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Defining the relationship between the rules in *Foss v harbottle* and *Salomon v salomon*: A Nigerian view

Babajide S Shoroye
Senior Lecturer, Department of Business Law, Faculty of Law, Lagos State University, Lagos, Nigeria

Abstract
Most fundamental rules and principles of modern company law evolved from landmark cases decided long ago under common law. Two of such cases are *Foss v Harbottle* and *Salomon v Salomon & Co Ltd*. For over a century these cases have constituted indispensable cornerstones of company law in common law jurisdictions. However, with statutory intrusions to clarify or modify the rules in different jurisdictions, there are now identifiable differences in their original formulation at common law and their statutory enactment. For the most part, the rules have been codified in their substantive respects, but conditions and extenuating circumstances of their applications now vary according to statutory provisions. In this paper, we identify and analyse the relationship between the rules under common law and within the provisions of the Nigerian Companies Act 2020. We show that the relationship between the rules under the Act may be defined only in terms of their substantive provisions, and not in their respective exceptions. Hence, we point out that the common law exceptions to both rules are based on different grounds, and for different objectives under the Act. Significantly, the statutory variance we identify in this paper has implications for legal proceedings for the protection of corporate rights and the rights of minority members of companies in jurisdictions with statutory provisions similar to the Nigerian Companies Act 2020.

Keywords: *Foss v harbottle*, *Salomon v salomon*, companies act 2020, majority rule, separate legal personality

Introduction

Most fundamental rules and principles of modern company law evolved from landmark cases decided long ago under common law. Two of such cases are *Foss v Harbottle* [1] and *Salomon v Salomon & Co Ltd* [2]. For over a century these two cases have constituted indispensable cornerstones of company law in common law jurisdictions. The decisions in these cases firmly articulated the principles of corporate litigation, corporate governance, the majority rule, and the rule of separate legal personality of an incorporated company. While there have been statutory intrusions to either clarify or modify the rules and principles established in the two cases [3], their fundamental legal effects on the jurisprudence of company law remain precedent and decisive as they have been since the 19th century when the cases were decided.

For instance, statutory provisions have validated that it is only the company that has the legal right to seek redress against any wrong done to it, and that it is the majority members that have the power to make decisions for the company, as originally held in the case of *Foss v Harbottle*. Likewise, no statute has altered the decision in the case of *Salomon v Salomon* which held that the incorporation of a company confers on such company a legal personality that is distinct from its incorporators or members. The combined effect of these two seminal cases underpins the nature and legal status of a company, the incidence of incorporation, and the legal right of an incorporated company as provided in contemporary statutes on company law and practice.

Although the two cases were decided at different times, on different principles, and with different attendant rules, there is however a functional relationship between their respective rules as they impact on the formation and administration of a company. In other words, from their common law origins and through statutory interventions, the rules in *Foss v Harbottle* and *Salomon v Salomon* have addressed different foundational aspects of company law, and served different purposes in corporate jurisprudence. However, in terms of legal and practical effects both rules are intrinsically related and mutually dependent; one rule either strengthens or delimits the other for the purpose of achieving its full legal ramifications for a corporate entity.

In this paper, we identify and examine the relationship between the rules in *Foss v Harbottle* and *Salomon v Salomon* under common law. We discuss the ambit of the relationship in its essential respects for the purpose of showing how both rules have shaped modern company law. But since the rules have largely been enacted in statutes of many common law jurisdictions, this paper critically analyses the relationship between the rules under the relevant provisions of the Nigerian Companies and Allied Matters 2020. It is therefore in the context of the Nigerian statutory provisions that this paper clearly defines the relationship between the long-standing rules in *Foss v Harbottle* and *Salomon v Salomon* [4].

The rule in *Foss v harbottle*

The common law rule on the enforcement of legal rights of a company and the decision on whether or not to enforce such rights is encapsulated in the case of *Foss v Harbottle* decided about the first half of the 19th century. It was decided in that case that where a wrong is done to a company, it is the company itself that can sue to remedy the wrong. And it is the majority members of the company who can make the decision as to whether the company should sue for redress or not. This case therefore laid the ‘‘proper plaintiff’’ and the ‘‘majority rule’’ principles of corporate litigation and corporate governance respectively. That

is, the proper party to enforce corporate rights and how to make corporate decision.

The relevant facts of *Foss v Harbottle* are that some of the directors of a company had sold their own land to the company at an over-valued and exploitative price. They also mortgaged the land in the name of the company and then appropriated the money from the mortgage to themselves. An aggrieved member of the company instituted this action to compel the directors to make a refund of the money to the company, and for a receiver to be appointed for the company. It is from these facts that the court, per Wigram VC, determined that the company was an incorporated body, and the conduct with which the defendants were charged in this suit was an injury not to the plaintiffs exclusively; it was an injury to the whole corporation by individuals whom the corporation entrusted with powers to be exercised only for the good of the corporation [5].

Wigram therefore held that it was not, nor could it successfully be argued that it was a matter of course for any individual members of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law the corporation and the aggregate members of the corporation are not the same thing for purposes like this. According to Wigram, directors constitute the organ with the power to sue for redress in the name of the company. But the majority members in a general meeting can exercise such power where the directors failed or neglected to sue, but no individual member is empowered to sue like the plaintiff in the case.

