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# THE JUSTICE JOURNAL

2014

A JOURNAL OF

CONTEMPORARY LEGAL ISSUES

Volume 6

2014

A JOURNAL OF  
CONTEMPORARY LEGAL ISSUES

UNIVERSITY OF IBADAN LIBRARY

VOLUME VI

# JUSTICE JOURNAL

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PUBLICATION OF THE  
FEDERAL MINISTRY  
OF JUSTICE,

ABUJA, 2014

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Federal Ministry of Justice.

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Fifth Edition  
Published by  
Federal Ministry of Justice  
Abuja, Nigeria.

ISSN: 1115-1277

*Printed by*

Nigerian Institute of Advanced Legal Studies  
Supreme Court Complex,  
Three Arms Zone,  
P.M.B., 385, Garki-Abuja,  
Nigeria.

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# CURRENT DEVELOPMENTS IN DERIVATIVE ACTIONS UNDER NIGERIAN COMPANY LAW

By

Kunle Aina LL.M, LL.B, B.L.\*

## ABSTRACT

*This paper examines the process laid down by the Companies and Allied Matters Act (CAMA) 2004 for bringing a Derivative Action by minority shareholders in Nigeria. The basis for the action is the exceptions to the rule in Foss v Harbottle and the need to ensure that fraudsters who are in control of the company's machinery for filing action in the name of the company do not use the opportunity to enrich themselves to the detriment of the company. The procedure laid down in the CAMA as well as the restrictive interpretation of the law by the Supreme Court in Nigeria is analysed and the way forward suggested.*

## Introduction

The rule laid down in the case of *Foss v. Harbottle*<sup>1</sup> is basically a rule of the majority and without the exceptions to the rule, it is a complete bar to minority shareholder action and will seem to give the majority and the Directors absolute powers. Where the Directors are the wrong doers who are also in control, the possibility of redress by the minority or the company is virtually impossible<sup>2</sup>. The dearth of actions in Nigeria by minority shareholders may be linked to the difficulties in surmounting the hurdles placed by the common law on derivative actions. In response to these difficulties, the Nigerian Law Reform Commission<sup>3</sup> proposed an amendment to the common law position and this led to the enactment for the first time of sections

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1. (1843) 2 Hare 461.

2. A. Beck and A. Borrowdale: *Guidebook to New Zealand Companies and Securities*, New Zealand CCH (NZ) Limited, 1990, 4th ed. P. 232 States that, 'the [common law] derivative action is universally recognized to be completely inadequate as a procedure for protecting the interests of minority shareholder.

3. Nigerian Law Reform Commission Report on Reform of Nigerian Company Law, Vol: 1,2 and 3.

303-309 of the Companies and Allied Matters Act 1990<sup>4</sup> (hereinafter called CAMA) which for the first time introduced the statutory 'derivative action'.

A derivative action is an action brought by a shareholder of a company in the name or on behalf of a company<sup>5</sup>, 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<sup>6</sup>. The right of action rightfully belongs to the company because it is the company rather than the shareholder that is wronged, and since it is only the company that can complain<sup>7</sup>, it follows that only the company can maintain the action, and not the individual shareholder. However, the decision to maintain the action is the responsibility of the directors,<sup>8</sup> but where it is the directors themselves who are at fault, the law must find a way to permit some other persons to initiate and sustain the action on behalf of the company.

This paper discusses the rule laid down in *Foss v. Harbottle*, the common law derivative action and the statutory derivative action including the application of the sections 303-309 of CAMA. It seeks to critically examine the conditions for the actions and the need for the courts to exercise maximum control of the proceedings and to apply a more judicious interpretation of the law. It also examines the recent decisions of the Supreme Court in this area of the law and concludes with suggestions for reforms in the law.

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4. Now CAP C20 Laws of the Federation of Nigeria 2004. (CAMA).

5. 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. <http://epublications.bond.edu.au/blv/vol10/1851/5> visited 1/5/2013 at 2.30pm.

