GLOBAL TRENDS IN STATUTORY DERIVATIVE ACTIONS: LESSONS FOR NIGERIA[1]

Abstract

Owing to the incoherence of case law in respect of derivative actions, there appears to be a universal shift from common law derivative actions to pure statutory derivative actions - in which common law derivative action is completely abolished. At present even though there is a statutory derivative action regime in Nigeria, it is tainted with common law. Besides, whenever there is a lacuna in the law, recourse to common law appears to be the only option. This article seeks to explore how to reform statutory derivative action regime in Nigeria in line with global inclinations.

Introduction

Derivative actions originated from common law as one of the means of escaping from the nuisance created by the decision in *Foss v. Harbottle*[2] which established the principles of the proper plaintiff and the majority rule. In order to protect minority interests a member is allowed to bring an action to enforce a right vested in the company or remedy a wrong done to the company as opposed to a right vested in the plaintiff as a person. Thus even though the law has created several means of redressing the injustice that may be occasioned by the enforcement of the rule, it is only via a derivative action that a member is allowed to enforce or defend a cause of action 'belonging to' the company and not himself; hence the use of the word 'derivative'.[3] In instances where the law allows shareholders to bring personal actions, the remedies available are restricted to obtaining declarations and injunction while an applicant in a derivative action can obtain damages on behalf of the company for wrong done to it. A plaintiff was however required at common law to show that there was fraud on the minority and that the wrongdoers who have failed to take an action to redress the wrong done to the company are the ones in control. This requirement meted considerable hardships to litigants and created uncertainty as to the meaning of 'fraud on the minority'[4] and 'control.'[5] The growing criticism as to the procedural impediments and deficiencies in the common law derivative actions led to enactments by common law countries seeking to evade the incoherence of case law.

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[2] (1843) 2 Hare 467 E.R. 189.

[3] The concept of derivative action appears to have been developed by the courts in the United States by the recognition of its true nature, that is, that the individual member sues on behalf of the company to enforce rights derived from it. See Paul von Nessen et al, The Statutory Derivative Action: Now Showing near You' (2008) *Journal of Business Law* 627 at 629s.

[4] *Wallesteiner v Moir (No.2)* (1975) WLR 389

[5] *Prudential Assurance Co Ltd v Newman Industries Ltd and Ors. (No2)* [1982] 1 All ER 354

Today virtually all the common wealth countries from Nigeria[6] through Ghana[7] to South Africa,[8] Hong Kong,[9] Singapore,[10] Australia,[11] New Zealand,[12] Canada[13] and the United States of America[14] have enacted laws on derivative actions with most of them making serious departure from common law derivative actions thus birthing a statutory derivative action regime for the Commonwealth. This new era received very strong legislative backing with the enactment of The Companies Act 2006 in the United Kingdom.[15]

It is proposed in Part I of this article to discuss the evolution of derivative action under the common law and its inherent problems – particularly the burden placed upon the plaintiff to show that there is 'fraud on the minority' and that the 'wrongdoers are the ones in control' which necessitated the shift to the statutory derivative action regime.

Part II would attempt to analyse statutory derivative action in Ghana, the United Kingdom and South Africa while making references to other Commonwealth countries.

Part III of this discourse shall attempt to examine derivative action under Nigerian Law as at present while making comparative analysis with other Commonwealth countries particularly Ghana, the United Kingdom and South Africa.

It is hoped that this analysis would lead to valuable suggestions which would serve as a platform for revisiting the law in this area by the reforms that would follow thereafter. The suggested reforms would be discussed under Part IV of this Article.

On the whole the discourse in this article shall be limited to the aspect of derivative actions bothering on bringing derivative suits and shall not be concerned with other aspects such as discontinuance, funding the cost of the action and the like.

Derivative Actions Under the Common Law

In the case of *Foss v. Harbottle*[16] the plaintiff and another shareholder brought an action for themselves and all other shareholders against the directors for selling the company's property to themselves at an under value. In accordance with the proper Plaintiff rule[17] the court held that the wrong had been done to the company which was a separate personality from the plaintiff shareholders was the proper plaintiff.

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[6] Companies and Allied Matters Act 2004,ss.303-309

[7] Companies Act 1963,s.210

[8] Companies Act 2008,s.165

[9] Companies Ordinance 2005, pt IVAA

[10] Companies Act 1994,s.216

[11] Corporations Act 2001,ss.236-240

[12] Companies Act 1993,s.165

[13] Canadian Business Corporation Act 1995, s.231

[14] Federal Rules of Civil Procedure, r.23 (1)

[15] Andrew Keay 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action under the Companies Act 2006 (2008) 124 Law Quarterly Review 469 at 472-474.

[16] Above n. 2

[17] *Salomon v. Salomon* [1897] AC 2, HL

The decision above would have been impregnable if the culprits had been outsiders because in that case it would be reasonable to expect the directors to sue. It was however unreasonable to expect the directors to sue themselves in this case.

Sir James Wigram V.C saw the problem and the injustice occasioned by not allowing redress for a wrong done when he suggested as follows

"The company could sue in the name of some one whom the law has appointed to be its representatives"

"A suit could be brought by individual corporators in their private character, and asking in such character the protection of those rights to which in their corporate character they were entitled."[18]

The actual interpretation of the suggestion of Wigram V.C is that in situations where the wrongdoers themselves are the ones in control of the company, the minorities could bring an action to protect the rights of the company. It is therefore proper to posit that the suggestion made by the court in the case of *Foss v. Harbottle*[19] marked the beginning of derivative common law actions[20] and laid down three prerequisites- obtaining leave of the court, establishing fraud on the minority and control by the wrongdoers[21]. Derivative actions also upsets the second principle of the Rule in *Foss v. Harbottle*[22] which is the majority or internal management rule of a company that maintains that corporate irregularities can be ratified by a simple majority of the members. The principle was well encapsulated in *Edwards v. Halliwell*[23]

This principle forms the basis of the principle of corporate democracy and explains the non - interference attitude of the courts in matters of corporate management.

