

# Corporate Litigation and the Majority Rule: Retreating from the Precipice

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## ABSTRACT

*Corporate litigation is one of the methods of resolving both internal and external corporate disputes; however Company Laws all over the world establish a number of different forums for the resolution of internal corporate disputes that occur between directors inter se, shareholders inter se, or between shareholders and directors. However the Majority rule seems to undermine the rights of the minority share holders to seek redress for wrongs committed against the company. Thus the need to protect the minority members of the company and retreat from the precipice of the Majority rule. To enhance the protection of the minority, the Supreme Court's decision in *Edokpolo & Company Ltd v. Sem - Edo Wire Industries Ltd*<sup>1</sup>, which added an exception to the list of exceptions to the majority rule stating that the rule in *Foss v. Harbottle* will not apply when the interest of justice requires it, should be included to the statutory exceptions under CAMA. Consequently, judicial authorities suggest that the law is closing gradually on the rule in *Foss v. Harbottle* with a demolishing hammer; therefore I would recommend in line with the tide of informed opinion, that sections like section 299<sup>2</sup> should be reviewed appropriately to meet the changing faces of law because "the reason of law is the soul of law; ratio legis est anima legis".*

**Keywords:** *Corporate Litigation, Majority Rule, Minority Protection.*

## INTRODUCTION

It is trite that equity will not suffer a wrong to be without a remedy, but the majority rule in corporate governance seems to undermine the whole jurisdiction of equity especially where there is an increasing need for equitable control of the majority. The company like all progressive present day Organisations upholds the democratic principle, that the majority will must be the will of the company. However, the vitality of corporate governance lies in the recognition it gives the minority and equitable settlement is however, a desirable solution for corporate dispute<sup>3</sup>. Corporate litigation is one of the methods of resolving both internal and external corporate disputes; the other methods for the resolution of such disputes includes; shareholders in general meeting (AGM), board of directors meetings (BOD) and in the case of Nigeria, the Corporate Affairs Commission (CAC) investigating under the Companies and Allied Matters Act<sup>4</sup>. This work aimed at assessing provisions of the Companies and Allied Matters Act and other similar Acts on the legal protection of the minority under corporate governance in a company by identifying the inadequacies and current best practices in the provisions. It will also appraise the dimensions of corporate litigation as it relates to the positions of the court on the protection of the minority and also provide plausible recommendations for reforms for the protection of the minority.

## HISTORICAL PERSPECTIVE, PRACTICE AND LEGISLATION

Company Law is a dynamic and exciting body of law of enormous practical and commercial importance, it cannot be properly understood without reference to its historical background as its practice and legislation on companies has since been exploding in volume. The earliest form of association of persons was the Guild system. A Guild was an association of craftsmen in a particular trade. Members of the Guild traded on their own, but were guided by obedience to the rules of the Guild. The Guild could also confer on their members a monopoly of dealing in a particular kind of commodity<sup>5</sup>. The Companies Act 1862 was the first real modern Companies Act to be introduced in English history and the most recent is the Companies Act 2006. The Nigerian Company Law is a product of the Received English Common Law. Nigeria's first indigenous enactment was the Companies Act 1922. The Companies and Allied Matters Act 1990 is the latest of Nigeria's Company Law Legislation and this is the crux of this research.

**Majority Rule:** Before the principle of Majority rule, the first case ever reported on redress of corporate wrong was *The Charitable Corporation v. Sutton*<sup>6</sup>, where members of a non-trading corporation were allowed to sue the committee-men for fraud, breach of trust and negligent conduct. Ever since then the organic principle of the company as emphasized by the striking analogy of Denning L.J in *Bolton (Engineering) Co. Ltd. v. Graham & Sons*<sup>7</sup>, has made it clear that a company, just like an individual is capable of doing wrong, but the question as to who can sue is what led to the majority rule principle. The doctrine known as the majority rule was laid down in *Foss v. Harbottle*<sup>8</sup> and subsequently re-emphasized in *Mozley v. Alston*<sup>9</sup>. It states that in order to redress a wrong done to the company or to the property of the company, or to enforce rights of the company, the proper plaintiff is the company itself, and the court will not ordinarily entertain an action brought on behalf of the company by a shareholder.

