A COMPARATIVE STUDY OF INSTITUTING DERIVATIVE ACTION CLAIMS IN NIGERIA AND THE UNITED KINGDOM

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INTRODUCTION

The shareholders of a company entrust the daily management of the company to a group of experts,namely directors. But as the owners of a company, shareholders maintain certain means of influence over the management of the company in order to protect the value oftheir shares and their right to receive dividends. Normally theirinfluence is exercised through the expression of opinions and the casting of votes at shareholders' general meetings. However,there are other means of influence and one of them is thederivative action. It is 'derivative' as the party bringing the action does not have the right to sue, but such a right is 'derived' from that of the company. It is an action against directors brought by ashareholder on behalf of the company. Where a company hasincurred damage due to a breach of duty by a director, thecompany is entitled to take an action against the director, but is usually reluctant to do so. The derivative action enablesshareholders to enforce directors' liability on behalf of thecompany[1].

Derivative action' is defined as a(corporate) action by which someone enforces a right that belongs to acompany for and on behalf of the company[2]. To provide further clarityto this broad definition, we can identify six features that are normallypresent in derivative actions:

(1) harm is done to the company;

(2) the harm is normally inflicted by someone who owes a duty to thecompany;

(3) the organ of the company that is legally empowered to rectify theharm by filing an action for relief in the name of the company hasfailed to fulfil its pertinent duties, most often because the personwith effective control of the organ is the same person who caused theharm;

[1]Koji Takahashi , 'Shareholder derivative action: safeguards against abuse', p.1

[2]Harald Baum and Dan W. Puchniak ,'The Derivative Action: An economic, historical andpractice-oriented approach',Cambridge Press, p.7

(4) an exceptional delegation of the company's power to enforce its legalrights is given to another legal person (the 'derivative plaintiff') forthe purpose of enforcing the company's right through a derivativeaction;

(5) the cost of the derivative action is prima facie borne by the derivativeplaintiff; and

(6) relief from a successful derivative action flows directly to the company(not to the derivative plaintiff).

A derivative action is not a *qui tam pro corporatus quam pro se ipso*.The shareholder is not demanding a right in his or her name as well as thecorporation's; but rather a right solely in the corporation's name[3].

BRIEF HISTORY OF DERIVATIVE ACTION

The derivative action developed in courts of equity. Its origin —lies in judicial recognition of a new wrong or maladjustment for which pre-existing legal procedures proved more or less inadequate. Developed in both United States and English courts, the first U.S. —classic derivative action where [a court permitted] a shareholder to sue to compel the directors to restore corporate assets taken in violation of their fiduciary duty was *Taylor v. Miami Exporting Co.,*5 Ohio, 165. 78. Several other plaintiffs throughout the country followed suit by filing derivative actions.

Many of the procedural hallmarks of the derivative action that exist today developed in these early cases. Courts required the corporation to be a party to the litigation in order to prevent the possibility of a double recovery in an action later brought by the corporation. Also, any recovery would go to the corporation as opposed to the individual that brought the suit. This made the corporation's role in these actions . . . that of a passive recipient of the proceeds as the most logical and convenient mode of aggregate recovery. Accordingly, when a shareholder sued the management he sued on a right belonging to shareholders. The United States Supreme Court recognized derivative actions in 1855.

[3] Black's Law Dictionary 1282 (8th ed. 2004). The full Latin nomenclature for a *qui tam*statement is *qui tam pro domino rege quam pro se ipso in hac parte sequitur*; translates to"who as well for the king as for himself sues in this matter". An action brought under astatute that allows a private person to sue for a penalty, part of which the government orsome specified public institution will receive.Within the context used herein, a play of words is used, substituting government forthe corporation, to highlight that a derivative action is not executed to benefit both the shareholder and the corporation.

Despite criticism, shareholders continue to use derivative actions in an attempt to enforce officers' and directors' fiduciary duties.

In the 1970s, it became increasingly difficult for a plaintiff to succeed with a derivative action. While courts previously viewed derivative actions as a useful regulation device, procedural barriers such as special litigation committees make their current efficacy questionable.

DERIVATIVE ACTION IN THE UNITED KINGDOM: PRE-2006 COMPANIES ACT

A. THE RULE IN FOSS V. HARBOTTLE AND WRONGDOER CONTROL

In *Foss v Harbottle*, the foundational derivative action case, **Wigram VC** held that the derivative litigant had no standing to bring the action. The decision was based on two propositions: first, that the company itself had been wronged and, therefore, only the company through its board and shareholder body could elect to sue;[4] and second, that it made no sense for the court to entertain an action which could at any subsequent time be ratified and cured by the general meeting.[5]This paragraph suggested two grounds where a derivative action can be brought;

A. Where the shareholder meeting does not have the power to confirm or ratify a wrong

[4]

[5]Ibid.

B. Where the corporate organs cannot be set in motion in the company'sinterests because of some practical barrier to action[6] or because the organs are controlled by the parties who have allegedly wronged the company.

