Corporate Democracy is a Fable: A Comparative Analysis of the Minority Protection Rule under the Nigerian and United Kingdom’s Company Law

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ABSTRACT

In the corporate governance system, a balanced protection of both the minority and majority shareholder’s interest is fundamental. Therefore the size and/or volume of a shareholder’s investment in the company is a matter of individual and collective decision. This work deals the comparative analysis of the protection of the rights of minority shareholders under the UK’S Company Act, 2006 and Nigerian Companies And Allied Matters Act, CAP C24 LFN 2004. Soon after incorporation, a company becomes a separate entity which can sue or be sued in its own corporate name. It therefore means that it is the company that has the legal right and competence to sue for or against the company. The work will tend to juxtapose the protections available to minorities shareholder under the UK’s company and Nigerian Company Laws in order to ascertain the quantum and adequacy of protection afforded to the minority in these jurisdictions. In some cases, the application of the majority rule has worked injustice and hardship against the minority. Since the decision of the court in Foss v Harbottle, company operations have revolutionized such that oppression of the minority by reliance on the majority rule at any slight opposition could no longer be supported. Hence the introduction of certain exceptions to the majority rule, which are commonly referred to as the exceptions to the rule in Foss v Harbottle. Suffice it to state that in contemporary company law, these exceptions are more relevant in their application than the general rule itself. This translates to say that company law today is more interested in protecting minority rights than covering the caprices of the majority. This work will evaluate the relevant provisions of the two country’s company law with a view of striking a balance between the two jurisdictions and identifying which jurisdiction that has more healthy approach towards protecting the interest(s) of the minority.

Keywords: Corporate, democracy, fable, comparative, analysis, minority, law.

INTRODUCTION

In democracy you indeed have to win by majority. A company, which is a group of entities and individuals act in accordance with the decision taken by the majority. In any jurisdiction, company law has provided a number of methods and principles guiding the control of the exercise of company (through democratic process) by the majority of the shareholders of their voting power at the meeting of the company in a prejudicial manner. In the corporate governance system, a balanced protection of both the minority and majority shareholder interest is fundamental. Therefore the size and/or volume of a shareholder’s investment in the company is a matter of individual and collective decision. Undoubtedly the controversial common law rule never allowed the shareholders to ratify wrongdoing by the directors. Base on the foregoing, it practically becomes impossible for the legislature or the courts to identify in advance substantive decisions which can prohibit such common law rules on the ground that they will always be unfair to the minority. But unfortunately, this has not been the case as it concerns the minority shareholders as was enunciated in the celebrated case of Foss v Harbottle (supra) (even in the face of judicial activism). In response to the
common law rule, there was a move from substance to procedure, and in fact the legislatures have made greater use of the rule which determines how the shareholders are to determine what they shall decide.

For the purpose of clarity, it is expedient to define who is a person, (natural or artificial) who owns more than 50% of a company's shares. Often, he is the founder of the company who in order to confer himself with the power to control the company, acquires by controlling shares which he allocated to himself. However a shareholder need not acquired more than 50% of the shares of the company to be a majority shareholder if he controls the company. By virtue of S. 119(3) of the Nigerian Investments and Security Act, 2007, the manner in which a person controls a company is provided and the test to determine a person who controls a company includes but not limited to:

- Person who beneficially owns more than one half of the issued share capital of the company.
- Is entitled to vote a majority of the vote that may be cast at a general meeting of the company, or has the ability to control the voting of a majority of those votes, either directly or through a controlled entity of that person.
- Is able to appoint or veto the appointment of a majority of the directors of the company.
- Is a holding company, and the company is a subsidiary of that company as contemplated by the Act;
- Has the ability to materially influence the policy of the company in a manner comparable to a person who, in ordinary commercial practice, can exercise an element of control referred to above.

In some cases, the application of the majority rule has worked injustice and hardship against the minority. Since the decision of the court in Foss v Harbottle (supra), company operations have revolutionized such that oppression of the minority by reliance on the majority rule at any slight opposition could no longer be supported. Hence the introduction of certain exceptions to the majority rule, which are commonly referred to as the exceptions to the rule in [1]. Suffice it to state that in contemporary company law, these exceptions are more relevant in their application than the general rule itself. This translates to say that company law today is more interested in protecting minority rights than covering the caprices of the majority.