6. Section 303, CAMA.

7. See Lord Davey in *Burland v Earle* (1902) AC 83.

8. Under normal circumstances, the General meeting may maintain an action in the name of the company where the directors are unable to act, see section 63, CAMA.



### **The Common Law Position**

The fundamental underlying basis for the rule in *Foss v. Harbottle* is the application of the principle of democracy to company law which is derived from the rule originally applicable to municipal corporations. In the old case of *A.G. v. Davy*<sup>9</sup> the court established the principle of the supremacy of the majority over that of the minority and the decision of the majority prevails over that of the minority members. The power of the majority extends to every facets of the company; for example, they have the power to:

- (a) approve directors' acts<sup>10</sup>,
- (b) alter the constitution of the company<sup>11</sup>, or
- (c) appoint<sup>12</sup> and dismiss<sup>13</sup> directors. The majority rule is however better known in terms of its corollary that, in an action to remedy any wrong done to the company the proper plaintiff is the company itself and it is for the majority to decide whether the company should sue for redress. This was the rule laid down in the case of *Foss v. Harbottle*.<sup>14</sup>

### **Basis and Rationale for the Rule**

The rule is based on two important principles of Company Law. These are the doctrine of separate personality and basic partnership principle.

- (a) **Separate Personality:** The company is a separate person entirely from the incorporators, in the words of Lord Macnaghten<sup>15</sup>, in the case of *Salomon v. Salomon*<sup>16</sup>.

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9. (1741) 2ATK 212.

10. Section 63(5) (c) CAMA.

11. Sections 44-46 CAMA.

12. Sections 247-248 on appointment of Directors.

13. Section 262 CAMA.

14. See Sir Wigram VC in (1843) 3 Have 461 at 491.

15. *Salomon v. Salomon* (1897) A.C. 22 at 51.

16. (1899) A.C. 22.

The company is at law a different person altogether from the subscribers. ...; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers, as members liable, in any shape or form, except to the extent and in the manner provided by the Act. Clearly, the doctrine of corporate personality established the company as separate entity from the shareholders and therefore in matters of corporate litigation, the company must be its own plaintiff. In fact as an attribute of corporate personality it has the power to sue and be sued in its own name.<sup>17</sup>

**(b) Non-interference in the internal management of company:** This may be a fallout of the separate legal entity doctrine and a relic of partnership principle now part of company law. The courts have reiterated severally, that it will not interfere in the internal arrangements of a company and do not have the jurisdiction to do so.

**(c)** Another important principle of company law that underlies the Derivative action is that all the shareholders cannot maintain an action on behalf of the company, only the Directors are by law the appropriate organ to decide whether to take an action in the name of the company or not. In *John Shaw & Sons Salford Ltd v. Shaw*<sup>18</sup>, Greer L. J explained that:

If powers of management are vested in the directors, they and they alone can exercise those powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering the articles or.... by refusing to re-elect the directors of whose powers they disapprove. They cannot themselves usurp the powers by which the articles are vested in the directors any more

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17. Section 37 CAMA.

18. (1935) 2 KB 113.

than the directors can usurp the powers vested by the articles in the general body of shareholders.<sup>19</sup>

In summary, whenever there is a reference to the rule in *Foss v. Harbottle* it is the broader set of principles which is being referred to, and not just the limited scope of *locus standi* rule that was referred to in the case itself.<sup>20</sup>

### Exceptions to the Rule

Without the exceptions the hope of the minority shareholder to participate in the affairs of the company would have been sealed. However, there are four traditionally accepted exceptions to the rule, as set out by Jenkins L.J in *Edwards v. Halliwell*<sup>21</sup>, these are:

- (a) Where the act complained of is illegal or is wholly *ultra vires* the company.

If the action complained of is illegal<sup>22</sup> or *ultra vires*<sup>23</sup> the company, the rule does not apply because the majority of the members cannot ratify the transaction<sup>24</sup>. In *Smith v Croft (No. 2)*<sup>25</sup>, the act complained of relates to the giving of financial assistance to facilitate the acquisition of shares in the company contrary to the Companies Act 1981. The court held that the act was illegal, the individual shareholder may maintain an action.