Nonetheless as has been said earlier,[24] where the wrong is a fraud on the minority and the directors who ought to take action to redress the matter are in control and have failed to take action, a derivative action can be instituted as an exception to the rule for the simple reason that fraud is not capable of being ratified.[25] In addition the plaintiff is required to show good faith and conduct in bringing an action.[26] More importantly, the plaintiff was required to show *prima facie* that all the above, before being allowed to proceed.[27]

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[18] *Foss v. Harbottle*, above n 2 at 491-492

[19] Above n. 2

[20] See *Wallesteiner v Moir (No.2)* above n 4 at 396, where the terminology 'derivative action' was first recognized in the UK as a substitute for 'minority shareholders action.'

[21] There are however arguments that there are cases decided in the United States as far back as 1822 from which the common law derivative action could have drawn some inspiration. The earliest case reported to recognise Derivative Action was *Dodge v Woolsey* 59 U.S (18 How) 331 (1885). See Paul von Nessen et.al. above n 15. See also Terrence L. Robinson Jr. 'A new Interpretation of Contemporary Ownership Requirement in shareholder Derivative Suits: In re Bank of New York Derivative Litigation and the elimination of the Continuing Wrong Doctrine' (2005) Brigham Young University Law Review 229 at 232 where the author posited that derivative actions originated in England in the aftermath of the Industrial revolution from where it spread to the United States. The aim of derivative actions was to resolve corporate conflicts between shareholders and directors as a result of separation of ownership from control.

[22] Above n. 2

[23] [1950] 2 All ER 1064 at 1066

[24] *Wallesteiner v. Moir* above n 4

[25] *Cooks v. Deeks* [1916] 1 A.C 554

[26] *Prudential Assurance Co Ltd v Newman Industries Ltd and others (No2)* above n 5; *Smith v Croft (No 2)* [1987] 3 All E.R 938-942

[27] *ibid*

All these requirements were created in order to protect the rule in *Foss v. Harbottle*[28] but have however become bottle necks resulting in the need to depart from the common law method.
The challenge of derivative action has never been whether it should be permitted or not but that of balancing between the idea of free access to court by shareholders in order to checkmate the wrongdoing directors and the fact that derivative actions may be motivated by personal interests of the shareholder who is litigious in nature or intends to embarrass the directors as a result of personal grievances or wants to use the action to coerce the directors into some personal settlements.[29]
Common law has been more interested in restricting derivative actions in order to curb selfish motives than promoting free access to the courts so that corporate wrong doing can be minimised.[30]
This Part of this article shall be concluded with a brief discourse on the complexity of the requirement of 'fraud on the minority' and 'control by wrongdoers.' We shall attempt to discuss the issue of the problem of the requirement of showing good conduct and establishing a prima facie case in the later part of this article.

Fraud on the Minority

It is needless to say that the concept of fraud on the minority has been successfully applied without hitch or criticisms in several cases.[31]
The cases have also maintained that fraud is not restricted to the common law sense but includes the wider equitable sense of unconscionable acts, breach of fiduciary duty, breach of trust, misappropriation of money, property or advantages, abuse or misuse of power etc.[32] However it has been said that the expression' fraud on the minority' is misconceived since the courts have established that the wrong is not a wrong done to the shareholders but a wrong done to the company.
The more difficult task however appears to be in trying to reconcile decided cases relating to wrongs that can be ratified or not ratified.
In the case *Cook v Deeks*,[33] where the directors diverted the company's contract to themselves, it was held that action was an illegality which could not be ratified. However in the case of *Regal(Hastings) Ltd v Gulliver*,[34] where the directors made use of corporate information which the company did not have the resources to engage in, the directors were held to have breached their fiduciary duty but the court opined that the directors would not have been held liable to account for their profit if the transaction had been ratified. In effect while the earlier case was regarded as an illegality, the latter case was treated as mere irregularity. It however remains uncertain when the courts would consider a matter as a mere irregularity and when it would not.[35]

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[28] Above n 2.

[29] Paul L.Davies, *Gower And Davies' Principles of Modern Company Law* (8th edn, Sweet & Maxwell,London, 2008) 609.

[30] *Ibid* at 610.

[31] *Wallesteiner v Moir* (No.2) above n 4, *Menier v Hooper's Telegraph Works Ltd* [1874] Ch App 350, *Atwool v Merryweather* [1867] L.R.5 Eq.464a. However in the case of *Heyting v Dupont* [1964]1 W.L.R 843,the court had wondered if there might not be cases where derivative actions could be allowed without fraud.

[32] Robert R.Pennington, *Company Law* (7th edn, Butterworths, London 1995) 876, John H Farrar, *Farrar's Company Law* (4th edn, Butterworths, London 1998) 436, *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 All ER 909 at 992.

[33] Above n 25 at 564.

[34] [1947] 1 All E.R 378 at 382.

[35]In *MacDougall v Gardiner* [1875] 1 Ch 13, the decision of a chairman to refuse a request for a poll in breach of the articles was held to be a mere irregularity. Compare with *Pender v Lushington* [1877] 6 Ch.D 70 where the refusal of the chairman to recognise the votes attached to shares was held to be illegal being against the personal right of the shareholders.

Control by the Wrongdoer

Control may be *de jure* or *de facto*, however in the case of *Pavlides v. Jensen*[36] the court held that control means a majority of the votes capable of being cast at a meeting i.e. *de jure* control. It is however possible that control may be arrived at *de-facto* due to poor attendance since the issue of control at a particular meeting would be determined by a majority of those voting and present at the meeting.

In the *Prudential* case[37] the court allowed a derivative action even though it was not pleaded and could not be alleged that the defendants had a voting control, on the premise of interest of justice.[38] Admittedly, the interest of justice principle is capable of creating uncertainity but in the present case the defendants controlled the corporate assets and were in possession of corporate information which was required to prove the several allegations, thus without doubt they had control.

It has been said that a derivative claim must show that the defendant directors are capable of preventing the company from suing in its own at a general meeting.[39] In reality the directors can prevent a suit by the company not only through majority shareholding but also through their influence. In addition if the Memorandum and Articles of Association of a company confers powers of management on the defendants having control would not be a difficult task.

