CORPORATE LITIGATION: DIRECTORS' OR SHAREHOLDERS' PREROGATIVE? *

Abstract

Long-drawn ripples of controversy have been generated in academic and juristic circles as to the operation of the organic division of powers vis-a-vis corporate litigation. This write up sets out to review this protracted fray. In order to arrive at this juncture due consideration will be-given to Nigerian legal stand-point.

Keywords: Corporate Litigation, Directors, Shareholders, Company

1. Introduction

The basic distinction between a company in legal theory and other forms of business associations is the fact of its incorporation or registration. Incorporation or registration of a company means no more than an act of securing for a business concern, legal or corporate personality. On incorporation, the company becomes a distinct but artificial person from its human members whom we known as natural persons. The company begins to have some rights and is subject to liabilities, disabilities or duties just as human beings. A corporation is an abstraction; a legal abstraction. It has no mind of its own. A mind however must be found. It could be located in a person or persons who may be said to be the directing mind and will of the corporation, the very ego and centre of the personality of the corporation.[1] In *Kate Enterprises Ltd v Daewod Nigeria Ltd*[2], the Supreme Court reiterated that companies have no flesh and blood. Their existence is mere legal abstraction. They must therefore of necessity, act through their directors, managers and officials. And any manager or officials of the company well placed to have personal knowledge of any particular transaction in which the company is engaged can give evidence of been transaction. These human persons represent the organs of a company. The organ constituted by the shareholders is termed 'the company in general meeting'[3] and the one constituted by the directors is known as the 'Board of directors'[4]. This organic status of the general meeting and the Board vests them with the constitutional authority to act as the company[5]. Thus, the corporate structure is rid of the hitherto position whereby the board represents the company as its agent. The concomitant of this state of affairs was the introduction and entrenchment of organic division of powers within the corporate structure.

2. Consideration of Prerogative

Long-drawn ripples of controversy have been generated in academic and juristic circles as to the operation of the organic division of powers vis-a-vis corporate litigation. This write up sets out to review this protracted fray. In order to arrive at this juncture due consideration will be-given to Nigerian legal stand-point. Prior to 1906, it was the position of Anglo-Nigerian Company Law that the general meeting above every other person or body had the right to institute proceedings on behalf of a company and to give directions as to the conduct of those proceedings. Thus, if an individual wished the rights of the company to be protected, the matter was to be referred to the general meeting who could then decide by majority votes whether or not to institute an action. This position was amply illustrated by the provisions of Companies Clauses Consolidation Act[6]. Section 90 thereof reads as follows: 'The directors shall have the management and superintendence of the affairs of the company and they may lawfully exercise all the power of the company, except as to such matters as are directed by this or the special Act to be transacted by a general meeting of the company --- and the exercise of all such powers shall be subject also to the control and regulation of any general meeting specially convened for the purpose'. In pursuance of this provision, the English Court of Appeal in *Isle of Wright Railway v. Tahaurdin*,[7] refused an application by the directors of a statutory company for an injunction to restrain the holding of a general meeting of the shareholders, one purpose of which was to appoint a committee to re-organise the management of the company. This was because 'such a meeting is the only way in which they can interfere, if the majority of them think that the course taken by the directors, in a matter which is intra vires of the directors, is not for the benefit of the company'[8] This should not come as a surprise. During the epoch review, the courts took the view that the general meeting was the company

* **By Chioma Vivian ITESHI, PhD, BL,** Lecturer, Department of Commercial and Industrial Law, Faculty of Law Ebonyi State University Abakaliki, Nigeria. email: canyigor@yahoo.com; and

***A.K MGBOLU, PhD, BL**, Senior Lecturer Faculty of Law Ebonyi State University Abakaliki, Nigeria. Email: mgboluaustine@gmail.com

[1] (1987) A.C at 22 L.T Ch. at 35

[2] (2006) 2 L.C at 508 Particularly at 535-536.