However, in the recent past, statutory regimes of the both jurisdictions under evaluation have emerged with, perhaps an apparent promise and/or developments to better the protection of the minority interest. This work will then look at how welcomed these developments are and to comparatively analyse whether these exceptions have occasioned a sufficient protection to the minority in the two jurisdictions.

MINORITY PROTECTION UNDER THE UNITED KINGDOM'S COMPANY LAW

Fundamentally, the rule in Foss v. Harbottle (supra) was a judicial policy creation borne by the need to prevent the courts from hearing claims arising from the affairs of a company brought by a member or members of the company. The rule, sort to advance in this case, the distinctiveness of a company’s personality (corporate personality) and its members in the context of being capable of suing and being sued in its own name rather than members suing in their personal capacity on matters concerning or affecting it (the company). In this case, Mr Foss and Mr Turton, who were members of a statutory company called the Victoria Park Co, alleged that various people, including five directors of the company (one of whom was Mr Harbottle), had made secret profits as promoters of the company and that the directors had breached their fiduciary duties to the company by causing it to enter improper and fraudulent transactions. Foss and Turton commenced an action against the alleged wrongdoers, ‘on behalf of themselves and all other proprietors of shares except the defendants’ Hence, Wigan V-C had this to say:
"The Victoria Park Co is an incorporated body, and the conduct with which the defendants are charged in this suit an injury not to the plaintiffs exclusively; it is an injury to the whole corporation...It was not, nor could it successfully be, argued that it was a matter of course for any individual member of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law the corporation and the aggregate members of the corporation are not the same thing for purposes like this"

Owing to this development, the 'derivative claim principle’ emerged as against the ‘proper claimant principle’, being an avenue for accessibility to redress injustice by a member or few members of the company in the event that majority rule surfaces to kill the justice pursued over a dispute in companies limited by shares. For the purpose of clarity, majority rule envisages that in any corporate organization, the settlement of disputes is reached based on a decision agreed upon by the majority of the members of such organization. Essentially, it is an internal management policy where matters are conclusively settled by majority decision in a general meeting and it is not reviewable by the courts. [2] This then leads to establishing and explaining the ratifiability principle. Ratifiability principle is a common law principle which presupposes that the majority in a general meeting have the right to decide on whether or not to litigate in the company’s name. [3] This again was succinctly explained by Wigan V-C in Bagshaw v. Eastern Union Railway Co [4]

...If the act, though it be the act of the directors only, be one which a general meeting of the company could sanction, a bill by some of the shareholders, on behalf of themselves and others, to impeach that act cannot be sustained, because a general meeting of the company might immediately confirm and give validity to the act of which the bill complains.

Vitally, derivative claim cannot be discussed in isolation without touching on related subjects like the rule in Foss v. Harbottle (supra), the majority rule and the ratifiability principle. Derivative claim in this context is the right of action of a company granted to a member of the company by the court to pursue a proceeding in his (member’s) own name. This has been treated as an exception to the proper claimant principle. Accordingly, the proper claimant principle presupposes that the legal right of a company belongs to the company as a separate person and not to its members. Therefore, the company is the only person able to claim redress for injury to itself. [5] It then suffices to state that a member of a company bringing proceedings to enforce a right of the company is said to be deriving a right of action from the company.

Hence, a derivative claim is defined in s 260(1), of the UK'S Companies Act 2006 as a proceeding by a member of a company in respect of a cause of action vested in the company, and seeking relief on behalf of the company. A derivative claim occurs where there is a dispute between a member of a company and its directors over the merits of bringing a claim and normally, the power to decide on litigation vests in the very persons who ought to be sued. To this end, the court is usually implored to ignore the company’s decision not to sue because the company's decision not to sue is in fact, taken by the same people who should be sued. The court in Burland v. Earl [6] buttressed further:

But an exception is made to the [proper claimant principle], where the persons against whom the relief is sought themselves hold and control the majority of the shares in the company, and will not permit an action to be brought in the name of the company. In that case the
courts allow the shareholders complaining to bring an action in their own names. This, however, is mere matter or procedure in order to give a remedy for a wrong which would otherwise escape redress. [7]

The foregoing therefore lays the proper foundation for the consideration of the effectiveness of the statutory derivative claim as captured in the UK's Companies Act 2006. But before that, the common law picture of derivative claim has to be painted.