In *Atwool v Merryweather*[7], Page VC observed in this regard:

If I were to hold that no bill could be filed by shareholders to get rid of the transaction on the ground of the doctrine of Foss v. Harbottle, it would be simply impossible to set aside a fraud committed by a director under suchcircumstances, as the director obtaining so many shares by fraud would always be able to outvote everybody else.[8]

It is most important to note that although it is typically described as an exception to the rule, the legal relevance of wrongdoer control arises as the substantiveproduct of the proper plaintiff rule[9]. It is only where the company, through its organs, is 'incapable' of acting that derivative litigation can be considered at all[10]. Ultimately, the question which has to be answered in order to determine whether the rule in *Foss v Harbottle*applies to prevent a minority shareholder seeking relief as plaintiff for the benefit of the company is: 'Is the plaintiff being improperly prevented from bringing these proceedings on behalf of the company?' If it is an expression of the corporate will of the company by an appropriate independent organ that is preventing the plaintiff from prosecuting the action, he is not improperly but properly prevented and so the answer to the question is 'No'. At common law derivative actions can only be brought in relation to certain wrongs which, disloyally, serve the directors' personal interests. In a classic statement of the rule in *Burland v Earle*[11], the Privy Council observed that the exception was applicable in relation to wrongs of a 'fraudulent character' where 'the majority areendeavouring directly or indirectly to appropriate to themselves money, property, or advantages which

[6]In *Foss v Harbottle*one of the claims was that it was not possible to call a shareholder meeting due to the absence of formally appointed directors.

[7](1867)L.R. 5 Eq. 464n

[8] See Russell v Wakefield Waterworks Company[1982] 1 ALL ER 354, 358.

[9] See Russell v Wakefield Waterworks Company, ibid,

[10] It is to be noted that this seminar paper will refer only to the wrongdoer control requirement rather than general meeting incapability.

[11](1902) AC 83

belong to the company, or in which the other shareholders are entitled to participate'. Such wrongs are often said to be non-ratifiable wrongs. But what wrongs are not ratifiable in English law? Jurists and commentators alike have complained about the absence of clarity in relation to whatamounts to a non-ratifiable wrong[12]. The reason for this is that in English law, outside of an ultra vires or illegal act such as the giving of unlawful financial assistance, there is no such category[13]as it has been unable to specify which wrongs fall within it. If close attention is paid to the cases which are said to stand for specific non-ratifiable wrongs, most importantly *Cook v Deeks*where directors appropriated for themselves a corporate opportunity, we see that the reason that the general meeting could not ratify the wrong was that the general meeting was controlled by the wrongdoing directors, and to allow ratification would therefore perpetuate the wrong and that the basis of the decision was the nature of the misappropriation, *not* the fact that thedirectors voted as shareholders in the fruitless attempt to ratify the wrong[14]. Seefor example Lord Millett's recent decision in *Waddington v Chan*[15]. The 2006 Act[16] explicitly retains 'any rule of law as to acts that are incapable of being ratified by the company'.Such provision should be read as being applicable to ultra vires acts (internally) and unlawful acts such asunlawful financial assistance.

Around 1950, the 'fraud' and wrongdoer control restrictions were grouped into an exception to the rule in *Foss v Harbottle*known as 'the fraud on the minority' exception[17]. Prior to 1950 the cases did not refer to the 'fraud on the minority' exception. Today, it would typically be said the fraud on the minorityexception involves two propositions: first, the wrong must be a non-ratifiable wrong or a wrong that falls within a category of

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[12] Gower and Davies(8thedn.) 588. Airey v. Cordell(2006)EWHC 2728at (44)

[13]See S. Worthington, 'Corporate Governance: Remedying and Ratifying Directors' Breaches' (2000) 116 *LQR* 638 rejecting the ratifiable / non-ratifiable distinction.

[14]K. Wedderburn 'Derivative Actions and *Foss v Harbottle*' (1981) 44 MLR 202 where Lord Wedderburn argues in relation to *Cook v Deeks*[1916] 1 A.C. 83, 93

[15][2009] 2 BCLC 82.

[16]Section 239(7)

[17]*Edward v Halliwell*[1950] 2 All E.R. Prior to 1950 the cases did not refer to the 'fraud on the minority' exception. See K.W. Wedderburn, 'Shareholders Rights and the Rule in *Foss v Harbottle*' (1957) CLJ 194203-204;

'fraud'; and second there must be wrongdoer control of the general meeting[18]. Accordingly, if one were to allowderivative actions in the absence of either wrongdoer control or some other formof general meeting incapability then the common law proper plaintiff rule wouldno longer be applicable.

B. POST-WRONGDOER CONTROL / FRAUD ON THE MINORITY HURDLES

As we have seen, underpinning the common law derivative action rules is anunderstanding that in the absence of an 'independent' general meeting there is nocorporate body capable of acting truly independently in the corporate interest inrelation to the litigation decision against directors. In such circumstances anexception is made to the rule that the company is the only possible plaintiff.However, although allowing an individual shareholder to bring an action addressed the independence problem it does not provide any guarantee that the individualshareholder's decision to bring the action, and her management of the action, willbe in the corporate interest. In *Prudential Assurance Co. v Newman Industries Ltd*[19] theCourt of Appeal held that whether a derivative action could be brought must bedealt with at a preliminary hearing at which the court would determine:

(i) whether the company was 'prima facie entitled to the relief claimed'; and

(ii) whether 'prima facie' 'the action fell within the proper boundaries of the exception to the rule in *Foss v Harbottle*'.