Thus the Court of Appeal in the *prudential* case defined control in a very liberal terms as follows:-[40] ' a wide spectrum extending 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.'

However it was held in the case of *Smith v Croft (No. 2)*[41] that even where the persons in control of a company are able to prevent it from suing, derivative action may not be commenced or continued if the persons who can exercise a majority of the votes which can be cast at a general meeting of the company (other than those who are in control) are opposed to it. This Article therefore agrees with Prof Pennington that the precise meaning and application of the phrase 'wrongdoer's in control' remains unsettled.[42]

Statutory Derivative Action in Ghana

Ghana appears to be the first Commonwealth country to embrace the statutory derivative active action, having enacted a law in that respect in 1963 which is remarkable for its simplicity.[43]

Section 209 of the Ghanaian Companies Act[44] prescribes civil liabilities for breach of duties of a director. It is noted that civil liability to the company is not limited to directors but includes third parties.

Even though there is no mention of derivative suit or action in the Act, section 210 of the Ghanaian Companies Act makes provision for allowing a member to enforce the liabilities due to the company under section 209 of the Act from the directors or any other party.

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36 [1956] Ch. 565

37 Above n 5 at 359

38 Robert R.Pennington above n32 at 883-884

39 *Ibid* at 883. See also *Birch v Sullivan* (1958) All ER 56

40 *Prudential* above n 5 at 364

41 [1988] Ch. 114

42 Above n 5 at 364

43 Above n 7 See Also Paul von Nessen, above n 3.

44 Above n 7

Proceedings may be instituted by the company[45] and also by the Registrar after an investigation into the affairs of the company.[46]

Statutory Derivative Action in South Africa

South Africa has specifically abolished the common law derivative action by virtue of section 165 (1) of the Companies Act 2008. Statutory derivative action was introduced by the Companies Act 61 of 1973 on the recommendation of the Van Wyk de Vries Commission which found that the common law derivative action was so narrow that it had little significance in the context of shareholder protection.[47] It does appear however that the South Africa legislation is not as simple as the Ghanaian Act, the SA Act prescribes a detailed procedure to be followed in order to bring a derivative action, perhaps in an attempt to broaden its scope and make it relevant. Thankfully the common law requirement of having to prove fraud on the minority and wrongdoer are conspicuously absent.

A shareholder, beneficial owner of shares, director, prescribed officer of the company, registered trade union or representative of employees or any person granted leave by the court can serve a notice on the company demanding[48] that the company takes legal action to protect the legal interests of the company[49].

The company is expected to appoint an independent and impartial person or committee to investigate the demand and report on the facts that may give rise to the cause of action stated in the demand, the probable costs of pursuing the cause of action and whether the action would be in the best interest of the company. The company is expected to either initiate an action or take legal steps to protect the company's interests as contemplated in the demand within 60 business days or serve a notice of refusal to comply with the demand to the person who made the demand.[50]

However a company that has been served with a demand may apply within 15 business days to a court to set aside the demand only on the grounds that it is frivolous, vexatious or without merit.[51]

It is innovative that the SA Act not only stipulates expressly what the company is expected to do after receipt of the letter of demand but also stipulates the duration within which it is to be done. This at least serves to provide some clarity which did not exist at common law derivative action process.

A person who has made a demand may apply to a court for leave to bring or continue proceedings in the name and on behalf of the company, and the court may grant leave only if the company has done one of the following:- has failed to take any particular step required, appointed an investigator or committee who was not independent and impartial, accepted a report that was inadequate in its preparation, or was irrational or unreasonable in its conclusions or recommendations, acted in a manner that was

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[45] Companies Act 1963 (Ghana) s 210(2)

[46] Companies Act 1963 (Ghana) s 210 (4)

[47] Lindi Coetzee, 'A Comparative Analysis of the Derivative Litigation Proceedings under the Companies Act 61 of 1973 and the Companies Act 71 of 2008' (2010) *Acta Juridica* 290 2010 <http://heinonline.org>

[48] Companies Act 2008 (SA) s 165(4). An applicant may apply for leave of the court to institute a derivative action without observing the rule on demand if that action be taken by the company in exceptional circumstances.

[49] Companies Act 2008 (SA) s 165 (2)

[50] Companies Act 2008 (SA)s 165 (4)

[51] *Ibid* at s 165 (4) (b)

inconsistent with the reasonable report of an independent, impartial investigator or committee or served a notice refusing to comply with the demand, as contemplated.[52]

The court must also be satisfied that the applicant is acting in good faith, that the proposed or continuing proceedings involve the trial of a serious question of material consequence to the company, and that it is in the best interests of the company that the applicant be granted leave to commence the proposed proceedings or continue the proceedings as the case may be.[53]

A rebuttable presumption that granting leave is not in the best interests of the company arises if it is established that all of the directors who participated in the decision not to take any action acted in good faith for a proper purpose, did not have a personal financial interest in the decision and reasonably believed that the decision was in the best interests of the company.[54]

It is not stated whether the company would be a party to the application for leave however it seems that for the company to be able to establish its good faith and fair dealing it must necessarily be a party to the proceedings.

The applicant on his own part is required to show that he is acting in good faith, that there is a serious question to be tried and that the proposed action in the best interests of the company. This scenario appears to be analogous to that of interlocutory injunctions in civil procedure and is reminiscence of what is obtained under the common law scenario where much time and resources were expended in trying to prove fraud on the minority, wrongdoers control and good conduct of the applicant[55]

Elsewhere it has been suggested that the attitude of the courts i.e. liberal or conservative would determine if the derivative action process is a departure from the old common law or not.[56] Nevertheless it is posited that if the legislative attitude is liberal like the case of Ghanaian Act, it would be very difficult for the courts to adopt a rigid approach and that there is a need to adopt a liberal legislative stance in order to do away with the common law approach.

