption of two reformed remedies would have within Cypriot company law.

In response to this widespread concern on the length and cost of trial, the UK Law Commission suggested that, if the conditions within which a derivative claim is brought become more transparent, then the members maybe encouraged to bring a derivative claim rather than the costly and lengthy proceedings of s994.[1034] Truly, the recommendations of the Law Commission found their place within the more accessible statutory derivative action in Part 11 of the UK CA 2006. There is no doubt that even after the codification of the derivative action the unfair prejudice remedy remained a remedy of choice amongst minority shareholders.[1035] However, the new statutory derivative action added value to the existing body of English company law, as it provided the courts with the chance of reasserting the importance of the proper plaintiff rule and striking a more appropriate balance between the interests of minorities and those of the company.[1036] Conclusively, it can be assumed that the recommendations of the UK Law Commission are of significant importance for the Cypriot jurisdiction setting the foundations for the reform of the common law derivative action in Cyprus, as a main a priority in the list of future legal amendments.

[1033] Ibid, at para. 16.4
[1034] Law Commission, Shareholder Remedies, Consultation Paper, No 142 (1996)
[1035] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 285
[1036] A.M. Gray, 'The statutory derivative claim: an outmoded superfluousness?' [2012] Company Lawyer 295, 302

5.4 Concluding Remarks

The recommendations advanced in this Chapter, aimed at forming an effective and accessible framework, which seeks to protect the interests of Cypriot shareholders, to enhance the accountability of the wrongdoers and to prevent to a reasonable extent the risk of vexatious litigation. Another objective of this reform proposal was the introduction of a workable framework, that would not simply repeat the weaknesses of the English and German statutory remedies, but would engage with both the civil and common law elements, so that it aligns with the mixed nature of the Cypriot legal system. The reform proposals depart from the old English version of the common law derivative action. The most notable recommendations concern the extension of the cause of action to cases of negligence, the incorporation of "the interests of the company" criterion, the removal of the ratification concept, the modifications discussed to construe a more shareholder-friendly cost allocation system and the available options that Cypriot legislators should consider to strengthen the accessibility of minority shareholders to corporate information rights.

The successful use of the remedy cannot be explained by the availability of a single element, but of a whole range of accessible criteria.[1037] For that reason, the suggested reforms were, firstly, formed upon the policies of the PRM, so that the proposed remedy could assert its representative role in protecting the company's interests, when the company is incapable of looking out of the cave; remedying the wrong itself, since the wrongdoers fraudulently manage its corporate affairs. Secondly, the proposed remedy followed some practical lessons from the English and German rules on derivative claims to balance the need of the Cypriot jurisdiction to preserve the common law

[1037] Martin Gelter, 'Why Do Shareholder Derivative Suits Remain Rare in Continental Europe' (2012) 37 Brook J Int'l L 843

tradition within its legal framework and the need to respect the civil law culture to which most European jurisdictions abide by, in order to reassert their competitiveness in the European market.

The advantages that the English unfair prejudice remedy confers on minority shareholders revealed and that it would be a welcome development in Cyprus, in order to relieve the Cypriot remedy of s202 from the burden of the uncertain term "oppression" and to extend the circumstances under which a minority shareholder could gain redress against both personal and corporate wrongs. As explained in Chapter 2, the expanded scope of the English unfair prejudice remedy, in awarding relief for corporate wrongdoing, should not be underestimated, as it provides a new perspective on the way that corporate wrongs can be reimbursed in certain circumstances.[1038] The oppression remedy as it currently stands in Cypriot company law is incapable of covering even half of the situations that are covered under the scope of the unfair prejudice scheme. So, it can be concluded that the replacement of "oppression" with "unfair prejudice" should be considered by Cypriot legislators, as an additional legal change that would promote effective shareholder protection in Cyprus. Although, Cypriot legislators should set clear limits between the two remedies, as there are situations that purely belong to the authority of derivative proceedings and cannot practically be covered by an order on unfairly prejudicial conduct. Also, evidence from the Cypriot jurisdiction and from other common law jurisdictions has shown that the derivative action is more popular than the oppression remedy in companies of a closely held character – as it is the case for most of the Cypriot ones – and so its reform should become a priority in Cyprus, so that the new remedy can be of an effective use to the vast majority of Cypriot companies. Hence, the Chapter concludes that Cypriot legislators should prioritise the