- (b) Where the matter in issue requires the sanction of a special majority or there has been non-compliance with a special procedure.

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19. See also *Breckhand Group Holdings Ltd v. London and Suffolk Properties Ltd* (1989) BCLC 10.

20. See Sir Wigram L.C in *Foss v. Harbottle*. (1843) 2 Hare 461 at 491.

21. (1950) 2 All ER 1064, 1067, see also Osunbor O. "A critical Appraisal of the 'Interest of Justice' as an exception to the Rule in *Foss v. Harbottle*" *International and Comparative Law Quarterly* Vol. 36 No 1, 1987.

22. *Powell v. Kempton Race -Course Company* (1897) 2 Q B 242.

23. *Hoole v. Great Western Railway* (1867) LR 3 Ch 262.

24. *Prudential Assurance Co. Ltd. v Newman Industries Ltd (No. 2)* (1982) Ch. 204.

25. (1988) Ch 114.

Where by the company's own rules and constitution an act or decision can only be approved by a special majority, to allow the company to do otherwise is to allow it break its own constitution. In *Baillie v. Oriental Telephone Co. Ltd.*,<sup>26</sup> and *Cotter v. National Union of Seaman*<sup>27</sup> the court held that individual shareholder has *Locus Standi* to maintain an action to prevent the majority from breaching the constitution of the company, and the action is recognized because it is an act that cannot be ratified by the majority

- (c) Where the member's personal rights have been infringed: Where it is the personal rights of the shareholder that is involved the rule in *Foss v. Harbottle* does not apply.<sup>28</sup> The reason is simple, the articles constitute a contract between the company and the members<sup>29</sup> as well as between the members *inter se*,<sup>30</sup> to observe all that is stated in the articles to perform and observe. It follows, that where the articles have so provided for rights accruing to the shareholder, it is mandatory that the company observes and performs the covenants in the articles failure of which the members can enforce their personal rights.<sup>31</sup> We must point out however, that the shareholder must be able to prove that the rights being enforced is strictly that of a member and not outsider rights, where it is, under common law it will remain

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26. Where the shareholder is only seeking for damages on behalf of the company for loss suffered by the company as a result of *ultra vires actions* or illegal act, then he must satisfy the court that the wrongdoers are in control. See, *Taylor v National Union of Mineworkers (Debyshire Area)* (1985) BCLC 237. Since the wrong done is to the company directly, then the company is the only recognized claimant.

27. (1915) 1 Ch. 503.

28. Wedderburn, K.W., "Shareholders' right and the rule in *Foss v. Harbottle*" *Cambridge Law Journal* Vol. 194 1957 p 207.

29. *Pender v. Lushington* (1877) 6 Ch. D. 70.

30. *Hickman v. Kent or Romney Sheepbreeders Association* (1915) 1 Ch. 881.

31. *Rayfield v. Hands* (1960) Ch. 1.

unenforceable.<sup>32</sup> In Nigeria, section 41 of the Companies and Allied Matters Act (CAMA 2004) now allows officers and directors of the company to sue directly to enforce their rights as enshrined in the articles. It is a traditional practice for all members having the same grievance to sue in a representative capacity. This was the acceptable form as used in *Edwardsv Halliwell*<sup>33</sup>, *Woods v Odessa Waterworks*<sup>34</sup>, *Catesby v. Burnett*<sup>35</sup> and others. The advantage is that it prevents the company from being torn apart by litigation<sup>36</sup>.

- (d) A fraud has been perpetrated against the company and the wrongdoers are in control:

It has been long settled that the one true exception to the rule in *Foss v. Habottle* is where a fraud has been perpetrated against the company by those who hold and control the majority shares in the company and will not permit an action to be brought in the name of the company<sup>37</sup>.