At common law, derivative claims were allowed only under the “fraud on the minority” exception to the rule in Foss v Harbottle (Supra). The court recognized that the majority rule principle may lead to abuses by the controlling majority who may perpetrate wrongful acts against the company and ratify them. To curb such excesses, the court developed exceptions to the rule in the Foss case to allow a minority shareholder to bring an action in respect of a wrong done against the company, the most notable one being the “fraud on the minority” exception. This is where a fraud is committed by those who control the company and they use their controlling power to prevent the company from suing in respect of the fraud. In [8], Lord Davey observed that the fraud on the minority would occur when, “the officers of the company are endeavoring directly or indirectly to appropriate to themselves money, properties or advantages which belong to the company or in which other shareholders are entitled to participate”.

A fraud on the minority was found and addressed in the case of Wallersteiner v Moir (No.2). [9] In that case, Lord Denning stated thus;

>“It is a fundamental principle of our law that a company is a legal person with its own corporate identity, separate and distinct from the directors and shareholders ... If it is defrauded by a wrongdoer, the company itself is the one person to sue for the damage. Such is the rule in Foss v Harbottle..."

Where the wrongdoers are directors who hold a majority of the shares... who can sue for damages? Those directors will vote down any suggestions that the company should sue them themselves ... In one way or another some means must be found for the company to sue”.

The derivative action now became the means devised by the courts to allow the company to sue. As a matter of fact, the action derives from the company. However, where the wrongdoers were in control of the company and used their controlling powers as a preventive weapon stopping the company from suing in respect of the wrong, the courts would then allow a shareholder to bring a derivative action on behalf of the company. The scope of the exception was limited to fraud. In [10], directors of a company had sold the company's asset in Cyprus at an undervalued rate. The court held that a minority shareholder could not succeed under the fraud exception as the directors had been merely negligent and the exception does not apply to negligence. However, in [11] the exception was extended to self-serving negligence and where the directors benefit themselves in breach of their fiduciary duty.

Impliedly, at common law, negligence could not sufficiently on its own ground a claim under the fraud exception. Although the derivative action provided some sort of relief to an oppressed shareholder under the fraud on the minority exception but it was not without its own weaknesses. These weaknesses translated into limitations to the reality of the much expected protection that was hoped it would pose to minority shareholders. As could be deduced from the above, the scope was limited to fraud and self-serving negligence. Hence, the claimant needed to prove; [12]

Fraud on the minority or in the case of negligence, he had to prove that the wrongdoer benefited from the negligence. Secondly, he had to prove that the fraud was committed by those who were in control of the company.
The company had to be joined in the claim so that it could derive any benefit from it. The claimant had to fund his own action and ran the risk of paying the defendant's cost if he lost the case. Furthermore, it was expected and anticipated that by the rule of equity, the claimant must come before the court with a clean hand should be applicable.

[13] As a result of the limitations inherent in the common law, shareholders were by implication discouraged from bringing derivative claims and where claims were initiated they were hardly successful. In any case, common law derivative claim procedure remained the only platform for seeking redress by a wronged shareholder(s) at that time. In 1996, The Law Commission undertook an intensive examination of the problems inherent in the common law derivative claim and consequently described the law as 'rigid, old fashioned and unclear'. The Commission further noted the inaccessibility of the appropriate rules to lawyers because 'to obtain a proper understanding it is necessary to examine numerous cases decided over a period of 150 years' [14]. The Commission was of the view that the common law no longer reflected the needs and realities of the modern corporate world. It also noted that "the procedure is lengthy and costly, involving a preliminary stage which in one case (Smith v Craft (No. 2) [15] took 18 days of court time to resolve". Based on the outcome of the Commission's examination of the common law derivative claims, it recommended that derivative action be given a statutory footing replacing the common law rules. Hence, the new statutory regime emerged to remedy the common law requirement of wrongdoer control and fraud on the minority. It is therefore believed that the statutory derivative action is formulated to make the law more flexible, efficient and cost-effective. But it is however fraught with some worries that it will open up a floodgate of litigations that would create a leeway to vexatious claims which could spiral into discouraging individuals from accepting appointments as directors. [16]