In *Foss v. Harbottle*<sup>10</sup>, the plaintiffs, Foss and Turton, were shareholders in a company called 'The Victoria Park Company' which was formed to buy land for use as a pleasure park. The defendants were the other Directors and shareholders of the company. The plaintiffs alleged that the defendants had defrauded the company in various ways and in particular, that certain of the defendants had sold land belonging to them to the company at exorbitant price. The plaintiffs now asked the court to order that the defendants make good the losses to the company. Vice Chancellor Wigram held that since the company's board of directors was still in existence, and since it was still possible to call a general meeting of the company, there was nothing to prevent the company from obtaining redress in its corporate character, and the action by the plaintiff could not be sustained.

The import of the court's decision is to the effect that the court will normally not interfere in a matter which is within the competence of the company to settle itself or, in the case of an irregularity, to ratify or condone by its own internal procedure. Where it is alleged that a wrong has been done to a company, prima facie the only plaintiff is the company itself. By the fact of codification of the rule, considerable certainty has therefore been introduced in this regard. This rule was followed in the Nigerian case of *Abubakri &*

Ors v. Smith<sup>11</sup> were the court held, amongst other things that; 'we therefore hold that the rule in Foss v. Harbottle applies to an unincorporated association possessing a constitution or a set of rules and regulations entitling it to sue and be sued as a legal entity, and that the janat-ul-muslim of Lagos is such a body. It follows that the rule in Foss v. Harbottle applies to religious body in the same way and to the same extent as it does to a limited liability company or a trade union'. The Nigerian court in the case of Elufioye & Ors. v. Halilu & Ors<sup>12</sup> held that the rule in Foss v. Harbottle<sup>13</sup> has two limbs, viz; 'that in respect of any wrong against the company or union only the company or union can sue in its own name; and that the court will not interfere in any transaction where it is within the power of the majority shareholders to ratify or undo such action'

Also, section 299<sup>14</sup> has entrenched this famous common law rule, it states thus; 'Subject to the provisions of this Act, where an irregularity has been committed in the course of a company's affairs or any wrong has been done to the company, only the company can sue to remedy that wrong and only the company can ratify the irregular conduct'. It is worthy of note that the rule in Foss v. Harbottle also incorporates judicial policy that the court will normally not judge intra-corporate disputes, if the shareholders decide that the matter will not be heard. Hence, under this 'majority rule', if the majority shareholders decide in general meeting that no action shall be taken against offending directors, that, in principle, is the end of the matter. This controversial possibility was confirmed in Tika Tore press Ltd. v. Abina, where it was held that; 'however wrong the directors' action might have been, it was open to the shareholders in general meeting to ratify their wrong doings'.

***Rationale for the (Shareholder) Majority Rule:*** The rule is a deduction from the doctrine of corporate personality. One of the legal consequences of the artificial nature of a company as a legal person is that inevitably, decisions for and actions by, it have to be taken for it by natural persons, and if these natural persons actions were wrong, the majority shareholder can ratify the wrong actions, this has been referred to as 'majority control'. One of the rationales of this rule is that since the ratification of a wrong or irregularity is intra vires, the company or the association can ratify the act complained of by the minority, hence it is idle exercise for the court to interfere. Also, the rule prevents multiplicity of actions by shareholders. It prevents the company from being 'torn into pieces'. The rule can therefore be regarded as a strong safeguard for the interest of all concerned in the company.

***Dilemma of the (Shareholder) Majority Rule:*** Beneficial though this principle, strict application could create some intricate practical and legal problems. Firstly, unless the company decides to sue, its rights may never be enforced, with the result that both minority and majority will suffer. Unfortunately, in practice, the decision to sue or not is in fact the decision of the Board of Directors where the discretion is not restricted by the article of association, and it is human for the board to be unwilling to sue where they are the wrong doers. Secondly, the meaning of the majority may be a little ambiguous. It should be noted that the majority for this purpose does not necessarily mean numerical assemblage of

shareholders; it may mean one member, who is a wrong doer, since by appropriate provisions in the article, non - voting as well as voting shares can be created thus disenfranchising most of the shareholders. Overriding the issue above is the question whether the directors' disputed exercise of managerial power is wrong done to the company or whether it is a wrong done by the company against the shareholders. The question is of critical importance, for if the act is considered a wrong done to the company, then the rule will apply however, if it is considered a wrong done by the company against the shareholders, the shareholders has a personal right of action against the company, where he will have to sue in his own name under the general principle of tort, contract, etc .