[3] Hereafter may be referred to as shareholders

[4] Hereafter referred as the board.

[5] See S.233 of Companies and Allied Matters Act (CCAMA) Cap. 59, Laws of Federation, 1990 now cap. C 20, LFN, 2010.

[6] (1945)8 & 9 vict. c 16

[7](1983) 25 Ch.D at 329

[8] See per Cotten L.J at 329

whereas the directors were merely the agents of the company subject to the control of the company in general meeting. Against the backdrop of the decision-making primacy of the general meeting, it was held in a line of 19th century cases that the organ had the prerogative of commencing corporate litigation.[9] In order to consolidate, and fully savour the advantages of the new corporate era augured by the decision in *Automatic Self-Cleansing filter Syndicate Co-Ltd v. Cunninghanme*,[10] companies almost invariably adopt,[11] inter alia, Article 80, Part 1 Table A, schedule 1, 1968 Companies Decree 17. The article, in extenso, provides as follows:

> The business of the company shall be managed by the directors, who may pay all expenses incurred in promoting and registering the company, and may exercise such powers of the company as are not, by the Decree or by those regulations, required to be exercised by the company in general meeting, subject, nevertheless to any of these regulations, to the provisions of the Decree and to such regulation[12] being not inconsistent with aforesaid regulations and provisions as may be prescribed by the company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

From a perusal of the foregoing article, a seemingly incontrovertible[13] conclusion vigorously asserts itself; that all the say in respect of corporate management has been put into the hands of the Board. According to Professor Gower:

> The modern rule, therefore, is that under an article in the terms of table A the members in general meeting cannot give directions on how the company's affairs are to be managed, nor can they overrule any decision come to by the directors in the conduct of its business.[14]

Inclining his view to this line of reasoning Professor K.W. Wederburn did not hesitate to submit, inter alia, as follows:

> But modern articles of association, such as Article so of, table A, companies Act, 1948, invariably delegates general powers of management to the board of directors; and case-law establishers that by such articles the shareholders have derived themselves the right to interfere with ordinary day-to-day management decisions of the directors by contracting in the articles that --- the directors and the directors alone shall manage.[15]

It must be noted that, where an article in the form of Article 80 forms part of a company's articles of association, the directors would have been entrusted with the power to do everything that the company could do except where the authority of a general meeting is expressly prescribed. In their own contribution, the learned authors of Halsbury's Laws of England; lord Hailsham et al opined that:

> Where, under the articles, the business of the company is in be managed by the directors and the articles confer on them the full powers of the company subject to such regulations not in consistent with the articles, as may be prescribed from time to time by the company in general meeting, the shareholders are not enabled by resolution passed at a general meeting without altering the articles, to give effective directions to the directors as to how the company's affairs are to be managed, nor are they able to overrule any decision reached by the directors in the conduct of the company's business.[16]

3. Exception of the Board's Litigation Prerogative

This write up has attempted to establish the rule that company is the only proper plaintiff where it suffers any wrong and that by the articles the board is the only organ competent to commence and defend proceedings on behalf of the company; however, there are circumstances where the Court will disregard this rule and permit a

[9] See C T Lebechi 'Corporate Litigation: Directors' or shareholders' Published by *the Advocate* Vol. 13, International Journal of the Law Students' Society, O.A.U. Ile-Ife at 80-82

[10] (1906)2 Ch. at 134

[11] S. 10(1) Companies Decree, 1968 now Cap. C20 Laws Federation, 2010; as amended; enjoins companies to adopt some or all of the articles in Table A.

[12] Emphasis mine

[13] It has been contended that the exercise of the powers of corporate management via this article is subject to the control of the general meeting see infra.

[14] Gower, *Principles of Modern Company Law*, 4th ed. (1979) at 146

[15] '*Control of Corporate Litigation'*. (1976)39 M.L.R at 327.

