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AWOLALU, OLUDARA,AJIBIKE

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UNDERSTANDING AND EVALUATING THE  
ENFORCEMENT OF CORPORATE LAW IN NIGERIA:  
THE CASE FOR ENHANCED PUBLIC CIVIL  
ENFORCEMENT.

A thesis submitted to Durham University for the degree of  
Doctor of Philosophy in the Faculty of Social Sciences and  
Health

2017

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School of Law

Durham University

## **ABSTRACT**

In recent years, countries around the world have witnessed a number of corporate scandals, varying in their enormity. Nigeria has been no exception, having suffered its fair share of these corporate scandals.

In many countries, the discovery of some new corporate scandal is unsurprisingly accompanied by calls, from various quarters, for increased directorial accountability. Such calls are then, in their turn, followed by the introduction of new corporate and securities regulations, as well as reforms to existing corporate governance codes. In this quest for increased directorial accountability however, almost all the attention tends to be placed on the substantive content of the laws and codes governing directors. Much less attention, by contrast, has been devoted to the effectiveness of the enforcement regimes applying to these laws and codes. Yet, in the absence of effective enforcement, substantive rules have little impact. Consequently, while it is important to have appropriately developed company law regimes, which impose duties and responsibilities on directors, such laws are likely to fall well short of the mark unless they are also well enforced. It therefore becomes necessary to examine critically enforcement within the context of corporate law.

In light of the crucial importance of enforcement in securing directors' compliance and accountability, this thesis focuses upon the enforcement of corporate law in Nigeria. It analyses three major enforcement regimes in Nigeria: the criminal enforcement regime, the private civil enforcement regime and the public civil enforcement regime. Drawing on criteria for determining effective enforcement developed in the course of this thesis, it argues that the public civil enforcement regime offers the best potential for achieving significant real improvement in the enforcement of corporate law in Nigeria. To further reinforce the argument made for an enhanced public civil enforcement regime, this thesis uses three enforcement case studies derived from the UK and from Australia. The enforcement experience in these countries, whose corporate law regimes bear close similarities with that of Nigeria, have revealed that the public civil enforcement regime, by a clear gap, offers a potentially effective enforcement regime in corporate law. In short, then, this thesis argues that attaining effective enforcement of corporate law is within Nigeria's reach but this can however be achieved only if it reforms, and develops, public civil enforcement in order to realise the potential benefits of this enforcement regime.

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## LIST OF ABBREVIATIONS

ACJA	Administration of Criminal Justice Act 2015
APC	Administrative Proceedings Committee
ASIC	Australian Securities and Investments Commission
CAC	Corporate Affairs Commission
CAMA	Companies and Allied Matters Act 1990
CBN	Central Bank of Nigeria
CDDA	Company Directors Disqualification Act 1986
CIC	Capital Issues Committee
EDN	Edition
EFCC	Economic and Financial Crimes Commission
FCA	Financial Conduct Authority
FSA	Financial Services Authority
ISA	Investments and Securities Act 2007
IST	Investments and Securities Tribunal
NCCG	National Code of Corporate Governance 2016
SEC	Securities and Exchange Commission
UN	United Nations

US	United States

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- Banks and other Financial Institutions Act Cap B3 LFN 2004.
- Code of Corporate Governance for Licensed Pensions Operators 2008.
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- Companies Act 1968.
- Companies and Allied Matters Act (CAMA) Cap c20 Laws of the Federation of Nigeria 1990.
- Companies Ordinance 1912.
- Companies Ordinance 1922.
- Companies Proceedings Rules 1992.
- Companies Regulation 2012.
- Constitution of the Federal Republic of Nigeria 1999.
- Criminal Code Act CAP 77 LFN 1990.
- Economic and Financial Crimes Commission (Establishment) Act 2004.
- Evidence Act 2011.
- Investments and Securities Act 2007.
- Law (Miscellaneous Provisions) Law, Cap 65 Laws of Lagos State 1973.
- National Code of Corporate Governance 2016.
- Nigerian Enterprises Promotion Decree of 1972.

- Penal Code (Northern States) Federal Provision Act 1960.
- Public Complaints Bureau, the Corrupt Practices Decree (No 38 of 1975).
- Public Officers (Investigation of Assets) Decree (no 5 of 1966).
- Recovery of Public Property (Special Military Tribunals) Decree 1984.
- Recovery of Public Property (Special Military Tribunals) Decree 1984.
- SEC Rules and Regulations 2013.

### **UK Legislation**

- Civil Procedure Rules 1998.
- Companies Act 1862.
- Companies Act 1948.
- Companies Act 1985.
- Companies Act 2006.
- Company Directors Disqualification Act 1986 c.46.
- English Companies (Consolidation) Act 1908.
- Financial Services and Markets Act 2000.
- Insolvency Act 1985.
- Insolvency Act 2000.
- Joint Stock Companies Act 1856.
- Limitation of Liability Act 1855.
- Small Business, Enterprise and Employment Act 2015.

### **US Legislation**

- Financial Institutions Anti-Fraud Enforcement Act of 1990 (FIAFEA) 12 U.S.C.

- Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) 12 U.S.C.
- Sarbanes-Oxley Act 2002.

### **Canadian Legislation**

- British Columbia Company Act RSBC 1996, C.62.
- Canada business corporations act RSC 1985 c C-44.

### **Australian Legislations**

- Corporations Act 2001

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- FG Hawkes (western) Ltd Re [2015] EWHC 1585.

- Foss v Harbottle (1843) 2 Hare 461.
- Hogg v Cramphorn Ltd [1967] Ch 254.
- Howard Smith v Ampol Petroleum Ltd [1974] AC 821.
- Iesini v Westrip Holdings Ltd [2010] BCC 420, 448.
- Johnson v Gore, Wood & co [2002] 2 A.C 1, HL.
- Nurcombe v Nurcombe (1984) 1 B.C.C 99269.
- Percival v Wright [1902] 2 Ch. 421 Ch D.
- Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch. 204.
- R v Holyoak, Hill and Morl (unreported UK case).
- R v Sussex Justices, Ex p McCarthy [1924] 1 KB 256.
- Re Asytec (BSR) Plc [1998] 2 BCLC 556.
- Re Blackspur Group Plc [1998] 1 WLR 422.
- Re Stanford Services Ltd & ors (1987) 3 BCC 326.
- Robinson v Harman (1848) 1 Exch 850.
- Salomon v Salomon & Co Ltd [1897] AC 22, HL.
- Secretary of State for Business, Innovation and Skills v Adedapo [2015] CSOH 152.
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- Smith v Croft (no 2) [1988] Ch 114.
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## **DEDICATION**

To Him who is able to do exceedingly, abundantly, above all I could dare ask or think...

# CHAPTER 1: INTRODUCTION

## 1.1 Background

Companies are a dominant feature of modern society. They own the stores from which we buy food and other supplies, they provide the water, gas and electricity which we rely on, they also supply many of the services that we require for our daily convenience.<sup>1</sup> They are therefore an integral part of our everyday life. Similarly, in recent times, large multinational companies have continued to increase in terms of both their size as well as the sphere of their influence. As Anderson and Cavanagh note

Of the 100 largest economies in the world, 51 are corporations; only 49 are countries...to put this in perspective, General Motors is now bigger than Denmark; DaimlerChrysler is bigger than Poland; Royal Dutch/Shell is bigger than Venezuela; IBM is bigger than Singapore; and Sony is bigger than Pakistan.<sup>2</sup>

It is therefore evident that companies are increasingly becoming more powerful than nations and have become a huge political, economic and social force in today's global world.<sup>3</sup> In light of the immense power and influence wielded by companies, it is essential that those controlling them be subject to checks and balances.

---

<sup>1</sup> See D French, S.W. Mayson & C. Ryan, 'Company Law' (29<sup>th</sup> edn, OUP 2012-2013) 1.

<sup>2</sup> S Anderson & J Cavanagh, 'Top 200: The Rise of Corporate Global Power' (Institute for Policy Studies) <<http://s3.amazonaws.com/corpwatch.org/downloads/top200.pdf>> accessed 14<sup>th</sup> October 2016.

<sup>3</sup> Note that the terms 'companies' and 'corporations' are used interchangeably throughout the course of this thesis.

A company is regarded in law as a separate legal entity.<sup>4</sup> It is however an ‘artificial’ entity<sup>5</sup> and therefore requires human agents to act on its behalf. The basic company model consists of its members (shareholders) and the directors who control and manage it. In small companies, it is very common for the members of the company to also function as the directors of the company. However, this is less often true in larger companies. As Parkinson notes, ‘in all but the smallest companies efficiency necessitates the delegation of authority to manage the business to a specialized management team’.<sup>6</sup> Large public listed companies<sup>7</sup> are often ‘widely-owned’ making it impossible for all the shareholders to be directly involved in the company’s management.<sup>8</sup> In order for these companies to run efficiently, there is need for delegation of power from the shareholders to the directors. It is important to note here that the companies which this thesis is concerned with are such ‘widely owned’ companies, including those that are publicly listed. These are the sort of companies where there has been a delegation of power from the shareholders to the directors thereby creating room for those directors to act in their own self-interests to the detriment of the company’s shareholders.

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<sup>4</sup> *Salomon v Salomon & Co Ltd* [1897] AC 22, HL.

<sup>5</sup> It is worth noting that there are different theories of corporate personhood. See SK Ripken, ‘Corporations are People Too; A Multi-Dimensional Approach to the Corporate Personhood Puzzle’ (2009) 15 *Fordham Journal of Corporate and Financial Law* 97. Hence, some argue that the company is an artificial entity, see JV Schall, ‘The Corporation: What Is It’ (2006) 4 *Ave Maria Law Review* 105,118. Some others have argued that the corporation is a real entity, see W Jethro Brown, ‘The Personality of the Corporation and the State’ (1905) 21 *Law Quarterly Review* 365,370. Yet still some see the corporation as a ‘nexus of contracts’. See MC Jensen & WH Meckling, ‘Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 305. The different theories of the firm have certain elements of truth, they cannot however all be used at the same time. This thesis therefore chooses to view the firm as an artificial entity. This thesis therefore adopts this term throughout this thesis.

<sup>6</sup> JE Parkinson, *Corporate Power and Responsibility: Issues in The Theory of Company Law* (OUP 1993) 51.

<sup>7</sup> A public limited company is a company whose shares can be freely sold to the members of the public. However, a public listed company is a public limited company whose shares are listed and traded on an official stock exchange.

<sup>8</sup> ‘Widely’ owned means that ownership is in the hands of very many shareholders, each of whom likely owns only a small proportion of the total share capital.

The delegation of power from shareholders to directors creates an ‘agency relationship’,<sup>9</sup> which is said to be at the core of the corporate structure.<sup>10</sup> Delegation allows skilled managers to run corporations even though they lack personal wealth, while allowing wealthy individuals to invest even though they lack managerial skills.<sup>11</sup> It is therefore a symbiotic and ‘theoretically’ mutually beneficial relationship. The difficulty however arises when the interests of the agent diverges from that of the principal within the corporation.<sup>12</sup> Directors may act in their own interests, to the detriment of the shareholders, thereby reducing value to shareholders and the society.<sup>13</sup> This is known as the ‘agency problem’. Therefore, while delegation is required for ‘corporate efficiency’, it comes with its unique difficulty which is common to all agency relationships.<sup>14</sup>

Directors generally play an important role in corporations. Their activities have significant effects on their companies’ wealth, the wealth of their shareholders and the interests of other stakeholders in those companies.<sup>15</sup> The law therefore regards them as fiduciaries. The significance of directors’ position and responsibility in the company was further reiterated by Lord Goldsmith during the debate on the UK Company Law Reform Bill 2005, where he said ‘[w]e should remind ourselves that being a company director is a wonderful thing for the person who is the company director. But it is a position of great responsibility which involves running the affairs of a company for the benefit of other people. It is a heavy responsibility that we

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<sup>9</sup> To be clear the term ‘agency relationship’ used by economists to denote the relationship between directors and shareholders does not directly mirror a typical agency relationship in law.

<sup>10</sup> See FH Easterbrook and DR Fischel, ‘Corporate Control Transactions’ (1982) 91 Yale Law Journal 698,700.

<sup>11</sup> Ibid.

<sup>12</sup> Note that the terms ‘corporation’ and ‘company’ are used interchangeably throughout the course of this thesis. They however mean the same thing within the context of this thesis.

<sup>13</sup> Parkinson (n 6) 51.

<sup>14</sup> For further discussion of the agency problem and consequent agency costs, see chapter 2.

<sup>15</sup> A Keay, *Directors’ Duties* (Jordan Publishing Ltd 2009) 1.

should not water down'.<sup>16</sup> There is therefore an interest - private and public - in ensuring that directors do not take their responsibility lightly and that the company is directed, and managed, in the company's interests.

In light of this, countries around the world have developed and reformed their corporate law regimes in order to mitigate the agency problem and ensure that directors manage the company's affairs in its best interests. These reforms have included imposing stringent responsibilities on directors in the form of directors' duties and reporting obligations. Much less attention has however been placed on the *enforcement* of these laws and obligations. The pertinent question then is whether these rules are 'self-enforcing' and sufficient to secure compliance with the law. The answer must be a clear No. As Armour argues, 'the deterrent effect of a legal rule is a function not only of the size of the potential penalty but of the probability of its enforcement'.<sup>17</sup> In the absence of appropriate enforcement mechanisms, legal rules have little deterrent effect and are unable to secure adequate compliance. As noted by McDaniel, 'a right without a remedy is worthless'.<sup>18</sup> Therefore, while it is important to put in place good systems of laws that impose duties and responsibilities on directors, these laws are unlikely to be of any use in corporate governance unless they are well enforced. In short, the effectiveness of a regulatory regime therefore depends not just on substantive rules but, also importantly, on the availability of effective enforcement mechanisms.

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<sup>16</sup> Lords Grand Committee, 'Company Law Reform Bill' 6 February 2006 GC291, <<http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060206/text/60206-40.htm>> accessed 12<sup>th</sup> October 2016.

<sup>17</sup> J Armour, 'Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment' in J Armour & J Payne, *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart Publishing 2009) 77.

<sup>18</sup> MW McDaniel, 'Bondholders and Stockholders' (1988) 13 *Journal of Corporation Law* 205,309.

Nigeria provides the classic example of a country which has been unable to secure effective enforcement of its corporate law, in spite of the existence and body of substantive laws. Nigeria, with a population of about 186 million,<sup>19</sup> is Africa's most populous nation and the largest market for goods and services in Africa. The Nigerian legislative system is largely rooted in its colonial past and, like many other former British colonies, Nigeria inherited many of its rules and regulations from the colonial government.<sup>20</sup> As a result, Nigeria's company law has over the years been drawn from, and closely patterned after, the English common law and various UK Companies Acts.<sup>21</sup>

The Companies and Allied Matters Act 1990 (CAMA) is the current statute governing all companies in Nigeria. It makes provisions for financial statements, auditing requirements, accounting standards, directors' duties, shareholders' rights amongst other issues. Similarly, the Investments and Securities Act 2007 (ISA) governs the operation of Nigeria's capital market. It is therefore applicable to public listed companies and makes provisions regarding companies' annual reports and accounts, sale of shares to members of the public and investor protection. Furthermore, in keeping with international best practice, Nigeria has had a number of corporate governance codes and indeed, very recently, released a new National Code of Corporate Governance 2016 which commenced operation from the 17<sup>th</sup> of October 2016. In spite of these however, as will be seen in the course of this thesis, enforcement of corporate law in Nigeria is weak. There is a clear mismatch between

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<sup>19</sup> United Nations, 'Nigeria' <<http://data.un.org/CountryProfile.aspx?crName=NIGERIA>> accessed 18<sup>th</sup> November 2016.

<sup>20</sup> E.N.M Okike, 'Corporate Governance in Nigeria: The Status Quo' (2007) 15(2) Corporate Governance 175.

<sup>21</sup> The Nigerian Companies Ordinance 1912 drew heavily on the English Companies (Consolidation) Act 1908. Similarly, the Nigerian Companies Act 1968 was very similar to the English Companies Act 1948.

the quality of the substantive rules and regulations that apply to companies in Nigeria, and the level of enforcement that is achieved in practice. The main problem besetting Nigerian corporate law and governance lies then, not with the substantive rules and regulations themselves, but with their enforcement. Consequently, there is a crucial need to examine the mechanisms for enforcement of corporate law in Nigeria, with a view to achieving improvements that will address such lack of enforcement.

The foregoing comments explain and justify the overarching goals of this thesis. These goals are to demonstrate that Nigeria does indeed have an ‘enforcement problem’ in corporate law, to identify the causes of that problem, in terms of the weaknesses which undermine existing enforcement regimes in Nigeria, and to offer persuasive and practical avenues for reform.

To accomplish this, the thesis focuses upon *three* enforcement regimes in particular. These are, first, the criminal enforcement regime, second, the private civil enforcement regime and, third, the public civil enforcement regime. As noted, the purpose of doing so is to identify weaknesses within these regimes and to make suggestions for their reform and improvement. However, it will be useful to give an immediate sense, here, of the main reform that is suggested. Although none of the three regimes currently operates in a satisfactory way in Nigeria, this thesis shall argue that one of them – public civil enforcement – stands out as offering the *best* potential for achieving substantial and real improvement to the overall enforcement of corporate law in Nigeria. This thesis shall demonstrate that public civil enforcement offers significant advantages over both criminal enforcement and private civil enforcement, in terms of its potential to realise the proper purposes of enforcement. This is partly because of the inherent theoretical advantages of public civil enforcement compared to its alternatives, and also because the difficulties which

generally plague enforcement regimes in Nigeria are, it will be argued, most likely to be avoided in respect of public civil enforcement.

In short, then, this thesis focuses on demonstrating that public civil enforcement should be accorded much greater emphasis in Nigerian corporate law, and identifying the reforms that are needed to achieve that. This should not be taken to imply that the other enforcement regimes – criminal, and private civil – have no role at all to play, nor that their own effectiveness could not be improved through appropriate reforms. Indeed, during the course of this thesis some reforms to these other regimes will be suggested. They are not, however, and to emphasise the point, the focus of the work which is, as argued, enhancing and improving public civil enforcement.

This argument for an enhanced role for public civil enforcement regime in Nigeria is further reinforced by empirical studies drawn from the UK and from Australia. Analysis of enforcement case studies drawn from these countries support the arguments developed here both about the potential superiority of public civil enforcement, and about some of the reform measures that are necessary, in Nigeria, to realise this potential.

## **1.2 Research Questions**

The overarching research question with which this thesis is concerned might be expressed as follows: ‘which enforcement regime offers the greatest potential for delivering overall effective enforcement of corporate law in Nigeria?’ This thesis is therefore primarily concerned with how to ensure that corporate law requirements and standards are effectively enforced in Nigeria (whatever ‘effective enforcement’ might mean).



As mentioned earlier, while there is much literature on the requirements, which should be imposed on directors of companies, and the manner in which the content of corporate laws and regulations can be improved, much less attention has been placed on the enforcement of these corporate law requirements. This is particularly so in Nigeria where there is very little existing literature analysing enforcement issues, in respect of corporate law. This thesis aims to fill that lacunae in literature and make an original contribution to knowledge in this regard.

In order to answer the overarching research question which has been identified, this research identified a number of subsidiary research questions which must be addressed.

1. What exactly is the agency problem in corporate law, and what substantive legal strategies are in place to deal with this (in corporate law systems generally, and in Nigeria specifically)?
2. What role does enforcement play in securing compliance with these legal strategies, what are the goals and purposes of enforcement in corporate law, and by what criteria should an effective enforcement regime in corporate law be judged?
3. What is the current 'state of play' regarding enforcement of corporate law in Nigeria, how effective is it, and what are the reasons for its successes or failures?
4. How might enforcement of corporate law be improved in Nigeria? Is the author's hypothesis - that public civil enforcement provides the most plausible and desirable means of improving overall enforcement of corporate law in Nigeria - compelling? Consequently, should Nigeria

focus more of its immediate reform efforts on the public civil enforcement regime?

5. Can, and should, Nigeria learn from the experience of other countries in this regard?

### **1.3 Structure of Thesis**

To address the subsidiary questions, and in so doing answer the overarching question posed, this thesis adopts the following structure and is divided into three main parts. Part 1 provides a conceptual framework for the entire thesis. It starts in chapter 2 by examining the nature of the agency problem in corporate law. It also examines agency costs and the different types of agency costs which arise in corporations. Finally, it examines the legal strategies for mitigating agency costs in corporations.

Chapter 3 examines the enforcement problem in corporate law. It argues that enforcement of corporate law is necessary in order to secure compliance. It starts by conceptualising enforcement, before going on to examine the goal and purpose of enforcement. It further examines the importance of enforcement in corporate law and provides a justification for enforcement using deterrence theory. It then develops certain criteria which should be used to measure or determine an effective enforcement regime in corporate law. These criteria are deterrence, compensation and cost-effectiveness and they form the basis for the analysis of the different enforcement regimes in subsequent chapters. Finally, the chapter provides a typology of enforcement mechanisms in corporate law and sets out the enforcement regimes, which will be the subject of further analysis in the thesis.

Part 2 examines the Nigerian context of enforcement in corporate law. It starts in Chapter 4 by exploring Nigeria's corporate landscape. It first provides a detailed

history of commercial development in Nigeria. It then examines the legal forms for conducting business in Nigeria before moving on to focus specifically on incorporated companies. It identifies the structure of the legal framework governing companies in Nigeria and describes the regulatory agencies which are integral to this structure. This chapter reveals that Nigeria has a network of corporate laws, securities laws, corporate governance code and regulatory agencies which can protect shareholders' interests and in theory mitigate the agency problem. The important question however is whether reality matches up with this expectation.

Chapter 5 examines the criminal enforcement regime in Nigeria. It starts by discussing the criminal sanctions which are imposed on directors in Nigeria for breach. It however notes that the current criminal enforcement regime in Nigeria falls far below expectation. It therefore examines the issues and challenges which prevent effective criminal enforcement in Nigeria. It argues that the current criminal enforcement regime lacks a deterrent effect, is unable to secure effective compensation for victims and is not cost effective. It therefore concludes that the criminal enforcement regime, for these reasons, cannot be relied on to deliver effective enforcement of corporate law in Nigeria.