In response to that belief, the Law Commission cautioned that, 'members should be able to maintain proceedings about wrongs done to the company only in exceptional circumstances and that without good cause shareholders should not be encouraged to involve the company in litigation.' [17] As a result, the Companies Act 2006, Chapter 11 introduced a strict leave procedure and gave the courts new case management powers with the objective of protecting companies from disruptive litigations which may pose difficulties, challenges or hurdles to the interests and success of the company as provided for in S. 172 of the CA 2006. In the same vein, the law is equally concerned to uphold the majority rule principle in Foss v Harbottle (supra), while on the other hand, recognizing the need to protect the minority shareholders from abuse by the majority. The law aims to strike a balance between these two competing interests. At this juncture, it suffices to consider the prevailing statutory position, which is Companies Act 2006; chapter 11, in the light of cases that have come before the courts after the statutory reform to minority protection was sanctioned. In a nutshell, S.260 improves the position of minority shareholders by expanding the grounds for action as well as the category of potential defendants S.260 (3) & (4) Of CA and also by providing a wider category of potential claimants .These sections mark a vital departure from the common law by introducing a two-stage procedure for an application for permission to continue a derivative action. The first stage is governed by S 261(1) and tagged the 'prima facie stage' which is essentially a preliminary stage where the claimant is expected to apply to the court for permission to continue with his claim. Now under S 261(2) of the CA 2006, the court can summarily dismiss the claim if it appears to it that the application and evidence filed in support of it does not show a prima facie case that could compel the granting of such permission. The following plethora of cases (post-CA 2006 cases) goes to show how this part of the law has worked since it came into force.
In [18] a minority shareholder issued three set of proceedings including a petition under s.994 and a claim seeking permission to continue as a derivative action. The trial judge, Mr William Trower QC, held that it would normally have had to consider whether the application and the evidence filed in support of it disclosed a prima facie case. If it had not, the court would have been required to dismiss the application.

A stricter interpretation was applied in the [19] where Pelling J. stated that in considering the question of whether a prima facie case is established, ‘The court is bound to have regard, not merely to the factors identified in S.263(3) and (4), but to other relevant consideration since S.263(3) and (4) are not exhaustive.’

A similar strict approach to the prima facie question was followed in [20] Lewison J. raised the threshold for applicants and pointed out that at the first stage, the applicant was required to make a prima facie case for permission to continue the claim at which the court considered the question on the basis of the evidence filed by the applicant only, without requiring evidence from the defendant or the company. The judge stated that, the prima facie case to which S.261 (1) refers to is a prima facie case for giving permission. This necessarily entails a decision that there is a prima facie case both that the company has a good cause of action and that the cause of action arose out of a director’s default. [21]

The above dictum was cited with approval recently in [22] It should be noted that the test of prima facie case in S.261 was suggested in Prudential Assurance Co Ltd v Newman Industries Ltd (No.2) [23] where the Court of Appeal stated that the claimant ought to be required before proceeding with his action to establish a prima facie case that the company is entitled to the relief claimed and that the action falls within the proper boundaries of the exception to the rule in Foss’s case. The court did observe that the provision of S 261 intends to facilitate judicial control over derivative proceedings by introducing a gateway through which the applicant must pass before being allowed to continue his action. This is to avoid the obvious risk of abuse if every minority shareholder have an unfettered right to bring such an action. [24]

The second stage is governed by S.263 of the CA 2006. It takes place if the court decides that the claimant has a prima facie case. This stage demands a full hearing of the application for permission, and the court is required to take into account the factors listed in S.263 in deciding whether to give permission or not. The company is entitled to take part at this stage and the court may require the company to provide evidence under S. 261(3) (a). Once the court has heard the application, it may do one of the three things provided for under S. 261(4) of the Act. It may give permission to continue the application on such terms as it thinks fit; it may refuse permission and dismiss the claim; or it may adjourn the proceedings on the application and give such directions as it thinks fit.