The proper boundaries of the exception were not set forthin the *Prudential* judgment with any precision, however, it is clear from the case acourt should first, establish whether the company is incapable of acting for itselfand second, determine whether it is in the corporate interest to allow suchlitigation to continue.In subsequent cases a set of common law rules emerged which, in differentguises, assessed whether the proposed derivative action was in the corporateinterest. It is important to note that these rules are distinct

[18]See Gower, 6th eds 673-674. important early cases wrongdoer control was the first,and in some the only, consideration.

[19][1982] 1 All ER 354.

from the threshold andelemental requirement that a derivative action is simply unavailable in the absenceof general meeting incapacity, resulting from wrongdoer control or otherwise.These rules assist the court in determining whether a derivative action, which isformally available, is in the company's interest and whether the derivative litigant isthe appropriate person to bring the action. As **Lawton LJ** observed in *NurcombevNurcombe*[20]Since the procedural device has evolved so that justice can be done for thebenefit of the company, whoever comes forward to start the proceedingsmust be doing so for the benefit of the company and not for some otherpurpose. It follows that the court has to satisfy itself that the person comingforward is the proper person to do so.Relying upon *NurcombevNurcombe*, in 1995 the Court of Appeal in *Barrett v Duckett*[21] held that the action willonly be allowed to proceed if it is brought 'bona fide for the benefit of thecompany' and not for any ulterior purpose'. In the instant case,the action was not allowedto proceed because, amongst others, although the actions themselves fell withinthe wrongdoer control exception,[22] the shareholder was held to be motivated by apersonal grudge against the director, who was the ex-husband of the shareholder'sdaughter.The rules on permission to continue an action did not require that the actionbe objectively in the corporate interest until shortly before the enactment of the 2006 Act. In*Mumbray v Lapper*[23]this prerequisite to obtaining anindemnity order was extended to the question of whether a derivative actionwould be permitted to continue. Anotherapproach to determining corporate interest is to rely upon the viewsof the independent members of the corporate organs. For example, in *PrudentialAssurance* for the Court of Appeal the fact that the disinterested board had electednot to pursue the litigation would have been a weighty consideration for a courtconsidering a preliminary

[20][1985] 1 ALL ER 65.

[21][1995] 1 BCLC 243.

[22]In this case the claimants and defendant both held 50% of the shares in the company and therefore although there was no wrongdoer control the general meeting was disabled. There was not discussion of whether the wrongs fell within the fraud category, however, it appears clear on the facts of the case that they did.

[23][2005] EWHC 1152.

application. In *Barrett v Duckett*[24] for example, the Court ofAppeal appeared to accept that availability of an unfair prejudice action wasrelevant to their determination of whether or not to allow the litigation to proceed.

DERIVATIVE ACTION IN THE UNITED KINGDOM: POST 2006 COMPANIES ACT

The genesis of the reforms in this area can be traced back to the period between 1995 and 1997 when the English Law Commission conducted an extensive inquiry into shareholder remedies.Thesereforms have been further appraised and amplified through the deliberations of the CompanyLaw Review Steering Group between 1998 and 2001.[25] It was then endorsed by the
Government[26] and finally implemented by the Companies Act 2006[27].

The reforms of derivative claims are, naturally, part of this wider drive which is to steer a middle course between excessive reliance on a litigation remedy and judicial recourse for the shareholders on the one hand, and unreasonable interference in the affairs of the company on the other hand[28].

In the UK, Part 11 of the Companies Act 2006 (UK) contains a new derivative action procedure which came into force on 1 October 2007. Sections 260-264 deal with derivative actions in England and Wales or Northern Ireland while Sections 265-269 deal with derivative claims in Scotland.

In the UK s 260(3) specifies the types of breaches of duty under which a derivative claim may be brought. The section provides that a derivative claim 'may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving

[24]Op.cit

[25]Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: Final Report' (July 2001) URN 01/942 (CLR *Final Report*) at paras 7.46–7.51.

[26]Department for Trade and Industry, 'Modernising Company Law' (White Paper) (Cm 5553-I, 2002) (which was surprisingly reticent on the matter) and Department for Trade and Industry, 'Company Law Reform' (White Paper) (Cm 6456, 2005), para. 3.4.

[27]Following the Company Law Reform HL Bill (2005) 34. It was renamed the Companies Bill on 20 July 2006. It received Royal Assent on 8 November 2006.

[28]A Reisberg, *Derivative Actions and Corporate Governance: Theory and Operation* (Oxford University Press, 2007) 186.

negligence, default, breach of duty or breach of trust by a director of the company'. In addition, a derivative claim may be brought in respect of an alleged breach of any of the general duties of directors in Chapter 2 of Part 10, including the duty to exercise reasonable care, skill and diligence[29]. The breach of duty under s 260(3) includes breaches under the Act as well as under the common law. Hence, in the UK an action may be brought in respect of any negligence by a director of a company. As discussed above, common law makes a distinction between mere negligence or incompetence and negligence benefitting the wrongdoer[30]. The UK Act removes this distinction. Now, in bringing a derivative action against directors for negligence, shareholders need not establish that the directors received any advantage or benefit from their negligence or wrongdoing. This is a significant departure from the common law position.