Chapter 6 examines the private civil enforcement regime in Nigeria. It starts by addressing the various private enforcement actions in Nigeria and identifying their respective shortcomings. It then moves on to examine critically derivative actions in Nigeria. It demonstrates that this form of proceedings in Nigeria is deficient and places an unnecessary burden on potential applicants. It further argues that the problems with derivative actions go far beyond its current statutory manifestation. It is fraught with several inherent difficulties. Therefore, while the private civil enforcement regime offers some advantages over the criminal enforcement regime, it

cannot, on its own, secure any significant increase in the overall enforcement of corporate law in Nigeria. Therefore, the private civil enforcement regime is also unable to deliver effective enforcement in Nigeria.

Chapter 7 turns to public civil enforcement. It argues that public civil enforcement offers the best option for improving the enforcement of corporate law in Nigeria. It starts by analysing the theoretical advantages of public civil enforcement, using the criteria for determining effective enforcement which are set out in chapter 3. It argues that public civil enforcement generally offers the greatest potential for achieving greater deterrent effect, compensation, and cost effectiveness in comparison to the criminal and private civil enforcement regime. It then particularly examines the current public civil enforcement regime in Nigeria. It notes the shortcomings of the current regime and examines the factors that are responsible for this. It nevertheless argues that in spite of this, public civil enforcement offers the greatest potential for ensuring effective enforcement of corporate law in Nigeria. Besides from the general advantages of this regime, it is the most practically workable enforcement regime for Nigeria's corporate law as it avoids many of the difficulties which undermine the other enforcement regimes discussed in the last two chapters. It therefore offers the greatest benefit for effective enforcement of Nigeria's corporate law.

In light of the findings of chapter 7, chapter 8 makes specific proposals for reform of the country's public civil enforcement regime. The suggested reforms include identification of an effective enforcement agency, conferment of power to enforce breach of directors' duties on the Securities and Exchange Commission (SEC), clear whistleblowing laws and reporting channels, increase in regulatory oversight, complete overhaul of the Companies and Allied Matters Act (CAMA), regulatory accountability, and adequate funding for public regulators. It argues that these

reforms, if made, would achieve significant improvements in the enforcement of corporate law in Nigeria. It also argues that the reforms are feasible in Nigeria as the country has a past record of achieving successful reforms. The suggested reforms are therefore not impossible to achieve.

Part 3 draws lessons from other jurisdictions. Chapter 9 starts by examining the legal transplant debate. This chapter is considered necessary in light of the fact that this part of the thesis (chapter 10) draws empirical evidence from the UK and Australia as evidence for the superiority of public civil enforcement. In light of the ‘comparative’ element of this study, it is considered necessary to examine the legal transplant debate in order to demonstrate how the criticisms commonly made against legal transplants do not apply to this thesis’ attempt to draw empirical support from the UK and Australia. This chapter argues that legal transplants are possible and can indeed be successful. However, in order for any legal transplant to be successful, several factors must be put in place. These factors are set out in this chapter. Finally, the chapter argues that the concerns surrounding unsuccessful legal transplants do not arise with regards to this thesis’ attempts to learn lessons from the UK and Australia. Consequently, Nigeria can indeed gather empirical evidence, and learn lessons, from the enforcement experience of these countries.

Chapter 10 then turns to examine three specific enforcement case studies drawn from the UK and Australia. This chapter is considered necessary in order to provide empirical support for the arguments made for the superiority of public civil enforcement in part 2 of this thesis. It therefore reinforces the case for public civil enforcement in Nigeria. The choice of these two jurisdictions - the UK and Australia - is based on the several similarities which they share with the Nigerian legal system. The first case study examines derivative proceedings in the UK. It demonstrates that,

in spite of significant reforms carried out by the UK, derivative proceedings still fall short as an effective enforcement mechanism in that country. It therefore reiterates that private civil enforcement actions are fraught with inherent difficulties which cannot be resolved even by significant statutory reforms as evidenced by the UK experience. The chapter then goes on to examine what is arguably the UK's best example of a public civil enforcement regime, namely, its disqualification regime. It demonstrates that the disqualification regime has recorded good success in its enforcement activities. It does, however, have its own shortcomings in that it is unduly focused on directors of insolvent companies. Finally, the chapter examines the Australian civil penalty regime. It demonstrates that the Australian civil penalty regime has been successful as an enforcement regime. It therefore argues that there is overwhelmingly positive evidence in favour of public civil enforcement drawn from both the UK and Australian jurisdictions.

Chapter 11 provides the conclusion for the thesis and highlights areas for further research.

#### **1.4 Research Methodology**

In carrying out its research, this thesis uses a variety of research methodologies. First, it makes use of a doctrinal research methodology in analysing the law as it stands in Nigeria. In this regard, it analyses Nigeria's corporate law particularly with regards to the private civil enforcement regime. It therefore critically analyses the statutory derivative actions regime in Nigeria which is contained in the Companies and Allied Matters Act 1990 (CAMA). It does this with a view to identifying its strengths and, more particularly, its weaknesses. It also examines certain features of the Investments and Securities Act 2007 (ISA) as it applies to directors of listed companies. In addition to this, it briefly examines the features of the UK statutory derivative claims

regime which is contained in the UK Companies Act 2006 as well as its disqualification regime found in the Company Directors Disqualification Act 1986 (CDDA).

Secondly, this thesis, while not a fully interdisciplinary study, makes use of a number of other disciplines. In developing its argument on the need for, and justification for, enforcement, this thesis makes use of the deterrence theory. This theory is developed within the areas of criminology and economics. It is therefore primarily used within the field of criminal justice. This thesis however makes use of this theory in developing its argument for enforcement as well as its criteria for determining effective enforcement.

Thirdly, in carrying out its research, this thesis makes use of empirical data drawn from various sources. In evaluating the effectiveness of the UK statutory derivative claims regime, empirical data on the incidence of derivative claims in the UK between 2008 and 2016 was derived from the Westlaw UK case law database. Similarly, in analysing the effectiveness of the Australian public civil enforcement regime, this thesis makes use of empirical data drawn from different reports published by the Australian Securities and Investments Commission.<sup>22</sup> Enforcement data obtained directly from other official websites such as the Nigerian Securities and Exchange Commission and the UK Insolvency services are also relied on in this thesis. These data are useful in developing a clear understanding of the current state of affairs with regards to the various enforcement regimes examined.

Finally, in developing the reforms proposed in this thesis, several insights and lessons are drawn from the UK and Australia. Therefore, while this thesis does not engage in

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<sup>22</sup> See s10.4, Ch. 10.

a *direct* comparative study between the UK, Australia and Nigeria, it uses the UK and Australia to provide empirical support for the thesis' arguments for an enhanced role for public civil enforcement. It demonstrates that public civil enforcement has been very effective in both the UK and Australia; this is in comparison to private civil enforcement which continues to fall short in the UK despite statutory reforms. Therefore, the benefits of the public civil enforcement regime go beyond theoretical advantages, rather empirical evidence from other regimes show the clear advantage offered by the public civil enforcement regime.

This thesis makes use of both primary and secondary research sources. The primary sources used are case laws, laws and regulations from Nigeria, UK and Australia, and finally codes of corporate governance. Secondary sources include published books, peer-reviewed articles, online articles, newspapers articles, theses, working papers, law commission reports, parliamentary reports, annual reports, conference and seminar papers and various websites.

A number of difficulties were encountered in the course of this thesis. Chief among them was the difficulty in obtaining case law on private enforcement actions in Nigeria. E-reporting of case law is still at its developmental stage in Nigeria. There is only one reliable law reports database, 'the law pavilion', which is focused on Courts of Appeal and Supreme Courts' decisions. Another key problem was the difficulty in obtaining enforcement data regarding the success rate of the Australian civil penalty regime from the Australian Securities and Investments Commission (ASIC). Contact was made with key academics in the area of Australian corporate law and the author was informed about the general reluctance of ASIC to release private data. The data used in this thesis in that regard were therefore restricted to data available in ASIC's annual reports and report of enforcement outcomes.



## 1.5 Two Limits on the Scope of Thesis

This thesis is focused on the enforcement of corporate law; it is nevertheless important to delineate its scope. Two key points will be made in this regard.

Firstly, while this thesis analyses enforcement of corporate law, reference to ‘corporate law’ in this context does not encompass all aspects of that body of law. This thesis’ analysis of enforcement of corporate law is therefore limited to those corporate law requirements which have a *direct* and *significant* impact on the interests of shareholders and other stakeholders including the wider community. The test for determining this is whether failure to comply with this requirement could *directly* prejudice the interest of shareholders or other stakeholders. Hence the breach of corporate law requirements to be considered in this thesis include breach of directors’ duties, failure to disclose material information such as interests in transactions, issues relating to accounting records such as the financial statements and directors’ reports, fraud, money laundering, giving misleading or false information, insider dealing and other forms of market abuse or market manipulation. The enforcement analysis in this thesis does not therefore include all contraventions of corporate law. Minor breaches such as low level record keeping and reporting requirements that attract pre-determined administrative sanctions do not fall within the scope of this thesis. For example breach of reporting requirements in the Companies and Allied Matters Act 1990 (CAMA) such as delay in notifying the Corporate Affairs Commission (CAC) about a change in address of registered office,<sup>23</sup> delay in filing notice of location of register of members,<sup>24</sup> or delay in filing notification of change in details of directors or the secretary are not included.<sup>25</sup>

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<sup>23</sup> CAMA, s46.

<sup>24</sup> CAMA, s84.

<sup>25</sup> CAMA, s292.

Similarly, issues such as default in complying with the requirement on keeping register of members or in giving notification of the location of the register of members<sup>26</sup> do not fall within the scope of this thesis.

It is however crucial to note here that this differentiation does not imply that such administrative requirements and sanctions do not ‘matter’ or have any effect on shareholders. These administrative requirements are intended to ensure accountability and protect the integrity of the financial system. However, for the purpose of providing a clear focus, and due to word constraints, this thesis enforcement analysis is restricted to the aforementioned corporate law requirements.

Secondly, a familiar distinction has been drawn in corporate law between *regulatory strategies* and *governance strategies*.<sup>27</sup> However, the scope of this thesis is limited to regulatory strategies and not governance strategies. Therefore, in analysing enforcement mechanisms, this thesis focuses *solely* on enforcement of regulatory strategies. It therefore does not focus on enforcement of governance strategies such as shareholders’ rights to appoint or remove directors and shareholders’ voting rights within the company. As mentioned earlier, it focuses on enforcement of substantive rules and standards such as directors’ duties, accounting, and disclosure obligations. This is considered necessary as governance strategies in corporate law cover a reasonably wide sphere. They cannot therefore be diligently and comprehensively examined within the scope of this thesis due to limitations posed by word constraints.

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<sup>26</sup> See CAMA, ss83-84.

<sup>27</sup> See s2.4, Ch. 2.

# **PART 1 – THE CONCEPTUAL FRAMEWORK**

## **CHAPTER 2: THE AGENCY PROBLEM AND AGENCY COSTS**

### **2.1 Introduction**

Over the years economists and legal scholars have been concerned with the mechanisms for ensuring accountability in corporations, including ensuring that those who manage the company do so in a way that enhances the company's interests. This is known as the agency problem and is arguably the central theme of corporate law. An understanding of agency problems and agency costs is therefore central to any study of corporate law.

Consequently, this chapter briefly examines the agency problem in corporate law. It commences in section 2.2 by examining the nature of the agency problem, which exists in corporations. It then moves on in section 2.3 to examine agency costs and the different types of agency costs which arise in corporations. Section 2.4 then examines the legal strategies for mitigating agency costs in corporations. It distinguishes between two types of legal strategies namely 'regulatory strategies' and 'governance strategies'. It then concludes by noting the need for effective enforcement of these legal strategies. This chapter serves as a foundation for the discussion which is to follow in subsequent chapters.

## 2.2 The Agency Problem

According to Jensen and Meckling, an agency relationship is defined as ‘a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some services on their behalf which involves delegating some decision making authority to the agent.’<sup>1</sup> The agency problem arises out of this relationship and can be defined as the problem inherent in attempting to induce an agent to act in the principal’s interest.<sup>2</sup> This problem arises whenever the welfare of one party (the principal) depends upon the actions of another party (the agent), and may occur in virtually any contractual relationships in which one party promises to perform something for another.<sup>3</sup>

According to Kraakman et al, three generic agency problems arise in corporations.<sup>4</sup> The first involves the conflict between the firm’s owners and its managers; in this case, the owners are the principals while the managers are the agents. The problem here lies in ensuring that the managers act in the owner’s interest and not their own personal interest. The second agency problem is the conflict between the controlling shareholders (agents) and the minority shareholders (principals). The third agency problem is the conflict between the firm (agents) and other parties such as creditors, employees and consumers (principals). Our central concern in this thesis is however with the first category of agency problem – the conflict between managers and owners.<sup>5</sup>

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<sup>1</sup> M.C Jensen and W.H Meckling, ‘Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure’ (1976) 3 *Journal of Financial Economics* 305, 308.

<sup>2</sup> *ibid* 309.

<sup>3</sup> Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2<sup>nd</sup> edn, OUP 2009) 35.

<sup>4</sup> *ibid* 36.

<sup>5</sup> Note that the use of the term ‘owners’ to describe shareholders in the company has been criticised and described as ‘misleading’. This is particularly more so for large listed companies whose shareholders do not possess the rights and responsibilities expected of ‘owners’. See MM Blair, ‘Corporate “Ownership” (1995) 13 (1) *The Brookings Review* 16.

The basis of the agency problem is the assumption that the interests of principals and agents diverge.<sup>6</sup> In this regard, the shareholders are the principals while the managers are the agents in the agency relationship. The shareholder as the principal delegates day to day running of the company to the managers, who are the agents.<sup>7</sup> Delegation is ordinarily beneficial to both managers and agents within the corporate entity. It enables skilled managers (agents) to use their skills in managing a corporation even when they lack the wealth to invest. It also allows wealthy individuals (shareholders) to invest even where they lack the skills to manage the entity.<sup>8</sup> However, the problem that arises here is that the agents do not always make decisions that are in the principal's best interests.<sup>9</sup> For example the agent may misuse his managerial power for personal financial benefits or may not take certain risks which are in the principal's overall interest, due to the belief that those risks might not be in his (the agent's) own best interests.<sup>10</sup> There are also problems of 'information asymmetry', which puts the principal at a disadvantage because of the fact that the agent possesses more information than the principal does.<sup>11</sup>

In understanding the conflicts of interests that may arise between managers and shareholders in a corporation, it is useful to make use of Eisenberg's classification. According to Eisenberg, conflicts of interests between managers and shareholders in public corporations may come in different forms. The first category is known as 'shirking'.<sup>12</sup> This occurs because all agents have a possible interest in working at a

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<sup>6</sup> CWL Hill & Thomas M Jones, 'Stakeholder Agency Theory' (1992) 29(2) *Journal of Management Studies* 131, 132.

<sup>7</sup> J Solomon, *Corporate Governance and Accountability* (4<sup>th</sup> edn, Wiley 2013) 9.

<sup>8</sup> FH Easterbrook and DR Fischel, 'Corporate Control Transactions' (1982) 91 *Yale Law Journal* 698, 700.

<sup>9</sup> Solomon (n 7) 9.

<sup>10</sup> CA Mallin, *Corporate Governance* (4<sup>th</sup> edn OUP 2013) 17.

<sup>11</sup> *ibid* 17.

<sup>12</sup> MA Eisenberg, 'The Structure of Corporation Law' (1989) 89 (7) *Columbia Law Review* 1461, 1471.

slow pace and refusing to put in the effort and discomfort required to achieve good results. Hence the managers may fail to give the company sufficient attention, preferring to spend their time on other leisure activities.<sup>13</sup>

The second category is described as the problem of ‘traditional conflicts of interest’.<sup>14</sup> This arises because agents may have an interest in diverting the principal’s assets for their own personal use through ‘unfair self-dealing.’ This could be by exploiting potential business opportunities intended for the company.<sup>15</sup> Unfair self-dealing may also occur where the manager sells assets to the company at a value, which is higher than the current market price or where the company loans money to the manager interest free.<sup>16</sup>

The third category is ‘positional conflicts of interest’.<sup>17</sup> Those conflicts arise because corporate managers are relatively autonomous and therefore have a wide range of discretion, which increases their likelihood of maintaining and improving their managerial position at the shareholder’s expense. Positional conflicts may arise in several ways, for example, managers may seek to improve corporate size in order to enhance their power, status and salary even if this is detrimental to shareholders. They may also seek to maximize the cash and keep reinvesting it even where it is more efficient to distribute to shareholders as dividends, or they may even make it very difficult for anyone to monitor their performance.<sup>18</sup> Managers may also seek many perquisites such as holidays charged on the company, private jets, classy cars, unnecessary office equipment and the like, thereby reducing shareholder value.<sup>19</sup>

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<sup>13</sup> Kershaw, *Company Law in Context: Text and Materials* (2nd edn, OUP 2012) 178.

<sup>14</sup> Eisenberg (n 12) 1471.

<sup>15</sup> Kershaw (n13) 178.

<sup>16</sup> *ibid* 177.

<sup>17</sup> Eisenberg (n 12) 1471 & 1472.

<sup>18</sup> *ibid* 1472.

<sup>19</sup> Solomon (n 7)10.

According to Eisenberg, positional conflicts are more important than either shirking or traditional conflict of interests'.<sup>20</sup> While managers may abstain from shirking because their self-esteem is linked to their hard work and achievements and may not engage in unfair self-dealing due to their sense of morality; these factors may be insufficient to prevent positional conflicts. The top managers' self-esteem often depends on maintenance of their status and as such, they may find it more difficult to curb their taste for the finer things of life.<sup>21</sup>

It is important to note that the agency problem in corporate law arises in corporations where there is a delegation of authority from the shareholders to the manager. In a firm where the shareholder is also the director and CEO, the interests of all parties are 'fully and unavoidably' aligned and as such, there arises no agency problem.<sup>22</sup> However as the manager's equity reduces in the company, his incentive to misappropriate company resources potentially increases resulting in an increase in agency costs.<sup>23</sup> The interests of the shareholders and managers are no longer fully aligned, resulting in the agency problem. The severity of the agency problem may also depend on the extent of dispersion of shares in the company. In a closely held company (i.e. companies with few shareholders each holding large proportion of shares), there is little room for directors to make decisions that benefit them directly at the company's expense. The few shareholders who own significant amount of shares in the company have sufficient incentives to monitor management and keep up to date with the company's performance.<sup>24</sup> Any evidence of mismanagement by the director could therefore result in greater controls over the director's decision-making powers or even his removal. Consequently, the manager's incentive to act in a self-

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<sup>20</sup> Eisenberg (n 12)1473.

<sup>21</sup> *ibid* 1473.

<sup>22</sup> Kershaw (n 13)171.

<sup>23</sup> Jensen and Meckling (n 1)172.

<sup>24</sup> Kershaw (n 13) 173.

interested manner is reduced.<sup>25</sup> However in a company with many shareholders (a widely owned company), the manager's incentive to act in a self-interested manner can be fully activated as there may be no shareholder with a sufficient incentive to monitor management.<sup>26</sup> It is this problem that Adolf Berle and Gardiner Means were chiefly concerned with in their classical book, 'The Modern Corporation and Private Property', published in 1932.<sup>27</sup> A general concern of corporate law has therefore been how to align the manager's interests with the shareholders thereby ensuring that managers run the company in a way that enhances shareholder value. Agency theory therefore focuses on developing the most efficient incentive in the contract governing the principal-agent relationship<sup>28</sup> that will better align the interests of both parties and reduce agency costs.

### **2.3 Agency Costs**

Agency costs arise due to the non-alignment of the managers' interest with those of the shareholders.<sup>29</sup> They occur as a result of the shareholders' attempts to monitor management and are therefore an unavoidable result of agency relationships.<sup>30</sup> In order to limit the divergence of interest between the principal and agent, the principal may provide certain incentives to the agent. This may result in the principal incurring certain 'monitoring costs'.<sup>31</sup> These 'monitoring costs' include the

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<sup>25</sup> *ibid* 173. This does not however mean that agency problem never arises in closely held corporations. As long as there is some delegation of authority from a principal to an agent, there is a possibility of agency problem arising. The agency problem is however often more severe in widely dispersed corporations.

<sup>26</sup> *ibid* 174. See further EM Dodd, 'Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?' (1935) 2 (2) *The University of Chicago Law Review* 194, 196-197.

<sup>27</sup> See AA Berle & GC Means, *The Modern Corporation and Private Property* (New York: The Macmillan Company 1932).

<sup>28</sup> KM Eisenhardt, 'Agency Theory: An Assessment and Review' (1989) 14(1) *The Academy of Management Review* 57, 58.

<sup>29</sup> JS Ang, R.A Cole & JW Lin, 'Agency Costs and Ownership Structures' (2000) LV (1) *Journal of Finance*.

<sup>30</sup> Jensen and Meckling (n 1) 328, Jill Solomon (n 7)10.

<sup>31</sup> Jensen and Meckling (n 1) 308.



costs of initiating shareholder engagement, putting in place incentive schemes for management and remuneration contracts to align the interests of shareholders and managers.<sup>32</sup> In addition to this, the agent may also expend resources to guarantee that he will not take certain actions that are detrimental to the principal or to ensure that the principal is compensated if he takes such actions; this is known as ‘bonding costs’.<sup>33</sup> This includes the costs of including certain information in the annual report, such as risk management information, costs of contractual guarantee to have the financial statements audited,<sup>34</sup> and cost of arranging meetings with shareholders.<sup>35</sup> In addition to this, the principal may also suffer ‘residual loss’ which is the cost to the principal resulting from the divergence of interests between principal and agent.<sup>36</sup> Examples of this would include losses suffered by the company as a result of the manager’s exploitation of certain business opportunities for himself or shirking.<sup>37</sup> The totality of these costs (i.e. monitoring costs by the principal, bonding costs by the agent and residual loss) is defined as ‘agency costs’.<sup>38</sup>

The extent of agency costs differs from firm to firm and depends on a variety of factors.<sup>39</sup> It is however practically impossible for both the principal and agents to incur zero costs in an agency relationship.<sup>40</sup> Agency costs are borne by the shareholders and as such, they have an incentive to ensure that these costs are minimized.<sup>41</sup> It is therefore necessary to control the agency problem where managers are not the residual claimants in the corporation and as such do not bear the costs of

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<sup>32</sup> Solomon (n 7)10.