Foss v Harbottle therefore established the rule that it is the company itself that is the proper plaintiff with the requisite *locus standi* to sue in order to remedy any wrong done to it. Also, that it is for the majority members of a company to approve the decision as to whether the company should sue for remedy or not. The reason for the rule, as adumbrated by Wigram VC, is that based on the Incorporation Act of the company in issue the majority members at a general meeting had the power to bind the whole body, and every member must be taken to have come into the corporation upon the terms of being liable to be so bound. Therefore, the court would be acting in vain if it were to declare in favour of the plaintiff who complained about the directors' acts, when the majority members could decide to ratify the acts complained about in the suit.

This rule in *Foss v Harbottle* has since then been adopted and amplified in subsequent cases with similar facts [6]. In *Edwards v Halliwell* [7] Jenkins LJ reiterated that the rule in *Foss v Harbottle* comes down to two principles: First, 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 association of persons itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company or association and all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then no wrong had been done to the company or association and there is nothing in respect of which anyone can sue.

Instructively, the basis of the rule in *Foss v Harbottle* is the legal personality of an incorporated company which makes a company a separate and distinct entity that is independent of its promoters and shareholders. Thus, it is the separate legal personality possessed by the company that confers it with the legal capacity like natural persons to sue for redress for any wrong it suffers. However, the legal personality of the company is an artificial contraption since a company does not possess a personal mind and self-will like natural persons. Accordingly, the company depends on its human owners and members for its management and decision-making power, and that power is vested in its directors or majority members [8]. The separate legal personality of a company which formed the basis of the rule in *Foss v Harbottle* was established in the case of *Salomon v Salomon*.

The rule in *Salomon v salomon*

The case of *Salomon v Salomon* proclaimed the fundamental rule that a registered company is a separate legal entity, distinct from its directors and shareholders, and is to be treated as any other independent and natural person with its own rights and liabilities. Although the decision and rule in *Foss v Harbottle* was based on the separate legal personality of a registered company, the case of *Salomon v Salomon* was actually decided more than fifty years after the former. Separate legal personality had already become an attribute of joint stock companies of the time but its legal implications were not fully grasped until *Salomon v Salomon* [9]. From an analysis of its historical context, McQueen argues that the significance of *Salomon v Salomon* with respect to the rule of separate legal personality only evolved after the decision itself [10]. And according to Lipton, the rule of separate legal personality already largely developed, and a very large number of one person or closed companies had already been formed at the time of the decision in *Salomon v Salomon* [11]. Therefore, at the time the case of *Foss v Harbottle* was decided the perceived difference in the fundamental relationship of a joint stock company and its shareholders indicates the extent to which the rule of separate legal entity had developed.

The willingness of the courts in pre-*Salomon v Salomon* era to confer a legal personality on a corporation that was separate from its shareholders was evident in the case of *R v Arnaud* [12] decided in 1846, five decades before *Salomon v Salomon*. In that case, a corporation, of which a number of members were not British subjects, was held to be capable of being registered as a British shipowner even though foreigners were prohibited from owning in whole or in part, directly or indirectly, a British ship. The court, per Denman CJ, held that it was the corporation that was the legal owner and not its members, hence there could be valid registration [13].

The history of the evolution of the rule of separate legal personality shows a number of commercial developments that were reflected in the English Companies Act of 1862 which introduced new wording that implicitly described a registered company as being separate from its members by providing that members may ''form an incorporated company'' [14]. The commercial developments changed the legal and functional nature of the company form, and also served to further differentiate a company from a partnership. By the time *Salomon v Salomon* was decided the company form had largely evolved away from its partnership origins, and the concept of separate legal entity, in relation to joint stock companies, had become almost fully developed [15].

However, it was the case of *Salomon v Salomon* that clarified and firmly established that, once the formal process of registering a company has been concluded, the company becomes a corporate

legal personality separate and distinct from its promoters and those who come in to manage and run its business. The facts of the case involve one Mr Salomon, a sole proprietorship of a manufacturing business, who registered a company (Salomon and Salomon & Co Ltd) to which he sold his business. Mr Salomon owned all the shares of the company except six, which were held each by his wife and five children. As the managing director of the company Mr Salomon invited creditors to invest in the company, and he also held debentures of the company which made him a secured creditor to the company.

When the company eventually collapsed and a liquidator took over, Mr Salomon made a claim as a debenture holder and secured creditor. But the liquidator contended that Mr Salomon could not rank ahead of other creditors because the company and Mr Salomon were one and the same, and that the company had carried on business as an agent of Mr Salomon, therefore he was personally liable for the debt of the company. When the case got to the Court of Appeal, it was held that the company was a mere sham and that Mr Salomon remained the sole proprietor of the company's business, and he was liable to indemnify the company against its debts to third parties.

But on appeal to the House of Lords, the judgment of the lower court was set aside. The House of Lords determined that the company was formed in compliance with the provisions of the applicable statute and therefore, the company was a separate person and not the agent of Mr Salomon, its major shareholder and manager. According to their Lordships, the company and Mr Salomon were two separate entities as such the debts of the company were not the debts of Mr Salomon; the company must be treated like any other independent person with its rights and liabilities appropriate to itself, and not to Mr Salomon.