However, in a true departure from the common law rule that the courts would not interfere once a conduct has been ratified or approved by the majority of the shareholders, the SA Act stipulates that ratification does not prevent a person from making a demand, applying for leave, or bringing or intervening in proceedings with leave and does not prejudice the outcome of any application for leave, or proceedings brought or intervened in, with leave. The court may however take that ratification or approval into account in making any judgement or order.[57]

The SA Act also prescribes that the right of a person to serve a demand on a company, or apply to a court for leave, may be exercised by that person or another person on behalf of that first person.[58] This denotes that the applicant does not have to be personally involved and implies that the SA Act has gone ahead of common law to make derivative actions simpler in this regard.

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[52] Companies Act 2008(SA) s 165(5)(a)

[53] Companies Act 2008 (SA) s 165 (5) (b)

[54] Companies Act 2008 (SA) s 165(7)

[55] See *Prudential* case, Above n 5 at 364-366.

[56] Andrew Keay above, n 15

[57] Companies Act 2008 (SA) s 165(14)

[58] The rule at common law is that a letter of demand must be signed under the hand of the person making the demand. See also the Nigerian case of *Nigerian Commercial and Industrial Enterprises Limited v. Omolayo, Bamidele and Anor* [1976] Nigerian Commercial Law Review 339, where it was held that a statutory letter of demand by a creditor company must be signed by a director, secretary or other officer of the company to be valid for the purpose of a winding up petition.

Statutory Derivative Claims in the United Kingdom[59]

Derivative claims arises when a member(s) of a company is seeking relief or remedy on behalf a company in respect of a cause of action vested in the company.[60]

In abolishing the Common law derivative action[61], a derivative claim can only be brought under Part 11 of the Companies Act 2006 or in pursuance of an order of the court in proceedings for protection of members against unfair prejudice under section 994 of the Companies Act.[62]

A derivative action can be brought under the UK Act in respect of a cause of action arising from an actual or proposed act or omission involving breach of trust or negligence by a director or another person or both.[63] The inclusion of negligence as a cause of action is a significant departure from common law.[64] Under the old common law, negligence on its own could not be a cause of action for a derivative claim except it is shown that the directors or those in control have benefitted from the negligence or proposed negligence.[65]

In order to protect those who are beneficial owners of shares but whose names have not been entered in the Register of Members, membership is deemed to include those categories of people to whom shares have been transferred or transmitted by operation of law but whose names are yet to be entered in the register of members.[66]

A member is allowed to bring or continue a cause of action that arose before he became a member but not after he has ceased to be a member since the concept of membership involves shareholding which is a bundle of rights in a company during the pendency of the shareholding.[67]

Thus a member has the right to protect the interest of the company and obtain relief while he is a member whether or not the cause of action arose before or during the pendency of his shareholding but cannot do so after he has ceased to be a member even where the cause of action arose while he was a member. Meanwhile director includes a former director or shadow director.[68]

An applicant is required to obtain permission of the court before being allowed to institute a derivative action. The application which is *ex parte* would only be allowed if the applicant has produced enough evidence that disclose a prima facie case.[69]

Where an applicant is able to disclose a prima facie case, the company may be required to give evidence and shall be entitled to take part in the proceedings. The Applicant would only be entitled to proceed if the court grants the application.[70]

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[59] With effect from October 1, 2007. See, Companies Act 2006 (UK). This is supplemented by CPR 19.9 to 19.9F as amended by the Civil Procedure Rules 2007 and the Practice Direction.

[60] Companies Act 2006 (UK) s 260(1)

[61] There is however no substantive rule replacing the common law rule in *Foss v. Harbottle*. See Carsten A. Paul 'Derivative Actions Under English and German Corporate Law' (2010) 1 ECFR 87

[62] Companies Act 2006 (UK) s 260 (2)

[63] Companies Act 2006 (UK) s 260 (3)

[64] See *Heyting v Dupont*. Above n 31

[65] *Pavlides v Jensen* [1956] Ch 565 where it was held that a derivative action could not be brought based on a negligent act which could be ratified by the general meeting. However in *Daniels v Daniels* [1978] 1 Ch.406, it was held that where the directors benefitted from their negligent act, a derivative action could be brought.

[66] Companies Act 2006 (UK) s 260 (5) (c)

[67] Companies Act 2006 (UK) s 541. See also Alan Dignam & John Lowry, *Company Law* (Oxford University Press, Oxford 2009) 160-161

[68] Companies Act 2006 (UK) s 260 (5) (a) & (b)

[69] Companies Act 2006 (UK) s 261

[70] *Ibid*

The UK Act provides some mandatory provisions and discretionary guidelines which the court must consider before granting leave or permission. The court is required to refuse leave as follows:-[71]

i. Where a person who is under a duty to promote the success of the company would not seek to institute the proceedings.[72]

ii. Where the cause of action which arises out of an act or omission that is yet to occur or that has occurred, has either been authorised or ratified by the company.

The discretionary guidelines which the court must consider are as follows:-[73]

i. whether the member is acting in good faith,

ii. the importance that a person who has a duty to protect the success of the company would attach to raising or continuing them,

iii. the likelihood of authorisation of the act or omission,

iv. the ratifiability of the act or omission,

v. whether the company has decided not to pursue the claim, and

vi. whether the matter was one which the applicant could pursue in his own right rather than on behalf of the company.

Moreover the court is required to have particular regard to the view of the independent members of the company who have no personal interests in the matter.[74]

It is noted that the common law requirement of requiring the applicant to prove fraud on the minority and wrongdoers control is absent from the UK legislation. However the requirement of having to show that there is a prima facie case[75] leads to the same problem that existed under common law whereby the proceedings could lead to the risk of having a trial within a trial. More so as the company may also be required to produce evidence in order to determine whether to grant permission to proceed on a derivative claim.