<sup>33</sup> Jensen and Meckling (n 1)308.

<sup>34</sup> *ibid* 325.

<sup>35</sup> Solomon (n 7)10.

<sup>36</sup> Jensen and Meckling (n 1)308.

<sup>37</sup> Kershaw (n 13)177-178.

<sup>38</sup> Jensen and Meckling (n 1)308.

<sup>39</sup> *ibid* 328.

<sup>40</sup> *ibid* 308.

<sup>41</sup> *ibid* 328.

their decisions.<sup>42</sup> Without effective control mechanisms, management are likely to take decisions that are not in the best interests of the residual claimants.<sup>43</sup>

## **2.4 Legal Strategies for Reducing Agency Costs**

The law has a crucial role to play in minimizing agency costs in corporations. This can be achieved through rules and procedures that increase disclosure by agents or ensure enforcement actions against them.<sup>44</sup> This section will therefore make use of Kraakman et al's taxonomy in highlighting different legal strategies for reducing agency costs. According to Kraakman et al, the law often makes use of 'legal strategies' in reducing agency costs. These legal strategies can be divided into two categories; these are 'regulatory strategies' and 'governance strategies'.<sup>45</sup>

### **2.4.1 Regulatory Strategies**

Regulatory strategies are 'prescriptive' and usually prescribe certain terms that govern the principal-agent relationship in order to act as a check on the agent's behaviour.<sup>46</sup> These strategies seek to directly influence the agent's exercise of its powers.<sup>47</sup> Regulatory strategies may come in different forms as discussed below

#### **2.4.1.1 Rules and Standards**

Regulatory strategies may be formulated as either 'rules' or 'standards'. Rules are usually fairly detailed and precise in specifying how the target of the rule must behave. The target therefore knows, before she acts, or *ex ante*, with a fair degree of precision, what behaviour is required. A provision saying 'do not drive faster than 30mph on this road' would be an example of a rule. By contrast, standards are usually

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<sup>42</sup> EF Fama and MM Jensen, 'Separation of Ownership and Control' (1983) 26(2) Journal of Law and Economics. 301, 304.

<sup>43</sup> *ibid* 304.

<sup>44</sup> Kraakman & others (n 3)37.

<sup>45</sup> *ibid* 37 &38.

<sup>46</sup> *ibid* 38.

<sup>47</sup> PL Davies, *Introduction to Company Law* (OUP 2002) 119.

more general, and leave the precise determination of what behaviour the standard demands in any particular factual situation to the adjudicator to work out once the situation has already arisen. The precise requirement of a standard thus varies from situation to situation, and is only ‘crystallised’ for each position *ex post* or once the situation is known. A provision requiring drivers to drive ‘carefully’ would be an example of a standard.

Rules, prescribing specific conduct beforehand, are usually used in the corporation to safeguard the company’s creditors and public investors. This could include rules on dividend payments,<sup>48</sup> minimum capital requirement, tender offers and proxy voting.<sup>49</sup> This also includes rules governing issuing of shares, prohibiting a company’s acquisition of its own shares,<sup>50</sup> or giving financial assistance to purchase its own shares to mention a few.<sup>51</sup>

Most jurisdictions do not rely solely on rules and therefore make use of standards to govern transactions that may be too complex to regulate by specific rules.<sup>52</sup> As mentioned earlier, standards are not as clear as rules and require the judiciary for effective administration. Compliance with them is therefore usually determined on a case-by-case basis.<sup>53</sup> Standards may be used to govern ‘intra-company relations’ such as insider self-dealing.<sup>54</sup> Important examples of standards are company law provisions governing directors’ duties, which set out behaviours, expected of directors.<sup>55</sup> They also include provisions of the law on disqualification of directors.<sup>56</sup>

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<sup>48</sup> Davies (n 47)120.

<sup>49</sup> Kraakman & others (n 3) 39.

<sup>50</sup> See Companies Act 2006, s 658(2).

<sup>51</sup> See Companies Act 2006, s678 (1). See also Davies & Worthington, ‘*Gower’s Principles of Modern Company Law*’ (10<sup>th</sup> edn Sweet & Maxwell 2016) chapter 13 on rules governing capital maintenance.

<sup>52</sup> Kraakman & others (n 3) 39.

<sup>53</sup> Davies (n 47) 121.

<sup>54</sup> Kraakman & others (n 3) 40.

<sup>55</sup> Kershaw (n 13)314.

These standards are used by adjudicators to determine *ex post* (after occurrence), whether there has been a breach or not.<sup>57</sup>

#### **2.4.1.2 Entry and exit**

Another category of regulatory strategies involves setting the terms of entry and exit. Here the law prescribes certain terms of entry for agents, for example by requiring them to disclose certain information before taking on their role as agents. The entry strategy is important in ensuring that only the right agents are admitted into the public capital market. Another example of entry strategies are the rules requiring disclosure of certain information to prospective public investors in order to ensure that they can make an informed decision.<sup>58</sup> Entry strategies would include listing rules, rules regulating public offer of shares and prospectuses.

The law may also prescribe exit strategies such as the grant to shareholders of the right to sell or transfer their stock. The doctrine of separate corporate personality provides for free transferability of shares.<sup>59</sup> Hence, the exit strategy allows hostile takeovers because shareholders can freely sell their shares<sup>60</sup> thereby potentially acting as an effective disciplining mechanism for management.

#### **2.4.2 Governance Strategies**

Governance strategies are non-prescriptive laws that seek to assist the principal's control over the agent's behaviour. Their effectiveness therefore depends on the principal's ability to exercise the powers granted to them.<sup>61</sup> Governance strategies have been classified into three categories as discussed below

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<sup>56</sup> See for example Company Directors Disqualification Act 1986 c.46.

<sup>57</sup> Kraakman & others (n 3) 40.

<sup>58</sup> *ibid* 40.

<sup>59</sup> Davies (n 47)144.

<sup>60</sup> Kraakman & others (n 3) 41.

<sup>61</sup> *ibid* 38.

### **2.4.2.1 Selection and removal**

This category encompasses the rights granted to shareholders to appoint and remove directors. These rights play an essential role in the corporation. They allow shareholders to appoint the best persons to manage the company and to remove them if they fail to perform.<sup>62</sup> In most jurisdictions, shareholders have the right to appoint and remove directors. For example, the UK Companies Act 2006 grants shareholders the powers to appoint and remove directors.<sup>63</sup> These rights are an important controlling device in corporations and play an important role in corporate governance.<sup>64</sup> They can also be useful in addressing the agency problem and ensuring that management act in the company's best interests.

### **2.4.2.2 Initiation and Ratification**

Another set of governance strategies is the power of shareholders (principals) to intervene in management. Shareholders may generally initiate or ratify certain management decisions. It is however worth noting that these governance strategies are not as prominent as shareholders' powers to appoint and remove directors. Managerial power is usually delegated to the board of directors and only very crucial or huge corporate decisions require shareholder ratification.<sup>65</sup> The general management and control of the corporation is therefore usually vested in the board of directors. An example of this is the UK Model Articles for companies limited by shares, which confers general management powers on directors.<sup>66</sup> Despite this, most countries' company law reserves certain important decisions for shareholder approval. This includes decisions regarding altering the company's constitution,

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<sup>62</sup> Davies (n 47) 127.

<sup>63</sup> See Companies Act 2006, ss.160 &168.

<sup>64</sup> Kraakman & others (n 3) 42.

<sup>65</sup> See CAMA, s 63(3).

<sup>66</sup> See UK Model Articles, Articles 3 & 4.

restructuring the company, voluntary winding up and approving certain transactions.<sup>67</sup>

### **2.4.2.3 Trusteeship and reward**

The last category of governance strategies identified by Kraakman et al consists of incentives, which intend to align the interests of the agent with that of the principal. The first incentive is the ‘reward strategy’, which rewards agents for acting in the principal’s interests.<sup>68</sup> An example of this is the performance related pay, which ties the agent’s pay to his performance in the company. This includes share option schemes<sup>69</sup> or bonuses for increase in share value. This strategy gives agents the incentive to maximize returns for the shareholder due to the financial rewards of doing so.<sup>70</sup>

The second incentive strategy, which is the ‘trusteeship strategy’, tries to remove conflict of interest beforehand by ensuring that agents do not have anything to gain by acting in a self-interested manner. An example of this ‘trusteeship’ strategy is the use of non-executive directors on the board.<sup>71</sup> Such non-executive directors only function as directors in the company and hold no other managerial position within that company.<sup>72</sup> Where this strategy is used, it is assumed that conflict of interest is removed. Non-executive directors do not personally gain from self-interested decisions; they are therefore expected to act as a check on management misbehaviour.

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<sup>67</sup> Davies (n 47)125.

<sup>68</sup> Kraakman & others (n 3) 43.

<sup>69</sup> JE Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (OUP 1993) 68.

<sup>70</sup> Kraakman & others (n 3) 43.

<sup>71</sup> *ibid* 43.

<sup>72</sup> Davies (n 47)200.

Similarly, the use of auditors to audit financial statements and approve certain transactions is a trusteeship strategy intended to remove conflict of interest.<sup>73</sup>

From the foregoing, we can see that there is a range of legal strategies intended to reduce agency costs. It is important to note that these legal strategies are not rigidly classified and may sometimes overlap. Furthermore, none of these strategies is effective on its own as they all have costs and benefits.<sup>74</sup> They are however useful for understanding the various responses to the agency problem. They will also be useful further in this thesis in discussing various enforcement mechanisms. This is because the efficiency of these legal strategies depends, largely, on the existence of certain institutions to secure enforcement. As noted by Kraakman et al that, ‘Legal strategies are relevant only to the extent that they induce compliance’.<sup>75</sup> In the absence of effective enforcement, these legal strategies may not achieve their intended purpose of reducing agency costs.

## **2.5 Conclusion**

The central problem of corporate law is the agency problem and the agency costs which occur as a result of this. It is therefore necessary that a discussion of enforcement in corporate law should commence with a study of the foundational problems of corporate law. This has been the focus of this chapter, which has examined the nature of the agency problem in corporate law and the consequent agency costs which follow. It has also made use of Kraakman et al’s typology in discussing the legal strategies, which are in place for mitigating the agency problem in corporate law. These legal strategies form the bedrock of this thesis’s classification and discussion of enforcement mechanisms in corporate law.

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<sup>73</sup> Kraakman & others (n 3)43.

<sup>74</sup> Davies (n 47) 201.

<sup>75</sup> Kraakman & others (n 3) 45.

As mentioned in the previous section, it is insufficient to have legal strategies for mitigating the agency problem in corporate law without ensuring effective enforcement of these strategies. It is therefore necessary to examine the concept of enforcement in corporate law.



## **CHAPTER 3: THE ENFORCEMENT PROBLEM IN CORPORATE LAW**

### **3.1 Introduction**

The previous chapter examined the agency problem and agency costs as well the legal strategies for reducing agency costs. This chapter now turns to the question of enforcement itself. It provides the theoretical foundation on which the remainder of the thesis will be built. In particular, it aims to *conceptualise* enforcement itself, and to explain why there must be enforcement of corporate law's regulatory strategies in terms of the *goals* and *purposes* that enforcement seeks to achieve. It then puts forward a set of criteria by which the effectiveness of enforcement can be judged. These criteria will be applied to Nigeria itself in subsequent chapters.

The chapter starts by examining the concept of enforcement in section 3.2 before going on to examine the goal and purpose of enforcement in section 3.3. It then moves on in section 3.4 to examine the importance of enforcement. Section 3.5 provides a justification for enforcement of corporate law using the deterrence theory. It argues that the deterrence theory justifies the need for enforcement in corporate law, as sanctions are an integral part of securing compliance with prescriptions of the law or standards. Section 3.6 briefly examines the concept of compensation. Section 3.7 then goes on to examine the determinants of effective enforcement in corporate law. It examines the criteria that can be used to judge or determine an effective enforcement regime. It argues that an effective enforcement regime must be able to deter offenders and/or compensate the victims of the offence. In addition to this, an

optimal enforcement regime must be cost effective. Finally, section 3.8 classifies the various enforcement mechanisms in corporate law followed by concluding remarks in section 3.9.

### 3.2 Conceptualising Enforcement

The term *enforce* generally means ‘to make sure that a law, rule or duty is obeyed or fulfilled’.<sup>1</sup> It may also mean to ‘compel compliance with (a law, rule or obligation)’.<sup>2</sup> Posner has however described enforcement of law as the ‘process by which violations are investigated and a legal sanction applied to the violator’.<sup>3</sup> While this definition partially connotes what enforcement is, the use of the term ‘legal sanctions’ in this context makes the definition unduly restrictive and narrow. While sanctions represent an integral part of enforcement, those sanctions need not be legal or formal. Enforcement can still take place with non-legal or informal sanctions. These non-legal or informal sanctions may include ‘reputational sanctions’,<sup>4</sup> ‘name and shame’, ‘truthful negative gossip’, or shunning the offender amongst others.<sup>5</sup>

Enforcement, then, generally involves two basic elements; the first is the investigative element, which involves examining and getting informed about a violation or breach. The second element, which is sanction, connotes imposing some sort of penalty on the violator. Hence, these two elements ought to be present in any enforcement activity. Enforcement may therefore be defined as the process of ensuring compliance through investigation and imposition of proper sanctions in case of breach. The term

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<sup>1</sup> C Soanes & S Hawker, *Compact Oxford English Dictionary for University and College Students* (OUP 2006).

<sup>2</sup> See J Pearsall, *The Concise Oxford English Dictionary* (10<sup>th</sup> edn, OUP 1999).

<sup>3</sup> RA Posner, *Economic Analysis of Law* (9<sup>th</sup> Edn Wolters Kluwer 2014) 859.

<sup>4</sup> J Armour ‘Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment’ in J Armour & J Payne, *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart Publishing 2009) 74.

<sup>5</sup> See R C Ellickson, *Order without Law: How Neighbours Settle Disputes* (Harvard University Press 1991) for an example of the role of norms and non-legal sanctions in enforcement.

enforcement also connotes that the thing being enforced is obligatory; hence, it is difficult to discuss enforcement in relation to a rule or duty that is merely discretionary.

### **3.3 The Goal and Purpose of Enforcement**

The questions to be considered here are what is the goal of enforcement and what purpose does it serve? Although the words ‘goal’ and ‘purpose’ are quite similar and mean the same thing in some contexts, in other contexts they may have different meanings. According to the New Oxford English Dictionary, a goal represents ‘an aim or desired result’, while a purpose represents ‘the reason for which something is being done’.<sup>6</sup> Within the context of enforcement, the goal of enforcement therefore connotes the final or end result of enforcement while purpose implies the reason or rationale behind enforcement and why enforcement is considered to be necessary.

#### **3.3.1 The Goal of Enforcement**

According to Stigler, the goal of enforcement is to ensure compliance with rules of prescribed behaviour.<sup>7</sup> He opines that ‘all prescriptions of behaviour for individuals require enforcement’.<sup>8</sup> This definition aptly describes the whole essence of enforcement. While there may be different reasons for enforcement, the central goal and intended result of enforcement is to secure compliance. Another commentator, Reiff, in identifying the goals of enforcement, goes a step further in postulating that the goals of enforcement may depend on whether the right has not been violated (pre violation stage), or whether it has been violated but not yet enforced (post violation

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<sup>6</sup> The New Oxford English dictionary (Clarendon Press) 1998.

<sup>7</sup> G Stigler, ‘The Optimum Enforcement of Law’ in G S Becker and W M Landes (eds), *Essays in the Economics of Crime and Punishment* edited by (National Bureau of Economic Research New York, Columbia University Press 1974) 56.

<sup>8</sup> *ibid* 55.

stage) or whether it has been violated and enforced (post enforcement stage).<sup>9</sup> In the pre-violation stage, the goal of enforcement is to enable social interaction and improve social cooperation. Enforcement at this stage is needed for social cooperation as in the absence of it no one will be willing to accept a promise to perform from another or be willing to cooperate. Promises are effectual only where the person promised knows it will be fulfilled. Enforcement here therefore enables individuals to honestly commit themselves to act in certain ways thereby preventing potential violations. It compels parties to cooperate at the risk of punishment for failure to do so. At the post-violation and post enforcement stage, enforcement is needed to prevent conflict from resulting in an unending cycle of violation and retaliation.<sup>10</sup> Hence, it helps to contain conflict to prevent it from degenerating into a crisis.

Reiff's classification of the goals of enforcement into different stages provides clarity and enables understanding of the different stages through which enforcement may move. However, what Reiff refers to as different goals of enforcement may be more properly described as the purpose of enforcement at different stages of violation rather than the goals of enforcement. At the pre-violation stage, enforcement enables people to cooperate with and fulfil their promises to each other at the risk of punishment. This then ensures compliance with stipulated standards of behaviours and agreements made to others. At the post violation and post enforcement stage, enforcement enables the offended party to comply with rules of society by refraining from unlawful retaliations. When the offended party knows the breach will be

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<sup>9</sup> M Reiff, *Punishment, Compensation and Law: A Theory of Enforceability* (Cambridge University Press 2005) 45.

<sup>10</sup> *ibid* 74.

redressed he is less likely to seek retaliation.<sup>11</sup> He is also more likely to accept the result of enforcement due to the threat of sanction for unlawful retaliation. Therefore, enforcement at the different stages ensures compliance both by the offending and the offended party. It can therefore be said that at the heart of enforcement is the need to ensure compliance with certain rules, standards or expectations and this represents the ultimate *goal* of enforcement.

### **3.3.2 The Purposes of Enforcement in Corporate Law**

As mentioned earlier, in section 3.3, the goal of enforcement is different from the purposes it is intended to serve. This section therefore examines the purposes of enforcement. Generally, enforcement may serve three main purposes; these are deterrence, compensation and retribution. Rules may be enforced in order to deter potential violations, to compensate injured parties, or to provide retribution by punishing the violator in a manner that the beneficiary no longer feels the need to retaliate. Retribution helps to quench the desire for retaliation by the injured party by ensuring that the offender is punished in a way that satisfies the injured party's desire for revenge.<sup>12</sup> Retributivists believe that the punishment should match the crime in some way and what is sometimes used to measure this in the modern day is the 'moral gravity' of the offence.<sup>13</sup> Several factors determine the moral gravity of an offence; these include the intention and motive of the offender.<sup>14</sup> With respect to civil offences or private law however, moral gravity plays a less significant role. The measure of damages payable for breach of contract is likely to be the same whether the breach was intentional or negligent or even accidental. For civil violations, the

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<sup>11</sup> On the link between retribution and retaliation see RA Posner, 'Retribution and Related Concepts of Punishment' (1980) 9(1) *Journal of Legal Studies* 71-92.

<sup>12</sup> Reiff (n 9)119.

<sup>13</sup> See CH Whiteley, 'On Retribution' (1956) 31(117) *Philosophy* 154,155-156.

<sup>14</sup> See A Smart, 'Mercy' (1968) 43(166) *Philosophy* 345, 345-359 for a discussion on the moral gravity of an offence.

injury caused by the violation is the important factor and not necessarily the moral gravity of the offence.<sup>15</sup> Retribution is therefore more apt in response to crimes and violent offences rather than in relation to private law.

In spite of this however, the idea of retribution may sometimes come to play in corporate law. This is because there is sometimes a public desire for revenge in respect of directors' misconducts, which have an impact on the members of the public. An example of this is the UK banking crisis, which brought with it a strong desire for retribution by aggrieved members of the public. An instance where this desire for revenge was actualised is seen in the vandalization of the Edinburgh home and car of the former CEO of RBS, Sir Fredrick Goodwin, by a vigilante group called 'bank bosses are criminals'.<sup>16</sup> The attack came in the wake of statements by Max Hastings in the Daily Mail where he stated that 'the time has come to address the entire robber banker culture' and further encouraged standing outside the homes of those failed bank chiefs and throwing rocks through their windows.<sup>17</sup> This statement is a reflection of the public anger and desire for revenge against those bank chiefs by members of the public. It also shows that there is sometimes a desire for retribution in enforcement of corporate law norms. There are therefore obvious instances of overlap between public and private law in relation to corporate law. This perhaps explains why criminal liability is imposed for certain wrongdoings by directors. Nevertheless, corporate law still largely belongs to private law; therefore, the focus in this thesis

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<sup>15</sup> Reiff (n 9) 132.

<sup>16</sup> BBC, 'Sir Fred Goodwin's home attacked' 25th March 2009

<<http://news.bbc.co.uk/1/hi/7962825.stm>> accessed 8th July 2015. See also A Simpson, 'Sir Fred Goodwin attack: Bank Bosses Are Criminals group claims responsibility' 25th March 2009. <<http://www.telegraph.co.uk/finance/newsbysector/banksandfinance/5048091/Sir-Fred-Goodwin-attack-Bank-Bosses-Are-Criminals-group-claims-responsibility.html>> accessed 8th July 2015.

<sup>17</sup> M Hastings, 'Seize their Porsches and throw them in jail! Shameless bankers are worse than Train Robbers' (Daily Mail 23<sup>rd</sup> march 2009) <<http://www.dailymail.co.uk/debate/article-1163623/MAX-HASTINGS-Seize-Porsches-throw-jail-Shameless-bankers-worse-Train-Robbers.html>> 23<sup>rd</sup> march 2009> accessed 8<sup>th</sup> July 2015.

would be on deterrence and compensation as these are the key purposes of enforcement in private law, and by extension corporate law.

### **3.4 The Importance of Enforcement in Corporate Law**

Many notable corporate law scholars have identified the importance of enforcement in corporate law. LLS & V<sup>18</sup> in their studies on investor protection considered both the content of the law and the quality of its enforcement in protection of shareholder rights.<sup>19</sup> They noted that shareholder protection encourages the growth of equity markets. However, this shareholder protection includes not just having the rights contained in laws and regulations, but also effective enforcement of these rights.<sup>20</sup> They also opined that a sound system of legal enforcement could compensate for weak rules as active and efficient courts could step in to redress wrongs done to investors by management.<sup>21</sup> Furthermore, in their study showing the impact of investor protection on financial markets, they found that effective investor protection, which includes both law and effective enforcement, contributed to the growth of the financial market in countries that had them. According to them, any corporate governance reform needs to focus on certain principles and part of these principles is that legal rules are important, and ‘good legal rules are the ones that a country can enforce’.<sup>22</sup> Therefore, LLS & V did not focus exclusively on legal rules alone; rather they acknowledged the equal importance of enforcement in a country’s legal environment.