From the judgment of the House of Lords, a company becomes a separate legal entity by virtue of its incorporation, and from the date of incorporation the company is at law a different person altogether from the subscribers to the memorandum even though it may be that after incorporation the business of the company is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits [16]. Thus, *Salomon v Salomon* effectively established the rule of separate legal personality of a registered company, and the rule was subsequently adopted and applied in other cases that turned on the relationship between the company and its promoters or controlling shareholders.

For example, in *Macaura v Northern Assurance Co. Ltd* [17], the plaintiff who was a major shareholder and managing director of a company had insured the company's property in his own name. When the property was consumed by fire and he sued for claims the House of Lords held that the insurers were not liable under the contract of insurance on the property since the property belonged to the company and as such the plaintiff did not have any insurable interest in the property; the plaintiff and the company were separate entities with different and independent rights and liabilities. Similarly, in *Lee v Lee's Air Farming* [18] the plaintiff's husband was the major shareholder, controlling director and chief pilot of the company. When he died in the course of the company's business the Privy Council held that plaintiff could claim workers' compensation as her husband could be an employee of the company because he was a separate and distinct entity from the company.

A necessary corollary to the rule of separate legal personality in *Salomon v Salomon* is the principle of limited liability of members of an incorporated company. The subscribers to the company's memorandum of association and any other shareholders or members of the company are liable for the debts or liabilities of the company only the extent of the value of their shareholdings in the company. As a distinct and independent entity, the company only admits its members as investors who are entitled to returns according to their respective investments. Therefore, when the company falls on hard times and is unable to continue business as a going concern, its members cannot share in its debts or liabilities beyond their respective investment portfolios.

However, members and shareholders of the company, including its creditors, are entitled to ensure that they have returns on their investments, and that the company does not collapse due to mismanagement or fraudulent conduct of the company's business. As noted earlier, corporate legal personality does not confer the company with human characteristics such as a mind or self-will possessed by natural persons. The company necessarily depends on its human incorporators and members to manage its business and direct its affairs. In the case of *Bolton Engineering Co. Ltd v Graham & Sons* [19], Lord Denning, in his characteristic erudition, succinctly explained the compulsory dependence of the company on its human members and employees;

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 direction 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 on what it does.

By necessary implication, therefore, the company is at the mercy of its managers and directors who represent its mind and will; who make all necessary decisions for the company. In their capacities the managers and directors can potentially expose the company to avoidable risks and plunge it into losses instead of profit. They may also engage in fraudulent transactions and undertake criminal business schemes all in the name of the company, but effectively in their selfish interests. Under the rules in *Foss v Harbottle* and *Salomon v Salomon*, these instances of possible malfeasance by those in control of the company may go unredressed, to the detriment of the company and its shareholders. Hence, at common law, there are exceptions to both rules.

Exceptions to the rules in *Foss v harbottle* and *Salomon v salomon*

In an essential respect, the rule in *Foss v Harbottle* is anchored on the rule in *Salomon v Salomon*. But it is the exceptions to both rules that mostly bear out the features of the foundational relationship between the rules. For instance, the combined effect of the two rules is that directors are the only ones vested with power to make decisions in the name of the company. The residuary power lies in the general meeting which could be exercised where the board of directors is incapacitated, but no individual member is empowered to act in the name of the company. The vesting of the company's management powers in the directors, and judicial restriction on interference with the

power have a long history. As long ago as 1812 Lord Eldon, LC had declared in *Carlen v Drury* [20] that; "This court is not to be required on every occasion to take the management of every playhouse and brew house in the Kingdom".

Almost a century later in 1902, Lord Davey was categorical in objecting to any form of judicial interference in matters of internal management of the company, and stated in the case of *Burland v Earl* [21] that the court has no jurisdiction to do so. And in subsequent decades in the early 20th century Greer, LJ held in *Shaw & Sons (Salford) Ltd v Shaw* [22] that if powers of management are vested in the directors, they and they alone can exercise these 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 their articles, or, if the opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove.

According to Lord Wilberforce in *Howard Smith v Ampol Petroleum Ltd* [23], there is no appeal on merits from management decisions to courts of law nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly made. The exclusion of shareholders from interfering in management decisions is a strong reason for the courts to exhibit some reluctance in doing so, as the simple question is; if the shareholders as a general body cannot interfere in management decisions, why should the courts? The courts cannot be more interested in the running of the affairs of the company than the shareholders themselves except perhaps when the interests of creditors are involved [24].

The rules in *Foss v Harbottle* and *Salomon v Salomon* are easy enough to apply when the company is being managed properly without fraud or negligent conduct of directors; when the interests of the company and that of shareholders are not jeopardized. But as Lord Denning observed in the case of *Wallersteiner v Moir (No 2)* [25], suppose the company is defrauded by insiders who control its affairs - by directors who hold a majority of shares - who can then sue for damages? According to the law Lord, those directors are themselves the wrongdoers; if a board meeting is held, they will not authorise proceedings to be taken by the company against themselves, and if a general meeting is called, they will vote down any suggestion that the company should sue them.

