

**E-Notes (Compiled)**  
**on**  
**Company Law-II**  
**(No. 2)**  
(LL.B. 3yrs - ivth Semester)  
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**Derivative Action**

**Synopsis**

Principle

Who can be benefited under such action

*Locus standi* in such action

**Elaborate Analysis**

**Derivative Action**

- The principle of rule by majority has been made applicable to the management of the affairs of companies. Once a resolution is passed by majority it becomes binding on company as well as on its members.
- **In principle**, a company is a **distinct legal entity** which means, it is a separate legal person **from the members who compose it**. It can sue or be sued in its own name. Thus, if any wrong is done to the company, it is the company which is the legal entity having its own personality and that can only institute a suit against the wrongdoer. So, the **shareholders** (members) **individually do not have a right to do so**.
- **But**, in certain circumstances **an individual member may** bring an action to remedy a wrong done to his company or to **compel his company to conduct its affairs** in accordance with its **memorandum and the rules of law** governing it, **even though no wrong has been done to him personally**,

and even though the majority of his fellow members do not wish the **action** to be brought.

- The form of his action in **these exceptional cases** is peculiar, because the **plaintiff does not sue in his own right alone**, but **on behalf of himself and all his fellow members** other than those, if any, against whom relief is sought.

- If the member sues for relief against the company, it must, of course, be made a defendant;

- If he seeks to enforce a corporate claim against other persons, the company must still be joined as a co-defendant so that it may be bound by the judgement, and so that it may enforce any order giving relief against the substantive defendants.

- The **individual member's action in these exceptional cases** may be **described as representative**, because **it is brought on behalf of himself and persons other than himself** who would go along with him to protect their legitimate corporate rights.

- When **relief is sought against third parties** for the **company's benefit**, the action may also **be described as derivative**, because the individual **member sues to enforce a claim which belongs to the company**, and his **right to sue is derived from it**.

#### **Who can be benefited under derivative action?**

- In *Spokes v. Grosvenor etc., Hotel*, 2 QB 124, it was held that if the derivative action succeeds, any property or damages recovered **do not go to the plaintiff** but it **goes to the company**.

- In this regard, it is also **noticeable** that the plaintiff shareholder **can complain** in a derivative action of **wrong committed before** he became a member.

- **But**, a derivative action commenced by a member **may not be continued** by him **if he ceased to be a member**.

***Locus standi in such action***

- The **plaintiff** in such action **is not an agent** for the persons **on whose behalf he sues**.
- In *Forest v. Manchester, Sheffield and London Rly. Co.*, it was held that the court will only allow a derivative action to proceed if it is brought for the benefit of the company, and so if the plaintiff's motive is to benefit a rival concern which has encouraged him to sue and has indemnified him against costs, the action will be stayed.
- **Likewise**, in *Re, Exchange Banking Co. Flitcroft's* case, it was observed that if directors have paid dividends out of capital, but the company has since earned sufficient profits to replace the capital expended, it seems that the court will not permit a member to bring a derivative action to compel the directors to repay the dividend out of their own pockets, because the company could immediately use the money received from the directors to pay a further dividend, so that the **result would be to benefit not the company**, but its **members individually**.

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