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<sup>18</sup> LLS & V is the acronym used for Rafael La porta, Florencio Lopez-de-Silanes, Andrei Shleifer and Robert W Vishny.

<sup>19</sup> R La Porta, F Lopez-De- Silanes, A Shleifer and R W Vishny, ‘Law and Finance’ (1998) 106(6) *Journal of Political Economy* 1113, 1115. See also LA porta et al, ‘Legal Determinants of External Finance’ (1997) NBER Working paper no 5879.

<sup>20</sup> La Porta & others, ‘Investor Protection and Corporate Governance’ (2000) 58 *Journal of Financial Economics* 3, 15.

<sup>21</sup> La porta & others, ‘Law and Finance’ (n 19)1140.

<sup>22</sup> La porta & others, ‘Investor Protection and Corporate Governance’ (n 20) 21-22.

Similarly, Coffee in his analysis on the impact and importance of enforcement argued that the level of enforcement intensity could explain the differences in financial development between jurisdictions.<sup>23</sup> He argued that the main difference between the financial development of common law and civil law countries is the level of enforcement.<sup>24</sup> Hence, enforcement plays a major role in a country's financial development. It is therefore insufficient to have rules alone without effective enforcement.

The importance of effective enforcement has also been noted by Goldschmid who opined that 'there is no issue so integral to market confidence as effective enforcement'.<sup>25</sup> Economies require private investments in order to grow and as noted by Millstein 'capital does not flow to dangerous neighbourhoods'.<sup>26</sup> This statement is consistent with the results of an empirical study carried out by Bhattacharya and Daouk.<sup>27</sup> In their study, they found that enforcement of insider trading laws was generally associated with a reduction in the cost of equity.<sup>28</sup> Thus, investors are likely to invest more in a market that has effective investor protection. Hence, while it is important to have strong securities and companies law to reassure investors that their

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<sup>23</sup> JC Coffee Jr, 'Law and the Market: The Impact of Enforcement' 2007) 156(2) University of Pennsylvania Law Review 229, 233.

<sup>24</sup> *ibid* 244.

<sup>25</sup> HJ Goldschmid, foreword 'Enforcement and Corporate Governance: Three Views' (Global Corporate Governance Forum Focus 3, Washington DC: The International Bank for Reconstruction and Development/The World Bank, 2005)

<[http://www.ifc.org/wps/wcm/connect/6ab71c8048a7e7b3accfef6060ad5911/Focus\\_ENFCorpGov3.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/6ab71c8048a7e7b3accfef6060ad5911/Focus_ENFCorpGov3.pdf?MOD=AJPERES)> viii accessed 17<sup>th</sup> July 2014.

<sup>26</sup> IM Millstein, 'Non-traditional modes of enforcement' in Enforcement and Corporate Governance: Three Views' (Global Corporate Governance Forum Focus 3, Washington DC: The International Bank for Reconstruction and Development/The World Bank, 2005) <[http://www.ifc.org/wps/wcm/connect/6ab71c8048a7e7b3accfef6060ad5911/Focus\\_ENFCorpGov3.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/6ab71c8048a7e7b3accfef6060ad5911/Focus_ENFCorpGov3.pdf?MOD=AJPERES)>, 1 accessed 17<sup>th</sup> July 2014.

<sup>27</sup> U Bhattacharya & H Daouk, 'The World Price of Insider Trading' (2002) 57(1) Journal of Finance 75-108.

<sup>28</sup> Ferran similarly argues that mere adoption of insider trading laws does not affect the cost of equity in a country in the absence of enforcement. Enforcement of insider laws therefore significantly reduces the cost of equity. See E Ferran, 'The Enforcement of Insider Dealing Laws' in J Armour & J Payne, *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart Publishing 2009) 57.



assets are protected, this is simply not enough. As rightly noted by Berglof and Claessens, ‘enforcement more than regulations, laws-on-the books or voluntary codes is key to effective corporate governance...’<sup>29</sup> In the absence of proper enforcement, most of the corporate governance mechanisms will be ineffective. The law is ‘incomplete’ and is unable to cover all foreseeable wrongs; hence, it is important to devise enforcement mechanisms to ensure compliance. Enforcement is therefore needed to address gaps in the law and to deal with clear violations of the law.<sup>30</sup>

In spite of the many arguments in favour of enforcement of corporate law as highlighted above, some scholars are more sceptical about the innate need for enforcement in corporate law. Blair and Stout, for example, have argued that the internalised norms of trust and trustworthiness play important roles in discouraging misconduct by directors.<sup>31</sup> They further argued that external incentives such as sanctions, which aims at ensuring compliance, could be counterproductive. The next section will however rebuff such scepticism, and seek to justify the inherent need for enforcement in corporate law.

### **3.5 Justification for Enforcement using the Deterrence Theory**

The previous section has examined reasons why enforcement is considered important as identified by different scholars. This section will however develop a justification for enforcement using the deterrence theory. The analysis of the deterrence theory in this section will reveal the inherent need for enforcement in corporate law.

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<sup>29</sup> E Berglof and S Claessens, ‘Corporate Governance and Enforcement’ in ‘Enforcement and Corporate Governance: Three Views’ (n 26) 27.

<sup>30</sup> I Millstein (n 26) 2- 3.

<sup>31</sup> See M.M Blair & L.A Stout, ‘Trust, Trustworthiness and the Behavioural Foundations of Corporate Law’ (2001) (149) 6 University of Pennsylvania Law Review 1735-1810.

### 3.5.1 The Deterrence Theory

The issue of enforcement has concerned economists, legal practitioners, criminologists and criminal justice lawyers over the years who have tried to study the relationship between enforcement and compliance.<sup>32</sup> The ‘deterrence theory’<sup>33</sup> has often been used to highlight the need for enforcement particularly within the field of criminal justice. While this theory is more frequently used within the context of criminal behaviour and criminal justice, this thesis applies the deterrence theory in justifying the need for enforcement in corporate law.

Deterrence generally means refraining oneself from an act or omission due to the fear of penalty. It is more formally defined as ‘the omission of an act as a response to the perceived risk and fear of punishment of contrary behaviour’.<sup>34</sup> Deterrence could be general or specific; it is specific where it deters previous violators who have been punished from committing further violations and it is general where it aims to deter persons who have not yet violated from doing so.<sup>35</sup>

The concept of deterrence has a long history and has been evident through the ages. Indeed many of the torturous punishments used in ancient times were intended to serve as a warning and deterrence to others.<sup>36</sup> The formal deterrence theory itself can however be traced to the early works of two philosophers, Cesare Beccaria and Jeremy Bentham. Cesare Beccaria’s essay ‘*on crimes and punishment*’ written in

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<sup>32</sup> See for examples G Stigler, ‘The Optimum Enforcement of Law’ in G S Becker and WM Lands (eds), *Essays in the Economics of Crime and Punishment* edited by (National Bureau of Economic Research New York, Columbia University Press 1974); I Ehrlich, ‘The Deterrent Effect of Criminal Law Enforcement’ (1972) 1(2) the Journal of Legal Studies 259-276.

<sup>33</sup> On the mislabelling of the ‘deterrence doctrine’ as a ‘theory’, see J Gibbs, *Crime, Punishment and Deterrence* (Elsevier 1975) 5-9. This term ‘deterrence theory’ would however be used in this thesis as it is the most used term.

<sup>34</sup> J Gibbs, ‘Crime, Punishment and Deterrence’ (n 33) 2.

<sup>35</sup> R Paternoster, ‘How much do we Really Know about Criminal Deterrence?’ (2010) 100(3) Journal of Criminal Law and Criminology 765, 766.

<sup>36</sup> See J.C Ball, ‘The Deterrence Concept in Criminology and Law’ (1955) 46 Journal of Criminal Law, Criminology and Police Science 347.

1764 formed the basis for the deterrence theory.<sup>37</sup> He was of the opinion that all human beings have a self-interest in committing crimes and that crimes could be prevented by punishment, which is certain, proportional and swiftly applied. He also believed that for punishment to be effective, the disadvantage posed by the punishment should outweigh the potential advantage of committing the crime. Similarly, Bentham identified the principle of utility in his work published in 1789 where he stated that ‘Nature has placed mankind under the governance of two sovereign masters, pain and pleasure’.<sup>38</sup> Utility is the difference between the benefits and costs of one’s actions; an individual would therefore generally choose that course of action which has greater benefits than costs. Bentham’s original deterrence model was therefore based on the premise that compliance with the law depends on increasing the severity of punishment to the point that it removes the pleasures normally associated with breaking the law.<sup>39</sup>

Following its initial dominance, the deterrence theory was subsequently neglected for nearly two centuries in favour of other perspectives on criminology.<sup>40</sup> Modern day interest in the ‘deterrence theory’ was however reignited in 1968 by Gary Becker’s seminal article on *Crime and Punishment* and Jack Gibb’s article on *Crime, Punishment and Deterrence*.<sup>41</sup> Becker’s inspiration for his work on the deterrence theory was informed by a personal experience where he chose to violate a parking

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<sup>37</sup> C Beccaria, *Of Crimes and Punishment* (Jane Grigson tr, Marsilio publishers 1996) 50.

<sup>38</sup> J Bentham, ‘An Introduction to the Principles of Morals and Legislation in *the works of Jeremy Bentham published under the superintendence of his executor, John Bowring* (Edinburgh volume 1 )1.

<sup>39</sup> Bentham *ibid.* See also John T Scholz, ‘Enforcement Policy and Corporate Misconduct: The Changing Perspective of Deterrence Theory’, (1997) 60(3) *Law and Contemporary Problems* 253, 254.

<sup>40</sup> T.C Pratt et al, ‘The Empirical Status of Deterrence Theory: A Meta-Analysis’ in F.T Cullen, J.P Wright and K.R Blevins (eds), *Taking Stock: The Status of Criminological Theory* (Advances in Criminological Theory, Vol 15, Transaction Publishers 2008) 367.

<sup>41</sup> See G.S Becker, ‘Crime and Punishment: An Economic Approach’ in G.S Becker and W.M Landes (eds), *Essays in the Economics of Crime and Punishment* (National Bureau of Economic Research, New York 1974) and J.P Gibbs, *Crime, Punishment and Deterrence* (1968) 48(4) *The South western Social Science Quarterly* 515.

rule based on a calculation in his mind of the cost and benefit of parking illegally.<sup>42</sup> According to Becker, all things being equal, the higher the probability of a person's conviction or punishment for offences, the lower the number of offences he commits.<sup>43</sup> This decrease may be substantial or negligible; nevertheless, there is still a decrease. This approach is based on economists' analysis of choice. It therefore assumes that 'a person commits an offence if the expected utility to him exceeds the utility he could get by using his time and other resources at other activities'.<sup>44</sup> An increase in the probability of conviction and the severity of punishment reduces the utility expected from the offence thereby reducing the number of offences committed.<sup>45</sup>

Sociologist Gibbs's article was closer to Beccaria's approach as he focused on the role of punishment in criminal behaviour. He was therefore keen on examining whether punishment was effective in reducing crime. While acknowledging the limits of the empirical data on the subject, in his empirical research he found some evidence that punishment is effective in ensuring compliance with the law. His empirical study therefore revealed that states that had high severity and certainty of sanctions had lower homicide rates than states with lower certainty and severity of sanctions.<sup>46</sup>

The deterrence theory is generally based on the cost-benefit approach to decision making. It is therefore argued that people would often choose that course of action which offers greater individual benefits than costs. Deterrence theorists generally

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<sup>42</sup> D Clement, Interview with Gary Becker, (The Federal Reserve Bank of Minneapolis, 1st June 2002) <[http://www.minneapolisfed.org/publications\\_papers/pub\\_display.cfm?id=3407&](http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3407&) > accessed 9<sup>th</sup> June 2016.

<sup>43</sup> G.S Becker, 'Crime and Punishment: An Economic Approach' in G.S Becker and W.M Landes (eds), *Essays in the Economics of Crime and Punishment* (National Bureau of Economic Research, New York 1974) 9.

<sup>44</sup> Ibid 9. See also M Polinsky and S Shavell, 'The Economic Theory of Public Enforcement of Law' (2000) 38(1) *Journal of Economic Literature* 45, 47.

<sup>45</sup> See further BR Cheffins, '*Company Law: Theory, Structure and Operation*' (OUP 1997) 199.

<sup>46</sup> J.P Gibbs, 'Crime, Punishment and Deterrence' (1968) 48(4) *The South Western Social Science Quarterly* 515,524.

assume that human beings are ‘self-interested, rational and reasoning’ creatures.<sup>47</sup> The theory is therefore based on a view of human beings as ‘rational utility maximizers’, who consider the consequences of their actions and are influenced by these consequences in their decisions.<sup>48</sup> For example, one may decide to get a degree if the perceived future benefits are greater than the costs. Similarly, when given the opportunity to commit a crime or violate a law, an individual weighs the costs and benefits of doing so in comparison to other options.<sup>49</sup> A person would therefore commit a crime where the expected benefits outweigh the expected costs.<sup>50</sup> The expected benefits here would include tangible benefits such as monetary gains as well as intangible benefits such as reputational gains. The costs would include monetary expenses incurred to commit the crime, time expended and the anticipated punishment for committing the offence.<sup>51</sup> An essential element of the deterrence theory is therefore the ‘psychological’ process an individual goes through before committing a wrongful act.<sup>52</sup> Hence, supporters of the deterrence theory advocate the need to ensure that ‘amoral’ persons calculate that it is in their best interests to comply with, rather than to break, the law.<sup>53</sup> Clearly then, punishment or sanctions for violations are a central part of the deterrence theory. Punishment generally leads to undesirable change in wellbeing. Therefore, a rational potential violator would usually consider the risk of undergoing that undesirable change when deciding whether to commit an offence or wrongful act.

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<sup>47</sup> R Paternoster (n 35) 782.

<sup>48</sup> D.J Pyle, *The Economics of Crime and Law Enforcement* (Macmillan 1983) 10.

<sup>49</sup> K.R Williams and R Hawkins, ‘Perpetual Research on General Deterrence: A Critical Review’ (1986) 20(4) *Law and Society Review* 545, 547. See also S Shavell, *Economic Analysis of Law* (Foundation Press 2004) 97.

<sup>50</sup> R.A Posner, *Economic Analysis of Law* (9<sup>th</sup> Edn, Wolters Kluwer 2014) 258.

<sup>51</sup> *ibid* 258.

<sup>52</sup> Williams and Hawkins, (n 49) 546.

<sup>53</sup> J Scholz, ‘Deterrence, Cooperation and the Ecology of Regulatory Enforcement’ (1984) *Law and Society Review* 179.

Several factors have been thought to determine the deterrent effect of punishment;<sup>54</sup> this thesis would focus on four key ones.<sup>55</sup> The first is the *certainty* of punishment. It is argued that the greater the likelihood that punishment will be imposed, the higher the deterrent effect of that punishment. The second factor is the speed with which punishment is applied. This is also known as *celerity* (swiftness) of punishment. The idea is that when punishment is swiftly applied, there is a greater association between the criminal acts and its costs in the minds of offenders. The third element, which is also considered very essential, is the *severity* of punishment. To ensure its effectiveness, punishment should be sufficiently severe and proportionate to the offence.<sup>56</sup> In addition to the three factors mentioned above which have been generally identified by scholars, a final factor which affects deterrence is the *variety* of sanctions available. This factor may be considered an offshoot of the ‘severity’ factor. In order to effectively deter, it is necessary to have a good range of sanctions for punishing any offence committed. This will ensure that an *appropriately* severe punishment is imposed for every wrong committed. Hence, in order to sufficiently deter offences, the certainty, severity and celerity of punishment should be increased. Similarly, the enforcer should have a good variety of sanctions at its disposal.

### **3.5.2 Criticisms of the Deterrence Theory**

The general deterrence theory is commonly used in criminal justice to theorize about the efficiency of legal sanctions.<sup>57</sup> It has been the subject of much discourse, particularly in the area of criminal justice, it has however also been the subject of some criticisms. Two of such criticisms will be addressed here.

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<sup>54</sup> Note that the terms punishment and sanction are used interchangeably in the course of this thesis.

<sup>55</sup> Other factors thought to influence deterrence include the particular population in question, the individual’s level of education, the value system, and the individual’s knowledge of the law and its punishment. See Ball (n 36) 348.

<sup>56</sup> See Beccaria (n 37) 49-70; see also S.S Simpson, *Corporate Crime, Law and Social Control* (Cambridge Studies in Criminology, 1<sup>st</sup> edn, Cambridge University Press 2002) 23.

<sup>57</sup> Williams & Hawkins (n 49) 546.

The first criticism is based on the premise that deterrence itself is a *complex phenomenon* and depends on a wide range of factors. Robinson and Darley have criticised the deterrence theory on the basis that in order for a law to deter potential offenders certain conditions must exist. These are that the potential offender must be aware of the law, he must be able to calculate that the cost of violation is greater than the benefit, and he must be willing to let this calculation influence his conduct at the time of offence.<sup>58</sup> Robinson and Darley however argue that potential offenders rarely know the law, cannot calculate the expected costs versus benefits of their actions and do not make rational self-interested decisions.<sup>59</sup>

While this viewpoint may be accepted for ordinary criminal offenders or offenders who are motivated by substances like drugs, alcohol or influenced by passion (crimes of passion), the same seems less true of the sorts of people who ‘on average’ tend to be rational. At the inevitable risk of some simplification, directors are, on average, likely to be people who are relatively well educated and informed. Moreover, their training and experience would often require them to make rational and well-reasoned business decisions on a day-to-day basis. They are therefore fully capable, and indeed well versed, in making rational decisions that involve costs-benefits calculations. Directors in large public listed companies also know that the control of the company lies with them and that shareholders may not have the incentive to monitor or enforce their rights,<sup>60</sup> they may therefore have a higher incentive to mismanage the company. An increase in the certainty, celerity, variety and severity of sanctions would therefore provide the incentive required for compliance.

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<sup>58</sup> P.H Robinson and J.M Darley, ‘The Role of Deterrence in the Formulation of Criminal Law Rules: At Its Worst when doing its Best’ (2002-2003) 91 *Georgetown Law Journal* 949, 953.

<sup>59</sup> *ibid* 953.

<sup>60</sup> For the problems occasioned by the separation of ownership and control in widely dispersed corporations see AA Berle Jr & GC Means, *The Modern Corporation and Private Property* (Harcourt, Brace & world, rev edn. 1967).

The second criticism of the deterrence theory is based on the argument that members of a society do not comply with rules and standards due to the *fear* of sanctions. Rather, they comply because they have *internalised* certain norms and values of the society. Consequently, compliance with the law is not as a result of the fear of potential sanctions, but due to internalised norms. Toby argues that punishments are unnecessary because the ‘socialisation’ process prevents most deviant behaviour.<sup>61</sup> This is because persons who have accepted and internalised the moral norms of the society would not commit crimes. It is therefore only the ‘unsocialised’ who will be deterred by a plain calculation of the punishment and pleasure of committing a crime.<sup>62</sup> Toby’s argument is therefore based on the premise that societal norms and values play a greater role in securing compliance. Similarly, Tyler argues that people are influenced by social values of right and wrong, and only obey the law if they believe it is legitimate and moral.<sup>63</sup>

Truly, people refrain from violating the law for several reasons. For some it may be due to their moral values or religious beliefs, while others may be influenced by the stigma associated with violating the law.<sup>64</sup> Hence, individuals may refrain from violating the law or committing an offence because they have internalized the norm. In spite of this however, this thesis argues that the deterrence theory is applicable in several respects. While societal norms and individual values play an important part in defining our conducts or condemnation of wrongful actions, those norms and values are nevertheless influenced by the punishments available for actions classified as wrongful by the society. The ‘internalisation of norms’ argument ignores the fact that

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<sup>61</sup> J Toby, ‘Is Punishment Necessary?’ (1964) 55 *Journal of Criminal Law, Criminology & Police Science* 332,333.

<sup>62</sup> *ibid.*

<sup>63</sup> T.R Tyler, *Why People Obey the Law* (Princeton University Press 2006).

<sup>64</sup> See J Gibbs, *Crime, Punishment and Deterrence* (Elsevier 1975)12.



enforcement actually reinforces social condemnation of particular actions.<sup>65</sup> Therefore, if an individual condemns an action but subsequently discovers that the action is not punished, the severity of condemnation towards that wrong is likely to reduce. Hence, while individuals may refrain from certain illegal acts, not due to fear of punishment but because they evaluate that act to be wrong, that moral evaluation is itself greatly influenced by the sanctions available for that wrong. Similarly, in the absence of sanctions, persons who are inclined to comply due to their internalised norms or values, may be discouraged from doing so if they perceive that those who fail to comply are not punished. Sanctions therefore contribute both to the internalization of norms as well as deterrence of potential offenders who fail to internalize those norms.

As mentioned earlier, an individual may refrain from committing an offence or violation due to several reasons besides from the fear of sanctions, hence any empirical assertion of deterrence is hardly irrefutable. The deterrence theory however does not assert that the threat of sanctions deters *all* individuals in *all* circumstances.<sup>66</sup> As argued by Dodd one would have to be an especially ‘hostile critic’ of directors to deny that a good number of them are motivated by a genuine desire to comply with corporate law, not just because it is ‘legal and safe’ to do so but, because they believe it is the morally right thing to do.<sup>67</sup> Consequently, the deterrence theory does not apply to *all* individuals or, more specifically, *all* directors. It is nevertheless sufficient to say that ‘in some situations, some individuals are deterred from some

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<sup>65</sup> Ibid 80.

<sup>66</sup> See Ball (n 36) 349-350.

<sup>67</sup> See EM Dodd, ‘Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?’ (1935) 2 (2) the University of Chicago Law Review 194, 199; Daniel Attenborough, ‘Enforcement of Corporate Conduct under the Equitable Maximisation and Viability Principle’ (2013) 33(4) Legal Studies 650,657.

crimes by some punishments'.<sup>68</sup> Hence, while we cannot assert that deterrence applies in *all* situations and that people *always* calculate the costs and benefits of their actions before committing a violation, there are definitely *some* individuals who are deterred only by punishment.