As obtained in common law the conduct of the applicant is also taken into consideration, because the court is required to give particular attention to whether the member seeking to pursue the claim is acting in good faith.[76] There has been considerable concern that the combined effect of the requirement of Section 172 of the UK Act on the duty of directors to promote the success of the company and the new stipulation that a cause of action may arise from negligence might encourage a lot of derivative

[71] Companies Act 2006 (UK) s 263
[72] Companies Act 2006 (UK) s 172
[73] Companies Act 2006 (UK) s 263(3)
[74] Companies Act 2006 (UK) s 263 (4)
[75] *Prudential* Case, above n 5
[76] This shall be discussed in more details in the later part of this article.

actions by shareholders.[77] While not denying the possibility of more derivative action, it is opined the fear of a deluge of actions is mitigated by the fact that it is the applicants who would be required to prove that a director who is promoting the success of the company would not bring the action, and that burden cannot be easily discharged thus discouraging, frivolous actions.

While at common law the mere fact that a cause of action can be ratified[78] by the majority of members at the general meeting is a bar to bringing a derivative action, under the UK Act a claim must be refused only when it has been authorised or ratified by the company.[79] The likely hood of ratifying a cause of action by members of the company must however be taken into consideration in deciding whether to grant permission or not.[80] Perhaps in tacit approval of the common law decision of *Smith v. Croft* (No 2)[81] which demanded the view of majority of the minority, the UK Act[82] stipulates that the view of independent members of the company who have no interests whether direct or otherwise must be taken into consideration. The usual scenario in derivative suits is that the majority shareholders have vested interests in the transactions which the applicants find offensive, therefore the independent members are invariably minority members. Be that as it may the requirement of the view of independent members is invaluable in preventing the wrongdoing directors from ratifying their breach of duties.

Statutory Derivative Action in Nigeria

Prior to the promulgation of the Companies and Allied Matters Act (CAMA) in 1990,[83] the law governing the protection of minorities was the common law and Nigerian case law.[84] However on the recommendation of the body set up to amend the 1968 Act[85] it was decided that the law should be codified to simplify the proceedings with respect to the enforcement of rights deriving from the company and to restrict the effect of the Rule in *Foss v. Harbottle*[86]. Thus the rule in *Foss v. Harbottle*[87] should continue to exist but should be codified. The codification included the exceptions to the rule.[88] The exceptions should however be extended to cover the principle evolved in *Daniels v. Daniels*,[89] i.e. that a member may sue the directors where the directors profited from their negligent acts even when fraud is not involved.

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77 Andrew Keay, above n 15 at 469

78 *Regal (Hastings) v Gulliver*, above n 34, *Pavlides v Jensen*, above n 65

79 Companies Act 2006 (UK) s 263(2)

80 Companies Act 2006 (UK) s 263(3)

81 Above, n 26 at 186-187

82 Companies Act 2006 (UK) s 263(4)

83 The Act has been revised in the Cap C20 Laws of The Federation of Nigeria 2004.

84 See *Omisade v Akande* (1987) All Nigeria Law Report 285, where it was held that the Plaintiff Respondent, a director who had equal shares with the 1st Defendant/ Applicant who was also a director of the company was entitled to sue for a wrong done to the company. The court observed that the company could not because of a deadlock under the common law. It is however opined that in this case there could not have been any 'fraud on the minority' as required by common law to obtain relief since both the Plaintiff and the defendants owned equal shares and were both directors.

85 This has been repealed by the Companies Act 1990.

86 Above n 2. See also the Nigerian Law Reform Commission 'Working Papers on the Reform of Nigerian Company Law- Vol 1 - Review and Recommendations p.239

87 *Ibid*

88 *Ibid*

89 [1978] Ch 406

An applicant in a derivative action is not limited to a member or beneficial owner but includes a former registered holder or beneficial owner, a director or an officer and a former director/officer, the Corporate Affairs Commission and any other person appointed by the court.[90]

In accordance with what is obtained at common law, an applicant is expected to apply for leave to institute a derivative action and would be granted leave to sue if he is able to satisfy the court as follows:- [91] That the wrongdoers are the directors who are in control and would not take action, which the applicant has given reasonable notice to the directors and they have failed to take action, that he is acting in good faith and that the action is taken in the best interests of the company. However in a twist contrary to the common law position, an application made or an action brought shall not be dismissed or stayed by the reason only that the breach has been ratified or may be ratified by the shareholders[92] but evidence of ratification by the shareholders may be taken into account by the court in making an order under section 304 of CAMA.[93]

Suggested Reforms

This paper is of the opinion that there is a need to simplify and modernise the law on derivative actions to enhance the protection of minority shareholders and thus improve corporate governance.[94] The common law rules of court. Derivative actions are a veritable tool in providing access to justice for both shareholder and non-shareholder interest in a company but there is a dearth of them perhaps due to their unpopularity arising from bottlenecks created by common law.

The current trend in statutory derivative action is not the codification of common law principle but a departure from it even though in varying degrees as seen above.

Apart from the absence of the phrase 'fraud on the minority,' section 303 of CAMA appears to be a complete codification of common law. It is suggested that Nigeria should take a bold step like United Kingdom[95] and South Africa[96] by expressly abolishing the common law derivative actions and also repealing the common law content in its statutory derivative action as much as possible. The cause of action should be made to include an actual or proposed act or omission involving negligence even where the directors have not benefitted from it[97].

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[90] Companies and Allied Matters Act 2004 s 309

[91] Companies and Allied Matters Act 2004 s 303

[92] Companies and Allied Matters Act 2004 s 304

[93] *Ibid*

[94] See Law Commission Consultation Paper 142, *Shareholders Remedies* (1997), para 14.1. See also consultation Paper, p 388, M. Scarlett 'Imitation or Improvement? The Evolution of Shareholder Derivative Litigation in the United States, United Kingdom, Canada and Australia' (2011) 28 *Ariz.J.Int'l & Comp.Law* 569. Under English common law, minority shareholders had virtually no effective mechanism to protect themselves or the company, or to discipline corporate management. The jurisprudence on shareholder derivative action was regarded as obscure, complex and inaccessible to lawyers specializing in this field. The circumstances in which this derivative action can be done under common law are so obscure and difficult to establish that this form of action is virtually non-existent in England. These criticisms helped spur the 2006 reform of the Companies Act"

[95] Companies Act 2006 (UK) s 260 (2).