***Minority (Shareholder) Protection in Nigeria:*** The impression one gets from the discussion of the rule in *Foss v. Harbottle* so far, is that minority shareholders are in a situation of helplessness, due to the fact that they do not possess any right as such to institute actions to redress wrong done to the company or to correct certain irregularity in the management of the affairs of the company. But the courts have over the years laid down several exceptions to this rule. Section 300 has codified these exceptions and it states thus:

*"Without prejudice to the rights of members under sections 303 to 308 and sections 310 to 312 of this Act or any other provisions of this Act, the court on the application of any member, may by injunction or declaration restrain the company from the following:*

- (a) Entering into any transaction which is illegal or ultra vires;
- (b) Purporting to do by ordinary resolution any act which by its constitution or the Act requires to be done by special resolution;
- (c) Any act or omission affecting the applicant's individual rights as a member;
- (d) Committing fraud on either the company or the minority shareholders where the director fail to take appropriate action to redress the wrong done;
- (e) Where a company meeting cannot be called in time to be of practical use in redressing a wrong done to the company or to minority shareholders; and
- (f) Where the directors are likely to derive a profit or benefit, or have profited or benefited from their negligence or from their breach of duty".

The Supreme Court in Nigeria in *Edokpolo & Company Ltd v. Sem - Edo Wire Industries Ltd* , added an exception to the list, stating that the rule in *Foss v. Harbottle* will not apply when the interest of justice requires it. But this is a lamentable omission in our statute. It should be noted that all the statutory exception under the Nigerian law originated from United Kingdom case laws. Though quit similar to that of Nigeria, one of the differences is that a person who is not a member could bring such an action, but shares must have been transferred to him/her . The English court may make whatever order it sees fit to and other statutory protection such as derivative claims and proceedings under Insolvency legislation of United Kingdom is also available to such a minority member. The South Africa legislation holds the same position with that of United Kingdom, but the issue of time limit was addressed in the Companies Act 1973 of South Africa, the application must be made within 6 weeks of passing such resolution .

### **Corporate Litigation and Minority Protection: The Interplay**

Corporate litigation derives from the legal personality of a company. Once it is incorporated, a company assumes a legal status distinct from its subscribers . It becomes capable of exercising all the power and functions of an incorporated entity. In *Isle of Wight Rly v. Tahourdin* the English Court of Appeal held that the general meeting was the company, the board of directors being mere agents of the company and thus considered subjects to the control of the general meeting. The Court of Appeal therefore refused the application by the directors for an injunction to restrain a general meeting from holding. That general meeting was aimed at appointing a committee to re-organise the management of the company. Section 63 , has settled the matter of division of powers, it provides that a company can act through: its members in general meeting, its board of directors, or through officers and agents appointed by or under authority derived from the members in general meeting or the board of directors. In carrying out their functions by way of management and administration of the company, the Board of Directors is bound in the course of interaction with others, within and outside the company, to have disputes/disagreements. Such disputes could ultimately lead to litigation where not resolved internally. Litigations that arise out of such conflicts are referred to as corporate litigation. One critical essence of this explanation to the issue of corporate litigation is that the issue of when the company has done wrong or has been wronged becomes relevant in determining the parties to any dispute regarding the company. Capacity in Corporate litigation is the foundation of Minority Protection, a shareholder has three options of maintaining corporate litigation, these include; Direct or Personal Action; Representative Action and Derivative Action.