### **3.5.3 Some Empirical Evidence of Deterrence in the Corporate Context**

Having looked at the theoretical arguments on deterrence, it is necessary to examine whether there is any empirical evidence in support of deterrence. The general empirical evidence on deterrence suggests that increase in the likelihood of conviction and punishment as well as increase in the severity of punishment do indeed have a deterrent effect on the general populace and individuals who have an incentive to commit crime.<sup>69</sup> Therefore, while many may not agree with the notion of criminals as rational calculators, a number of empirical studies have shown that criminals respond to certain variables such as increases in the probability of being caught and the severity of penalty.<sup>70</sup> This is irrespective of the intention behind the crime or whether the crime is committed by white-collar offenders.<sup>71</sup> For example, there are empirical studies to show that an increase in police officers in the US in the 1990s could be partly responsible for the decline in crime rate. This could perhaps be due to an increase in the certainty of punishment.<sup>72</sup>

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<sup>68</sup> Gibbs, 'Crime, Punishment and Deterrence' (n 46) 11.

<sup>69</sup> N Garoupa, 'The Theory of Optimal Law Enforcement' (2002) 11(3) *Journal of Economic Surveys* 270.

<sup>70</sup> R Posner, 'Economic Analysis of Law' (n 4) 258; see also I Ehrlich, 'Crime, Punishment and the Market for Offences' (1996) 10(1) *Journal of Economic Perspectives* 43-67 whose empirical study was consistent with the fact that punishment and other incentives have a deterrent effect on offenders.

<sup>71</sup> R Posner, 'Economic Analysis of Law' (n 4) 258.

<sup>72</sup> R Paternoster (n 35) 791. See more specifically S.D Levitt, 'Using Electoral Cycles in Police Hiring to Estimate the Effect of Police on Crime' (1997) 87 *American Economic Review* 270,271; T.B Marvell and C.E Moody, 'Specification Problems, Police Levels, and Crime Rates' (1996) 34 *Criminology* 609, 623.

Although the word ‘crime’ was used in Becker’s analysis, he however intended his analysis to cover all violations and not just felonies.<sup>73</sup> As such, the deterrence theory has been used in different areas of law including within the corporate context. The theory has therefore been used to explain tax compliance as well as compliance by corporate entities with rules and laws. The question has frequently been whether certainty and severity of punishment influence compliance.

Klepper and Nagin in their study on tax compliance analysed the deterrent effect of enforcement and found that taxpayers’ compliance was based on the perceived risk of detection and prosecution for non-compliance. They found that taxpayers make a cost–benefit analysis in their decision to comply and the effect of their calculations was closely related to the enforcement process.<sup>74</sup> Similarly, in an empirical analysis by Zubcic and Sims on the effect of enforcement actions by ASIC (Australia’s Securities and Investment Commission) on corporate compliance, it was found that the number of complaints against companies which had previously been the subject of prior enforcement or investigation was much lesser than companies who have not previously been subject to enforcement action.<sup>75</sup> This empirical analysis therefore supports the argument that enforcement action affects compliance of companies who have previously been the subject of enforcement action.<sup>76</sup>

A study by Welsh on the effect of increased sanctions and enforcement activity on corporate compliance also shows that there is a link between increased enforcement

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<sup>73</sup> Becker (n 41) 3.

<sup>74</sup> S Klepper and D Nagin, ‘Tax Compliance and Perceptions of the Risk of Detection and Criminal Prosecution’ (1989) 23(2) *Law and Society Review* 209-240.

<sup>75</sup> J Zubcic and R Sims, ‘Examining the Link between Enforcement Activity and Corporate Compliance by Australian Companies and the Implications for Regulators’ (2011) 53(4) *International Journal of Law and Management* 299, 306.

<sup>76</sup> *Ibid* 307

and increase in compliance.<sup>77</sup> During the interviews conducted on the impact of enforcement regime on the incentive to comply, most interviewees (which included company secretaries, compliance managers and partners) agreed that the introduction of new enforcement regimes caused them to pay more attention to their compliance system. Similarly, a court decision on enforcement was also found to have incentivized companies to pay more attention to their compliance policies as they realized that there is a real risk of prosecution for corporate offences.<sup>78</sup>

In a study by Gunningham, Thornton and Ragan which was conducted to understand the motivation for firms' environmental behaviour; most respondents stated that the threat of fines or prison sentence was a principal motivating factor in their environmental actions.<sup>79</sup> The fear of detection and penalties was therefore an important factor precipitating changes within the firms. Many respondents to the study also believed that without effective enforcement, compliance would decrease over time. The compliant firms would lose confidence in the system due to the injustice inherent in the lack of sufficient punishment for offenders.<sup>80</sup> In a similar study, the response by the interviewees also showed that enforcement helped to reassure compliant companies that they are not 'foolish' for complying since their competitors who fail to comply are apprehended and penalised.<sup>81</sup> Furthermore a majority of firms reported taking an environmental action or reviewing their compliance system upon hearing about enforcement actions taken against another

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<sup>77</sup> M Welsh, 'New Sanctions and Increased Enforcement Activity in Australian Corporate Law: Impact and Implications' (2012) 41 *Common Law World Review* 134, 164.

<sup>78</sup> *Ibid* 159-161.

<sup>79</sup> N Gunningham, D Thornton and RA Kagan, 'Motivating Management: Corporate Compliance in Environmental Protection' (2005) 27(2) *Law & Policy* 294.

<sup>80</sup> *Ibid* 294- 309.

<sup>81</sup> D Thornton, N Gunningham and RA Kagan, 'General Deterrence and Corporate Environmental Behavior' (2005) 27(2) *Law & Policy* 262, 273.

company.<sup>82</sup> From the foregoing, it is clear that there is an obvious link between enforcement actions and level of compliance even within the corporate context.

### **3.5.4 Deterrence theory and Directors' Compliance**

To recap, thus far it has been argued that the deterrence theory is indeed applicable to efforts to secure compliance by directors with corporate law requirements. As mentioned in section 3.5.2, Directors are often well-educated and rational persons who can fully calculate the costs and benefits of their actions. Therefore, in order to ensure compliance by directors, the costs of non-compliance must outweigh the potential benefits. To increase these costs, the certainty, variety, severity and celerity of sanctions must be increased. Where the probability of punishment is low, management may continue to engage in breach of corporate law requirements to the detriment of shareholders. Similarly, sanctions imposed for directors' breach must be varied, reasonably severe and swiftly applied after the breach. This will ensure that directors who are predisposed to engaging in certain misconducts are deterred from doing so due to the costs of noncompliance thereby securing both specific and general deterrence. Hence, both the offending directors as well as other directors would have a greater incentive to comply thereby enhancing corporate governance.

While effective enforcement of corporate law is unlikely to *totally* eradicate all forms of mismanagement, it nevertheless has a role to play in *reducing* it. As Becker argues, the optimal level of crime will rarely be zero. Hence, there will always be some level of crime in the society.<sup>83</sup> Similarly, agency costs can never be zero as confirmed by Jensen and Meckling.<sup>84</sup> However, it is possible to find the right mix of certainty,

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<sup>82</sup> *ibid* 279.

<sup>83</sup> Becker (n 41) 98.

<sup>84</sup> M.C Jensen and W.H Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305, 308.

celerity, variety and severity of sanctions that will reduce agency costs and agency problems to optimal levels.

In the absence of effective enforcement of directors' duties and norms of conduct, there is unlikely to be proper compliance.<sup>85</sup> Directors often do not 'passively' obey the legal rules or standards that apply to them.<sup>86</sup> Thus, while having directors' duties and other norms may provide some educational benefit, they are unlikely to be regarded as useful in the absence of effective enforcement.<sup>87</sup> An effective regulatory regime therefore needs both substantive rules and effective enforcement mechanisms.<sup>88</sup>

### 3.6 Compensation

Before moving on to consider the criteria for judging effective enforcement in corporate law, it is worth examining briefly the concept of compensation. Compensation may be defined as the award of a sum of money which is, as far as possible, equivalent to the claimant's *loss*.<sup>89</sup> The loss may be pecuniary (such as financial loss) or non-pecuniary (such as reputational loss, anxiety, pain and suffering). The remedy, which is used to achieve compensation either in torts or in contracts, is award of damages. Damages are therefore generally intended to compensate for loss suffered.<sup>90</sup> In torts, physical losses are usually the subject of the action for damages. However, for breach of contract, commercial (financial) losses

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<sup>85</sup> A Key, an Assessment of Private Enforcement Actions for Directors Breaches of Duty' (2014) 33(1) Civil Justice Quarterly 76.

<sup>86</sup> See BR Cheffins, 'Company Law: Theory, Structure and Operation' (OUP 1997) 199; Attenborough, (n 67) 657.

<sup>87</sup> Key (n 85)77.

<sup>88</sup> J Armour, 'Enforcement Strategies in UK Corporate governance: A Roadmap and Empirical Assessment' in J Armour & J Payne, *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart Publishing 2009).

<sup>89</sup> A Burrows, *Remedies for Torts and Breach of Contract* (3<sup>rd</sup> edn, OUP 2004) 29.

<sup>90</sup> It must be noted that the terms 'damages' and 'compensation' are not synonymous as some award of damages may be non-compensatory. Damages may be punitive, restitutionary, nominal or contemptuous. See Burrows *ibid*

are often the subject of the action.<sup>91</sup> Within the context of corporate law, damages may therefore be claimed for financial losses suffered as a result of directors' breach.

Damages for breach are granted to compensate for loss suffered by the innocent party and not to punish the wrongdoer.<sup>92</sup> The aim of compensatory damages is therefore to put the claimant in the position he would have been if the breach had not occurred.<sup>93</sup>

An important aspect of compensation is the concept of 'causation'.<sup>94</sup> Damages would generally not be awarded to compensate loss that was not caused by the breach. An inherent requirement of compensatory damages is therefore that the defendant's breach must have been a cause of the claimant's loss. Thus the claimant must be able to establish that 'but for' the breach he would not have suffered the loss.<sup>95</sup>

Directors are subject to certain duties and obligations under corporate law. Hence, where there has been a failure to comply with any of those duties or obligations, there has been a breach for which damages may be awarded by the court. This is in line with Lord Diplock's decision in *Photo Production Ltd v Securicor Transport Ltd*,<sup>96</sup> where he stated that '[e]very failure to perform a primary obligation is a breach of contract'. Compensation for loss suffered as a result of directors' breach is therefore a key purpose of enforcement in corporate law.

There are several issues surrounding the concept of compensatory damages. One of these concerns the measure of damages and whether damages may be calculated using the 'expectation measure' or the 'reliance measure'.<sup>97</sup> Another issue, which has

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<sup>91</sup> J. Beatson, A Burrows, J. Cartwright, *Anson's Law of Contract* (29<sup>th</sup> edn 2010 OUP) 534

<sup>92</sup> *ibid*

<sup>93</sup> See *Robinson v Harman* (1848) 1 Exch 850 @855

<sup>94</sup> J Poole, *Textbook on Contract Law* (13<sup>th</sup> edn, OUP 2016) 359.

<sup>95</sup> See *Barnett v Chelsea and Kensington Hospital Management Committee* [1969] 1 QB 428 for an application of the 'but for' test.

<sup>96</sup> [1980] AC 827 @849

<sup>97</sup> See R Stone and J Devenney, *the Modern Law of Contract* (11<sup>th</sup> edn, Routledge 2015) Ch. 15. See also S.A Smith, Atiyah's Introduction to the Law of Contract (6<sup>th</sup> edn, OUP 2006) Ch. 14.

been the subject of much discussion, is the development of a ‘compensation culture’ particularly in the area of personal injury claims.<sup>98</sup> These issues are however beyond the scope of this thesis and would not be the subject of further analysis. For our purposes, it is nevertheless sufficient to say that compensation in the form of an award of damages may be obtained where there has been a breach such as a breach of directors’ duties.

### **3.7 Criteria for Judging an Effective Enforcement Regime in Corporate Law**

As discussed in the previous sections, enforcement of corporate law is necessary in order to secure compliance. An important issue is how to determine whether an enforcement regime is effective: what criteria can be used to judge the effectiveness of an enforcement regime in corporate law. This thesis proposes two such criteria, which can be used to determine the effectiveness of an enforcement regime. The first is that the enforcement regime must meet the *purpose of enforcement* namely *deterrence and/or compensation*. The second criterion is that the enforcement regime must be *cost effective*. Each will be discussed in turn below.

#### **3.7.1 Deterrence and/or Compensation**

As discussed in section 3.3.2 Enforcement in corporate law may generally serve two main purposes these are deterrence and compensation. A key criterion of an effective enforcement regime or enforcement action is therefore its ability to fulfil an enforcement purpose.

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<sup>98</sup> For academic literature on the compensation culture see K. Williams, ‘State of Fear: Britain’s “Compensation Culture” Reviewed’ (2005) 25 Legal Studies 499; R. Lewis, A. Morris and K. Oliphant, ‘Tort Personal Injury Statistics: Is There a Compensation Culture in the UK?’ (2006) 14 Torts Law Journal 158; J. Hand, ‘The Compensation Culture: Cliché or Cause for Concern?’ (2010) 37 Journal of Law & Society 569.



The first issue to be discussed is whether every enforcement action needs to meet both deterrence and compensatory purposes in order to be properly regarded as effective enforcement? If this question were answered affirmatively, it would mean that an enforcement action would be considered ineffective if it only fulfils one purpose - deterrence or compensation. The nature of an enforcement action generally determines whether it can fulfil both deterrence and compensatory purposes or just one of these purposes. Certain enforcement actions can however only possibly fulfil one purpose. Therefore, the inability of an enforcement action to meet both deterrence and compensatory purposes does not imply that the enforcement action is ineffective. It is nevertheless essential that an enforcement action in corporate law be able to either deter potential offenders or compensate the victims for loss suffered. Failure to achieve either of this makes the enforcement action or regime inherently ineffective.

The second, and perhaps more important, question is whether either deterrence or compensation can be regarded as the primary purpose of enforcement in corporate law. Deterrence generally relates to the offender or potential offenders while compensation deals with the victim of the wrongdoing. Therefore, while deterrence is aimed at preventing further occurrence of the wrong, the aim of compensation is to, as much as possible, restore the victims to the position in which they were before the wrong was inflicted.<sup>99</sup> Several reasons may be advanced for advocating deterrence as the primary purpose of enforcement in corporate law. One directly relates to the fact that the central theme of corporate law and corporate governance is the reduction of agency costs and problem, which has at its core a need to *deter* directors from misconduct. In addition to this, however, there are several other reasons why the

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<sup>99</sup> JM Darley and TS Pittman, 'The Psychology of Compensatory and Retributive Justice' (2003) 7(4) Personality and Social Psychology Review 324, 325.

compensatory purpose cannot reasonably be regarded as the primary purpose of enforcement in corporate law.

The first is in regards to the difficulty with compensating victims of wrongs committed by directors. Compensation involves awarding a sum of money to a victim or defendant for loss suffered.<sup>100</sup> Therefore, in order to properly compensate, the victims of the wrong must be identifiable. The issue with compensation in corporate law is however the difficulty with identifying and adequately compensating the victims of directors' breach. The interest of the company is often considered synonymous with that of the shareholders;<sup>101</sup> there is therefore a case for arguing that the direct victims of directors' misconducts are the shareholders. This immediately raises the question of how to adequately compensate all the shareholders who have suffered loss due to the directors' breach. This difficulty becomes more acute where the company is a widely held company with hundreds or perhaps thousands of shareholders.

Asides from the shareholders of the company, breach by directors may also cause loss to other stakeholders such as creditors, employees, customers,<sup>102</sup> and members of the public.<sup>103</sup> In such cases, it will be difficult to identify all the victims or to fully compensate them. Furthermore, while a number of people in these circumstances may desire to claim compensation, there will remain a substantial number who will be unable to prove their claim or unwilling to claim compensation. There are therefore difficulties with properly compensating victims of directors' breach. Another

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<sup>100</sup> P Giliker & S Beckwith, *Tort* (2<sup>nd</sup> edn Sweet & Maxwell 2004) 2.

<sup>101</sup> See JE Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (OUP 1993) 76-77.

<sup>102</sup> An instance where a director's breach may cause loss to customers is where substandard or even harmful goods are sold to customers in order to increase the company's profits.

<sup>103</sup> The global financial crisis provides a classic example of cases where directors' breaches had far-reaching consequences on members of the public.

problem with compensation as the primary purpose of enforcement is the difficulty with obtaining 'perfect compensation. 'Perfect compensation' restores the victim to the same position he would have been if no injury occurred.<sup>104</sup> This is however impossible to attain in principle as monetary loss is not the only loss suffered by victims of directors' misconducts. Therefore, losses such as emotional distress, inconvenience and pain may not be adequately compensated.

In addition to the difficulty with adequately compensating all the victims of a breach, another problem lies with the very nature of the compensatory remedy. As mentioned earlier, compensation is generally intended to reimburse for loss suffered, therefore where no loss is suffered compensation is generally inapplicable. The implication of this is that if compensation were accepted as the key purpose of enforcement in corporate law, enforcement would generally be considered unnecessary in cases where the company has not suffered any loss from the directors' breach. It is therefore only when the company has suffered a loss that breach will be enforced. Many would however disagree with the idea of permitting directors to breach the law without redress as long as the company has not suffered any loss. Similarly, if compensation is considered the primary purpose of enforcement in corporate law, directors may easily defend themselves on the basis that their breach has not caused any loss to the company or its shareholders or may even argue that the company has gained from the breach.<sup>105</sup>

Even where the company has suffered loss, which can be compensated, compensation as the key purpose of enforcement still causes some difficulties. Reisberg has

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<sup>104</sup> See R.D Cooter, 'Punitive Damages, Social Norms and Economic Analysis' (1998) John M Olin working papers in law economics and institutions 96/97-6, <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=109970](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=109970) >, 6 accessed 2<sup>nd</sup> August 2016.

<sup>105</sup> See generally J. Cox, 'Compensation, Deterrence and the Market as Boundaries for Derivative Suit Procedures' (1983) 52 *George Washington Law Review* 745-788.

identified some of these difficulties in his analysis of the purpose of derivative actions. He argues that the compensatory rationale cannot fully justify derivative actions for several reasons.<sup>106</sup> First, the compensation from the derivative action may not accrue to the persons who were shareholders at the time of injury. In a public company, share ownership changes very frequently such that those who owned the shares at the time of wrongdoing are unlikely to be the same owners at the time of recovery. Secondly, injury to the company is not necessarily synonymous with injury to the shareholders as their loss may even exceed that of the company. Thirdly, while the total amount recovered from derivative actions may be substantial; the amount that accrues to any individual shareholder is unlikely to be significant based on individual shareholding.<sup>107</sup> Fourthly, derivative actions do not always result in tangible relief and finally, compensation can be more easily achieved through other means without need for recourse to costly litigation.<sup>108</sup> It is therefore difficult to fully justify derivative action based on its compensatory benefits. Reisberg however opined that a derivative action might have deterrent benefits to prevent misconduct not only at the particular company to whom a duty is breached but also to other companies.<sup>109</sup> Therefore, shareholders can still benefit as a result of the deterrent effect of the derivative action at the other companies where they hold shares. Hence, for him, the primary rationale or justification for derivative actions is its deterrent benefits and not compensation.

The difficulties identified by Reisberg above also apply to many other enforcement actions in corporate law. Therefore, as with derivative actions, most other

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<sup>106</sup> A Reisberg, 'Shareholders' Remedies: The Choice of Objectives and The Social Meaning of Derivative Actions' (2005) 6(2) *European Business Organisation Law Review* 227,249.

<sup>107</sup> *ibid* 247-248.

<sup>108</sup> A Reisberg, *Derivative Actions and Corporate Governance: Theory and Operation* (OUP 2007) 58-59.

<sup>109</sup> Reisberg, 'Shareholder Remedies: The Choice of Objectives' (n 106) 250.

enforcement actions are primarily justified by their deterrence purpose. In spite of this however, the compensatory purpose still plays a major role in enforcement of corporate law and is not to be discarded. While many enforcement actions are primarily intended to deter with an ancillary compensatory purpose, some other enforcement actions are primarily compensatory and are equally important. Similarly, some enforcement actions straddle both categories. Compensatory enforcement actions can therefore sometimes have a deterrent effect. This would be the case where the compensation is set at a level which is sufficient not only to reimburse victims of the offence but also to properly deter potential offenders. In this regard, the enforcement action has fulfilled a dual purpose of compensating and deterring, although the former remains its primary purpose. An instance where this would be the case is where punitive damages are awarded.<sup>110</sup> In most instances however, the compensation awarded is usually set at a level which is only sufficient to compensate victims without necessarily having any deterrent effect on the offender.

In order for an enforcement action to have a deterrent effect, the penalty must be high enough to remove any benefit that is otherwise gained from the breach.<sup>111</sup> An enforcement action may however require only payment of compensation to the victims without necessitating disgorgement of the ill-acquired profit or wealth. Where the compensation payable is significantly lower than the profit derived from the fraud or other misconduct, the enforcement action is unlikely to have any deterrent effect. Even where the wrongdoer is required to fully disgorge the profit made, this is still unlikely to have a deterrent effect as it only restores the wrongdoer back to the position he would have been had he not committed the offence. A classic example of a case where the penalty was purely compensatory is the case of *Re*

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<sup>110</sup> See below text accompanying fn. 115 for a discussion on punitive damages.

<sup>111</sup> See s3.5.1 above on the deterrence theory.

*Produce Marketing Consortium Ltd*<sup>112</sup> where Knox J held that the court's jurisdiction under s214 of the UK Insolvency Act 1986 was 'primarily compensatory not penal'. Therefore, the amount the director was liable to contribute was limited to the amount by which the company's assets had depleted by the director's conduct.

Similarly, while a compensatory enforcement action may infrequently deter, enforcement actions primarily intended to deter do not often fulfil a compensatory purpose. Enforcement actions often focus exclusively on deterrence without any form of compensation to the aggrieved persons. This is mostly due to the nature of particular enforcement actions which are intended to deter further offences rather than compensate victims. Enforcement actions such as criminal proceedings against directors, fines, reputational sanctions, directors' disqualification and shareholders exit from the company are by their nature intended to deter further offences rather than compensate victims for losses suffered. They therefore generally do not offer any compensatory benefit to the victims of the breach.