The Companies Act 2006 (UK) also provides that the cause of action may be against the director, a third party, or both[31]. This means that a member could bring a derivative claim against a third party where the damage suffered by the company arose from an act involving a breach of duty on the part of the director, and the third party has improperly received property as a result of the said breach (for example, for knowing receipt of money or property transferred in breach of trust or for knowing assistance in a breach of trust).

A derivative claim may be brought by a member in respect of wrongs committed prior to his or her becoming a member[32]. Although there is no equivalent provision in the legislation of the other jurisdictions, it might be argued that a member in these other jurisdictions would nonetheless be entitled to bring a derivative claim in respect of

[29]Companies Act 2006 (UK) s 174.

[30] In Pavlides v Jensen [1956] Ch 565 it was held that mere negligence or incompetence on thepart of controlling directors does not justify a derivative suit. In contrast, in Daniels vDaniels[1978] Ch 406, the Court deemed it necessary to show that the directors, orpersons connected with them, have derived benefits from the negligence of directors.

[31]Companies Act 2006 (UK) s 260(3).[2011] 2 CLJ 678.

[32]Ibid s 260(4).

wrongs committed prior to his becoming a member, because the provision in the UK Act reflects the fact that the rights being enforced are those of the company rather than those of the member. This is the position at common law. The definition of a 'director' includes a former director, and a shadow director is treated as a director for the purpose of a derivative claim. The general duties of directors apply to shadow directors as well[33].

The 2006 Act allows a broader range of claims to be brought and gives a much clearer guidance to the courts and to shareholders when considering whether to pursue a derivative claim.The Act empowers the courts to make consequential orders ifleave is not granted. Once proceedings have been brought, the member is required toapply for permission to continue the claim. This is a two-stage process. At the firststage, the applicant is required to establish a prima facie case for the grant ofpermission, and the court will consider the issue on the basis of the applicant'sevidence alone without requiring evidence to be filed by the defendant. The courtmust dismiss the application at this stage if what is filed does not show a prima faciecase, and the court may make any consequential order that it considers appropriate(for example, a costs order or a civil restraint order against the applicant). At thesecond stage, if the application is not dismissed, the court may direct the company toprovide evidence and, on hearing the application, may grant permission, refusepermission and dismiss the claim, or adjourn the proceeding and give such directionsas it thinks fit.

In the UK, at the second stage (that is, after the first stage where the court is satisfiedthat the applicant has a prima facie case) the court will decide in a main permission(or leave) hearing and on evidence from the applicant and the defendant whether thecase should proceed. Section 263 of the Companies Act 2006 (UK) sets out the criteriawhich the court is required to take into account at this stage. The court will refusepermission to continue the claim under s 263(2) if it is satisfied that:

[33] (2012) 24.2 BOND LAW REVIEW136-142, Companies Act 1965 (Malaysia) s 181B(4).41 Ibid s 181E.

(a) a personacting in accordance with the duty to promote the success of the company would not
bring the claim, or
(b) if the act or omission complained of has been authorised orratified by the company.

In considering whether to give permission, the court musttake into account the following criteria:
a) whether the member is acting in good faith in seeking to continue the claim;
b) the importance that a person acting in accordance with s 172 (duty to promote the success of the company) would attach to continuing it;
c) where the cause of action results from an act or omission that is yet to occur,whether the act or omission could be ratified by the company;
d) where the cause of action arises from an act or omission that has already occurred,whether the act or omission could be or would be likely to be ratified by thecompany;
e) whether the company has decided not to pursue the claim;
f) whether the act or omission gives rise to a cause of action that the member couldpursue in their own right (that is, a personal action) rather than on behalf of thecompany[34].

Further, in considering whether to give permission, the court shall have particularregard to any evidence before it as to the views of independent members of thecompany who have no personal interests, direct or indirect, in the matter. Section 263(2)(a) has codified the common law test in *Airey v Cordell*[35](‘Airey’) in determining whether permission ought to be given in the bringingof a derivative claim. In this case the Court held that this would depend on whethera hypothetical and independent board of directors would sanction the claim, and thatit was not for the court to assert its own view of what it would do if it were the board,but merely to be satisfied that a reasonable board of directors could

[34]Companies Act 2006 (UK) s 263(3).

[35][2006] EWHC 2728

take the decisionthat the minority shareholder applying for permission to proceed would like it totake.

The difficulties concerning the question of whether someone with a duty acting topromote the success of the company (that is, a hypothetical independent director)would seek to continue the claim or not were considered in *Franbar Holdings Ltd vPatel*[36] In this case, one of the reasons the application forpermission to continue a derivative action was refused was because a director, actingin accordance with his duty to promote the success of the company, would not seekto continue the claim. The Court outlined several factors which the hypotheticaldirector would take into account which included:

1. the prospects of success of theclaim,
2. the ability of the company to make a recovery on any award of damages,
3. anydamage to the company's reputation and business in the event of the action failing,
4. and the cost of the proceedings.

Another important reason for the refusal was theability of the shareholder to seek relief on the basis of unfair prejudice (that is, thecriteria in the Companies Act 2006 (UK) s 263(3)(f)).