Lord Denning therefore held in the case that: ''In one way or another some means must be found for the company to sue. Otherwise the law would fail in its purpose. Injustice would be done without redress''. In order to protect the company and its minority shareholders, including its creditors, against unjust actions of its directors and those in control the concept of ''derivative action'' was developed as an exception to the rule in *Foss v Harbottle*. Similarly, the doctrine of ''lifting the veil of incorporation'' was developed as an exception to the rule in *Salomon v Salomon*. In their respective applications, both exceptions were developed under common law so that minority shareholders of a company may be able to sue in order to redress a wrong done to the company, and the veil of incorporation may be lifted so as to ascertain the human actors in a company that has committed fraudulent or criminal acts.

Derivative Action

In laying out the rule in *Foss v Harbottle* Wigram VC had pointed out that it would be too much to deprive members the right to seek remedy on behalf of the company if a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters for the protection of those rights to which in their corporate character they were entitled; the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue [26]. Though, in the case Wigram did not find any justification to depart from the rule, this *obiter* in his judgment however implies that in exceptional circumstances minority members of the company may be able to sue in the name and on behalf of the company.

In the subsequent case of *Burland v Earle* [27], while adopting the rule in *Foss v Harbottle* Lord Davey stated that an exception would be made where the persons against whom relief is sought are themselves in control of the majority of the shares of the company, and would not permit action to be brought in the name of the company. Derivative action is therefore the type of suit which can be commenced by a minority shareholder in the name and on behalf of the company, particularly in cases where the company has suffered a wrong and the majority members in control of the company failed or refused to remedy the wrong. Thus, under common law derivative action was a procedural device that allowed minority shareholders to institute actions on behalf of the company as an exception to the rule in *Foss v Harbottle* [28].

In the case of *Edwards v Halliwell* [29] Jenkins, LJ observed that the rule in *Foss v Harbottle* is not so rigid as not to admit of some exceptions where necessary in the interest of justice, and he identified four of such exceptions, namely: ''where the act complained of was *ultra vires* the company''; ''where the issue is such that it could only be done by a special majority of the members and not a simple majority''; ''where the personal rights of the shareholder have been invaded''; and ''where what has been done amounts to a fraud on the minority and the wrong-doers are in control of the company''. Under any of these exceptional circumstances, minority shareholders may sue in the name and on behalf of the company.

However, the fourth exception of fraud on the minority and the wrong-doers in control has been widely considered as the only real exception to the rule in *Foss v Harbottle*, since it constituted the most potent ground upon which the minority shareholders could maintain a cause of action for and on behalf of the company [30]; the exception was readily applied where fraud had been perpetrated by the majority who controlled the company, and would not permit an action to be brought in the name of the company [31]. Following *Foss v Harbottle* the case of *Burland v Earle* stated the ground for derivative action based on fraud on the minority as ''the majority will not be allowed to appropriate to themselves money, property or advantages which belong to the company or in which the other shareholders are entitled to participate'' [32].

Derivative action based on the exception of fraud on the minority and wrong-doers control does not however assure of consistent outcome in every case of alleged malfeasance by the majority in control of the company, due largely to contextual definitions of ''fraud'' and ''control'', including judicial nuances around the elements to be proved in those terms [33]. Questions such as; what amounts to fraud, type of control, and whether the alleged wrong-doing is ratifiable or not, weigh in heavily on the success of a

derivation action that proceeds on ''fraud on the minority and wrong-doers control'' exception to the rule in *Foss v Harbottle*. But more relevant in the context of this paper is that allegation of fraud committed in the name of the company also provides ground for lifting the veil of incorporation as an exception to the rule in *Salomon v Salomon*.

Lifting the Veil of Incorporation

The rule of separate legal personality would not be followed when doing so would result in unfair and unjust consequences for those dealing with the company. Therefore, the veil of incorporation is lifted when the court side-steps the separate legal entity status of the company in order to determine the shareholders or those in control of the company. The purpose is to hold members of the company personally liable for the obligations of the company as if the company and its members were one and the same. In the case of *Salomon v Salomon* Lord Halsbury had hinted on the possible exception to the rule of separate legal personality by stating that the rule would apply provided there was ''no fraud and no agency and if the company was a real one and not a fiction or myth'' [34].

Where the rule of separate legal personality of the company is used to defeat public convenience, justify wrong, protect fraud or defend crime, the rule would be disregarded and the company treated as an association of persons [35]. According to Lord Denning in *Littlewoods Mail Order Stores Ltd v IRC* [36], the rule in *Salomon v Salomon* does not ''cast a veil over the personality of a limited company through which the courts cannot see. The courts can, and often do, pull off the mask. They look to see what really lies behind''. From the cases, the courts have indeed drawn aside the veil of incorporation to see what laid behind the corporate entity and ensure that the company is not used as a ''device'', ''sham'', ''façade'' or an ''alias'' to commit wrongful acts and perpetrate injustice [37].

There is no clear judicial guideline for lifting the veil of incorporation and the courts consider different factors under different circumstances, including "the underlying social, economic and moral factors as they operate in and through the corporation [38]". In the relatively recent case of *Prest v Petrodel Resources Ltd & Others* [39] the Supreme Court of the United Kingdom observed that the law relating to the circumstances in which it would be permissible for the courts to lift the veil of incorporation was characterised by ''inadequate reasoning'', and that ''piercing the corporate veil is more of a label than a coherent principle or rule of law'' [40]. Lord Neuberger however concluded in that case that there was a principle that the corporate veil could be pierced, but it was a limited rule.