[1038] Chapter 2

replacement of the common law derivative action with a statutory remedy, as an amended oppression remedy based on the English law, is not mechanically perfect in order to respond to all types of corporate wrongdoing; its defining feature is not to redress corporate wrongs, but to enable an association amongst the members to be ended, without a winding up order, on the basis that the wrongdoing is contrary to the terms on which the parties had agreed.[1039]

[1039] Brenda Hannigan, 'Drawing Boundaries between Derivative Claims and Unfairly Prejudicial Petitions' (2009) 6 Journal of Business Law 606, 617.

Chapter 6

Conclusion

6.1 Summary of the Thesis

This study aimed to serve two main objectives. Firstly, it aimed to advance reform proposals, for the replacement of the problematic Cypriot common law derivative action, with a statutory remedy, which would be able to meet the Cypriot corporate governance realities, to encourage the accountability of the wrongdoers and to increase the levels of minority shareholder protection in Cyprus. Secondly, it aimed at providing a conceptual rethink of the content of the derivative action and its objectives, through the development of the Platonian Remedial Model (PRM). The analysis of Cypriot company law demonstrated that Cypriot company law lacks effective mechanisms of shareholder protection and as a result there is no prospect of adequate protection for Cypriot shareholders in cases of both personal and corporate wrongdoing.

Following the comparative examination of the English and German law on derivative claims, Chapter 2 argued that both jurisdictions are presented with some propitious and some strict procedural rules in different aspects of their derivative proceedings. Identifying differences and similarities between the English and German provisions on derivative claims, the analysis showed that none of the examined jurisdictions offers the golden ticket to effective shareholder protection, as the design of some legal rules in both jurisdictions blocks access of minority shareholders to the remedy. The English and German statutory laws, were compared in order to track similarities and differences relating to the legal standing requirements that the litigant needs to satisfy in order to proceed with the claim, particular factors that judges

consider throughout the judicial screening process and shareholders' incentives to start claims of this nature, such as, litigation costs and access to claim-related information. These comparative considerations showed that both statutory laws are far from being perfect, as the delicate balance between effective use and abuse of the remedy, is a challenging task that has not been achieved to a great extent. Although, different aspects of both statutory remedies showed the way towards a more accessible derivative action and offered valuable lessons to the proposed framework for Cyprus.

Before the development of proposals for the reform of the Cypriot derivative action, the thesis poses an important research question of whether shareholder protection in Cyprus is weak. Firstly, Chapter 3, explored how the remedy has developed in Cyprus. Secondly, it examined how English and other foreign judgments have influenced the development of Cypriot common law and finally evaluated whether the current remedial framework is fit for the purpose of providing effective shareholder protection. Chapter 3 also, identified the aspects of the English common law remedy that apply and appear in existing Cypriot case law. It then investigated developments in English case law which have not yet been expressly considered by judgements of Cypriot Courts. The comparative analysis of the English and Cypriot case demonstrated that the Cypriot remedy maintains the problematic aspects of the abolished English common law regime. The Chapter argued that on the one hand the interpretation of the English common law principles by Cypriot courts assert some degree of flexibility in the way that derivative claims are understood within Cypriot company law, compared to the strict interpretations of English courts, when the common law remedy was still in force. On the other hand, the analysis showed that the strict nature of the legal criteria upon which the Cypriot common law remedy has been formed, defeats any flexible interpretations provided by the Cypriot courts, rendering the remedy doctrinally