There are therefore instances where some tension may exist between deterrence and compensation as purposes of enforcement. An enforcement action which provides optimal deterrence will often not provide optimal compensation. An example of this will be the derivative action remedy discussed above which might deliver optimal deterrence without adequate compensation. This would be the case, for example, where a derivative action is pursued in spite of the fact that the costs of pursuing the action outweighs the damages which will be paid to the company.<sup>113</sup> Similarly, an optimal compensation may not provide an optimal deterrence as seen in the case of *Re Produce Marketing Consortium Ltd*<sup>114</sup> mentioned above where the damages

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<sup>112</sup> (1989) 5 BCC 569, 598.

<sup>113</sup> Reisberg, 'Derivative Actions and Corporate Governance' (n 109)55.

<sup>114</sup> See fn. 112.

ordered by the court was purely compensatory. Private law in many countries also restricts punitive damages perhaps due to the absence of sufficient protection for defendants in civil proceedings compared to criminal trials.<sup>115</sup> Compensation is therefore often restricted to disgorgement of profit whereby the wrongdoer gives up his gains from the injury but remains in the same position he would have been if the wrong not been committed. Hence in these situations, optimal compensation may be obtained with minimal or no deterrence.

It is therefore hardly possible to obtain both optimal deterrence and optimal compensation in one enforcement action. As mentioned earlier, the nature of an enforcement action determines which purpose it meets. However, in those rare cases where there is a direct conflict between a deterrence and compensation purpose, preference must be given to the *primary* purpose of enforcement in corporate law, which is deterrence.

The discussion in this section has shown the various issues surrounding deterrence and compensation as the key purposes of enforcement in corporate law. Where an enforcement action or regime is able to meet both deterrence and compensatory purposes, it is highly commendable. However, an enforcement action or regime is considered effective if, at the very minimum, it fulfils one of these two purposes. Failure of an enforcement action to either deter future wrongdoers or compensates victims of the wrong therefore makes it ineffective.

### **3.7.2 Cost – Effectiveness**

The second criteria for judging the effectiveness of an enforcement action or regime in corporate law is its cost effectiveness. It is simply insufficient for an enforcement regime to fulfil an enforcement purpose; it has to be cost effective as well. Cost

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<sup>115</sup> RD Cooter (n 104) 4.

effectiveness within this context connotes that the *benefits* of procuring the enforcement action outweigh its *costs*. Consequently, besides from ensuring that enforcement fulfils its purpose of compensating and/or deterring, it is also essential to go a step further to ensure that the benefits of pursuing that enforcement activity *balances or outweighs* its costs. Costs and benefits in this regard may be understood in two different senses. The first is the cost and benefit of the enforcement regime to the society as a whole. The second concerns the cost and benefit of each individual enforcement action to the particular company in respect of whose directors the action is brought. It is also important to note that the costs and benefits of enforcement in this respect are not measured in purely pecuniary terms, rather intangible costs and benefits may be considered.

The potential benefits of enforcement to society (public benefits) may include greater deterrence, enhanced compliance with corporate law and standards, increased investments as investors feel more secure, more stable companies, improved financial markets, stronger capital market and overall improved corporate governance. On the other hand, the public costs of enforcement may include the financial costs of investigating and enforcing, time expended in pursuing enforcement actions, possible reduction in the willingness of qualified persons to take up executive positions, negative publicity potentially leading to reduced investments, and the increased pressure on corporate regulators and enforcement agencies.

Besides from the general benefits and costs of enforcement to the society, there are also some specific (private) costs and benefits of enforcement to the companies whose directors are the subject of enforcement action. The potential private benefits of enforcement actions to companies include the compensation paid to the company, the deterrent effect of an enforcement action on the offending director and other



directors, improved accountability by directors, increased compliance with corporate governance standards, greater returns to shareholders and possible reduction in agency costs. Costs of enforcement to companies would include monetary expenses, time spent in pursuing the enforcement action and the potential negative publicity for the company. It would also include the chilling effect of the enforcement action on directors causing them to be more risk averse, the possibility of ‘soured future relations’ with the erring directors,<sup>116</sup> and the possible reduction in the pool of qualified persons willing to act as directors as a result of fear of potential sanction.

In determining whether an enforcement action or regime can be classified as effective, a key consideration should be the costs and benefits of that enforcement system. Where the costs of procuring an enforcement action outweigh its benefits, that enforcement action is to be regarded as ineffective.

### **3.7.2.1 Why Costs and Benefits?**

The first question to be addressed is whether all enforcement regimes and actions should be driven by a cost-benefit calculation. One may argue that a cost-benefit analysis is unnecessary in designing an enforcement regime or in taking a decision to enforce wrongdoing. It may be argued that the only necessary thing in enforcement is proof that there has been a breach and that enforcement of that breach would either deter wrongdoing or compensate victims of the misconduct. After all anyone who has committed a wrong should face the consequences of doing so. This view is quite moral and perhaps justified in certain circumstances. The problem with this single-minded view of enforcement, however, is that it justifies taking an enforcement action even where it would have serious negative consequences that can defeat the very purpose for enforcing. Suppose that a public company (perhaps a financial

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<sup>116</sup> F.A. Gevurtz, ‘Who represents the Corporation? In search of a better method for determining the Corporate Interest in Derivative Suits’ (1985) 46 University of Pittsburgh Law Review 265,299.

institution) is quite large and connected to other companies that its failure would affect not only other companies, but also the livelihood of several members of the community. If an enforcement action were to be commenced against directors of that company which would potentially lead to its bankruptcy, the most reasonable course of action would be to refrain from that particular course of action and look for another alternative that has less dire consequences. It is therefore very important that before any enforcement action is taken its costs must be weighed against its potential benefits. It can therefore only be considered truly effective where its benefits outweigh its costs.

Another possible counter argument to the cost and benefit approach to enforcement is that it is unfair and immoral to allow certain wrongs go un-redressed based on an economic calculation of its costs versus its benefits. It may then be argued that all wrongs ought to be redressed and compensation paid where necessary. Admittedly, it can be considered more equitable to always pursue enforcement whenever there has been a breach. However, the problem with this argument is that enforcement resources are generally *limited*. It is therefore necessary for potential enforcers to weigh the costs and benefits of an enforcement action before embarking on it.<sup>117</sup> As noted in earlier parts of this chapter, the goal of enforcement is to secure compliance and this is the end which every enforcement regime and action should seek to achieve. However, this goal of compliance should not be pursued in a manner that is detrimental to the society and the companies that the law seeks to protect. It is therefore not simply the case that the end justifies the means with regards to enforcement actions. Hence, it is important to weigh the costs and benefits of

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<sup>117</sup> On the cost of enforcement and the desire of policy makers to balance the cost and benefit of enforcement see Garoupa (n 69).

enforcement in order to ensure that its pursuit does not have a counterproductive effect.

Therefore, while several factors may determine the design of an enforcement regime or action, the cost and benefit analysis has a crucial role to play in the determination of effective or optimal enforcement. An enforcement regime should therefore be designed in a manner that seeks to maximise benefits and minimise costs. The important question to answer in designing an enforcement regime should therefore be whether its features would provide more benefits than costs.

### **3.7.2.2 Public Costs and Benefit versus Private Costs and Benefits**

As noted earlier in section 3.7.2, costs and benefits may be used in two different senses. They may be used in the general sense of the costs and benefits of enforcement to the society (public costs and benefits); they could also be considered in the more specific sense of the costs and benefits of individual enforcement actions to companies (private costs and benefits). Hence, the cost-benefit calculation has at least two different levels.

Although there are areas of interplay between the two, some tension may occur between the public costs and benefits of enforcement and the private costs and benefit of enforcement to the individual company. This is due to the fact that the public benefits of enforcement do not always translate to individual (private) benefits for the company. A public enforcement action may offer immense public benefits in terms of enhanced general deterrence and increased compliance with the relevant rules and standards. It may nevertheless offer little private benefit to the company or may indeed be detrimental to it as a result of, say, the adverse publicity, or the distraction to management, caused by the public enforcement action. A public enforcer is however likely to focus on the public costs and benefits of an enforcement action in

deciding whether or not the action is worth pursuing. It may therefore commence an enforcement action which offers little or no private benefit to the company.

Similarly, a company may refrain from embarking on a private enforcement action where it believes the action offers no private benefit to it but imposes costs on it. A private enforcement action by a company may be costly to it in terms of reduction of share value due to the consequent negative publicity, valuable time wasted, loss of the directorial skills, and cost of searching for a replacement. It may however impose zero costs on the society rather it may be socially beneficial to it due to the general deterrent effect of the enforcement action. In this instance, there is an obvious conflict between the public benefits and the private benefits of enforcement.

Companies as economic actors would generally be expected to choose the course of action which is more beneficial and less costly to them. Private enforcers in the company will therefore calculate the private benefits and costs of enforcement rather than the public costs and benefits. Hence, shareholders seeking to bring derivative actions would expectedly be concerned with the benefits to the company and its shareholders of bringing the action rather than the public benefits. This in itself is hardly surprising, as the law does not compel private individuals to bring actions that are contrary to their interests. Thus, a principal who suffers loss as a result of the agent's conduct is not compelled to seek redress for the wrong no matter how offensive the conduct is to public policy.<sup>118</sup> Hence, even where the pursuit of enforcement is beneficial to the society, a private agent cannot be compelled to seek redress where the costs to it of doing so are greater than the benefits. A potential criticism of private enforcement actions could therefore be the limited number of such enforcement actions. This will be the subject of more analysis in chapter 6.

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<sup>118</sup> Gevurtz (n 116) 300.

The main challenge therefore lies in designing an enforcement regime that aligns, to a reasonable extent, the public benefits of enforcement to the society with the private benefits to the company. This is the major challenge for the design of an optimal enforcement regime.

### **3.8 Categorisation of Enforcement Mechanisms in Corporate Law**

At this stage, it is apt to try to gain an understanding of what exactly is meant by enforcement mechanisms in corporate law and what actions may be properly classified as enforcement. In order to understand enforcement, it is necessary to classify all the means of enforcement into different forms. When most people conceive enforcement, they are usually thinking about enforcement through the courts. However, while judicial enforcement actions are important, they are not the only means by which a legal right can be enforced.<sup>119</sup> If we take such a narrow view of enforcement, we risk excluding other important ‘informal’ mechanisms, which may be used to secure compliance without the need for judicial proceedings.<sup>120</sup>

Enforcement can be classified based on different criteria. It could be classified based on the process of enforcement; hence, we could have judicial and non-judicial enforcement, official and unofficial, private and public, or even formal and informal enforcement. Enforcement could also be classified based on the well-being which the mechanism is intended to protect; we could classify enforcement into physical, financial or psychological. Yet still, we could classify enforcement based on the extent to which the enforcement mechanism is subject to individual control. Thus, some enforcement mechanisms could be in the sole control of the beneficiary while others will be under the control of the state.<sup>121</sup> The method of classification used

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<sup>119</sup> Reiff (n 9)17.

<sup>120</sup> Armour (n 4) 73.

<sup>121</sup> Reiff (n 9)16-18.

would usually depend on the feature desired to be given prominence. It is however important to note that each category need not be mutually exclusive and as such there may be overlapping areas.

Reiff in classifying enforcement mechanisms divides them into six categories these are; physical force, strategic power, moral condemnation and regret, social criticism and withdrawal of benefit of social cooperation, automatic enforcement and legal sanctions.<sup>122</sup> More specifically within the context of corporate law, Armour makes use of a four- way taxonomy in analysing the enforcement mechanisms in corporate law. According to him, enforcement strategies in UK corporate governance could be divided into public enforcement and private enforcement and further divided into formal and informal enforcement.<sup>123</sup> This thesis would however make use of a different classification in analysing the different enforcement mechanisms in corporate law.

### **3.8.1 Enforcement of Regulatory Strategies or Governance Strategies?**

In attempting to classify enforcement in corporate law, it is necessary to consider whether enforcement is only relevant in relation to prescriptive rules (regulatory strategies) or whether non-prescriptive norms (governance strategies) should also be considered.<sup>124</sup> Kraakman et al opine that enforcement is most directly related to regulatory strategies such as rules and standards.<sup>125</sup> Governance strategies on the other hand are largely dependent on actions by the principal to secure the agent's compliance. This tempts us to restrict our view of enforcement to regulatory strategies only. However, while enforcement may relate strictly speaking to rules or

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<sup>122</sup> *ibid* 19.

<sup>123</sup> Armour (n 4) 74.

<sup>124</sup> See Chapter 2 for a discussion on regulatory and governance strategies.

<sup>125</sup> Kraakman & others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2<sup>nd</sup> edn, OUP 2009) 45.

standards, it may be worthwhile to take a holistic view of enforcement with its goal in mind and view it as all measures taken to secure compliance. The action or inaction that results in ‘enforcement’ may not be clearly contained in a rule or code but may be implied by both parties.<sup>126</sup> If enforcement is restricted to only those remedies that strictly owe their existence to law, there is a risk of excluding other forms of enforcement like moral and social enforcement.<sup>127</sup> Since the primary goal of enforcement is to ensure *compliance*, then all measures taken to ensure compliance may rightly be described as enforcement. This view is supported by Armour who considered both regulatory and governance strategies in his analysis of enforcement, and further opined that whether such governance strategies can properly be classified as enforcement is merely a ‘semantic question’.<sup>128</sup> Hence, for him, the important thing is that the exercise of such rights or the threat of it may influence the manager’s decision in choosing self-interested behaviour.

### **3.8.2 Enforcement Classification**

This thesis makes use of a three-way table in classifying enforcement namely private civil enforcement, public civil enforcement and criminal enforcement. This classification broadly tracks the enforcement regimes which are actually used by different jurisdictions. As mentioned in section 3.8.1, enforcement is relevant to both regulatory and governance strategies. The classification adopted in this thesis however directly relates to *regulatory strategies*. This does not however imply, in any way, that governance strategies are less important in any discussion of enforcement in corporate law. Conceptually, enforcement is also directly relevant to governance strategies. However, for the purposes of this thesis, and due to word constraints, this thesis is unable to fully analyse enforcement with regards to both regulatory and

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<sup>126</sup> Armour (n 4) 75.

<sup>127</sup> Reiff (n 9)193.

<sup>128</sup> Armour (n 4) 105.

governance strategies. It has therefore chosen to focus on regulatory strategies as this category covers most enforcement actions in corporate law.

Private civil enforcement, as the name implies, are civil enforcement actions that are instituted by private parties. The private enforcer in this regard is often the company or its shareholders.<sup>129</sup> Public civil enforcement, on the other hand, denotes those civil enforcement actions that are instituted by regulatory authorities. This category includes both judicial and non-judicial proceedings. Hence, the courts or the regulatory authority may impose the sanction on the violators. Criminal enforcement actions, as the name implies, are simply enforcement actions that involve some form of criminal proceedings.

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<sup>129</sup> Note that different jurisdictions have varying rules regarding those who have a right to commence private enforcement actions against directors. For example, in the UK, Derivative claims can only be instituted by ‘a member of the company. See s260 Companies Act 2006. In Nigeria however, other persons aside from a member of the company can institute a derivative action. See further Chapter 6 on private civil enforcement actions in Nigeria.



**Table 3.1: Classification of Enforcement Mechanisms in Corporate Law**

<b>PRIVATE CIVIL ENFORCEMENT</b>	<b>PUBLIC CIVIL ENFORCEMENT (Judicial &amp; Non-Judicial Enforcement)</b>	<b>CRIMINAL ENFORCEMENT</b>
Derivative proceedings Shareholder's personal action Action by administrator or liquidator Representative actions Corporate actions	Director disqualification Civil judicial proceedings initiated by regulators Public civil sanctions imposed by regulators (pecuniary penalties, compensation orders, suspensions) Warnings and threat of sanctions by public regulators.	Criminal proceedings for offences such as: Fraud Insider Dealing Market Abuse

The analysis of enforcement actions for the rest of this thesis would be carried out within the scope of these three enforcement categories viz -private civil enforcement, public civil enforcement, and criminal enforcement. The analysis would reveal the strengths and more particularly, the weaknesses of the different enforcement regimes. As mentioned earlier, the limitations of the enforcement analysis in this thesis is that it focuses on regulatory strategies. It therefore does not include governance strategies in its analysis.<sup>130</sup>

<sup>130</sup> For the distinction between regulatory and governance strategies see Chapter 2, section 2.4.

### **3.9 Conclusion**

While the issue of enforcement has generally been the subject of discourse in economics, criminal justice and law, enforcement specifically within the context of corporate law has been given much less attention. Hence, much more focus has been placed on the content of corporate law, also commonly known as ‘law in books’, rather than its enforcement or ‘law in action’.<sup>131</sup> Enforcement within the context of the corporation is however as important as or even arguably more important than the substantive content of the law.

As discussed in the course of this chapter, enforcement of corporate law is essential for securing compliance with law, rules or standards. Hence, the ideal is not just to create rules, but to put in place appropriate and effective enforcement mechanisms in order to secure compliance. The next part of this thesis will therefore analyse enforcement regimes in corporate law specifically within the context of the Nigerian society. As mentioned earlier, the three enforcement regimes which this thesis will focus on are criminal enforcement, private civil enforcement, and public civil enforcement. This will be discussed in turns in chapters five, six, and seven respectively.

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<sup>131</sup> R Pound, ‘Law in Books and Law in Action’ (1910) 44 American Law Review 12.

## **PART 2 - THE NIGERIAN CONTEXT**

### **CHAPTER 4: THE NIGERIAN CORPORATE LANDSCAPE**

#### **4.1 Introduction**

Part 1 of this thesis provided theoretical foundations for its analysis. It examined the agency problem in corporate law as well as the enforcement problem in corporate law. Part 2 now turns the focus on to Nigeria itself. Chapter 4 begins by examining the Nigerian corporate landscape. It provides a detailed overview, in order to provide an understanding of the context within which corporations operate in Nigeria.

The chapter starts in section 4.2 by examining the history of commercial development in Nigeria divided between pre-colonial, colonial, and post-colonial developments. Section 4.3 then examines the legal forms for conducting business in Nigeria before moving on to focus specifically on incorporated companies. Section 4.4 addresses ownership patterns of public companies in Nigeria while section 4.5 turns to the legal framework governing companies in Nigeria. Section 4.6 identifies the public agencies with responsibilities for the regulation of public listed companies in Nigeria while section 4.7 concludes.

#### **4.2 History of Commercial Development in Nigeria**

Nigeria, one of the most populous countries in Africa, came into being in its present form in 1914 after the amalgamation of the Northern and Southern Protectorates by

Sir Frederick Lugard.<sup>1</sup> The name Nigeria was given to the country by Sir Lugard based on the recommendation of Flora Shaw who suggested that the country be named after the River Niger. Whilst Nigeria as a country is a creation of the British colonialists, its people nevertheless have a strong pre-colonial history.<sup>2</sup> Consequently, this section would look at the pre-colonial, colonial, and post-colonial history of commerce in Nigeria.

One crucial point to note before any treatment of Nigeria's history is that prior to the amalgamation in 1914, Nigeria as a country did not exist. Any history of Nigeria before that time is therefore really a history of some individual territories that now make up Nigeria. As a result of this, some may consider it an anomaly to discuss the history of 'Nigeria' pre-1914 when the entity was not even in existence. For the sake of convenience however, the name 'Nigeria' will still be used in treating the pre-1914 history.

#### **4.2.1 The Pre- Colonial Period**

Local trade in goods has been in existence in Nigeria for a very long time. In the pre-colonial period, exchange of goods (not services) was a feature of many communities and villages. Villages had specific local market days during which people exchanged goods.<sup>3</sup> This was however only a small part of the local trade as more trading took place on a more informal level in form of exchange between neighbours. Foodstuffs were the major item for sale during this period although other items such as horses, slaves, beads, cloths, salt, and calabashes were also traded.<sup>4</sup> While much of the trade

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<sup>1</sup> M Crowder, *A Short History of Nigeria* (Frederick A Praeger rev. edn. 1966) 21.

<sup>2</sup> Crowder *ibid* 21.

<sup>3</sup> R.O Ekundare, *An Economic History of Nigeria 1860-1960* (Methuen & co ltd 1973) 50.

<sup>4</sup> See E Isichei, *A History of Nigeria* (Longman 1983) Ch. 3.

then was between local communities, certain items, which were not universally available, were however transported over long distances to be traded.<sup>5</sup>

The predominant international trade during the pre-colonial era was the slave trade. However, even during the peak of this trade, slavers bought other items such as ivory and food commodities.<sup>6</sup> During this era, the Europeans merchants that traded in Nigeria did so as individuals with the exception of a few trading companies.<sup>7</sup> After the abolishment of the slave trade however, there was a shift in focus to the export of palm oil, which then became the main export item.<sup>8</sup>

#### **4.2.2 The Colonial Period**

The first British government influence in Nigeria was in 1851 when the British attacked Lagos in order to force Kosoko (the king of Lagos) to discontinue the slave trade.<sup>9</sup> Lagos subsequently became a British colony in 1862 and this marked the beginning of the spread of the British rule to Southern Nigeria and Northern Nigeria. On the 1<sup>st</sup> of January 1914, the Colony and Protectorate of Southern Nigeria and Protectorate of Northern Nigeria were united to form the territory that is now known as Nigeria.<sup>10</sup> The law applicable to the country at that time was the common law, doctrines of equity and statutes of general application which were in force in England on the 1<sup>st</sup> of January 1900.<sup>11</sup> Trade with the British government and other African colonies dominated during this era. As such, there were both exportation and

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<sup>5</sup> *ibid* 84.

<sup>6</sup> *ibid* 97.

<sup>7</sup> Ekundare (n 3) 53.

<sup>8</sup> Isichei (n 4) 98.

<sup>9</sup> Ekundare (n 3) 60.

<sup>10</sup> A Burns, *History of Nigeria* (5<sup>th</sup> edn, 7<sup>th</sup> imp, George Allen and Unwin Ltd 1958) 212.