It was observed in Iesini (supra) that at the second stage, something more than a prima facie case was required. The court would have to form a (provisional) view on the strength of the case in order to properly consider the requirements of S.263. The two-stage procedure gives the court enormous case-management powers. [25]

However and disappointingly, the two-stage procedure, seem to leave the claimant with more cost implication which in the end leaves the spirit of the harshness of the common law on derivative claim hunting an aggrieved minority shareholder. The merit of the case seems to be considerably brought into play at the initial leave stage resulting in increase in expenditure and delay. According to [26] it perpetuates the uncertainty and costs exposure for a potential claimants rather than encouraging unmeritorious claims. He proceeded to reason that the lack of any more definitive ground rules for a presumed grant of indemnity costs in the new legislation leaves open the judicial flexibility relied on to discourage unmeritorious claims, whilst also in deserving cases, facilitating ‘the Court’s ultimate intention to deter directors’ wrongdoing by enforcing this
tool of the corporate governance system” [27]. Further, it appears that the courts are still neck-deep in their approach of trying not to meddle with the internal management affairs of a company. Owing to this ‘traditional pragmatic approach’, [28] even in the eye of the new statutory regime, the much anticipated proliferation of cases was discouraged. For instance, in the case of [29] a minority shareholder claimant began a derivative claim and, as required by law, sought the court’s permission to continue. Warren J. held that the test to be applied was whether a reasonable independent board could decide that it was appropriate to bring proceedings. However, there was no indication as to how in practice the court could discern the views of the theoretical independent board [30]. Impliedly, the court would nevertheless retain the ability to strike a claim out at any time if it becomes apparent that no director acting in accordance with CA 2006, s 172 (duty to promote the success of the company) would seek to continue.

Again the court reiterated this traditional approach in [31] where it had to order that a claim by a minority shareholder be stayed for eight (8) weeks for the parties to attempt mediation even though there was a triable issue.

In conclusion, the statutory derivative claim has successfully expanded the grounds for such claims and equally modernized the procedure for such proceeding. The need to prove fraud on minority and the wrongdoer-control has been expunged. However, the procedure still poses some difficulties as indicated in the foregoing, capable of frustrating an aggrieved minority out of the proceeding and would continue to deter potential claimants. Therefore, minority protection still appears to be an unfinished business, consequently the statutory regime must been enhanced to afford the minority shareholders a more reasonable cost and time in pursuit of redress.

MINORITY PROTECTION UNDER THE NIGERIAN COMPANY LAW

As discussed above, membership of a company not only carries individual rights but also corporate rights, that is, rights that can be enjoyed and exercised not by a single individual but a member of individual members acting together. With regards to these rights, every member is bound by the decision of the majority [32]. The rule is that those who take interest in companies limited by shares have to accept majority rule [33]. The implication of this is that while the minority would always have the opportunity to have their say, the majority will always have the privilege to have their way. The above principle received a statutory blessing under S. 299 of the Companies and Allied Matters Act (CAMA). The provision provides as follows:

Subject to the provisions of this Act, where irregularity has been committed in the course of a company’s affairs or any wrong has been done to the company, only the company can sue to remedy the that wrong and only the company can rectify the irregularity.