inaccessible to minority shareholders, a fact that is confirmed by the low levels of derivative litigation in Cyprus. Chapter 3 argued that the Cypriot common law derivative action is truly problematic, so that Cypriot legislators could justifiably look for reform plans. Furthermore, the examination of the Cypriot oppression remedy in Chapter 3, showed that the remedy is not a viable alternative method of shareholder protection. The analysis on the strict wording and interpretation of the oppression remedy revealed that the remedy is problematic in many respects. Evidence from Cypriot case law, also, underlined the passivity of Cypriot judges to consider the availability of the remedy, as a decisive factor to reject the initiation of a derivative claim, a fact that confirms the weaknesses of the oppression remedy. The overall ineffectiveness of the existing alternative shareholder remedies within Cypriot company law along with the problematic nature of the Cypriot derivative action, reinforced the perception that Cypriot shareholders are deprived of any effective means for the protection of their interests. These arguments promoted the idea that a reform of the common law derivative action, could positively contribute to the improvement of those low levels of minority shareholder protection in Cyprus.

In the light of a reformed derivative action in Cyprus, the thesis posed an important research question, which led to a fundamental rethink of how the derivative action should be formed in order to effectively perform its compensatory and deterrent functions. Specifically, Chapter 4 questioned what kind of factor would determine the selection of the English and German legal criteria for the introduction of a new, flexible and accessible statutory remedy in Cyprus. In answering this question, the thesis considered essential the development of its own conceptual framework on what legal design the remedy should have in order to achieve adequate shareholder protection. The thesis deployed Plato's allegory of the cave to show how corporate wrong is understood

from a corporate governance perspective and why an accessible derivative action retains an important role on the accountability of corporate executives. The study correlated the concept of political corruption in the ancient Athenian society that Plato described in his allegory with the corporate corruption that appears in the modern corporate world. In specific, the simile described a corporate structure, which has suffered wrong by the wrongdoers and has no effective means to escape from the corporate cave that the wrongdoing directors have created, when the law on derivative claims does not facilitate shareholders' access to the remedy. This simile was used for the purpose of illustrating the agency problem in the corporate context and how more accessible laws on derivative claims, can respond to this problem, by assisting minority shareholders to deal with corporate misconduct, in this exceptional condition that the company is unable to do so. The use of Plato's allegory of the cave in a corporate governance context, highlighted the accessibility logic behind the effective use of the remedy and formed the conceptual framework of this thesis in the guise of PRM (Platonian Remedial Model) to govern the legal design that the remedy should have to respond to the needs of a swiftly changing corporate world. Chapter 5 applied the PRM, in order to advance reform proposals for the introduction of an effective derivative action in Cypriot company law.

Against the backdrop of a problematic remedial framework in Cyprus, the thesis in Chapter 5 advanced reform proposals for the introduction of a statutory derivative action within Cypriot company law. The Chapter advanced arguments in favour of utilizing the Platonian Remedial Model (PRM), developed in Chapter 4, as a guideline for the Cypriot legislators, in considering how to mold an accessible statutory derivative action, that would be influenced by both the common and civil law tradition. The examined jurisdictions had to offer different lessons to the Cypriot one, since the

incentives and restrictions contained in the procedural criteria of the English and German law differ in many respects. The question that received adequate attention in this thesis, is what would be the filtering factor that Cypriot legislators should consider in assessing and incorporating those English and German rules within Cypriot company law, that would transform the problematic Cypriot remedy to an effective one. The answer to this question is provided through the application of the PRM, which embraces the concept of accessibility in the formation of the law on derivative actions. In the absence of such a conceptual framework, the proposals for the reform of the Cypriot derivative action would have been impractical, as the impulsive incorporation of some flexible English and German procedural rules within Cypriot company law, would have resulted in the repetition of most of English and German mistakes discussed in the thesis, that render the two examined remedies inaccessible to minority shareholders in different stages of the derivative proceedings.