Even though the application of the principle may be limited, one enduring ground upon which it has been consistently applied for a century is where the company is used as engine of fraud or to promote fraudulent enterprise [41]. As far back as 1911 and as recent as 2011 the courts have lifted the veil of incorporation based on the courts' findings that the company was a mere sham and a cloak to commit fraud [42]. Other well-known cases include that of *Gilford Motor Company Ltd v Horne* [43]. In that case the court lifted the veil of incorporation after it determined that ''the company was formed as a device, a stratagem, in order to mask the effective carrying on of business of Mr Horne. And that it ''was clear that the main purpose of incorporating the new company was to perpetrate fraud''. Similarly, in *Jones v Lipman* [44] the court lifted the veil of incorporation and held that the company was ''the creature of the defendant, a device and a sham, a mask which he holds in an attempt to avoid recognition by the eye of equity''.

Thus, like derivative action is allowed as an exception to the rule in *Foss v Harbottle* where there is fraud on the company, the veil of incorporation is lifted as an exception to the rule in *Salomon v Salomon* based on fraud by the company. Both exceptions have the same objective of going behind the corporate wall and holding to account members or shareholders who are in control of the company, and who use their positions to engage in wrongful acts in the name of the company. The rules in *Foss v Harbottle* and *Salomon v Salomon*, including the exceptions to the rules, have been codified in the Nigerian Companies Act 2020. In the next part of this paper the relevant statutory provisions are critically examined in order to determine how the rules and the exceptions are related in scope and objective as compared with the common law.

The rules in *Foss v harbottle* and *Salomon v salomon* under the Nigerian companies act 2020

The Nigerian Companies and Allied Matters Act 2020 (the Act, or the Companies Act 2020) provides for the formation and registration of a company [45]. Once there is full compliance with the process and requirements for registration as provided in the Act, a certificate of incorporation is issued to the subscribers of the company's memorandum. All the attributes of a company, in terms of its legal status, rights and powers, emanate originally from the fact of registration. The effect of registration is that an artificial personality is completely born into adulthood, with no period of infancy or immaturity, capable of existing independently of those who brought it into life. This is sufficiently clear from the provision of section 42 of the Act;

As from the date of incorporation mentioned in the certificate of incorporation, the subscriber of the memorandum together with such other persons as may become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the powers and performing all functions of an incorporated company including the power to hold land, and having perpetual succession, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in this Act.

Accordingly, section 43(1) of the Act vests on the company all the powers of a natural person with full capacity to carry on its business or objects [46]. The common implication of the provisions of sections 42 and 43(1) is that the Companies Act 2020 enacted the rule of separate legal personality as in *Salomon v Salomon*, with its incident of limited liability of members of the company. The provisions also establish how the company can carry on its business with respect to its management and decision-making powers. In recognition that the company is merely an artificial personality, the Act provides that it shall act through its members in general meeting or its board of directors or through officers or agents appointed by, or under authority derived from, the members in general meeting or the board of directors [47].

The business of the company is managed by the board of directors who may exercise all powers of the company subject to the powers of the members in general meeting or the provisions of the Act [48]. Thus, under section 89 of the Act, any act of the

members in general meeting, the board of directors, or a managing director while carrying on in the usual way the business of the company, is treated as the act of the company itself and the company is criminally and civilly liable to the same extent as if it were a natural person. But in the division of powers between the board of directors and the members in general meeting, the company's management and decision-making powers are vested in the board of directors who is not bound to obey the directions or instructions of the members in general meeting, provided that the directors act in good faith and with due diligence [49].

However, the members in general meeting retain the power to ratify or confirm any action taken by the board of directors, and may make recommendations to the board of directors regarding action to be taken by the board. The members in general meeting may also act in any matter if the members of the board of directors are disqualified or unable to act because of a deadlock on the board or otherwise, including the commencement of legal proceedings in the name and on behalf of the company, if the board of directors refuse or neglect to do so [50].

From the foregoing statutory provisions on the effect of registration and the process of corporate governance, the company enjoys a separate legal personality, and its management and decision-making powers are exercisable by the board of directors or the whole body of members in general meeting. Consequently, under the Companies Act 2020 the company, as a separate legal personality with full capacity like a natural person, has the sole power to make decisions concerning its business and affairs, including the decision whether or not to sue for any wrong it suffers, or to ratify any irregular conduct of its business and affairs.

Accordingly, section 341 of the Act expressly provides that ''where an irregularity is made in the course of a company's affairs or any wrong is done to the company, only the company can sue to remedy that wrong and only the company can ratify the irregular conduct''. The provision of section 341 is a codification of the rule in *Foss v Harbottle* as it makes the company the proper plaintiff with the *locus standi* to institute legal action for the purpose of seeking redress for any wrong done it. Also, it is within the company's prerogative power to decide whether or not to ratify any irregular conduct of its business and affairs.