Numerous reasons had been adduced as the justification for the rule. Amongst these reasons is the protection of the legal personality principle, to avoid frivolous actions against the company and to prevent deadlocks in company management as every shareholder would like his opinion/view to prevail. By reason of the adversity or gross injustice that may arise by the operation of majority rule, the Nigerian Companies and Allied Matters Act contained plethora of provisions (by way of exceptions to the rule) improving the fragile and disadvantageous position of the minority in corporate democracy of company’s management. Theses exceptions are as follows:

i. Where the shareholders at the general meeting resolved to embark on a project which ultra vires the company’s power or illegal, the minority will successfully maintain an action against the company notwithstanding the rule in Foss v Harbottle (supra) [14].

ii. Where the company through the majority adopts Ordinary
Resolution instead of Special resolution [5]

iii. Pursuant to S. 300(c) of CAMA, where it is alleged that personal right(s) of a member of the company had been, or about to be infringed upon, the member can successfully maintain an action against the company. The above situation derived its potency from S. 41 of CAMA that created a binding contract between the members and the company, so where there is a breach any of the party can enforce the breach of the other.

iv. Pursuant to S. 300(d) of CAMA, where the company are perpetrating a fraud against the company the minority shareholders and an individual member can sue against the alleged fraud.

v. Pursuant to S. 300(e) & (f), where the company meeting cannot be beneficially held and where the directors drive benefit from their breach of duty, the minority or an individual can maintain an action.

In addition to the aforementioned provisions for redress which constitutes exception to the rule, the Nigerian company law provided in S. 310 of companies and Allied Matters Act, that an individual or the minority can maintain an action where the action of the company is unfairly prejudicial and oppressive to the members [26]

CONCLUSION

As earlier noted the need for minority protection cannot be over-emphasized. It is for this reason that various and apparent far reaching provisions had been made under the two jurisdictions under reference in order to safeguard corporate neglect of minority in corporate governance. However and flowing from the detailed discussion on the protection of the minority interest in company administration under the Nigerian Law and that of the United Kingdom, one could deduce that the two legal regime tried to protect the minority apart from the shareholders or individual rights to successfully maintain action under the provisos to S. 300 of CAMA, such corporate right can be protected through member derivative action. It is of great importance to distinguish what constitutes a shareholders personal action and derivative action. Shareholders derivative action involves the assertion by a shareholder of a corporate cause of action, either within or without the corporation, who have allegedly wronged it, where the corporation has failed to enforce such claim directly. Such action is brought in the right of the corporation by the shareholder on behalf of himself and all other shareholders, in contrast, the direct and individual shareholders action involves the enforcement by a shareholder of a cause of action belonging to such shareholder on the basis of his membership contract against the corporation [7]

In order for a member to bring a successful derivative action under the Nigerian law, the plaintiff must ensure that the wrongdoers are the directors who are in the control of the management, that the applicant must have given reasonable notice to the directors of his intention to apply to court if the directors fails to diligently prosecute the action, that the applicant must be acting bona fide without being reprehensible in his actions and finally that the company must be made to a party in the suit [3]

The question is which legal regime is more robust than the other. Looking at the relevant provisions of the UK’s Companies Act, 2006 [23], the law is more concerned about derivative action and very silent on member private action unlike the provisos to S.300 of The Nigerian Companies and Allied Matters Act,2004 where there were various grounds where a member can successfully maintain an action against the company.

Secondly, on the ground of member derivative action, the procedure for
maintaining such action under the UK law is most unrealistic having two stage procedure (whether a prima facia case has been established and the then the full hearing if it has been established). More so for such a claim to lie, it must be on the ground of fraud and self serving negligence. These grounds are very much limited in the contemporary corporate world where other form of injury can be done to the company outside the above grounds (ie fraud and self serving negligence). Conversely under the Nigerian Companies and Allied Matters Act, 2004 there are several grounds which still includes the two grounds under the UK law for one to bring a derivative action. Under the Nigerian law, where an act of the company is unfairly prejudicial and oppressive to its members, a member can bring a derivative action. Looking at the wording that above provision, “Unfairly and oppressive” it presents us with a wide spectrum of ground upon which a derivative action can lie unlike that of the UK which is specifically restricted to fraud and self serving negligence.

Finally, having evaluated the relevant laws of the jurisdiction under reference, Nigeria appears to have a better legal regime for the protection of minority interest in corporate governance than United Kingdom. Despite the various rules being kept in place, minority protection is still limited and hamstrung by some impediments like the reluctancy of the courts to delve into the internal affairs or politics of corporate entities and corporate corruption which can lead to inducement, manipulation or harassment of minority shareholders.

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