Furthermore, Chapter 5 developed strategies not only to enhance the role of the derivative action in Cyprus, but also to enhance the capabilities of other mechanisms of shareholder protection, such as the oppression remedy. The analysis provided in Chapter 5, clarified that it was the intention of the thesis to formulate specific reform proposals for the abolishment of the oppression remedy and its replacement with a unfair prejudice remedy, similar to the remedy found in ss994-996 of the UK Companies Act 2006. Although, this research attempts to improve minority shareholder protection in Cyprus, and calls Cypriot legislators to seek valuable insights from the rich experience and the multi-faceted evolution of the English law on unfair prejudice, in an effort to address existing problems in the Cypriot oppression remedy and to establish a modern and flexible alternative method of shareholder protection that would work side by side with a new statutory framework on derivative claims. The Chapter

argues in favour of legal changes that would improve the weaknesses of the Cypriot oppression remedy and would contribute to the development of an inclusive remedial framework in Cyprus. However, legal amendments to the Cypriot oppression remedy, would be accompanied by a number of difficulties relating to the strict legal requirements that the Cypriot shareholders would need to satisfy in order to find their way out of the company, by selling their shares at a fair price. Additionally, the Cypriot oppression remedy, even an amended version of it, can by no means deal with wrongs that the derivative action intends to remedy. Finally, evidence from Cypriot case law and other common law jurisdictions confirmed that the use of the derivative action is more popular than the oppression remedy in companies of a closely held character, such as the Cypriot ones. Following these findings, the Chapter suggested that the reform of the derivative action should be the main priority in the future list of Cypriot company law reforms, as the benefits of introducing a new statutory derivative action in Cyprus outweigh the gains from initiating changes on existing alternative methods of shareholder protection.

6.2 Contributions to Knowledge and Significance of the Thesis

The significance of this research lies on the selection of the examined jurisdictions, as the comparative approach followed in this thesis, has not been examined in relevant literature, in order to serve the objectives of this study. The comparative analysis of the English, German and Cypriot law on derivative claims offers a deep understanding of the doctrinal problems that surround the Cypriot company law and provides for effective responses to these problems, since the mixed legal nature of the Cypriot jurisdiction attracts the solutions that accompany the common law and civil law traditions of the English and German jurisdictions respectively. As it was explained in Chapter 2, in some aspects of the derivative proceedings the English law performs better

than the German one and the other way around. The comparative considerations and the arguments formed on the basis of these comparative considerations aimed at providing a way forward for Cyprus. Hence, the comparative approach, adopted in this study, entails another element of originality, as this is the first research project on Cypriot company law, at least to the best of the researcher's knowledge that proposes a new legal order for derivative actions in Cyprus that substantiates on insights offered by both English and German provisions. In general, the academic work on the broader subject of shareholder protection under Cypriot law, is scarce and it is usually concerned only with insights that the English law has to offer on the topic of shareholder protection.[1040] The in-depth and systematic analysis of the Cypriot company law has been lacking in academic literature and so this study aimed at filling this gap.

Much of the study's originality resides in the analysis of Cypriot cases too. The judicial interpretations provided in Chapter 3, and the critical discussion that concerns the interpretation of the common law derivative action by Cypriot judges, have occupied minimal space in academic literature, without elaborate detail. On the contrary, the detailed analysis of the Cypriot company in this study provides a detailed picture of the overall levels of minority shareholder protection in Cyprus and by evaluating alternatives methods of protection, substantiates its arguments on why and how Cypriot company should change on an array of issues relating to shareholder derivative litigation.

Furthermore, the real novelty of this research concerns the PRM (Platonian Remedial Model) which was developed through the allegorical analysis that Chapter 2 provided, based on Plato's allegory of the cave. The conceptual developments deriving

[1040] Georgios Zouridakis and Thomas Papadopoulos, 'A comparative analysis of derivative action in Cypriot company law: Comparison with English company law and the prospect of statutory reform' (2022) 29(1) Maastricht Journal of European and Comparative Law 62

from the allegorical analysis in this study, provide a significant degree of originality, as they do not only render the approach on derivative litigation academically interesting, but also differentiate its content from previous studies on the topic of derivative actions.