<sup>11</sup> By implication, all the laws governing the corporate form in England such as the Limitation of Liability Act 1855, the Joint Stock Companies Act 1856 & the Companies Act 1862 were applicable in Nigeria.

importation of goods.<sup>12</sup> Agriculture was the focus of international trade during that period and the key export items were palm products (palm oil and palm kernel), cocoa, rubber, groundnut and groundnut oil.<sup>13</sup>

The 1850s heralded the influx of British traders into Nigeria partly due to the statutory recognition of limited liability in England. This facilitated traders in pooling their resources together, thereby expanding their trading activities.<sup>14</sup> Trade in Nigeria during this period was monopolistic as a few expatriate (predominantly British) companies handled most of it. Some of the important English trading companies operating in Nigeria at the time include the River Niger Navigation & Trading Company, the Company of African Merchants, the Anglo-African Company, John Holt & Co, Messrs Miller Brothers & Co, the British Nigerian Syndicate, the African merchants of Bristol, the Merchants of London-Liverpool, and the United African Company. In addition to these English firms, there were also some German, Lebanese and Syrian firms trading in Nigeria.<sup>15</sup>

During this period, indigenous entrepreneurship was largely undeveloped due to the dominance of foreign commercial firms and the restrictive trade regulations, which prevented indigenous traders from getting access to much needed capital.<sup>16</sup> While, there was certainly some level of participation in international trade by indigenous traders, there is no reliable evidence that may be used to judge their level of participation in relation to the foreign firms.<sup>17</sup> The Nigerian traders at that time relied on individual capital resources, as the partnership and joint stock companies' business

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<sup>12</sup> C.B Anyansi-Archibong, *Strategy and Structure of Enterprise in a Developing Country* (Avebury 1988) 81.

<sup>13</sup> See Ekundare (n 3)79-83.

<sup>14</sup> *ibid* 90.

<sup>15</sup> *Ibid* 91&218.

<sup>16</sup> A Apena, *Colonization, Commerce and Entrepreneurship in Nigeria: The Western Delta 1914-1960* (Peter Lang 1997) 155.

<sup>17</sup> Ekundare (n 3) 219.

form were not attractive to them. This was partly because they valued their independence and lacked confidence in any partnership arrangement.<sup>18</sup> Another obstacle to the growth of indigenous traders was the difficulty with making contact with foreign manufacturers. Most foreign manufacturers preferred to do business with the more established foreign firms as they had better knowledge of those foreign firms than the indigenous traders did.

The situation however changed in the latter colonial period as some new and strong indigenous firms appeared on the scene. This caused some of the foreign firms, such as John Holt and UAC, to withdraw from retail trade and collection of export produce directly from farmers. The withdrawal of these foreign firms from certain aspects of foreign trade may be linked to both political and economic reasons. The political reason for withdrawal is linked to the strong influence that indigenous business men had in Nigerian politics causing foreign businessmen some anxiety to avoid being dragged into any domestic political 'mess'. The economic reason was linked to the sharp increase in the cost of keeping retail posts in several parts of the country making this business venture unprofitable for the expatriate firms. There are however no statistics to show the exact number of indigenous businesses that sprang up during this period.<sup>19</sup>

#### **4.2.3 The Post-Colonial Period**

After the country's independence in 1960, its economy was still largely dominated by multinational companies. However, Nigeria, like most other newly independent nations, viewed these foreign companies with suspicion due to their ties with past

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<sup>18</sup> *ibid* 344.

<sup>19</sup> *Ibid* 345 & 346.

colonialists.<sup>20</sup> It sought to remedy this by ensuring indigenous ownership and control of the key sectors of the economy.<sup>21</sup> In order to achieve this, the Government established state owned corporations which controlled industries such as telecommunication, electricity, postal and telegraphic services, shipping and air travel amongst others.<sup>22</sup> In addition to those sectors that were wholly owned and controlled by state corporations, the Government also promoted indigenous ownership and control of many other sectors. This was done by the promulgation of Nigeria's Indigenisation Decree in 1972.

The Nigerian Enterprises Promotion Decree of 1972 (decree no 4) otherwise known as the Indigenisation Decree came into force in 1974.<sup>23</sup> The main purpose of the Indigenisation Decree was to ensure that Nigerians attained control of their own economy. It was therefore intended as '...an assertion of economic nationalism...'<sup>24</sup> By virtue of this decree, twenty two enterprises listed in Schedule I were reserved exclusively for Nigerians, and foreigners were not permitted to hold stakes in such enterprises.<sup>25</sup> The enterprises contained in this schedule were those thought to be within the competence of indigenous people. Schedule II of the same decree also listed thirty-three enterprises in which Nigerians were required to hold 40 per cent equity. Foreigners could hold shares in such enterprises as long as Nigerians held at least 40 per cent equity. The enterprises contained in this list were those which

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<sup>20</sup> O Amao, 'Corporate Social Responsibility, Multinational Corporations and The Law in Nigeria: Controlling Multinationals in Host States' (2008) 52(1) *Journal of African Law* 89-113.

<sup>21</sup> B Ahunwan, 'Corporate Governance in Nigeria' [2002] *Journal of Business Ethics* 269, 270.

<sup>22</sup> *ibid* 270.

<sup>23</sup> A.A Akinsanya, 'State Strategies Toward Nigerian and Foreign Business' in I.W Zartman (ed), *The Political Economy of Nigeria* (Praeger 1983) 160.

<sup>24</sup> T.J Biersteker, 'Indigenization in Nigeria: Renationalization or Denationalization' in I.W Zartman (ed), *The Political Economy of Nigeria* (Praeger 1983) 188.

<sup>25</sup> Akinsanya, (n 23) 162.



required more capital or technical expertise.<sup>26</sup> In industries not listed in Schedules I and II, such as those requiring high technology, foreign investors were permitted to hold unrestricted equity. In addition to all these developments, the Federal Military Government acquired 55 per cent equity in petroleum production and 60 per cent equity in petroleum distribution.<sup>27</sup> Similarly, the Government acquired 40 per cent equity in all foreign owned banks and 49 per cent in all foreign owned insurance companies.

Surprisingly, the indigenisation decree did not affect the enthusiasm of transnational corporations investing in Nigeria. Most transnational corporations complied with the equity-sharing requirement of the indigenization decrees, and indeed only two out of the hundreds of transnational operating in the country at that time chose to leave.<sup>28</sup> The decree therefore did not affect the flow of foreign capital into the country. The reason for this apparent anomaly is that these transnational corporations found ways to beat the system by retaining managerial control of their corporations.<sup>29</sup> These corporations had a wide range of strategies by which they retained control, one of which was 'fronting'.<sup>30</sup> It is therefore doubtful whether the indigenisation decree was effective in ensuring indigenous ownership and control of enterprises.<sup>31</sup> In spite of this, the Indigenisation decree still had a positive impact on Nigeria's corporate landscape as it led to a great increase in the number of incorporated companies in

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<sup>26</sup> I Achebe, 'The Legal Problems of Indigenization in Nigeria: A Lesson for Developing Countries' (1988-1989) 12 *Hastings International & Comparative Law Review* 637,642.

<sup>27</sup> Akinsanya (n 23) 161.

<sup>28</sup> Biersteker (n 24) 192.

<sup>29</sup> *ibid* 193.

<sup>30</sup> Fronting was done by placing Nigerians in apparent positions of ownership or responsibility while in reality control still rested with the foreigners. Other methods used by transnational corporations to retain control include widespread distribution of shares, negotiation of exemptions from the government, changes in voting rules prior to indigenisation and outright bribery of government officials. See Biersteker (n 24)194-201 for further discussion of these measures.

<sup>31</sup> Biersteker (n 24) 201.

Nigeria.<sup>32</sup> As the next section will explore more fully, companies have now become an important part of the country's economic development especially with regard to industrial and commercial enterprises.<sup>33</sup>

### **4.3 Legal Forms of carrying out Business in Nigeria**

There are three major forms recognised by law for conducting business in Nigeria.

These are:

- Sole proprietorship
- Partnership
- Incorporated companies

The sole proprietorship is the businessperson who does her business alone while a partnership arrangement is a business formed by two or more persons. A partnership is expected to consist of no more than twenty partners except in cases of a partnership of legal practitioners, chartered accountants or a cooperative society.<sup>34</sup> The sole proprietorship and partnership remain important forms of doing business in Nigeria. The sole proprietorship is the oldest form of business unit and remains the most popular in the country; in spite of this, it remains the weakest business form. It lacks continuity as the illness or death of the owner may lead to its demise. It also lacks the outside capital, which is needed for expansion and growth.<sup>35</sup> While a partnership business form is an improvement on the sole proprietorship, it still faces some of the

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<sup>32</sup> J.O Orojo, *Company Law and Practice in Nigeria* (2<sup>nd</sup> edn, vol 1, Sweet & Maxwell 1984) 15. The oil boom also played an important role in the growth of Indigenous companies

<sup>33</sup> *ibid* 23. The Indigenisation decree was also repealed in 1995 and replaced with the Nigerian Investment Promotion Commission Act (Decree no 16 of 1995) which removed restrictions on foreign ownership and participation in enterprise with very few exceptions.

<sup>34</sup> See CAMA, s19. The Sole Proprietorships and Partnerships are classified as business names under the Companies and Allied Matters Act (CAMA) and can be registered under pt. B of the CAMA. Sole proprietors and Partners may however carry on business without registering as long as they trade with their real names. See CAMA, s573.

<sup>35</sup> Orojo, 'Company Law and Practice in Nigeria' (n 32) 24.

problems involved in the sole proprietorship. Its shortcomings also include a lack of a perpetual succession, lack of outside capital, legal limitations on the number of partners and unlimited liability.

#### **4.3.1 Incorporated Companies**

Under the Nigerian law, any two or more persons may form and incorporate a company.<sup>36</sup> An incorporated company may be limited by shares, limited by guarantee or unlimited.<sup>37</sup> A company limited by shares has the liability of its members limited to any amount, if any, remaining unpaid on its shares. A company limited by guarantee is one which has its members' liability limited to the amount they respectively agree to contribute to the company's asset in event of winding up. An unlimited company is one in which its members liability is unlimited.<sup>38</sup> Any of the above companies may choose to be private or public. However, even within the category of 'public companies', it is possible to distinguish further between public companies that are listed and those that are not. This thesis is however primarily concerned with public companies that are also listed i.e. public listed companies.<sup>39</sup>

In Nigeria, in contrast to the UK, there are no reliable statistics on the total population of registered companies. Therefore, data on the exact percentage of public versus private companies, limited versus unlimited companies, or companies limited by shares versus companies limited by guarantee is unavailable. This can be attributed to the fact that the Corporate Affairs Commission (CAC) has only recently commenced

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<sup>36</sup> CAMA, s18. Certain persons are however not qualified to join in the formation of the company. These are minors (persons less than 18 years), people of unsound mind, undischarged bankrupts, and persons who have been disqualified from acting as directors under the Act. See further CAMA, s 20.

<sup>37</sup> CAMA, s 21.

<sup>38</sup> Ibid.

<sup>39</sup> According to the Nigeria Stock Exchange, listing is defined as the process by which a security is admitted to trading in a market or on a board of a stock exchange. See Nigerian Stock Exchange, 'glossary of investment and market terms' <<http://www.nse.com.ng/investing/becoming-an-investor/glossary-of-investment-terms>> accessed 4<sup>th</sup> July 2017. A public listed company may therefore be defined as a company whose shares are admitted for trading on the stock exchange.

the move towards a system of electronic registration of companies;<sup>40</sup> prior to that, registration was completed by submission of paper documentation.

Concerning the proportion of listed companies, which makes up the Nigerian corporate landscape, available dated evidence suggests that only 13.3% of businesses in Nigeria are listed on the stock exchange.<sup>41</sup> This survey was however completed nearly two decades ago, at the turn of the democratic era in Nigeria, it is therefore unlikely to portray a true picture of the current economic situation.

In spite of the lack of reliable data on the percentage of listed companies that make up Nigeria's corporate landscape, there is nevertheless some data on the number of listed companies registered on the stock exchange. According to data obtained directly from the Nigerian Stock Exchange, there are currently 173 companies listed on the stock exchange.<sup>42</sup> However while this data gives us an idea of the number of listed companies in Nigeria, it does not provide information on the proportion of the corporate landscape which these companies represent. It is therefore difficult to estimate the economic importance of listed companies in Nigeria.

#### **4.4 Share Ownership Pattern of Nigerian Companies**

There has been some debate regarding the share ownership pattern of public listed companies in Nigeria. Much of this uncertainty is concerned with whether share ownership in Nigeria may be regarded as concentrated or widely dispersed or a hybrid of both. An understanding of the share ownership structure of Nigerian companies is however necessary for any discussion of its corporate law and governance. The solution to the agency problem in public companies with

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<sup>40</sup> Corporate Affairs Commission, 'CAC Closes Manual Registration in Five States and FCT' <<http://new.cac.gov.ng/home/cac-closes-manual-registrations-five-states-fct/>> accessed 4<sup>th</sup> July 2017.

<sup>41</sup> TA Oyejide & A Soyibo, 'Corporate Governance in Nigeria' (Paper presented at the conference on corporate governance, Accra, Ghana, 29-30 January, 2001) 7.

<sup>42</sup> Nigerian Stock Exchange, 'Listed Companies' <<http://www.nse.com.ng/Listings-site/listed-securities/listed-companies>> accessed 4<sup>th</sup> July 2017.

concentrated share ownership would usually differ from that of widely owned public companies.<sup>43</sup> An attempt to use the initiatives designed to reduce the agency problem in a widely owned economy for a more concentrated one is therefore likely to be unsuccessful.

Different scholars have attempted to analyse the share ownership structure in Nigeria. Ahunwan in his analysis opined that the share ownership structure in Nigeria is that of majority or concentrated ownership.<sup>44</sup> He argues that the major driving force behind the current share ownership structure in Nigeria was the Government's post-independence indigenisation policy discussed earlier on in this chapter.<sup>45</sup> While this now repealed indigenisation policy might not have been overtly successful in ensuring that enterprises in Nigeria are controlled by indigenes, Ahunwan argues that it had a significant impact on the share ownership structure of Nigerian companies. The major way in which the Decree affected the share ownership structure of companies is that due to its prohibition of 100% ownership in several sectors, many foreign corporations had to divest their shareholding. The divested shares were mostly bought by the Nigerian government with the remaining being bought by a few wealthy Nigerians.<sup>46</sup>

In his empirical analysis on the share ownership pattern of corporations in Nigeria, Ahunwan classifies corporations in Nigeria into four categories. Group A comprises of those corporations whose shares are fully owned by the Government.<sup>47</sup> Group B comprises of those corporations which are jointly owned by the Federal Government

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<sup>43</sup> I.O Bolodeoku, 'Corporate Governance: The Law's Response to Agency Costs in Nigeria' (2006-2007) 32 Brooklyn Journal of International Law 467.

<sup>44</sup> Ahunwan (n 21)272

<sup>45</sup> See s4.2.3 above

<sup>46</sup> Ahunwan (n 21) 271.

<sup>47</sup> This group includes companies such as petroleum refineries, insurance companies, hotels, and banks.

and foreign crude oil producing companies. In this group, the government holds majority shares. Group C comprises of public listed corporations which are jointly operated by foreign and local investors. The foreign investors in this group are mostly subsidiaries of multinational companies and they hold majority shares in many of those corporations. The last category -Group D - comprises of private corporations not listed on the stock exchange. This category of corporations is predominantly family owned. Ahunwan concludes from this analysis that the share ownership structure in Nigeria is that of majority or concentrated ownership. Companies in Group A are fully owned by the government, and in Groups B, C & D majority share ownership is held by the government, foreign investors and families respectively.<sup>48</sup>

Nmehielle and Nwauche however reached a different conclusion on the share ownership structure of Nigerian companies. According to them, the indigenisation programme in Nigeria led to a diffusion of Nigerians' shareholdings while the foreign shareholdings in those companies remained concentrated.<sup>49</sup> They argued that after the abolition of the indigenisation decree, there remained a large number of firms with dispersed Nigerian shareholders and dominant foreign shareholders. The privatization of state owned enterprises in Nigeria through public offer also contributed to diffusion of shareholding. They therefore opine that shareholding in Nigeria is largely diffused. The scholars however concede that this is not the complete picture of the share ownership structure in Nigeria. There are several cases of majority shareholdings borne out of family ownership of companies where family members still hold majority shares. There is also a substantial amount of Nigerian and foreign institutional shareholders thereby making it clear that some companies have majority

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<sup>48</sup> Ahunwan (n 21) 271-272.

<sup>49</sup> V.O Nmehielle and E.S Nwauche, 'External-Internal Standards in Corporate Governance in Nigeria' (2004) The GWU Law School Public Law Research Paper No. 115, 8 <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=627664&download=yes](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=627664&download=yes)> accessed 30<sup>th</sup> January 2015.

shareholders. They therefore conclude that ‘...Nigeria is not characterised by one typology of companies’.<sup>50</sup>

Tanko, in his analysis on the impact of Nigeria’s privatization programme on its share ownership structure, opined that shareholding in Nigeria is widely dispersed.<sup>51</sup> He argued that the first round of Nigeria’s privatization programme greatly widened the investor base as shares were bought by over 800,000 shareholders leading to a large number of shareholders each holding only a tiny proportion of shares.<sup>52</sup> Bolodeoku however, contrary to Tanko’s views, opines that Nigeria has a combination of concentrated and diffused share ownership. He notes that virtually all public companies in Nigeria have shareholders holding a substantial proportion of the company’s issued shares, with some shareholders even holding a clear majority. Widely dispersed shareholders however usually hold the remaining equity in such companies.<sup>53</sup> Scholarly opinion on the share ownership pattern of Nigerian companies is clearly divided into three; those who believe that share ownership is concentrated, those who believe it is highly dispersed and those who opine that it is a mixture of both systems. There is therefore a case for agreeing with Nmehielle and Nwauche’s statement that Nigeria is not characterised by one category of companies.

#### **4.5 The Legal Framework**

The legal framework governing companies in Nigeria can be broadly classified into three. These are

- Companies Law
- Securities law

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<sup>50</sup> *ibid* 8 & 9.

<sup>51</sup> M Tanko II, ‘The impact of Privatization on Capital Market Development and Individual Share Ownership’ (2004) < [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=689702&download=yes](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=689702&download=yes)> accessed 13/02/2015.

<sup>52</sup> *ibid*.

<sup>53</sup> Bolodeoku (n 43) 471 & 472.

- Corporate governance Codes

#### 4.5.1 Companies Law

Company law is foreign to the customs of Nigeria and as such, its history is a part of the history of received English laws introduced into the Nigerian legal system.<sup>54</sup> The first companies' statute in Nigeria was the Companies Ordinance 1912 (the 1912 Ordinance) which was mainly based on the English Companies (Consolidation) Act 1908. This 1912 Ordinance is important in the history of Nigerian company law as for the first time in Nigeria it made provision for the incorporation of companies by registration. The 1912 Ordinance was amended in 1917, and in 1922, both ordinances (the 1912 and 1917 ordinance) were consolidated to form the Companies Ordinance 1922 (the 1922 Ordinance). This 1922 ordinance continued in force until 1968 when it was repealed and replaced with the Companies Act 1968 (the 1968 Act).<sup>55</sup>

The 1968 Act was a major improvement from the previous Companies Ordinances as it made provisions for increased accountability by directors and better shareholder participation in companies' affairs. One of its most important features was that it required foreign companies desiring to do business in Nigeria to be incorporated locally.<sup>56</sup> The 1968 Act like its predecessor (the 1922 Ordinance) was a reflection of the UK Companies' Act of 1948. It therefore also incorporated some of the recommendations of the UK Jenkins committee.<sup>57</sup> It was listed under the exclusive legislative list in the 1979 Nigerian constitution and granted original jurisdiction to the Federal High Court in respect of companies' affairs and disputes.<sup>58</sup>

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<sup>54</sup> Orojo, 'Company Law and Practice in Nigeria' (n 32) 1.

<sup>55</sup> *ibid* 1-6.

<sup>56</sup> J.O Orojo, 'An Overview of the Companies and Allied Matters Decree 1990' in E.O Akanki (ed) *Essays in Company Law* (1<sup>st</sup> edn, University of Lagos Press 1992) 1.

<sup>57</sup> M.O Sofowora, *Modern Nigerian Company Law* (Soft Associates 2002) 11.

<sup>58</sup> *ibid* 11.



In spite of the improvements in the 1968 Act, it was still lacking in several respects and criticised by many. As such, the onus was placed on the Nigerian Law Commission to carry out a review and reform of Nigerian company law.<sup>59</sup> In coming up with the reform, the company law in Nigeria and the UK was examined, similarly the laws of various foreign countries including Ghana, India, Canada, and USA were considered.<sup>60</sup> After comprehensive reviews and consultations, the Companies and Allied Matters Decree (no 1) 1990 came into being with effect from the 1<sup>st</sup> of January 1990.

#### **4.5.1.1 The Companies and Allied Matters Act 1990**

The main Act regulating companies in Nigeria is the Companies and Allied Matters Decree No 1 of 1990 now known as the Companies and Allied Matters Act (CAMA) Cap c20 Laws of the Federation of Nigeria 1990.<sup>61</sup> It makes comprehensive provision for all issues relating to companies including formation and registration of companies, memorandum and articles of association, directors' duties, appointment and removal of directors, disqualification of directors, conduct of general meetings, shareholders' rights, financial reporting and auditing requirements and winding up of companies to mention a few. Most of the rules contained in Part A of CAMA, which regulates companies, apply generally to both public and private companies with very few exceptions.<sup>62</sup> This thesis is however focused on public listed companies and would therefore specifically examine the position of CAMA on some of those pertinent corporate law issues affecting shareholders in public listed companies.

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<sup>59</sup> Orojo, 'An Overview of the Companies and Allied Matters Decree' in Akanki (n 56) 2.

<sup>60</sup> *ibid* 3.

<sup>61</sup> CAMA is divided into four parts; Part A regulates companies, Part B - business names, Part C - incorporated trustees and Part D is the citation and commencement.

<sup>62</sup> Examples of these exceptions are CAMA, s211 which requires public companies to have statutory meetings, also s359 (1) which requires an audit committee for public companies.