Before the introduction of the statutory derivative action, the procedure was that the minority shareholders were allowed to maintain a representative action against the wrong doing directors to enforce the rights rightfully belonging to the company. It was common in the early case law to refer to this exception as fraud on the minority, while such mistake is still being carried on today in Nigeria<sup>38</sup>. If in fact any fraud is committed against the

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32. Wedderburn, K. W., "Shareholders' right and the rule in *Foss v. Harbottle*" *Cambridge Law Journal* Vol. 194 1957 p 209, see also, *Staples v. Eastman Photographic Co* (1896) 2 Ch. 303, *Greenhalgh v. Ardenne Cinemas* (1945) 2 All E.R. 719, *James v. Buena Ventures Ltd.* (1896) 1 Ch 456.

33. (1950) 2 All E.R. 1064.

34. (1889) 42 Ch. D. 636.

35. (1916) 2 Ch. 325.

36. *Pender v. Lushington* (1877) 6 Ch. D. 70, *Quin & Axtens v. Salmon* (1909) AC 442.

37. *MacDougal v. Gardiner* (1875-76) L.R. 1Ch D. 13 Harman L.J. in *Bamford v Bamford* (1980) Ch. 212.

38. Lord Davy in *Burland v. Earle* (1902) AC 83.

company only the company can complain, but because the real wrongdoers are in control and will not maintain action against them, then the law allows the minority shareholders to maintain an action to redress the wrong.

### Meaning of 'Fraud'

The courts have not set any precise parameters on the meaning of fraud, but acknowledged that it is wider than common law fraud.<sup>39</sup> The court in the earlier cases like *Cooke v. Deeks*<sup>40</sup> and *Pavilides v. Jensen*<sup>41</sup> have explained the position of the law to insist that there must be actual fraud or dishonesty, and mere negligence including gross negligence was not sufficient to qualify as fraud. In *Pavilides v. Jensen*<sup>42</sup> the directors approved the sale of a mine at gross under value. The minority shareholders sued complaining of fraud and gross mismanagement. The court held that a minority shareholder cannot sue on behalf of the company in these circumstances, as only negligence and no actual fraud could be proven. Since the majority can ratify a negligent action, the minority shareholder cannot therefore maintain an action.

However, in *Daniels v Daniels*<sup>43</sup> Templeman J was of the view that the exception would permit a minority to sue even in the absence of fraud where directors have abused their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company. The judge concluded that where the directors had benefited from their negligent act, then the minority shareholder can sue. In Nigeria, the Law Reform Commission has introduced this as a statutory exception now expressed in section 300 (f) CAMA 2004. In *Prudential Assurance Co Ltd. v. Newman Industries Co.*

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39. A. Dignam *et al.*: *Company Law*, London; Oxford University Press, 2009, P. 184.

40. (1916) 1 AC 554.

41. (1956) Ch. 505.

42. (1956) Ch. 505.

43. (1978) Ch. 406.

*Ltd (No 2)*<sup>44</sup> Vinelot J was of the view that the requirement of fraud will be satisfied where the majority use their votes to prevent action being taken against them. There is a clear consensus that any expropriation of company property by the directors or majority in control is tantamount to fraud. The Privy Council in the case of *Cooke v Deeks*<sup>45</sup>, where directors expropriated to themselves a contract in breach of duty and purported to ratify their breach of duty, held that the directors held the benefit of the contract on constructive trust for the company.

Vinelot J in *Prudential Assurance Co Ltd. v Newman Industries Ltd (No. 2)*<sup>46</sup> doubted strongly whether the plaintiff really needs to allege that the defendants have benefitted from the transaction. The defendants in fact may have been negligent without any interest in the transaction, or they may have been negligent and the benefit had been that of people close to him or a company in which he has substantial shareholding. He in fact expressed doubt as to whether the requirement for some benefit on the defendant's part was a valid one.

### **Wrongdoer in Control**

The next important hurdle that must be surmounted by the claimant is that he must also satisfy the court that the wrongdoers are in control and will not bring action against themselves. We must note that the Nigerian law has moved away from the common law position by simply stating in section 300 (d) CAMA 2004, that any member may by injunction or declaration restrain the company from:

Committing fraud on either the company or the minority shareholders where the directors fail to take appropriate action to redress the wrong done.

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44. (1982) Ch. 304.

45. (1916) 1 AC 554.