[96] Companies Act 2008 (SA) s 165(1)

[97] See Companies Act 2006 (UK) s 260(3). See also Companies Act 2008 (SA) s 165(2) which provides that the cause of action in derivative actions is to protect the legal interest of the company. This has been argued to be wide enough to cover the interests of members and minority shareholders See Lindi Coetzee, n 42 at 298-299. This paper finds and argues that protection of legal interests of the company would include protection of the company from negligent actions of the board and third parties.

The Companies and Allied Matters Act appears to assume that the wrongdoers are limited to the directors,[98] it is suggested that there should be an express provision that the cause of action may be against a director or another person or both.[99]
The requirement of obtaining leave as a preliminary matter should be discarded even though it is supported by many commonwealth jurisdictions.[100] It is posited in this article that the issue of standing to sue can be better dealt with during trial.
What an applicant is required to do at the preliminary stage is to show standing to sue; apart from the fact that this could increase litigation costs, it is capable of creating a trial within trial.[101] In the case of *Agip (Nig) Ltd v. Agip Petroli Int'l*[102] it was held that a minority shareholder who intends to bring a derivative action must apply for leave to sue by originating summons which must be made *inter-partes*. The hearing of the application must be in the manner of an ordinary interim application with both sides being afforded the opportunity to submit evidence and submission.[103]
In the UK what an applicant is expected to do at the preliminary stage is to show a prima facie case[104] while in Australia the serious question to be tried[105] criteria is demanded, but the meaning of the concepts remain elusive as neither the legislature nor the courts have been able to pin pointedly give any exact meaning. The Court of Appeal in the *Prudential Assurance* case[106] in an attempt to explain what a prima facie case entails stated that at the preliminary stage the court could not proceed on the basis that everything asserted was true nor should the plaintiff be required to prove fraud and wrongdoer control. This explanation also fails to resolve the issue.[107] Another comment on the *Prudential Assurance*[108] is that it was only in 1981 when the case was decided that it was established that the issue of the shareholders standing to sue had to be settled as a preliminary matter[109]. This means that it is possible to have derivative actions without a preliminary stage proceedings.
As has been said earlier in this paper[110] the requirement that an applicant in a derivative has to prove that the wrongdoers are the directors who are in control belong to the old common law order which has now been abolished by virtually all the Commonwealth countries. In the spirit of the new statutory derivative action it is suggested therefore that section 303(2) (a) of CAMA be repealed.

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[98] Companies and Allied Matters Act s 303 (2) (a)
[99] See Companies Act 2006 (UK) s 260 (3).
[100] See; Corporation Act 2001(Australia) s.237 (2).Companies Act 1993(NZ) s.165, Companies Act 2008(SA) s 165(2). It is observed that no such provision exist under the Companies Act 1963(Ghana)
[101] See, English Law Commission Consultation Paper above n 94
[102] [2010] 5 NWLR(Pt. 1187) 348 at393
[103] *Ibid* at 394
[104] Companies Act 2006(UK) s 261(2)
[105] Andrew Keay , above n 15 at 480
[106] Above n 5. At 218
[107] See Andrew Keay, above n 15 at 482, where it was suggested that the above explanation means that in order to establish a prima facie case there is no need for an applicant to show that he has more than a 50% chance of success and that the test of prima facie case in common law is likely to be less strict than that which applies in interim injunctions applications.
[108] Above n 5
[109] *Ibid* at 221
[110] Above Part 1

Section 303 (2) (b) of CAMA requires the applicant to give reasonable notice to the directors. This paper posits that this requirement is fundamental to a derivative action since the applicant's cause of action is tied to the director's refusal to take action. It is however recommended that a specific period like 60 days be prescribed as reasonable notice as obtains in South Africa.[111] However demand may be excused if the applicant can prove that the requirement of demand is futile.[112] In South Africa demand may be excused in exceptional circumstances:-if the applicant brings an application for leave to sue without making a demand can show that following the procedure for making a demand may cause irreparable harm or substantial prejudice to his application and reasonable probability that the company may not act[113]. Furthermore the court can only grant the applicant if he is able to show that he is acting in good faith, there is a serious question to be tried and that the application is in the best interests of the company[114]. It is argued that while the South Africa detailed provision on demand may be well intended, the several requirements therein may be employed by unscrupulous directors to defeat its real intention. This paper is in favour of simplification and therefore posits that if the plaintiff in a substantive suit can show that there is a reasonable probability that the company would not act to protect its right that would suffice as an exceptional circumstance to obtain a waiver.

An applicant is required to show good faith under Section 303(2) of CAMA as a pre- condition for instituting a derivative action. However the precise meaning of good faith remains unsettled even though it has been suggested that the 'clean hands' principle of equity would aid its interpretation.[115] The commonest example of lack of good faith is where the applicant participated in the breach he is complaining about or where applicant is bringing the action for a collateral purpose[116]. In Ghana[117] unlike in South Africa and the UK the conduct of the applicant is not dealt with as a preliminary condition to obtain right to sue neither is the applicant required to prove his good faith. However a defendant may apply that proceedings be stayed because the plaintiff participated in the act complained of or that it is inequitable in the circumstances to allow the plaintiff to conduct the action[118]. The court may either stay proceedings or order the plaintiff to pay security for payment of the costs of the defendant or direct the action or any part of it be heard in chambers[119]. This paper supports the position in Ghana and strongly recommends that same be adopted in Nigeria.

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[111] Companies Act 2008 (SA) s 165 (3) (b)

[112] In the United States if an applicant can show that majority of the directors were financially interested in the challenged decision or were not independent or had some other compelling interests, he may escape the requirement of demand. See, Aun, M. Scarlett above n 94, See also James, H, Shanell 'A procedural Treatment of Derivative Suit Dismissal by Minority Directors' (1981) 69 California Law Review 886.

[113] Companies Act 2008 (SA) s 165(6)

[114] *Ibid* at 165(5)

[115] Andrew Keay n 56 at 485-491.