In *Mission Capital Plc v Sinclair*[37], the Sinclairs' appointment asdirectors was terminated by the board and a new director, P, was appointed. TheSinclairs challenged the validity of the board action. They applied for permission tocontinue a derivative claim against the non-executive directors and P, claiming thatthe company would not be managed satisfactorily without them. The Court refusedpermission because the alleged damage to the company was speculative and anotional director would not attach much importance to it. In addition, the formerexecutive directors could pursue an action by way of an unfair prejudice petition.In *Stimpson v Southern Private Landlords*

[36][2008] BCC 885 ('Franbar').
[37][2008] EWHC 1339

Association[38]('Stimpson'),permission to continue a derivative action was again refused. The factors consideredby the Court in refusing permission were:

(i) only one of the alleged breaches of dutywas realistically arguable,

(ii) the value of the claim was modest,

(iii) the costs of thelitigation would be relatively substantial and the Association could not fund suchexpenditure, and

(iv) if the claim was unsuccessful, it would expose the Associationto the risk of insolvency.

Further, permission was refused because there was noevidence that the Association's merger with a larger landlord's association was notbeneficial to the Association's members, which suggested a lack of good faith on theclaimants' part. In view of these factors, the Court concluded that a hypotheticaldirector, acting in accordance with their duty to promote the success of the company,would not seek to continue the claim.

It should be noted that s 263(4) of the CompaniesAct (UK) makes reference to the views of members without a personal interest ratherthan those of independent directors. A strict interpretation of this provision wouldnot permit the court to take into account the views of parties outside the company.In *Langley Ward Ltd v Trevor ('Langley')*[39], the High Court refused permission tocontinue the claim on the basis that

(a) no hypothetical director seeking to complywith their duties under s 172 of the Act would consider it appropriate to prosecutecertain claims and

(b) the company was a natural candidate to be wound up and itwas therefore appropriate to leave the dispute to be dealt with by a liquidator ratherthan by litigation in a derivative action

CURRENT MODE OF INSTITUTING A DERIVATIVE ACTION IN THE UNITED KINGDOM (TWO-STAGE PROCESS)

As per Section 263(2): whether

[38][2009] EWHC 2072

[39](2011) All ER 78

a) a person acting in accordance with the duty to promote the success of the company would
not bring the claim, or
b) the act/omission complained of has been authorised or ratified by the company.
If the above criteria are satisfied, the court will refuse permission to continue the claim.
If the above criteria are not satisfied, the court must consider factors in s 263(3), that is,whether:
a) the member is acting in good faith in seeking to continue the claim,
b) the importance that a person with the duty to promote the success of the company would
attach to continuing,
c) where an act/omission is yet to occur, whether it could be ratified by the company,
d) where an act/omission has already occurred, whether it could be or would be likely to beratified by the company,
e) the company has decided not to pursue the claim,
f) the act/omission gives rise to a cause of action that a member could pursue in their ownright (that is, a personal action) rather than on behalf of the company.
Section 263(4): the court shall have particular regard to any evidence before it as to theviews of independent members of the company who have no personal interests, direct orindirect, in the matter[40].

DERIVATIVE ACTION IN NIGERIA

In Agip (Nigeria) Limited v. Agip Petrol Int'l[41], a brief definition was attempted
"A derivative action also known as a shareholder derivative suit is a lawsuit brought by a shareholder on behalf of a company against a third party. Often the third party is an insider of the corporation such as the directors or executive officers". (P. 1230, Paras. D - G).
From this definition, two facts are gleaned;

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[40]A quick run down of the two stage process of instituting derivative actions in the UK post 2006 Companies Act. (2012) 24.2 BOND LAW REVIEW 150

[41](2010) All FWLR (PT. 520) 1198 S.C

a. That in the matter of a derivative action, the defendants are seen as third parties for the duration of the suit.

b. That the so-called third party do not necessarily to be directors but someone holding an executive position.

Section 303 of the Companies and Allied Matters Act 2004 states as follows:-

1) Subject to the provisions of subsection (2) of this section, an applicant may apply for leave to bring an action in the name or on behalf of a company, or to intervene in an action to which the company is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the company.
2) No action may be brought and no intervention may be made under subsection (1) of this section, unless the court is satisfied that
   (a) The wrongdoers are the directors who are in control and will not take necessary action;
   (b) The applicant has given reasonable notice to the directors of the company of his intention to apply to the court under subsection (7) of this section if the directors of the company do not bring, diligently prosecute or defend or discontinue the action;
   (c) The applicant is acting in good faith; and
   (d) It appears to be in the best interest of the company that the action be brought, persecuted, defended or discontinued.

Categories of Persons Who Can Bring Action

Section 309 of the CAMA 2004 deals with persons who can institute a derivative action. They include;

(a) a registered holder or beneficial owner and a former registered holder or beneficial owner of a security of a company

(b) a director or an officer or a former director or officer of the company

(c) the Commission[42]

[42] Section 309 (c).

(d) any other person who in the discretion of the court, is a proper person to make an application under section 303 of the Act.