46. (1981) Ch. 257, the judgment was partly overruled by the Court of Appeal in (1982) Ch. 204.

From section 300 (d) CAMA 2004, it will seem that the Nigerian law has discarded the condition that the directors **must** not only have committed fraud on the company or the minority but must actually be in control. However, section 303 (2) (a)<sup>47</sup> actually in listing the requirements that must be satisfied by a claimant trying to commence a derivative action, the court must be satisfied that (a) the wrongdoers are the directors who are in control, and will not take the necessary action. The correct position will be to read the two provisions<sup>48</sup> together; if that is done, then the 'control' aspect of the exception is still the law in Nigeria.

The common ground must be that the fraudulent directors are exercising or capable of exercising sufficient control so as to prevent legal proceedings from being brought in the name of the company. Control had always been equated with control of the voting rights<sup>49</sup>, but recently, the courts have distinguished between *de facto* and *de jure* control and whether it is sufficient to establish only *de facto* control or whether the two must be established.<sup>50</sup> The pertinent question to ask is whether the directors actually have to own the majority of the company's shares or do they just have to be able to exercise sufficient control as to prevent the proceedings by the use of directorial powers<sup>51</sup>. The issue was discussed by Vinelot J in *Prudential Assurance Co Ltd. v Newman Industries Co. Ltd. (No 2)*<sup>52</sup>. In the case, the plaintiff, a large institutional investor, held 3% of the shares of Newman. It sought to bring a derivative action against two directors of Newman who, it alleged had defrauded Newman of over £400,000. The directors did not have a majority of the shares in Newman and so did not have 'control' of it. The transaction by which Newman had been allegedly defrauded had

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47. On commencing derivative action.

48. Sections 300(d) and 303 (2) (a) CAMA 2004.

49. *Burland v. Earle* (1902) AC 83, 93.

50. *Pavilides v. Jensen* (1956) Ch. 565.

51. A. Dignam *et al*: *Company Law*, London; Oxford University Press, 2009, p 176.

52. (1982) Ch. 204.



been approved by the shareholders in general meeting, but it was claimed that the shareholders had been misled into doing so.

The learned Judge examined all the earlier authorities<sup>53</sup> on the issue and concluded that the rule and the exceptions cannot be confined within a rigid formulation, the question can only be answered by reference to the principle which underlies the rule and the exceptions to it. The underlying principle, in the words of Vinelot J applies, '...wherever the persons against whom the action is sought to be brought on behalf of the company are shown to be able by any means of manipulation of their position in the company to ensure that the action is not brought by the company'.

The Court of Appeal<sup>54</sup> in England also took a realistic view of the meaning of 'control' and agreed that the 'control' is not just *de jure* control but will include a situation where the majority vote is made up of those votes cast by the delinquent himself plus those voting with him as a result of influence or apathy.<sup>55</sup>

### **The Statutory Derivative Action**

The statutory derivative action has been introduced in virtually all commonwealth jurisdictions for mainly the same reasons.<sup>56</sup> The statutory derivative action has been introduced in most jurisdictions to overcome the very strict and increasingly difficult requirements introduced by the courts and the recognition that an enhanced shareholder role (as owner and investor) is necessary if management's obligations and duties to its shareholders constitute more than a precatory body of law.<sup>57</sup>

In the United States, the derivative action is seen as a regulator of corporate management<sup>58</sup> and the most effective

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53. *Heyting v. Dupont* (1963) 3 All E.R. 97, Canadian case of *Burrows v Becker* (1967) 63 D.L.R. (2d) 10, *Attwool v. Meryweather* (1967) LR 5 sq. 264.

54. *Cumming - Bruce, Templeman and Brightman* L.J.J.

55. (1982) 1 All ER 354.

56. Choo, P.K.M., "The Statutory Derivative Action in Singapore - A Critical Examination" *Bond Law Review* Vol. 13 No 1 2001p 64.