Since the Act vests the company's management and decision-making powers on the board of directors and the members in general meeting, the implication is that any decision of the company is made either by those in control of the company, or by majority of the members in general meeting. In either case, individual members or members in the minority are not in position to make decisions for the company, and can only watch and expect that the business of the company is managed with due care and diligence in the overall interest of the company and its shareholders. Thus, where the company suffers wrong-doing or irregular conduct of its business it falls on the board of directors or the majority of members to make a decision whether to sue to remedy the wrong, or whether to ratify the irregular act.

However, in order to ensure the protection of minority members section 343 of the Act provides that any member may apply to the court for an injunction or declaration to restrain the company or its officers from; (a) entering into any transaction which is illegal or ultra vires; (b) purporting to do by ordinary resolution any act which by its articles or this Act required to be done by special resolution; (c) any act or omission affecting the applicant's individual rights as a member; and (d) committing fraud on either the company or the minority shareholders where the directors fail to take appropriate action to redress the wrong done.

Such application by minority shareholders may also be made; (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; (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; and (g) any other act or omission, where the interest of justice so demands. Clearly, the grounds contained in section 343(a) – (d) upon which minority members may seek injunctive or declarative relief are exactly the same with the grounds for derivative action as an exception to the rule in *Foss v Harbottle* [51]. However, under the Companies Act 2020 these are not the grounds for the commencement of derivative action like it was at common law.

In other words, under the Act the grounds in section 343(a) – (d) upon which minority members may apply to court for a restraining injunction or declaration do not constitute exceptions to the provision of section 341, as they were to the rule in *Foss v Harbottle*. At common law, where any of the grounds existed, particularly the fraud on the minority exception, an individual member could commence a derivative action. But under the Companies Act 2020, derivative action may be commenced only in pursuant to the provisions of section 346. From the provisions of the Act, therefore, derivative action is not commenced based on the common law exception to the rule in *Foss v Harbottle*; the rule now codified in section 341 while the exceptional grounds are contained in section 343(a) – (d). According to the provisions of section 346, with the marginal title, ''Commencing derivative action'';

1. Subject to the provisions of subsection (2), an applicant may apply to the Court for leave to bring an action in the name or on behalf of a company or a company's subsidiary, or to intervene in an action to which the company or the company's subsidiary is a party, for the purpose of prosecuting, defending or discontinuing the action on behalf of the company or the company's subsidiary.
2. No action may be brought and no intervention may be made under subsection (1), unless the Court is satisfied that—

a. a cause of action has arisen from an actual or proposed act or omission involving negligence, default, breach of duty or trust by a director or a former director of the company;
b. the applicant has given reasonable notice to the directors of the company of his intention to apply to the Court under subsection (1);
c. the directors of the company do not bring, diligently prosecute, defend or discontinue the action;
d. the notice contains a factual basis for the claim and the actual or potential damage caused to the company;
e. the applicant is acting in good faith; and
f. It appears to be in the best interest of the company that the action be brought, prosecuted, defended or discontinued.

From the above provisions, an applicant may apply to the court for permission to institute derivative action, or an action in the name and on behalf of the company, where all the grounds listed in paragraphs 346(2)(a) – (f) cumulatively exist. For the specific

purpose of the derivative action under section 346 of the Act, ''applicant'' is defined as; (a) a registered holder or a 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 a company; (c) the Corporate Affairs Commission; or (d) any other person who in the discretion of the Court, is a proper person to make an application under the section [52].

Thus, unlike the application by minority members for an injunction or declaration to restrain the company or its officers pursuant to the provisions of section 343 of the Act, in derivative action under section 346 the court only makes such order; (a) authorising 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 is paid, in whole or in part, directly to former and present security holders of the company instead of to the company; and (d) requiring the company to pay reasonable legal fees incurred by the applicant in connection with the proceedings [53].

The significant difference between the applications under sections 343 and 346 of the Companies Act 2020 is that while the former is for the protection of the rights of minority members of the company, the latter is to protect the corporate rights of the company itself. Consequently, in terms of the rule in *Foss v Harbottle* there is no direct relationship between the common law exception of derivative action and the derivative action under the Companies Act 2020. Though, the exceptional grounds for common law derivative action are replicated in section 343(a) – (d) of the Act, they do not however constitute the grounds for departure from the provision of section 341 of the Act, which is the statutory enactment of the rule in *Foss v Harbottle*. Thus, while the rule in *Foss v Harbottle* has been codified in the Companies Act 2020, its exception of derivative action proceeds on different grounds and for different objective from the derivative action provided in the Act.

Also, at common law derivative action was mostly anchored on fraud on the minority and wrong-doer control, in similar way fraud by the company effectively allowed the lifting of the veil of incorporation as an exception to the rule of separate legal personality in *Salomon v Salomon*. But under the Companies Act 2020, there is no express provision for the lifting of the veil of incorporation by the court. The closest provisions on lifting the corporate veil are those that empower the Corporate Affairs Commission (CAC) to appoint inspectors to investigate ownership of a company; for the purpose of determining the true persons who are or have been financially interested in the success or failure of the company, or able to control or materially to influence the management of the company [54].

Personal liability of directors, members and officers of the company are mainly for infractions of the provisions of the Act, and at the instance of the CAC. For examples, where the company fails to comply with provisions that require companies to keep annual accounting records under sections 374 – 375; where directors fail to deliver annual balance sheet and financial statements of profit and loss account to the CAC as required under section 388; laying before the general meeting or delivering to the CAC defective financial statements [55]; failure to comply with the provisions of sections 417 – 423 on annual returns; and where payment of dividend is made out of capital [56].