However, the English provision[43]permits only a member to bring the derivative action. This seems very restrictive as it doesn't allow other interested parties from bringing action especially when there is a just cause and no member is interested in bringing the action. In the Nigerian case of *Chief Akintola Williams &ors v Edu*[44] the Court of Appeal in Nigeria was of the view that a non-member of a company cannot institute a derivative action under the section in spite of the provisions that allows anybody to apply at the discretion of the court. The courts had refused to allow former shareholders and former directors because they lack sufficient interest in the outcome of derivative action, when in fact the Act expressly permits them to bring the application. *In Jacobs Farm Ltd v Jacobs*[45] the court was of the view that it was not the intention of the legislature to allow every former director to bring application for derivative action. Brayton J. is of the view that the sufficient interest rule is necessary in order to check applicants who may though be permitted under the Act but nevertheless, in law, have no *bona fide* financial stake in the corporation but are merely seeking leave for an improper purpose and not in the interest of the corporation. In a case, an application by an ex-director was declined because the primary reason for filing the action was for personal vendetta against the current directors. In Nigeria, the courts have reiterated in a number of cases that the issue of *locus standi* is very crucial to the filling of a derivative action. In *Adenuga v Odumeru,* Belgore JSC (as he then was) explored the sufficient interest rule thus;

> *The mere fact that appellants are financial members of the eighth defendant has not conferred on them locus standi because that alone would not disclose sufficient interest for them to bring this action. Looking at the statement of claim, the appellants have not disclosed sufficient interest to justify their*

[43] Section 260 Companies Act 2006 UK .
[44](2002) 3 NWLR (Pt 754) 400.
[45](1992) OJ No. 813 (Ont. Gen. Div).

bringing this action. A party must in his statement of claim aver enough facts to indicate what his interests are in the matter and how those interests stand threatened if the action was not brought. It is not enough to blandly state that he has an interest; there must be an averment that the interest is threatened.[46]

This position is rather strict and restrictive as the Act had specified the categories of persons that may file a derivative action and there is no mention of other conditions to deter this set of persons, the court ought not bring other extraneous matters to inhibit and stultify the legislature's clear intentions' in allowing a broader number of persons opportunity to seek redress on behalf of the company[47].

Pre-Action Notice

Section 303 (2) (b) of CAMA 2004 requires that an applicant for leave to bring a derivative action must give reasonable notice to the directors of the company of his intention to apply to the court under subsection 1 of the section and after giving the reasonable notice, if the directors do not bring, diligently prosecute or defend or discontinue the action the applicant is allowed to file a derivative action. The serving of such pre-action notice is compulsory. The advantage of this notice is that it is possible that the directors had not thought of this course of action and since the right is that of the company, it should be given the first opportunity to seek redress for itself. It is only if this is not done after a reasonable notice that the applicant may file the application. The problem with this provision is that;

a. there is no specification as to the number of days that will constitute a reasonable notice,
b. itdoes not specify the contents of the notice and whether the notice must contain such details as to enable the directors to know the specific actions to remedy.

[46](2002) 8 NWLR (pt. 821) 163.
[47]Kunle Aina, 'Current Developments in the Law on Derivative Action in Nigerian Company Law,'availableat http//academia.edu. accessed on 30/9/14

c. The Nigerian provisions do not give any exception to pre-action notice, unlike some other jurisdictions,

The essence is that such notice must of necessity contain sufficient details as to enable the directors take necessary action. Where the directors take action by filling an action on behalf of the company, a derivative action will not be necessary. It is, however, trite to note that where the fraudulent directors are in control, which in fact is a condition precedent for bringing the action[48], it is not likely that they will bring an action against themselves. It is humbly advised that this section be amended to allow the courts determine whether to waive the requirement based on the exigencies and the circumstances surrounding the particular situation.

Application for Leave

Section 303 (1) of CAMA 2004 makes express and specific provision for the shareholder intending to bring the derivative action to apply for leave of court as a mandatory precondition for the action. This is a standard precondition in all jurisdictions that have adopted the statutory derivative action.[49]

The Companies and Allied Matters Act merely provides that leave to bring the action must be granted by the court without necessarily specifying the procedure to be adopted in the application. This no doubt has created a lot of doubt and misconceptions and unfortunately the Supreme Court when given the opportunity failed to explain the appropriate procedure to be followed. In *Agip Nig. Ltd. v Agip Petrol International and others*[50].The facts of the case is as follows; the first respondent a company which has its registered office in Amsterdam held 60% of the appellant's shares while the balance of 40% of the appellant's shares were held by Nigerians. Pursuant to an international bid, the 1st respondent sold all its shares in the applicant company to the 2nd respondent (Unipetrol Nigeria Plc) under a sale agreement. The directors of the applicant were aware of the sale of the shares to the 2nd respondent and also approved it. The Nigerian Stock

[48] See American Law Institute, 1995. Principles of Corporate Governance, Analysis and Recommendations at 55.
[49]Section 303(2)(a) CAMA 2004.
[50]KunleAina, 'Current Developments in the Law on Derivative Action in Nigerian Company Law,'availableat http//academia.edu. accessed on 30/9/14

Exchange and Securities and Exchange Commission approved the sale of the shares. The minority shareholders believed that the sale of the shares was a fraud on them and so sought to reverse the sale. They thereafter commenced an action in the Federal High Court by filing a Writ of Summons, and also filed an ex parte application for leave to commence the derivative action in the name of the company. The High Court granted the order for leave to bring the action. The defendants appealed, to the Court of Appeal, the Court held that the Writ of Summons was incurably bad and a nullity. The applicants appealed to the Supreme Court against the judgment of the Court of Appeal, the Supreme Court upheld the decision of the Court of Appeal and held that;