[116] *Ibid*

[117] The requirement of good faith was dropped in Hong Kong at the Bills Committee stage in order to meet the need to set a purposefully low requirement to prevent the application for leave from becoming a trial within a trial." See Paul Von Nessen above n 43 at 647. See Aun M. Scarlett above n 94, where it was observed that even though the term "good faith "appears in early cases of shareholder derivative action, it has never served as basis for a reported court decision finding breached a fiduciary duty.

[118] Companies Act 1963 (Ghana) s 210(6)

[119] *Ibid*. It is not clear the precise rationale for hearing in chambers. Perhaps this might protect the company from the bad faith of the plaintiff.

Another requirement in commencing derivative action is that the applicant must satisfy the court that it appears to be[120] in the best interests of the company that the action be brought[121]. It has been suggested elsewhere that the phrase 'it appears to be' an invitation to the court to enter into some form of 'crystal ball gazing' and it has been suggested that the requirement should be that it is in the best interest of the company and that the action be instituted[122]. In South Africa an applicant is required to show that the action is in the best interests of the company. The UK act does not make mention of the requirement of best interest of the company but stipulates that leave should be refused if a person under a duty to promote the success of the company would not institute the claim, which appears to be analogous with the best interest requirement. It has been suggested that the requirement involves the following- adducing evidence as to the character of the company i.e. is it a small, large or family company, the type of business the company and the ability of the respondent to satisfy at least a substantial part of any order made in favour of the company.[123] This has been said to be an objective test involving a cost/ benefit analysis of the application.[124]

In South Africa a rebuttable presumption that granting leave is not in the best interests of the company if it is established that the proposed action is against a third party i.e. a person not related to the company, the company has decided not to bring proceedings, all the directors acted in good faith for a proper purpose; did not have any personal financial interest and acted according to what they believed was in the best interests of the company.[125] This paper should not be concluded without a discussion on who should be the proper Applicant or Plaintiff in a derivative action.[126] In all the jurisdictions registered holders of securities or members are entitled to bring derivative actions. While Ghana does not consider beneficial owners, the other countries – UK, South Africa and Nigeria make such provisions. However in the UK, a member can sue to enforce breaches of company's right that occurred even before he became a member[127] but not after he became a member[128]. It is only in Nigeria that a former member or former beneficial owner are allowed to sue. It appears that those who oppose the right to sue for a breach that occurred before becoming a member do so because of the likely abuses that it portends such as using the derivative suit to forum shop and using the derivative suit

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[120] *Italics mine*

[121] Companies and Allied Matters Act s 303(2) (d)

[122] Andrew Keay, above n 15 at 493-494 which restated the view of Australian courts that the claim must be in the best interests of the company.

[123] *Ibid*

[124] *Ibid*. See also *Prudential Assurance* case, above n 5

[125] Companies Act 2008 (SA) s 165 (7) & (8)

[126] Plaintiff would be more appropriate if the suggestion to discard the leave procedure is accepted.

[127] See explanation above n 67. Note that the UK position conflicts with the USA federal law and courts require the plaintiff to have been a shareholder at the time of the challenged transaction. Several states' statutes also require shareholders owning less than a prescribed amount of stock, measured either by shares or dollars, to post a bond in an amount sufficient to cover the defendants' reasonable attorneys' fees and expenses. See also-Terrence L. Robinson Jr.,(1991) "The Wrongful Doctrine- USA Federal Rule of Civil Procedure 23.1 provides that any shareholder who brings a derivative suit must have owned shares in the corporation at the time of the transaction but an exception to the general rule known as Continuing Wrong Doctrine- a shareholder may bring a derivative suit if the injurious effect of the alleged wrongful transaction continued while the shareholder owned shares in the corporation, even if the actions upon which the shareholder claim is based arose before his acquisition of the shares."

[128] See Paul Von.Nessen, above n 3 at 638-639 to the effect that in New Zealand and Singapore only current shareholders are allowed to institute derivative actions.

to litigate purchased grievances.[129] It is however the position of this paper that degree of shareholder sophistication does not exist in Nigeria, it is therefore suggested that members be allowed to sue for a breach of company's right that occurred even before they became members.
It is not clear what the legislature intends to achieve by allowing former members to bring derivative suits and it appears that most commonwealth countries do not accord former members standing to sue,[130] it is therefore suggested that the part of section allowing former members to sue should be expunged.

A director or officer[131] is allowed to bring an action in Nigeria and South Africa but they are not allowed to do so in UK and Ghana. It therefore appears that the provision under Nigerian law allowing it is argued that in reality it is only a truly independent director or officer than can institute a derivative action against fellow erring former directors and officers to also institute derivative actions appear more reassuring[132]. A unique feature of derivative actions in South Africa is that a Trade Union or representative of employees of the company is allowed to institute a derivative action.[133] At common law the courts have always applied the principles in the rule in *Foss v Harbottle* and its exceptions to trade unions and unincorporated societies.[134] Thus the inclusion of trade unions in the list of those who can bring a derivative action appears to be an attempt to codify the common law position. On the other hand it is argued that this provision could be interpreted to mean that members of the trade union or representatives of employees of a company are allowed to bring derivative actions. This is in tandem with the current thinking that directors should have regard to the interest of employees.[135] It is desirable that this should be accommodated in the Nigerian Legal framework as it is capable of bettering corporate governance. For instance in the famous Enron case, it was an employee who blew the whistle leading to the discovery of the massive fraud and grave breach of corporate governance regulations[136].