57. American Law Institute Tentative Draft No. 6 at 23.

58. *Cohen v Beneficial Industrial Loan Corp.* (1949) USSC 81.

means of enforcing the management's duties and obligations under the law<sup>59</sup>. In Canada, the Dickerson Committee considered the position and recommended the derivative action as the reasonable avenue through which the aggrieved party may initiate legal action to resolve problems within the company.<sup>60</sup>

Choo, Peale KohMing is of the view that statutory derivative action has primarily a deterrent objective, that by empowering the shareholders and others it serves to deter managerial misconduct by imposing the threat of liability. The law had always set some form of boundaries to directors' powers and these duties are owed principally to the company and not to individual shareholders, however the breach of these duties by directors must be enforced not by the board who are in fact the culprits, but the shareholders who are the ultimate losers. The duties, no matter how strict, are ineffective unless there is a very reliable and effective means of enforcing them. Parkinson observed as follows:

It is conceptually inelegant that the duties designed to control management should be enforceable only by management itself, the right to enforce the apparatus of control is surely distinguishable from the power to make decisions about the operation of the business and as such should not be regarded as a matter falling within the exclusive discretion of the board.<sup>61</sup>

### **The Nigerian Position**

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

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59. The United States offers a unique environment for derivative actions, and successful parties are awarded counsel costs, which serves as incentives to police management. Coffee J.C, "New myths and old realities. The American Institute Focus on Derivative Action" *The Business Lawyer* Vol. 48 No 4 1993pp1407-1441.
60. Law Commission Report No. 9 Company Law, Reform and Restatement. para. 68.
61. Note 69.

- 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, prosecuted, defended or discontinued.

The section allows an applicant to bring a derivative action by complying with the section. The requirements of and the conditions precedent including the procedure to be followed in Nigeria will be discussed in this part of the paper.

### **Who May Bring Action?**

Section 309 of the CAMA 2004 listed the categories of persons that may bring the application for derivative action. These are:

- (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<sup>62</sup>

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62. 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. This provision is similar to the Canadian position.<sup>63</sup>The Canadian provision also includes the catchall phrase that allows the courts to permit any other person who in the discretion of the court is a proper person to make the application.

The English provision<sup>64</sup> permits only a member to bring the derivative action. This seems very restrictive and foreclosed other interested parties from bringing action especially when there is a just cause and no member is interested in bringing the action. However, from the point of view of the courts, the practice seems to be very restrictive. In the Nigerian case of *Chief Akintola Williams &ors v. Edu*<sup>65</sup> 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<sup>66</sup> and former directors<sup>67</sup> 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*<sup>68</sup> 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,<sup>69</sup> an application by an ex-director was declined because the primary

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63. The Canadian Corporations Act 1970.

64. Section 260 Companies Act 2006 UK .

65. (2002) 3 NWLR (Pt 754) 400.

66. See *Jacobs Farms Ltd v Jacobs* (1992) OJ No 813 (ont.gen.dev).

67. *Schafer v. International Capital Corporation* (1997) 4 WWR 99 (Sask. QB).

68. (1992) OJ No. 813 (Ont. Gen. Div).

69. *Schafer v. International Capital Corporation* (1997) 5 NWR 99 (SaskQB).

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.<sup>70</sup> In *Adenuga v. Odumeru Belgore JSC* of the Supreme Court of Nigeria 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 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.<sup>71</sup>

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<sup>72</sup>.

### **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

70. See, *Adenuga v. Odumeru* (2002) FNWDR (pt 821) 163, *Central Bank of Nigeria v. Kotoye* (1994) 3NWLR (pt 338) 66, *Gombe v. P.W. (Nigeria) Ltd.* (1995) 6WWLR (pt. 402) 402.

71. (2002) 8 NWLR (pt. 821) 163.

72. *Ibid* at page 187-188.

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 there is no specification as to the number of days that will constitute a reasonable notice, the term is vague and imprecise and at variance with the position in other commonwealth jurisdictions.