(a) The applicant must apply for leave to commence the derivative action.
(b) The procedure for obtaining the requisite leave to commence a derivative action is not embodied in the Federal High Court (Civil Procedure) Rules 2000;
(c) The relevant rule is in the Companies Proceedings Rules, 1992 and rule 2 thereof which states that except in the case of the application mentioned in Rules 5 and 6 of the Company Proceedings Rules and applications made in proceedings relating to the winding up of companies, every application under the Companies and Allied Matters Act, 1990, shall be made by Originating Summons as shown in Form 1 in the schedule to the rules;
(d) That the Originating Summons must be served on the respondents to enable them respond to the application, so that the directors must be heard in the application for leave and failure to do this offends the constitutional provisions on fair hearing[51].

With greatest respect to the Supreme Court, the Court missed a great opportunity to give a direction and make a proper pronouncement in this area of the law. The Company Proceedings Rules, 1992 by virtue of its Rule 2 merely stated that every application under the Companies and Allied Matters Act 2004 (except those mentioned in Rules 5 and 6,

[51]KunleAina, 'Current Developments in the Law on Derivative Action in Nigerian Company Law,' availableat http//academia.edu. accessed on 30/9/14

and Winding Up of Companies Proceedings) shall be made by Originating Summons. We must note that the section 303 (1) of the CAMA 2004 also did not specify the procedure to adopt but merely provided that the applicant must apply for leave to bring a derivative action. However, the Companies Proceedings Rules did not specify whether the Originating Summons should be *ex parte* or on notice. The Supreme Court therefore cannot assume that it has to be on notice, we submit that the Rules are silent on the particular mode of the Originating Summons. This therefore calls for a fair understanding of the nature of the application and the comparative position in other jurisdictions.

The main purpose of applying for leave to bring a derivative action is to enable the court to first consider the application, to sift through all the documents in support of the application, to carry out an exhaustive review of the grounds for bringing the application and ensure that a prima facie case has been established before the directors of the company are invited to oppose the application or the action itself. In England for instance, section 261[52] of the Companies Act 2006, states that, once a derivative action has been brought, the member must apply to the court for permission to continue it. A paper hearing is first taken by the court. Where the court considers all the documents in support of the application and other evidence, the onus is therefore on the applicant to prove that he has *a prima facie* case, where this is not proved, the application will be dismissed. At this stage, the directors are not served or invited to be put on notice. The applicant may request the court to reconsider its decision at an oral hearing, though no new evidence is allowed. The permission to continue is akin to the application for leave under the Nigerian provisions[53].

Good Faith

The applicant must show that the application was filed in good faith. The proof of good faith is said to be necessary in order to discourage personal vendettas and vexatious

[52]Berkahn M, "The Derivative Action in Australia and New Zealand: Will the statutory provisions improve shareholders' enforcement rights?" ***Bond Law Review*** Vol. 10 No 1 1998. Available at http//epublications.bond.edu.au/blv/vol10/1851/5(Accessed 25/9/2014)

[53]Companies Act 2006 (UK).

actions. The proof of good faith is also a precondition in UK. Apart from the normal practice of merely declaring that the application was brought in good faith, the only way to prove good faith is to simply prove that the application is meritorious and supportable. The disadvantages of this condition is that it is difficult to prove, the right belongs to the company, and where the directors have decided not to take action, any action by any other person is likely to be viewed as personal and malicious. The author suggests in line with the original author quoted from that the requirement of good faith be deleted from the section 303 of the Act because where fraud has been committed by the directors, and they are in control and will not bring an action against themselves and the shareholder decides to take action, the good faith of the shareholder ought not to be of any material importance but the immediate concern of the court should be to arrest the situation[54].

Interest of the company

Section 303 (2) (d) Companies and Allied Matters Act 2004 provides that

"no action may be brought and no intervention may be made under subsection (1) of this section, unless the court is satisfied that:-

(e) it appears to be in the best interest of the company that the action be brought, prosecuted, defended or discontinued.

The refusal of the company to take action may be based on the interest of the company, by considering the benefit in terms of cost of the litigation and the outcome of the proceedings generally, whether it will benefit the company, generally or not. The court ought to take the view of the directors into consideration before allowing the action in the best interest of the company. The appropriate organ of the company to determine the best interest of the company will be the directors themselves, this must be directors not involved in the fraudulent action.