The PRM developed in this thesis, offers a methodologically organized and conceptually inclusive approach on how corporate wrongdoing is understood. The conceptual framework addresses the agency problem in an innovative way and introduces the policy premises, upon which the law on derivative claims should be formed in order to respond to questions of management control in the corporate form. The PRM seems to have accomplished a threefold objective. Firstly, the PRM responds to the shortcomings of the academic literature on derivative actions, by providing a theoretical framework that offers a descriptive approach on the exceptional state of corporate affairs, where the company has suffered wrong and the procedural complexities of the derivative action, eliminate management accountability and restrict the access of minority shareholders to the remedy. The allegorical analysis on the corporate cave works to that effect. By presenting the minority shareholders bounded, the thesis aimed to show the difficult position that minority shareholders are placed and the challenges that they are facing in the absence of a cost-effective and accessible derivative action. A derivative action is an action that should only be brought in exceptional circumstances.[1041] This exceptional nature of the remedy is illustrated in the picture of the corporate cave, which depicts this exceptional condition that the company cannot enforce its legal rights. The Picture 4.1 in Chapter 4, is a unique graphic that the researcher of this study introduced, inspired by Plato's allegory of cave and adapted to the reality of modern corporate governance. The Picture 4.1 seeks to

[1041] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 191

address the real problem with the law, as it currently stands not only in the Cypriot jurisdiction, but in any common or civil law jurisdiction that maintains inaccessible procedural rules on derivative claims. The picture of the corporate cave describes a practical reality; although in theory the derivative action is considered to be a powerful accountability mechanism, if the rules relating to it become inaccessible to minority shareholders, then no one can predict with confidence when and if the prisoner-shareholders would be allowed to proceed with a derivative claim and to find their way out of the corporate cave.

Except from the problems that shareholders face in this exceptional condition of managerial misconduct, the PRM underlines the solution to these problems, which is not other than accessibility to the remedy, so that it can perform well its compensatory and deterrence functions. By releasing one of the minority shareholders, who are bounded inside this corrupted corporate cave, the allegorical analysis, acknowledged the representative nature of the remedy and its cumulative effect. These descriptive insights provided an innovative outlook on how the derivative action is understood and what makes the remedy a powerful corporate governance mechanism. Finally, the PRM sets guidelines for designing effective regulatory measures where derivative actions are used to enforce the law and provides a new perspective from which a future reform of the derivative action in both common and civil law jurisdictions could be assessed at a legislative and judicial level.

It is not clear, if the application of the proposed framework in the Cypriot jurisdiction or any other jurisdiction that suffers the shortcomings of a problematic derivative action, can achieve the delicate balance between managerial freedom and effective shareholder protection. The examination of relevant academic literature in this thesis has proved that this task is quite challenging and very difficult to be achieved in

both common and civil law jurisdictions. The PRM does not advance a new policy for when and for what purposes the remedy should be used, nor it seeks to alter the role that the remedy plays in promoting corporate governance practices. However, it certainly encourages the introduction of more accessible rules on derivative claims, that might produce clearer incentives for the initiation of derivative litigation. It is hoped that the proposed framework would offer valuable insights to the legislators and courts as to how the law on derivative claims should be formed and interpreted.

6.3 Final Remarks and Future Directions

Undoubtedly, where fraudulent motives exist, managerial misconduct will always be inevitable.[1042] Neither the law on derivative claims nor any other corporate governance mechanism can extinguish any fraudulent intentions of a corrupted director. However, the critical analysis of relevant case law in this thesis, has shown that in these exceptional occasions of corporate malpractice, derivative actions can play a leading role in the promotion of good corporate governance practices, by deterring wrongdoers and compensating the company for the wrong suffered. This study, by introducing a Platonian approach on derivative litigation seeks to advance and extend the scope of current discussions on the law relating to derivative claims. Against this backdrop, it is hoped that the theoretical inquiry developed in this thesis provides useful insights for future study of the derivative action and contributes to the development of a new conceptual framework for subsequent discussions and directions in future research. The development of the proposed framework in this thesis, aimed at improving the function of the derivative action in Cyprus and so it could not explore the applicability of this framework in other jurisdictions. So, one of the further avenues of research relevant to

[1042] Arab Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2008) page 303

the subject of this thesis is the question of whether the Platonian Remedial Model advanced in this study could improve the law on derivative claims in other common and civil law jurisdictions that face similar procedural challenges in derivative litigation. It is hoped that the application of the PRM in jurisdictions that minority shareholders are deprived of an effective derivative action, would change the way in which those involved in corporate governance, perform their tasks.

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