In the Singapore Companies Act provisions, Section 216A provided for a period of 14 days' notice to the directors. The Nigerian provision does 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. 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. In Canada, a written request that the board takes action together with details of the claim comprised in a letter to the board will be sufficient.<sup>73</sup> The Nigerian provisions do not give any exception to pre-action notice, unlike some other jurisdictions, like the section 237(2)(e) of the Corporations Act 2001 (Canada) which gives the court the discretion to grant leave, even where notice was not given to the company, if it is satisfied that it will be appropriate to do so, while section 216 A(4) of the Singapore Companies Act allows the court to make interim orders as it thinks fit where the complaint established that it would not be expedient to give notice as required. In the United States, a shareholder must serve the board of directors with a demand prior to the pursuit of a derivative action. The demand will be excused when it is futile to expect the directors make a reasoned and unbiased decision on the matter, for instance, where the directors themselves are the

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73. Griggs L.2002. A statutory Derivative Action. Lessons that may be learnt from its past. UWSLAWRW 4.

persons whose actions are being questioned<sup>74</sup>. It is quite clear that where the fraudulent directors are in control, which in fact is a condition precedent for bringing the action<sup>75</sup>, it is not likely that they will bring an action against themselves; the requirement of pre-action notice is therefore superfluous and unnecessary. The notice will at best serve as an opportunity to organize their affairs, or take steps to cover up their misdeeds. It also assist to waste time unnecessarily, and since there is no specific time stipulated under the law, it could be argued that the company is indeed ready to take action but will require more time. The section should 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**

After serving the pre-action notice, this as we have discussed above is a mandatory pre-condition for bringing the application for derivative action in Nigeria. 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.<sup>76</sup>

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*<sup>77</sup>. The facts of the case is as follows; the first respondent a

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74. See B. Welling; *Corporate Law in Canada* 1992. 2nd ed.P. 527.

75. See American Law Institute, 1995. Principles of Corporate Governance, Analysis and Recommendations at 55.

76. See section 303(2)(a) CAMA 2004.

77. See, section 165(1) of the 1993 New Zealand Companies Act, section 216A of the Singaporean Companies Act, section 260(1) of the Companies Act 2006

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 1<sup>st</sup> 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 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 expert 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

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U.K. provided that the applicant after filing the action for derivative action must then apply for permission to continue the action, which is in the form of a leave application, the application is brought under the Civil Procedure Rule 19.9(1)-(4) UK.



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<sup>78</sup>.

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, 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 rationale for the application for the leave was explained by Berkahn<sup>79</sup> that the justification for making the applicant apply for leave is to prevent trivial or malicious actions from proceeding and also appears to be a recognition of the fact that to burden the company with the costs of bringing action at the

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78. *Chief Geoffrey Ozuh v. Chief Anthony Ezeweputa* (2005) 4NWLR (pt. 915) 221, Ogunbiyi JCA at page 247 explained the position thus, 'in the instant case, the applicants required leave under section 303(1) and (2) of Companies and Allied Matters Act 1990 before they could appeal. Even if they were members of the company, they could not go to court to protect the interest of the company without leave first sought and obtained'.

79. (2010) 5 NWLR (pt 1187) 348.

behest of someone with a relatively minor economic stake in the company may outweigh the benefits, even if the claim has merit. He went on to opine that the 'uncontrolled access to the remedy could also result in potential directors feeling so vulnerable to suit that they decline such positions, and their directors facing underserved reputational and financial damage due to a proliferation of spurious actions'<sup>80</sup>.

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. It is in fact a procedure crafted to sift frivolous applications from the serious ones and to safe guard the directors of the company from being dragged into court by any unserious litigant with no tangible evidence to support their claims. The insistence of the Supreme Court of Nigeria that the directors of the company must be served with the Originating Summons from the onset will defeat the real intentions of the legislature and is totally at variance with the standard in other jurisdictions. In England for instance, section 261<sup>81</sup> 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 Practice

80. Section 33 of the constitution of the Federal Republic of Nigeria 1999.

81. 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> visited 1/5/2013 at 2.30pm.

