

# Who has *locus standi* to bring derivative actions in Cyprus?



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Litigation, Cyprus

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## Introduction

A derivative action is a mechanism of equity that permits a member or a minority shareholder of a company to raise an action on the company's behalf when it refuses to bring such an action itself. The derivative character of such an action is evident because:

- the judgments are given in the company's favour, so that the plaintiff obtains no direct benefit; and
- the plaintiff can sue only if the company can sue itself, so that if the company is dissolved no derivative action can be brought.<sup>(1)</sup>

## Examples of derivative actions

As it has been elaborated in a number of previous cases, in order for a derivative action to be raised, there must be both evidence of fraud and of wrongdoers controlling the company to the extent that the company cannot be made a plaintiff.

It is a long-established principle that derivative actions can be brought only by registered members of a company – not for their personal benefit, but in order to enforce a right vested in the company.

Regarding persons recognised by companies as members, Section 27 of the Companies Act (Cap 113) states that "[e]very 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".

Moreover, in deciding whether a person is a member of a company, articles of association will also be considered. In *Rowland Investments Limited*,<sup>(2)</sup> the plaintiff was the beneficial owner of shares in defendant two, whose registered shareholder was defendant one. The Nicosia District Court made an explicit reference to the company's articles of association, which stated that:

*no person will be recognized by the Company as the holder of any share under a trust, and the Company will not be under any obligation to recognize in any way (even if it has been notified) any an interest under the law of equity.*

As such, the court held that the plaintiff could not be considered a member of the company, as it had no *locus standi* to raise the action in question. Therefore, the plaintiff's allegations in relation to conspiracy and deceit were dismissed without being examined.

Similarly, in the first-instance judgment in *Lexbrook*,<sup>(3)</sup> the plaintiffs beneficially owned shares in a company, on behalf of which a derivative action was raised. These shares were held by a third party on the basis of a trust deed that had been concluded between him and the plaintiffs. The court reaffirmed that they had no *locus standi* to initiate such proceedings.

In *Sergei Petrovich*,<sup>(4)</sup> the plaintiff held shares in a company both directly as a registered shareholder and indirectly as a beneficial owner by virtue of a trust deed. Again, the Limassol District Court held that the plaintiff had *locus standi* only for the shares that he had been a registered shareholder of.

### **Cypriot law as it stands**

Under Cypriot law it appears that whenever the shares in a company are held on trust by a nominee shareholder, only they are entitled to raise an action on the company's behalf under their capacity as a registered shareholder. In practice, this means that a company's beneficial owner has no *locus standi* to claim their rights.

This approach is subject to exceptions. In particular, English case law indicates that a beneficial owner of shares, despite being unable to raise a derivative action in their own name on the company's behalf, can make a derivative trust claim on behalf of a nominee shareholder or trustee. The court adopted this approach in *Eclairs Group*<sup>(5)</sup> where the beneficiary was held to be entitled to bring such a claim by joining the trustees as defendants and suing on their behalf. Nevertheless, it is noteworthy that this was a case where the beneficiaries had no *locus standi* to bring the proceedings themselves on the company's behalf but instead on behalf of the trustees.

Before the Companies Act 2006 was adopted, English case law granted the minority shareholders of a parent company the right to pursue a cause of action vested in a subsidiary of the parent company. Such actions fall in the category of a double derivative or multiple derivative claim. One of the main references regarding actions of that nature is the Hong Kong case of *Waddington*,<sup>(6)</sup> which was also discussed by Cypriot courts in *Zankuliyeva*.<sup>(7)</sup> It was subsequently established that it is a prerequisite for a shareholder of a parent company that wishes to enforce a right vested in a subsidiary company, to demonstrate that the control of the holding company belongs to a person against whom there are complaints of unlawful acts against the subsidiary. In *Universal*,<sup>(8)</sup> the court held that:

*the common law procedural device called the derivative action was, at least until 2006, clearly flexible enough to accommodate as a legal champion or representative of a company in the wrongdoer control of a Claimant who was either (and usually) and a member of that company or (exceptionally) a member of its parent company where that parent company was in the same wrongdoer control.*

This approach was accepted by the Cypriot courts in *Duo*.<sup>(9)</sup>

Although the above principles were expressed by first-instance courts, and could be overturned in future by the Supreme Court, this is the current legal position in Cyprus. The issue of derivative actions is of paramount importance in the modern corporate world. Considering that nominee shareholders are often found within complex company structures, the law as it currently stands does not always facilitate the protection of beneficial owners' interests.

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### **Endnotes**

- (1) Pennington's Company Law (3rd ed, P 564).
- (2) *Rowland Investments Limited v Siberian Drilling Services Limited ao*, 1801/2008, 17 October 2008.
- (3) *Ishakov ao v Lexbrook Limited ao*, 964/2017, 22 June 2018.
- (4) *Sergei Petrovich Poymanov v Aletarro Limited ao*, 3463/13, 3 December 2013.
- (5) *Eclairs Group Ltd v JKC Oil & Gas Plc*, [2014] EWCA Civ 640.
- (6) *Waddington Limited v Chan Chun Hoo Thomas* (FACV 15/2007).

(7) *Zankuliyeva Aigul Amanzholovna ao v Tedcom finance limited ao*, 2068/2010, 10 March 2011.

(8) *Universal Project Management Services Ltd, Fort Gilkicker Ltd ao*, [2013] EWHC 348 (Ch).

(9) *Duo v AFX CAPITAL MARKETS LTD ao*, 121/16, 21 May 2018.

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