### **CONCLUSION AND RECOMMENDATIONS**

As we have seen from the foregoing, the rule in *Foss v. Harbottle* appears to be a matter of procedure going to the root of the court's jurisdiction and this has made it possible for the court to invoke the rule in ousting its jurisdiction. Hence a major hurdle facing shareholders seeking to avail themselves of the assistance of the court to enforce duties of directors is the issue of locus standi. To enhance the protection of the minority, the provision under section 301 which requires notice to the company should be reviewed to permit simultaneous prior notice to both the court and the company. To enhance the protection of the minority, the right conferred on the outsider under section 41 (3) should be restricted to prevent excesses that may result from the present position of the law. To enhance the protection of the minority, the Supreme Court's decision in *Edokpolo & Company Ltd v. Sem - Edo Wire Industries Ltd* , which added an exception to the list of exceptions to the majority rule stating that the rule in *Foss v. Harbottle* will not apply when the interest of justice requires it, should be included to the statutory exceptions under CAMA. To enhance the protection of the minority, the 'enlightened shareholder value' duty should be introduced into corporate governance in Nigeria, it is the duty to act in the company's best interest, but it requires directors to have regard to the long term and to various 'corporate social responsibility' factors including the interest of employees, suppliers, consumers and the environment. Consequently, judicial authorities suggest that the law is closing in gradually

on the rule in *Foss v. Harbottle* with a demolishing hammer; therefore I would recommend in line with the tide of informed opinion, that sections like section 299 should be reviewed appropriately to retreat from the precipice of the majority rule and to meet the changing faces of law because "the reason of law is the soul of law; ratio legis est anima legis".

## NOTES

<sup>2</sup> (1984) 7 S. C 119

<sup>3</sup> Cap 20 Laws of the Federation 2004 (herein after referred to as *CAMA*).

<sup>4</sup> Preamble to the International Chamber of Commerce Rules of Conciliation and Arbitration (ICC Rules) 1988

<sup>5</sup> *CAMA*

<sup>6</sup> Gower and Davies, 2003, *Principles of Modern Company Law*, 7<sup>th</sup> Edition, London, Sweet & Maxwell Ltd, page 100.

<sup>7</sup> (1742) ATK p. 400

<sup>8</sup> (1957) 1 Q.B 159

<sup>9</sup> (1843) 2 HARE 461

<sup>10</sup> (1847) 1 PH 790

<sup>11</sup> *supra*

<sup>12</sup> (1973) N.S.C.C 451 at 457

<sup>13</sup> (1993) 6 NWLR 570

<sup>14</sup> *supra*

<sup>15</sup> Companies and Allied Matters Act, Cap 20 Laws of the Federation 2004

<sup>16</sup> *supra*

<sup>17</sup> Orojo J. O (1976) *Nigerian Company Law & Practice*, London Sweet & Maxwell Limited, 1<sup>st</sup> Edition, page 95.

<sup>18</sup> (1973) 4 S.C 63

<sup>19</sup> Sasegbon D. (1991) *Nigerian Companies & Allied Matters Law & Practice*, Nigeria DSC Publications, 1<sup>st</sup> Edition, page 472.

<sup>20</sup> See *Elufioye & Ors. v. Halilu & Ors. supra*

<sup>21</sup> See *Mozley v. Alston* (1847) 1 PH 790

<sup>22</sup> Barnes K. D (1992) *Case and Materials on Nigerian Company Law*, Ile-Ife Obafemi Awolowo University Press Limited, page 346.

<sup>23</sup> *supra*

<sup>24</sup> Companies and Allied Matters Act, Cap 20 Laws of the Federation 2004

<sup>25</sup> (1984) 7 S. C 119

<sup>26</sup> *supra*

<sup>27</sup> See section 994 of the Act.

<sup>28</sup> See section 252 of the Act

<sup>29</sup> *Salomon v. Salomon* (1987) A. C 22 H.L

<sup>30</sup> (1883) 25 Ch. D. 320 CA

<sup>31</sup> *CAMA*

<sup>32</sup> *supra*

<sup>33</sup> (1984) 7 S. C 119

<sup>34</sup> *supra*

<sup>35</sup> *supra*

<sup>36</sup> *CAMA*

(1883) 25 Ch. D. 320 CA

*CAMA*

*supra*

(1984) 7 S. C 119

*supra*

*supra*

*CAMA*