[16] *Halsbury's Laws of England*, 4th ed. Vol.7, para 503.

member to bring all action on behalf of the company. This brings to issue the rule in *Foss v Harbottle*[17] and exceptions thereto. The rule is two-pronged; however, this paper shall confine itself to the aspect that stipulates that 'The proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is prima facie the company or the association itself.' In that case, the two shareholders who appeared as plaintiff inter alia, a sale by the directors of their own property of inflated value to the company. The wrong alleged was thus a wrong to the company and the vice-chancellor ruled that the plaintiffs, had no standing to sue on behalf of the corporation. Also, in *Mosley v. Alston*,[18] two shareholders brought a personal action for a declaration that the board was holding office illegally and in contravention, to the terms of the company's articles of association. James J., was of the view that the rule applied. A usurpation of the office of director was a wrong done to the company and the company was the only proper complainant. This rule is premised on the separate legal personality of the corporation. If the corporation is a legal person separate from its members, it follows that for a wrong done to it, the corporation itself is the only proper plaintiff.[19] Taking in its purest form, the rule would allow the majority shareholders to ride roughshod over the minority. Thus, a number of exceptions have been worked out in an attempt to give shareholders who are aggrieved by an un remedied wrong to the company access to the courts to sue on behalf of the company.[20] The exceptions to the rule that were listed by Jenkins L.J., in *Edwards v Hallinell*, include inter alia fraud on the minority. Thus, the practice has been established of allowing a derivative action where fraud has been perpetrated against the minority by those in control of corporate affairs. By this practice, a shareholder is allowed to commence proceedings not on behalf of himself or the members generally but on behalf of the company itself. This is because his right to sue derives from the company's right of action. The plaintiff shareholder acts as the company's representative for purpose of the action. In *East Part Du Lead Mining Co. v Merryweather*,[21] proceedings arise out of the fraudulent promotion of a company. The owners of a derelict Mine formed a company, of which they become directors and shareholders, and sold the mine to it for a substantial suit. The outside shareholders sought to relieve the company of the purchase and to recover the money paid to the sellers. An action was commenced in the company's name but was dismissed when the miscreants secured, through the exercise of their votes, the passing of a resolution directing that the company should discontinue with the proceedings. A shareholder then initiated a new action on behalf of himself and all other members except the fraudulent directors. It was subsequently held that notwithstanding *Foss v Harbotlle* rule, the court would grant the order.

4. Article 80 and Corporate Litigation

The question that falls next for determination is whether the general management power vested in the directors via Article 80 confers on them an exclusive right to control corporate litigation. A corollary to this is as to whether corporate litigation forms a specific aspect of the general management power conferred on the directors by Article 80. In an essay[22] by Professor Wedderburn, it is the position that:

> Delegating general management of the company as in Article 80, does not vest in the directors an exclusive right to control legal proceedings in the company's name. However, if the articles have expressly granted to the director sole control of legal proceedings, then, the members would be contractually bound not to interfere---[23]

The learned scholar sought relief in *Marshall's Value Wear Co. V. Manning Wardle & Co.*[24] In that case, general management were delegated to the directors but the majority shareholders were permitted to override the directors' decision not to sue in defence of the company's rights. Also in *Parish Merchantile Co. Ltd v. Beaumont*[25] the court totally ignored the managing director's power to manage under the articles and held that an action commenced pursuant to that power was valid only because it had been ratified by the liquidator of the company. Writing in a subsequent article,[26] Professor Wedderburn, holds 'That the decision to commence or defend legal proceedings is within such general powers to manage the company's business, and therefore reserved for the directors, is supported by high authority and would seem logically to follow.'[27] It appears that the learned writer's