Direction 19 Con Derivative claims,<sup>82</sup> provides that the application will be decided without submission from the directors. If the court, decides that there is a *prima facie* case established, then, it will proceed to the full permission hearing and the Court may then order the directors to enter their defense to the application. The permission to continue is akin to the application for leave under the Nigerian provisions<sup>83</sup>. The position taken by the Supreme Court has therefore introduced serious anomalies in this area of the law.<sup>84</sup>

### 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 actions<sup>85</sup>. The proof of good faith is also a precondition in UK<sup>86</sup> and other jurisdictions<sup>87</sup>. 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. It also gives the court a wide discretion to shut out meritorious application on the simple ground that it was not launched in good faith. We believe that this condition should be deleted from the Nigerian law as it creates unnecessary loophole

82. See also the views expressed by the Dickerson Committee, proposals for a new Business Corporation Law of Canada, (1971), prior to the enactment of the statutory derivative action in Canada.

83. Companies Act 2006 (UK).

84. This amends the part 19 of the Court Procedure Rules (CPR).

85. Odeleye A, "Review of *Agip Nigeria Plc. v. Agip Petroli International*, available at <http://spajibade.com>. accessed on 31/01/13.

86. Eghobamien, O., "*Agip (Nigeria) Ltd. v Agip Petrolinter National & Tors* (2010) 1 CLRN 1 – The Triumph of form over substance in corporate commercial law" published in This Day Newspaper of June 1, 2010. <http://www.perchstoneandgraeys.com> visited 1/31-2013 at 4.25pm.

87. B. Welling: *Corporate Law in Canada* 1992. 2nd ed.P. 528.

that the courts may utilize to discourage serious and meritorious claims.

We suggest 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.

### **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:

- (d) it appears to be in the best interest of the company that the action be brought, prosecuted, defended or discontinued. This is similar to the position in other jurisdictions like Canada<sup>88</sup> where the courts have often equated the likelihood of success of trial with the interests of the corporation<sup>89</sup>. 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

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88. Section 263 (3) of Companies Act 2006. UK.

89. *TeoGekLuang v. Ng. Ai Tomg* (1999) ISLR 434.

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**

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<sup>90</sup>. The problem with this requirement is that it is restricted to only the fraud on the company exception, and does not extend to other breach of duty by the directors<sup>91</sup>. 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.<sup>92</sup> 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)<sup>93</sup> 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

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90. Section 303 (2(a)) CAMA 2004.

91. Maloney, "Whiter the statutory Derivative action" *Canadian Bar Review* Vol. 7 No 64 1986p 309; Ramsay, I, "Corporate Governance, shareholder litigation and the prospects for a statutory derivative Action" *University of New South Wales Law Journal* Vol. 15 p 149.

92. Section 303 (a)(a) CAMA 2004.

93. Companies Act 2006 UK.

no need to 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.<sup>94</sup> Interestingly, though the Nigerian provision<sup>95</sup> 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.*<sup>96</sup> 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 company is fraud which may take the issue outside the rule in *Foss v. Harbottle*<sup>97</sup>

### **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,

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94. Section 300 (f) CAMA 2004.

95. Companies Act 2006 (UK).

96. The situation in *Pavilides v. Jensen* will be approved under the Act.

97. Section 303 (2) (d) CAMA 2004.

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.<sup>98</sup> Ratification by the company of wrongs done to the company is an effective bar to further proceedings in court<sup>99</sup> 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.<sup>100</sup> In New Zealand, the statutory derivative action will not be available in respect of a wrong that can be ratified by a majority of shareholders.<sup>101</sup>

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 filing of a derivative

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98. (1990) 4 NWLR (pt 145) 422.

99. Per Nnaemeka -Agu JSC at page 466.

100. Section 305 CAMA 2004.

101. *Mac Dougal v. Gardiner (supra)*.

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.

### 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. The use of such terms as 'sufficient interest' and '*locus standi*' also helps the court to limit access to the court when there is no such limitation in the Act. The court insistence on the applicant for a derivative action on behalf of their company to show sufficient interest is not supported by the law and is calculated to defeat the purpose of the legislation. Since the law did not specify whether the application for the leave to bring the derivative should be made *ex- parte* or on notice, we should adopt the current international practice. The Nigerian legislation needs urgent amendments to bring it in line with current international standards.