The only provisions on when a court may lift the veil of incorporation and hold ''delinquent directors'' and controlling shareholders personally liable, relate to fraudulent and wrongful trading of a company that is being wound up [57]. Under the Companies Act 2020 there is therefore no provisions on lifting the veil of incorporation that approximate to the position at common law, such as on the ground of fraud by the company as exemplified in the notable cases of *Gilford Motor Company Ltd v Horne* [58] and *Jones v Lipman* [59]. In fact, the Act expressly provides in section 89 that ''any act of the members in general meeting, the board of directors, or a managing director while carrying on in the usual way the business of the company, shall be treated as the act of the company itself and the company is criminally and civilly liable to the same extent as if it were a natural person''.

Consequently, while the rule of separate legal personality in *Salomon v Salomon* is reflected in the provisions of sections 41 and 43(1) of the Companies Act 2020, its common law exception of lifting the veil of incorporation by the court is not so provided under the Act. Like the Nigerian statutory derivative action, lifting the veil of incorporation is on different grounds and for different purpose under the Act. In the final analysis, therefore, within the provisions of the Companies Act 2020, the relationship between the common law rules in *Foss v Harbottle* and *Salomon v Salomon* only crystallizes in the provisions on the substantive effects of the rules, and not in their exceptions or procedural devices to circumvent or ameliorate their effects.

Conclusion

Without doubts, the rules in the epochal cases of *Foss v Harbottle* and *Salomon v Salomon* laid the foundations for modern company law; the separate legal personality of a registered company and the majority rule in corporate governance reverberate through the whole gamut of contemporary theory and practice of company law. However, with statutory intrusions to clarify or modify the rules, perhaps in line with local and international commercial developments in different common law jurisdictions, there are now identifiable differences in their original formulation at common law and their current statutory enactment.

For the most part, the rules have been codified in their substantive respects, but conditions and extenuating circumstances of their application now vary according to statutory provisions. The Nigerian Companies Act 2020 provides for both rules without their exceptions as applied under common law. For instance, at common law the effect of the rule in *Foss v Harbottle* on the rights of minority members of the company was countered by the procedural device of derivative action. Although, the Companies Act 2020 provides for the established grounds upon which derivative action could be commenced under common law, derivative action within the provisions of the act is however not based on those grounds, and is not for the protection of the minority rights of members of the company. Similarly, while the rule in *Salomon v Salomon* is also codified in the Companies Act 2020, its exception of lifting the veil of incorporation, including the common law grounds for the exception, is not expressly provided for under the Act.

Significantly, we have identified in this paper that while there is a direct relationship between both rules and their respective exceptions under common law, no such direct relationship exists

within the provisions of the Companies Act 2020. The relationship between the rules under the Act may be defined only in terms of their substantive provisions, and not in their respective exceptions.

The implication of this difference in their statutory relationship is that derivative action under the Companies Act 2020 is for the protection of the corporate rights of the companies itself, and not for the protection of minority rights. A different action, through application to the court by individual members of the company, exists for the protection of the rights of minority members of the company. So also, different grounds and objective exist for lifting the veil of incorporation under the Act. Therefore, in legal proceedings for the protection of corporate rights and the rights of minority members of the company both common law rules and their respective exceptions should never be conflated under the relevant provisions of the Nigerian Companies Act 2020.