[17] (1843)2 Hare at 461.
[18] *Babatande Adenuga & ors v. J.K Odumesu* (2003) vol. 1NSCQLR 255 at 397-2 98 per S.O Uwaifo J.S.C.
[19] Stanley M. Beck on *Shareholders Derivative Action* (1974) 52 CAN.B. REV at 104.
[20] Beck, op. Cit at 166
[21] (1864)2 H.&M at 254.
[22] Shareholders' Rights and the Rule in *Foss v. Harbottle*, (1957) Cambridge L.T at 194.
[23] See foot note 22 at 203.
[24] (1909) 1 ch at 267, dictum of per Neville, J.
[25] (1950)2 All. E.R at 1064
[26] Control of Corporate Litigation, (1976)39 M.L.R at 327.
[27] Per Greer L.T., *Shaw & Sons (Salford) Ltd v. Shaw* (1935).

latter view renders the former a nullity. This essay throws its weight behind this later line of reasoning. Any contrary view, it is submitted, is patently uncalled for. It is evident that Articles 80 cannot allow an action frame in this way, since otherwise, it would be impossible to set aside the fraud. It is supremely undoubtedly that the shareholders derivative suit can be an important and effective agent in controlling directorial conduct. Indeed Professor Engene Kastoro has characterized such shareholder actions as the 'most important procedure the law has yet developed to police the internal affairs of the corporation.'[28]

In *Shaw & Sons (Salford) Ltd v. Shaw*,[29] the general power of management of the company was, by the articles, delegated to the directors. At a general meeting the company resolved that proceedings which had been instituted by the directors in the company's name by discontinued. The resolution was held invalid. Affirming this position in Alexander *Ward Co. Ltd. V. Samyang Navigation Co. Ltd*,[30] Lord Kilorandon said that 'the instruction of actions at law is an act of management'[31] Also, in *Atemologun v. Metro Motor Ltd*,[32] the Federal Revenue Court held that the appointment of a firm of solicitors by the chairman of Board was invalid as there was no resolution of the Board to that effect. Delivering the judgement of the court, Kabribi-White opined that '--- since the appointment of the solicitor is a power of management vested in the directors by the articles of association of the company in accordance with Articles 80, there must be a resolution of the Board in support of the exercise of the powers so vested in the Board.' In view of the foregoing, it becomes impracticable to insulate the specific question of control of corporate litigation from the broad question of control of corporate management.

5. Conclusion

This paper has prudently adopted the view that by virtue of the general powers of corporate management conferred by Article 80 of the common form articles of associations and subject to any contrary provision, the Board has the carte blanche to initiate, continue or withdraw corporate litigation. Accordingly, the case and comments that held contrary stand-point should, with due respect, be disregarded as they still retain the stale odour of the 19th century subservient status of the Board.[33] Laudably Nigerian Courts have taken a defined stand on the matter. Thus, the controversy and concomitant complexity spawned by the Marshall Value Geer[34] line of the cases, including the learned opinions of protagonists of the principles therein established have been decently interred. It must however be admitted that an abundant justice has not been done to this volatile topic. This paper has only 'stirred these points which wise heads in time may settle'[35] From the totality of the above averments, it is clear that a company may in many ways be likened to a human body. It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of the directors is the state of mind of the company and is treated by the law as such.[36]

[28] Beck, Op. cit at 162-163.
[29] See footnote 27
[30] (1975)2 All E.R at 424
[31] *Ibid* at 437
[32] *Aleruchi Etchesona Nsirim v. Onuma Construction Company (Nigeria) Ltd* (2001) vol. 5 NSCQLR at 775 per E.O Ayoula JSC.
[33] Equally, they have refused to see the merit of the stand-point that 'the professional view as to the control of the company in general meeting over the actions of directors has, over a period of years, undoubtedly varied.' See Lord Clauson in Scott v. Scott (1945) 1 All ER 582 at 585.
[34] See footnote 24
[35] See per Holt C.J., in *Coggs v. Bernard* (1703) 2 L.d Raym 909 at 920.
[36] *Kate Enterprises Ltd v. Daewod Nigeria Ltd* (2006) vol. 2 L.C 536-537 and footnote 1. See also *Okomu Oil Palm Company Ltd v. O.S. Iserhienr hien* (2001) vol.5 NSCQLR at 830.