Wrong Doers Are in Control

[54] KunleAina, 'Current Developments in the Law on Derivative Action in Nigerian Company Law,' availableat http//academia.edu. accessed on 30/9/14

We have discussed above that the application for leave to file a derivative action must prove that not only has fraud been committed but also that the wrongdoers are the directors who are in control and will not take necessary action[55]. It is arguable whether a derivative action may be filed where the director had been negligent and has benefited or likely to benefit from their negligent act or from their breach of duty.[56] Where the applicant cannot prove fraud, breach of duty or negligent act may be considered to be a wrongful act, and if it is, then the applicant will only need to prove that the wrongdoers are in control. The applicant will not only be tasked with proving the nature of the wrong committed against the company but must also prove that they are in control. In the English provisions, section 260(3)[57] laid down the ground for bringing a derivative action and provides that a claim may be brought only in respect of a course of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company. Clearly in the UK there is no need to the prove fraud on the minority or the company or that the wrongdoers are in control, so that where the directors had acted in good faith and has not gained any profit personally, the claim can still be brought.[58] Interestingly, though the Nigerian provision[59] is quite restrictive and limits the circumstances when an applicant may bring a derivative action. However, in explaining the position the Supreme Court had taken a more liberal position and defined fraud on the company in*Yalaju-Amaye v A.R.E.C. Ltd*.[60]thus:

> For although it is recognized that the word 'fraud' is a term of so wide an import that it is idle to attempt to define it, it at least appears clear that any act which may amount to an infraction of fair dealing or abuse of confidence, or unconscionable conduct or abuse of power as between a trustee and his shareholders in the management of a

[55] Section 303 (2(a) CAMA 2004.
[56] Section 303 (a)(a) CAMA 2004.
[57]Companies Act 2006 UK.
[58]Section 300 (f) CAMA 2004.
[59]Companies Act 2006 (UK).
[60] The situation *in Pavilides v Jensen* will be approved under the Act.

company is fraud which may take the issue outside the rule *in Foss v Harbottle*[61]

Powers of the Court

Section 304 of the Companies and Allied Matters Act 2004 listed the powers of the court under the section 303 of the Act. The court is authorized to make any one or more of the following orders:

(a)Authorizing the applicant or any other person to control the conduct of the action;

(b)Giving directions for the conduct of the action;

(c)Directing that any amount adjudged payable by a defendant in the action shall be paid in whole or in part, directly to former and present security holders of the company instead of the company;

(d)Requiring the company to pay reasonable legal fees incurred by the applicant in connection with the proceedings.

The court in exercising its powers under section 304 CAMA 2004 shall not stay or dismiss an action simply because an alleged breach of a right or duty owed to the company has been or may be approved by the shareholders of such company, but the court is enjoined to take into account evidence of approval by the shareholders. Ratification by the company of wrongs done to the company is an effective bar to further proceedings in court[62] provided the wrong is one that is capable of being ratified. We must note that though the issue of ratification is not really part of required conditions to be considered in an application for leave to bring the action under section 303 of the Act where the act complained of had been ratified, the directors will, if leave had been granted, show that the act had been ratified by the company and the company is not willing to take further action on the matter.[63]

[61]Section 303 (2) (d) CAMA 2004.

[62] Per Nnaemeka –Agu JSC at page 466.

[63] Section 305 CAMA 2004.

Section 306 of CAMA 2004 also provides for situations where the parties have agreed to settle and withdraw the matter out of court. The court must look critically into the matter to ensure that the rights of any applicant that may be affected by discontinuance, dismissal or stay of the suit as a result of settlement by the parties be put on notice. This will also prevent some collusive settlement between the parties for the benefit of the complainant and the defendants at the expense of the company. Once the court has approved the filling of a derivative action there should be no reason why such action should be discontinued with or without the approval of court if the applicant is no longer interested especially if he has been compromised, the court should be given the power to appoint an independent person or organization like the Commission to continue the due prosecution of the matter[64].

RECOMMENDATIONS

Among the recommendation this paper seeks to tender are;

1. that a method be put in place that would require a plaintiff filing a derivative action to provide notice to shareholders who may then move to nominate someone who would serve as lead plaintiff and thereby avoid unnecessary and questionable claims.
2. That sanctions be placed to serve as deterrents for shareholders who violate their fiduciary duties
3. Since the Nigerian law did not specify whether the application for the leave to bring the derivative should be made *ex- parte* or on notice, it is suggested that the current international practice especially that of the United Kingdom be adopted.
4. That by requiring shareholders to take responsibility for the course of the litigation, courts and legislatures can reduce frivolous claims, leaving more judicial energy for meritorious claims that can deter future corporate wrongdoing.

[64]KunleAina, 'Current Developments in the Law on Derivative Action in Nigerian Company Law,' availableat http//academia.edu. accessed on 30/9/14

5. The legislation o Nigerian Company Law needs to be urgently amended to bring it in line with current international legal standards and present prevailing realities.

CONCLUSION

The statutory derivative action is a very important tool available to the minority shareholder to protect their rights and that of the company. In Nigeria there has not been much cases, however in considering the few cases that had been filed before our courts, the courts have failed to give a proper, just and fair interpretation of the intentions of the legislature, and has been much concerned with strict adherence to form and technicalities and have lost the opportunity to do substantial justice and most importantly scare away honest applicants with genuine interests. Derivative actions can positively influence corporate Nigeria and the selected jurisdictions discussed in this paper. These actions allow shareholders to bring a corporation's cause of action to fruition, even if the directors refuse to address the situation either because of self-interest or in order to protect fellow board members. Unfortunately, many courts, commentators, and much of the public do not view the shareholder derivative action in the positive light that they once did. In order to prevent a backlash against derivative actions that could effectively destroy them, the courts and state legislatures need to address the problems with shareholder derivative actions as well as other forms of representative litigation.

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