References

1. (1843) 2 Hare 460
2. [1897] AC 22
3. For example, as the leading common law jurisdiction, the United Kingdom has enacted both rules under sections 16 and 260 of the Companies Act 2006. See also sections 19 and 165 of the South Africa Companies Act 71 of 2008; sections 42 and 341 of the Nigerian Companies and Allied Matters Act 2020.
4. It is important to point out that the relevant statutory enactments of both rules are similar across common law jurisdictions because most of the Companies Acts like that of Nigeria and South Africa substantially reflect that of the UK, the leading common law jurisdiction. For example, compare sections 16 and 260 of the UK Companies Act 2006 with sections 42 and 341 of the Nigerian Companies Act 2020, including sections 19 and 165 of the South Africa Companies Act 71 of 2008. Consequently, this paper's discussion on the relationship between both rules in the Nigerian statutory context applies *mutatis mutandis* to that of the UK and South Africa.
5. *Foss v Harbottle* above note 1 p. 202 para. 490
6. See *MacDougall v Gardiner* (1875) 1 ChD 13; *Burland v Earl* [1902] AC 83 at 93 (PC); *Shuttleworth v Cox Brothers and Co (Maidenhead) Ltd* [1927] 2 KB 9
7. (1950)2 All E.R. 1064
8. See the case of *Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113 CA at 134
9. Paul L Davies and Sarah Worthington, 2012, Gower and Davies' Principles of Modern Company Law (Sweet & Maxwell, 9th ed.) p. 35
10. Rob McQueen, 1999, 'Life Without Salomon', 27 Federal Law Review 181, 201
11. Phillip Lipton, 2014, The Mythology of Salomon's Case and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective, Monash University Law Review, 40: 2
12. (1846) 9 QB 806
13. As quoted by Phillip Lipton, *op.cit*
14. Section 6 of the Act; See Phillip Lipton, *op.cit*
15. Phillip Lipton, *op.cit*; See generally the author's historical analysis of the development of the rule of corporate legal personality.
16. See the judgment of Lord Macnaghten at p.51
17. [1925] A.C. 619
18. [1961] A.C. 12
19. (1934) 1 K.B 57
20. (1812) 1 V & B 154
21. [1902] AC 83 at 93 (PC)
22. [1935] 2 KB 113 CA at 134
23. [1974] AC 821 at 832
24. Anthony O. Nwafor, 2016, Enforcement of Corporate Rights-The Rule in Foss V Harbottle: Dead or Alive. Corporate Board: Role, Duties & Composition, 12:1
25. (1975) 1 All ER 849 (CA)
26. (1843) 2 Hare 461 at p. 492
27. (1902) A.C 83
28. See *Prudential Assurance Co Ltd v Newman Industries Ltd and others* (No. 2) [1982] Ch 204
29. (1950)2 All E.R. 1064
30. M.A. Maloney, 1986, 'Whither the Statutory Derivative Action', 64 The Canadian Bar Review 308, 310; Anthony O. Nwafor, 2017, Enforcement of Corporate Rights-; Gareth Baker and Samantha Hacking, 2016, 'UK: Statutory Derivative Claim Regime: Ten Years On', Mondaq Business Briefing 1; Mike Oluwaseyi Bamigboye, 2016, 'The True Exception to the Rule in Foss v. Harbottle: Statutory Derivative Action Revisited'. Available at <https://ssrn.com/abstract=2863851> accessed 10 September 2021
31. See *Daniels v Daniels* [1978] Ch 406; *Regal (Hastings) Ltd v Gulliver* [1980] 2 All ER 841; *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2; *Prudential Assurance Co Ltd v Newman Industries Ltd and others (No. 2)* [1982] Ch 204
32. (1902) A.C 83
33. K. Vere-Stevens, 1997, 'Should We Toss Foss: Toward an Australian Statutory Derivative Action' 25 ABLR 127; Anthony O Nwafor & Gloria C Nwafor, 2014, 'Breach of Duty: Power of Shareholders to Ratify Directors Fraudulent Dealings' 10 (2) Corporate Board: Role, Duties & Composition 32
34. [1897] A.C. 22, at p. 61
35. *United States v Milwaukee Refrigerator Transit Company* (1905) 142 F. edn. 247, per Sanborn J of the U.S Supreme Court.
36. [1969] 1 W.L.R. 1241, 1254
37. See *Daimler Company Ltd v Continental Rubber and Tyre Co (Great Britain) Ltd* [1916] 2 A.C. 307; *Bolton (Engineering) v Graham & Sons Ltd* [1956] 3 All E.R. 624; *Whitford Beach Pty Ltd v FCT* (1982) 150 C.L.R. 355; *Re Chisum Services Pty Ltd* (1982) 1 A.C.L.C. 292
38. *Tata Engineering Locomotive Co v. State of Bihar AIR* 1965 SC 40
39. [2013] UKSC 34
40. Per Lord Walker, at p. 508–9 [106]; See also the case of *VTB Capital v Nutritek* [2013] 2 AC 337
41. Other ancillary grounds where the veil of incorporation may be lifted are: to determine the true commercial realities of a group of companies as in *D.H.N Food products Ltd v Tower Hamlets London Borough Council* [1976] 1 WLR 852; to determine whether the company is a mere agent of the majority shareholder as was the case in *Re F.G (Films) Ltd*

(1953) 1 WLR 483; to determine whether what exists between the company and its shareholders is a trust relationship. See *Abbey Malvern Wells Ltd Ministry of Local Government Planning* (1951) Ch.728; to determine the enemy character of the company as in *Daimler Co Ltd v Continental Tyre & Rubber Co (Great Britain) Ltd* [1916] 2 A.C. 307; and to determine whether the company is used to evade or avoid the payment of taxes. See *Marina Nominees Ltd Federal Board of Inland Revenue* (1986) 2 NWLR (pt 20) 48.

42. See the cases of *Re Darby Exparte Brougham* (1911) KB 95 and *Antonio Gramsci Shipping Corp v Stepanovs* [2011] EWHC 333, respectively
43. (1933) Ch. 935 (CA)
44. [1962] l WLR 832
45. See PART B of the Act
46. Section 43(1)
47. Section 87(1)
48. Section 87(3); Section 88 provides that the board of directors may exercise its powers through committees consisting of such members of their body as they think fit; or may appoint one or more of its members to the office of managing director and may delegate all or any of its powers to such managing director.
49. Section 87(4)
50. Section 87(5)
51. The four grounds identified by Jenkins, LJ in the case of *Edwards v Halliwell* (1950)2 All E.R. 1064, at p. 1067
52. Section 352
53. Section 347
54. See section 369(1); Under section 8(1), the Corporate Affairs Commission is statutorily saddled with the mandate of administering the Companies Act 2020 Act, including the registration, regulation and supervision of the formation, incorporation, management, striking off and winding up of companies.
55. Section 391(1)
56. Section 433
57. See sections 672 – 675
58. (1933) Ch. 935 (CA)
59. [1962] l WLR 832