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[129] See, Terrence L. Robinson Jr., above n 127 at 23.1. In re *Bank of New York Derivative Litigation Rook v N.Y.*, 320 F.3d at 298-99. The court refused to apply the continuing wrong doctrine and held that a plaintiff must own stock in the corporation before the core of the alleged wrongful conduct transpired.
[130] See however Corporation Act 2001 (Australia) s 236 (1) which permits proceedings to be brought by past members. In Ghana the Companies Act 1993 (Ghana) s 210 (8) provides that the court shall have the order any sum to be paid to former members rather than current members. Perhaps former members should have the right to sue in circumstances contemplated by this section.
[131] In South Africa this include directors and officers of a related company. See, Companies Act 2008 (SA) s 165(2) (b).
[132] See However James H. Shanell "A Procedural Treatment of Derivative Suit Dismissal by Minority Directors" (1981) California Law Review, 885 at 886, where it was opined that the independence of outside directors is generally minimal or illusory because of directors- control of proxy machinery by the insiders, the ties of the outside to the insiders, problems inherent in the selection of outside directors and the limitation of outside directors time and access to information.
[133] See, Companies Act 2008 (SA) s 165 (2) (c)
[134] *Edwards v Halliwell*, above n 20, *Abubakri v Smith*[1973] Nigeria Supreme Court Cases 451
[135] See Companies Act 2006 (UK) s 172 (1) (c), Companies and Allied Matters Act 2004, s 279(4), Companies Act 1993, (Ghana) ,s 203(3).
[136] No Author,' Enron whistleblower tells of crooked company, NBC News (March 15,2006) http://www.nbcnews.com/id/11839869/ns/business-c

The Corporate Affairs Commission is allowed to institute derivative actions in Nigeria and Ghana.[137] Since 1990 when CAMA was enacted there has not been any reported case in which the Commission has brought any such action as it has functioned more or less as a depository of corporate documents[138]. In both South Africa[139] and Nigeria[140] any other person who in the discretion of the court is a proper person to make a derivative application is allowed to do so.

Under Section 310(1) (c) CAMA a creditor is allowed to bring an application for relief on the ground that the affairs of the company is being conducted in an illegal or oppressive manner which may prompt the court to exercise its powers.[141] It is argued in this article that the scope of those entitled to bring derivative actions be extended to creditor so that a creditor who is aggrieved by the actions of the directors does not have to engage in a circuitous journey of having to first apply under section 311 CAMA for relief before being allowed to institute a derivative action.[142]

On the final note it is observed that in other jurisdictions, statutory derivative action is supported by the rules of court.[143] In Nigeria, Corporate proceedings are largely governed by the Companies Proceeding Rules[144] and the Federal High Court (Civil Procedure Rules) 2009.[145] The later does not make provisions for derivative actions[146] but the procedure for obtaining leave and commencing derivative actions can be found in the earlier.[147] There are however other arrears such as , who are the necessary parties, mode of intervening and discontinuant that are yet to be covered. It is opined that the rules of court in Nigeria should make details provisions for derivative actions to make for clarity and simplicity.

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[137]Companies Act 1993 (Ghana) s 210(4). This is however limited to companies that have been investigated. See also Companies Act 1994(Singapore) s 216A (1) s where the Minister of Finance in respect of companies under investigation is allowed to take derivative actions.

[138] See Companies and Allied Matters Act 2004 s 312 dealing with the power of the Commission to bring civil proceedings in the name or on behalf of the company.

[139] Companies Act 2008 (SA) s 165 (d).

[140]Companies and Allied Matters Act, 2004 s 309

[141] Companies and Allied Matters Act 2004 s 312 (2) (c)

[142] See Business Corporation Act, 1985 (Canada) s.231which stipulates that a creditor is a capable of bringing a derivative claim. See also Companies Act 1993, (Ghana) s 203(3), whereby the directors are to have regard to the interests of creditors. It is argued that the creditors should he allowed to sue to protect their interests under the exceptions to the rule in *Foss v Harbottle*.

[143] See, Rule 23 Federal Rule of Civil Procedure of the United States, Rule 19 Civil Procedure Rules of the United Kingdom made pursuant to Civil Procedure (Amendment) Rules 2007.

[144] Subsidiary legislation made pursuant to The Companies & Allied Matters Act, Cap C20 Laws of the Federation of Nigeria 2004

[145] Subsidiary legislation made pursuant to the Federal High Court Act Cap F 2004.

[146] See *Agip v Agip*, above n 102 at 393

[147] See, Rule 2 Companies Proceedings Rules.

Conclusion

This article has tried to show that there is need for Nigeria to join the rest of the world in embracing the new statutory derivative regime which aims at not only avoiding the pitfalls of the common law derivative actions but also improving on the existing statutory derivative framework[149]. It is observed however that in most jurisdictions pitfalls also exist in respect of statutory derivative actions, in an attempt to ensure that derivative actions are not being misused for collateral advantages which results in collusive litigation and undue interference with corporate management. Derivative actions remain unpopular in Nigeria as at now and it is submitted that this is due to its lack of attraction and dynamism in its framework. It is posited therefore that since Nigeria is a developing country beset with corruption and gross corporate mal administration, the balance of convenience tilts greatly towards promoting and encouraging derivative actions in other to stimulate good corporate governance rather than protecting it by establishing legalistic hurdles for fear of its misuse.[150]

This paper therefore recommends a simple derivative action regime comparable to the Ghana model which at the same time borrows ideas that would afford sufficient clarity, certainty and modernity from jurisdictions such as United Kingdom, South Africa and other commonwealth countries, while at the same time retaining the good aspects of the existing regime.

It is believed that this bold step if taken would succeed in laying to rest the unruly ghost of *Foss v. Harbottle*.[151] This would lead to enhanced investor protection which would facilitate enterprise and make Nigeria more attractive as a location for doing business.[152]

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[148] See Ghana Companies Act (1993) s 210 (5) where it was stipulated that a member suing must do so in a representative capacity on behalf of himself and other members and must join the company as a defendant. In the case of *Agip v Agip*, above n 102, the minority shareholders sued in the name of the company and also joined the company as one of the defendant but unfortunately that issue was not addressed by any of the parties or the court. See also FHC/L/M82/79- *A.I.C (Nigeria) Ltd v Cheesolite System Building (Nig) Ltd* unreported.

[149] See Lindi Coetzee, above n 42 at 290

[150] It appears that the Law Commission in the UK favoured the balance being in favour of management since its clear policy is that derivative actions should be 'exceptional' and be subject to 'tight judicial control. See, Arad Reisberg," Derivative claims under the Companies Act 2006," Much Ado about Nothing" (June 13 03:23:35) http://ssrn.com/abstract=1092629.

[151] Above n 2

[152] Arad Reisberg, above n 155