#### **4.5.1.1.1 Organs of the Company**

A company may operate through three organs; the two main organs under CAMA are the board of directors and the general meeting.<sup>63</sup> The third organ is the managing director to whom the board of directors may delegate all or any of its powers.<sup>64</sup> The board of directors is responsible for management of the company's business and may exercise all the company's powers except those which have been vested in the general meeting.<sup>65</sup> Hence, in the absence of any contrary provision in the Act or the company's articles, the power to manage the company's business is primarily vested in the board of directors. Consequently, the only powers that the board cannot exercise are those expressly conferred on the general meeting.<sup>66</sup> The board is also not bound to obey the instructions of the general meeting provided it is acting within the confines of powers conferred on it and with good faith and due diligence.<sup>67</sup> Shareholders therefore cannot by ordinary resolution passed in general meeting interfere with the management powers vested in the directors.<sup>68</sup> From this provision, one may conclude that the board of directors have been vested with enormous powers under the Nigerian company law; this however does not mean that the general meeting have been left helpless as they have various powers under CAMA which will be discussed further in this chapter.

#### **4.5.1.1.2 Directors**

CAMA explicitly sets out the legal position of directors in the company. Directors are regarded as agents of the company and trustees of the company's money, properties and powers. Hence, they are required to account for all the company's money in their

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<sup>63</sup> CAMA, s 63(1).

<sup>64</sup> CAMA, s 64.

<sup>65</sup> CAMA, s 63(3).

<sup>66</sup> Y.H Bhadmus, *Corporate Law and Practice* (Chenglo Ltd 2009)188.

<sup>67</sup> See CAMA, s63 (4).

<sup>68</sup> Bhadmus (n 66)188.

control and would be liable to refund any money that has been mishandled.<sup>69</sup> CAMA requires all companies to have at least two directors. The first directors may be determined by the subscribers to the memorandum of association or named in the articles of association; subsequent directors are however to be appointed by the general meeting. The general meeting may also re-elect and reject directors, and while the board of directors have powers to appoint new directors to fill any casual vacancy, such appointments must be approved by the next general meeting.<sup>70</sup>

At each general meeting one-third or the number closest to one third of all directors must retire from office. The directors to retire are the ones who have been the longest in office. The members in general meeting may then elect other persons to fill the position of the retired director, or the retiring director if he offers himself for re-election, will be considered re-elected.<sup>71</sup> This is known as retirement by rotation and is intended to enable shareholders to exercise their powers to dispense with unproductive directors by automatic retirement.<sup>72</sup>

Another important provision in CAMA is the disqualification of directors.<sup>73</sup> The Federal High Court is granted powers to disqualify a person from being a director or from taking part in the management of any company for a period not more than 10 years. A disqualification order may be made against a director who has been convicted of an indictable offence in respect of promotion, formation or management of a company or has been found guilty of fraud in relation to the company, or guilty of an offence in the course of winding up a company. An application for a

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<sup>69</sup> CAMA, s283.

<sup>70</sup> See CAMA, ss247-249.

<sup>71</sup> CAMA, s259.

<sup>72</sup> Nmehielle and Nwauche (n 49) 13; CAMA, s 259.

<sup>73</sup> See generally CAMA, s254. See also CAMA, ss 257 & 258.

disqualification order may be made by the official receiver, the company's liquidator, a creditor or member of the company.

### *Directors' Duties*

CAMA makes comprehensive provision for directors' duties in Nigeria. While these duties are contained in the Act, they however owe their origin to common law and equity. Directors' duties can be broadly classified into two types. These are the fiduciary duties of good faith and the common law duties of care and skill.<sup>74</sup>

### **Fiduciary Duties**

Directors are regarded as being in a fiduciary relationship towards the company and are therefore required to observe utmost good faith towards the company and act in its best interests.<sup>75</sup>

The duties imposed on directors under CAMA are :

- i. Duty to act in the company's best interest s.279 (3&4)

CAMA requires directors to act in the best interests of the company as a whole. s.279 (3) provides that

a director shall act at all times in what he believes to be the best interests of the company as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinary skilful director would act in the circumstances.

The phrase 'best interests of the company' is very ambiguous and subject to various interpretations. The pertinent question is what exactly are the best interests of the

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<sup>74</sup> Nmeielle and Nwauche (n 49) 14.

<sup>75</sup> CAMA, s 279(1).

company? Does the company have its own interests as a legal person or are its interests synonymous to that of its stakeholders? The company as an artificial entity is incapable of having interests of its own.<sup>76</sup> At common law, however, the company's interests are often considered synonymous with that of its members as a whole.<sup>77</sup> It can therefore be said that directors under CAMA have a duty to act in the interests of the company's shareholders as a whole.

ii. Duty to exercise powers only for proper purpose s.279 (5).

A director is expected to exercise his powers only for the purpose for which they are specified. The main purpose of this duty is to ensure that the powers which have been conferred on directors are used only for the purpose for which they have been given and not an improper purpose. Hence, directors are not to exercise their directorial powers to retain control of the company in their own interest or to 'feather' their own nests.<sup>78</sup> Where the director's power is exercised for a purpose which is outside its limits ('collateral purpose'), the courts may intervene.<sup>79</sup> Directors who have acted honestly in the company's interests may still nevertheless be in breach of this duty if their powers have been exercised for a purpose for which it has not been conferred.<sup>80</sup> Many of the cases in which the issue of improper use of power has arisen are instances where the directors have used their powers to allot shares improperly to prevent a takeover.<sup>81</sup>

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<sup>76</sup> See J.E Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (OUP 1993) 76-77

<sup>77</sup> D Kershaw, *Company Law in Context: Text and Materials* (2nd edn, OUP 2012)337.

<sup>78</sup> See P.L Davies & S Worthington, *Gower's Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016) 16-28.

<sup>79</sup> S Mayson, D French & C Ryan, *Company Law* (29<sup>th</sup> edn, OUP 2012-2013) 479.

<sup>80</sup> *Ibid* 481.

<sup>81</sup> See *Hogg v Cramphorn Ltd [1967] Ch 254* where the directors used their powers to issue shares to attempt to frustrate a takeover bid which they in good faith decided was not in the company's best interests. See also *Howard Smith v Ampol Petroleum Ltd [1974] AC 821*.

iii. Duty not to fetter discretion to vote s.279(6)

Directors are required not to fetter their discretion to vote in a particular way. They are therefore expected to exercise independent judgement. Directors sometimes undertake to act in accordance with the instructions of an ‘outsider. This can occur where a holding company has nominees on the board of the subsidiary company or where the right to appoint a director is given to a class of shareholders or debenture holders.<sup>82</sup> Directors however must still preserve a significant degree of discretion as to how they would exercise their power. This duty therefore acts to prevent directors from fettering their discretion by, for example, contracting with a third party regarding how the discretion vested on them by the articles will be exercised or how they will vote at future board meetings.<sup>83</sup> The nature of this duty was explained by Lord Denning in *Boulting v Association of Cinematograph, Television and Allied Technicians*<sup>84</sup> that ‘it seems to be that no one, who has duties of a fiduciary nature to discharge, can be allowed to enter into an engagement by which he binds himself to disregard those duties or to act inconsistently with them’. Hence, a director is not expected to enter into any agreement by which he contracts to disregard his duties or act in a manner which is contrary to them. This duty will however generally not be broken where it is established that an agreement entered into by a director, in good faith, was in the company’s best interests.

iv. Duty to avoid conflict of interests s.280

Directors are required not to put themselves in a situation where their personal interests conflict with their duties to the company. Directors are therefore not allowed to make secret profit. They are expected to be loyal to the company and committed to

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<sup>82</sup> Boyle & ors (eds), *Boyle & Birds Company Law* (8<sup>th</sup> edn, Jordan Publishing 2011)639.

<sup>83</sup> A Dignam and J Lowry, *Company Law* (9<sup>th</sup> edn OUP 2016) 338; Boyle & ors *ibid* 640.

<sup>84</sup> [1963] 2 A.B 606,626.

its profitability alone.<sup>85</sup> If a director makes a secret profit or gets any unnecessary benefit as a result of his position in the company, he will be liable to account to the company. However where the director discloses his interest to the general meeting before the secret profit was made, he may escape liability.<sup>86</sup> Disclosure made after secret profit has been made does not count and director will still be liable to account for such profit.<sup>87</sup> Directors also have a duty not to misuse corporate information and this duty remains even after they are no longer directors in the company.<sup>88</sup>

CAMA also prohibits directors from accepting a bribe, gift or commission from any person in respect of any transaction with the company.<sup>89</sup> There is however a loophole here as it allows gifts made in gratitude to directors post transaction as long as such gifts are declared to the board and recorded in the minute book.<sup>90</sup> Given Nigeria's corruption and extortion culture, this is a major loophole as directors can solicit for bribes which will be disguised as gifts given in gratitude post-transaction.

v. Duty of Care and Skill s 282 CAMA

The directors' duty of care and skill requires directors to act in good faith, in the best interests of the company and with the degree of care, diligence and skill which 'a reasonably prudent director would exercise in comparable circumstances'.<sup>91</sup> Failure to take reasonable care in accordance with CAMA may give rise to an action in negligence and breach of duty. The standard required of directors in regards to this duty is not subjective, rather it is an objective one based on what a reasonable director

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<sup>85</sup> J.E.O Abugu, 'Directors' Duties and the Frontiers of Corporate Governance' (2011) 22(10) *International Company and Commercial Law Review* 322,327.

<sup>86</sup> CAMA, s 280(6).

<sup>87</sup> CAMA, s 280.

<sup>88</sup> CAMA, s 280(5).

<sup>89</sup> CAMA, s 287(1).

<sup>90</sup> CAMA s 287(3).

<sup>91</sup> CAMA, s 282.

would do in such circumstances. Subjective considerations may however also apply based on the level of specialised skills that a particular director possesses.<sup>92</sup>

In addition to these duties, directors also have a duty under CAMA to account for all the company's monies over which they exercise control and must refund any money which has been inappropriately paid away.<sup>93</sup> They also have several other duties with regards to giving appropriate notification to the Corporate Affairs Commission in respect of certain occurrences such as change of name, change of head office, creation of debentures etc. These duties imposed on directors cannot be waived by the articles of association, the company's resolutions or any other contract.<sup>94</sup> CAMA also clearly specifies that both executive and non-executive directors are subject to the same standard of care with relation to their duties under CAMA.<sup>95</sup> Hence, non-executive directors may not feign ignorance or claim that they simply made decisions based on the representation of executive directors. They are expected to seek independent information from other employees in the company where required.<sup>96</sup>

#### **4.5.1.1.3 The General Meeting**

As mentioned earlier the General Meeting is one of the main organs of the company under CAMA.<sup>97</sup> CAMA provides for three types of general meetings; these are the statutory general meeting, annual general meeting and extraordinary general meeting. The statutory general meeting is required to be held by every public company within the first six months of its incorporation.<sup>98</sup> The annual general meeting is to be held every year and not more than 15 months is expected to elapse between one annual

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<sup>92</sup> Dignam and Lowry, (n 83) 343.

<sup>93</sup> CAMA, s 283.

<sup>94</sup> CAMA, s 279(8).

<sup>95</sup> Executive directors may however be subject to additional liability arising from the master servant relationship. CAMA, s 281(4).

<sup>96</sup> Bolodeoku (n 43)515.

<sup>97</sup> See s4.5.1.1.1

<sup>98</sup> CAMA, s 211.



general meeting and the next.<sup>99</sup> The extra ordinary general meeting may be convened by the board of directors or the members of the company. Members holding not less than one-tenth of the paid up capital or not less than one-tenth of voting rights may requisition an extraordinary general meeting, and directors upon receipt of such requisition will convene a general meeting.<sup>100</sup>

CAMA requires twenty-one days' notice to be given for all general meetings; failure to give notice to any person entitled to it invalidates the meeting unless such failure is as a result of accidental omission.<sup>101</sup> In addition to this notice, public companies are required to advertise the notice of meeting in at least two daily newspapers.<sup>102</sup> Members of the company are also entitled to receive the company's financial statement which must be sent at least twenty-one days before the annual general meeting.<sup>103</sup>

Voting at general meetings is by show of hands unless a poll is demanded, however voting by proxy is permitted under the law.<sup>104</sup> CAMA also prohibits the issue of non-voting and weighted shares and requires that shares issued in a company may carry only one vote per share. No company may by its articles contravene this provision.<sup>105</sup>

CAMA further provides for two types of resolutions, these are the ordinary and special resolution. An ordinary resolution is one which is passed by a simple majority of votes cast by members of the company. A special resolution is one passed by at least three-fourth of votes cast by members of the company at a meeting of which 21 days' notice has been given stating clearly the intention to propose a special

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<sup>99</sup> See CAMA, s 213.

<sup>100</sup> CAMA, s 215

<sup>101</sup> CAMA, ss. 217 & 221.

<sup>102</sup> CAMA, s 222.

<sup>103</sup> CAMA, s 344 (1).

<sup>104</sup> CAMA, s 224.

<sup>105</sup> CAMA, s 116(1).

resolution.<sup>106</sup> All resolutions of public companies are required to be passed at general meetings.<sup>107</sup>

Members in general meeting have been vested with certain powers under CAMA. The general meeting in this regard refers to shareholders decisions in a ‘properly convened meeting’.<sup>108</sup> The general meeting has powers to ratify the board of directors’ actions and make recommendations to them.<sup>109</sup> They have the power to determine directors’ remuneration.<sup>110</sup> They are also vested with the power to act where the board of directors is unable to act or disqualified from doing so.<sup>111</sup>

In addition to this, one of the most important powers which the general meeting possesses is the power to appoint and remove directors. The general meeting has the power to re-elect directors, reject appointment of directors made by the board and appoint new directors.<sup>112</sup> They also have the power to remove directors. A director may be removed before the expiration of his term of office by an ordinary resolution of members in general meeting. This power to remove directors remains constant notwithstanding anything to the contrary in the director’s contract of employment or company’s articles. Hence, a non-performing director may be removed at any time by the general meeting. It is however important to note that this provision does not deprive the removed director of any entitlement to compensation for termination of employment.<sup>113</sup>

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<sup>106</sup> CAMA, s 233.

<sup>107</sup> CAMA, s 234.

<sup>108</sup> Amao & Amaeshi, (n 20) 121.

<sup>109</sup> CAMA, s 63 (5).

<sup>110</sup> CAMA, s 267.

<sup>111</sup> CAMA, s 63(5) a.

<sup>112</sup> CAMA, s 248.

<sup>113</sup> CAMA, s 262(6); see also Sofowora (n 56)183.

These powers granted to shareholders in order to exercise some control over directors' activities may be classified as governance strategies or rights.<sup>114</sup> Governance strategies may play a role in securing directors' compliance and overall enforcement of corporate law.<sup>115</sup> It is however argued that their effectiveness as an enforcement mechanism is somewhat limited by various problems. While shareholders have voting rights which include the right to remove an erring director, there are however several difficulties with exercising this right especially in widely held companies.<sup>116</sup> One of these difficulties is the collective action problem.<sup>117</sup> This problem is particularly acute in public listed companies as it is very difficult for shareholders in such companies to coordinate their activist efforts. Indeed, Black argues that in a widely dispersed corporation, shareholder passivity is unavoidable due to the collective action problem.<sup>118</sup> The cost and time involved in coordinating the several shareholders in the company would usually prevent any coordinated action against management.<sup>119</sup> Besides from the collective action problem, other difficulties that prevent shareholders' effective use of their voting rights include the free rider problem, shareholder apathy, information asymmetries and conflict of interests.<sup>120</sup> As a result of these problems, the effectiveness of shareholders'

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<sup>114</sup> See Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2<sup>nd</sup> edn, OUP 2009) 38. See also s2.4.2, Ch. 2.

<sup>115</sup> Bebchuk, for example, argues that shareholders' powers to intervene in corporate decisions should be increased in order to improve corporate governance. He was therefore of the opinion that shareholders' voting rights can potentially have a positive impact on corporate governance. See LA Bebchuk, 'The Case For Increasing Shareholder Power' (2005) 118(3) *Harvard Law Review* 883.

<sup>116</sup> A Reisberg, *Derivative Actions and Corporate Governance: Theory and Operation* (OUP 2007) 22.

<sup>117</sup> D Attenborough, 'The Vacuous Concept of Shareholder Voting Rights' (2013) 14(2) *European Business Organization Law Review* 147, 164.

<sup>118</sup> B S Black, 'Agents Watching Agents: The Promise Of Institutional Investor Voice' (1991) 39 *UCLA Law Review* 811.

<sup>119</sup> For a further discussion of the collective action or coordination problem see A Keay, 'Company Directors Behaving Poorly: Disciplinary Options For Shareholders' [2007] *Journal of Business Law* 656; I Anabtawi, 'Some Scepticism about Increasing Shareholder Power' (2005) 53 *UCLA Law Review* 561.

<sup>120</sup> For a detailed discussion of these difficulties see SM Bainbridge, 'Director Primacy :The Means and Ends of Corporate Governance' (2002) 97(2) *Northwestern University Law Review* 547; SM Bainbridge 'The Case for Limiting Shareholder Voting Rights' (2005) 53 *UCLA Law Review* 601; SM Bainbridge 'Director Primacy and Shareholder Disempowerment' (2006) 119(6) *Harvard Law*

governance rights as an enforcement mechanism is significantly limited as noted by Lord Wedderburn, the idea of shareholder democracy and shareholder control over managerial conduct is ‘fallacious’.<sup>121</sup>

In light of the limitations of governance strategies in securing effective enforcement, there is a need to look to regulatory strategies as a means of filling this gap and ensuring effective enforcement. CAMA makes provisions for these regulatory strategies and their enforcement. It therefore provides mechanisms which may be used to enforce directors’ duties. These include derivative actions, representative actions and personal actions. These enforcement actions will be discussed in chapter 6.

As noted above, CAMA is a very detailed legislation addressing various issues of importance in corporate governance. It covers many common law principles and case laws intended to ensure directors accountability and good governance in companies, it is therefore to be commended. In light of this, Bolodeoku in his analysis of CAMA’s response to agency problems gives it a ‘pass mark’<sup>122</sup> and notes that the statute’s response to agency costs and problems are ‘impressive’.<sup>123</sup> In spite of this however, CAMA is in need of reform in several other regards. This is more so in light of the fact that it is over two decades old, therefore most of its provisions are significantly outdated.<sup>124</sup>

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Review 1735; JC Coffee Jr, ‘Liquidity Versus Control: The Institutional Investor as Corporate Monitor’ (1991) 91 (6) Columbia Law Review 1277; G Proctor and L Miles, ‘Unresponsive Shareholders In Public Companies: Dial “M” For Motivate?’ (2000) 21(5), Company Lawyer 142.

<sup>121</sup> Lord Wedderburn ‘Control of Corporate Action’ (1989) 52 Modern Law Review 401.

<sup>122</sup> Bolodeoku (n 43) 470.

<sup>123</sup> *ibid* 522.

<sup>124</sup> Note that the Corporate Affairs Commission (CAC) has proposed to repeal CAMA 1990. Consequently, a bill for an Act to replace CAMA 1990 has been published. See CAC, ‘a bill for an Act to repeal the Companies and Allied Matters Act 1990 and enact the Companies and Allied Matters Act 2016 to provide for incorporation of companies, registration of business names together with incorporation of trustees of certain communities, bodies, associations and incidental matters’

#### **4.5.1.2 Companies Regulation 2012**

CAMA gives power to the Minister of Trade and Investment to make regulations for giving effect to some provisions of the Act.<sup>125</sup> In pursuance of these powers, the Companies Regulation 2012 was made to take effect from the 1<sup>st</sup> of January 2013. This legislation mostly deals with procedural issues and is intended to complement the substantive company law (CAMA) and to fill some gaps in it. Some of the procedural issues it addresses include registration of companies, business names and incorporated trustees, compliance with notice requirements under CAMA,<sup>126</sup> and the various forms to be used in complying with statutory requirements. The regulation also increased filing fees and puts in place stiffer penalties for late filing of documents with the Corporate Affairs Commission (CAC).<sup>127</sup> It also provides for electronic filing of documents with the CAC.<sup>128</sup> Hence, the regulation mainly covers procedural matters especially in relation to dealings with the CAC rather than substantive issues, which directly affect companies.

#### **4.5.2 Securities Laws**

In addition to CAMA, public listed companies are also governed by securities laws and regulations. These will be the discussed in this section

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<<http://new.cac.gov.ng/home/wp-content/uploads/2016/07/Draft-Bill-for-the-Repeal-of-CAMA-and-Enactment-of-New-Act.pdf>> accessed 19<sup>th</sup> January 2017.

<sup>125</sup> CAMA, ss. 16, 585 and 609.

<sup>126</sup> Such as notice of alteration in share capital, transfer of shares, change in directorship, change of name, and alteration of memorandum and articles of association.

<sup>127</sup> Companies Regulation 2012,

<<http://new.cac.gov.ng/home/corporate-affairs-commission-companies-regulation-2012/>> accessed 28<sup>th</sup> February 2015.

<sup>128</sup> Companies Regulation 2012, s.11.

#### **4.5.2.1 The Investments and Securities Act 2007**

The Investments and Securities Act 2007 (ISA) is the law that governs the operations of the Capital Market in Nigeria. It establishes the Securities and Exchange Commission (SEC) as the apex regulator of the Nigerian capital market and provides for its powers and functions.<sup>129</sup> It also regulates all aspects of the capital market including registration and regulation of capital market operators, investigation and monitoring of capital market operators and regulation of all sales of securities.

One of the functions of the SEC as stated by ISA is to ‘protect the integrity of the securities market against all forms of abuses including insider dealings’.<sup>130</sup> Hence ISA prohibits all forms of fraudulent activities in relation to securities such as manipulation of the securities market,<sup>131</sup> dissemination of false, misleading or illegal information in relation to sale of securities,<sup>132</sup> insider trading and abuse of information obtained in an official capacity by a public officer.<sup>133</sup> Engaging in any of the proscribed activities attracts both criminal liability of either imprisonment or fine<sup>134</sup> as well as civil penalties. ISA further regulates all Mergers and Takeovers and vests in SEC the power to review, approve and regulate all mergers, acquisitions, takeovers and all other forms of business combinations.<sup>135</sup> It also establishes an Investment and Securities Tribunal which has jurisdiction to hear disputes and determine questions of law relating to the capital market.<sup>136</sup>

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<sup>129</sup> ISA, s13.

<sup>130</sup> See ISA, s13 (i).

<sup>131</sup> ISA, s106.

<sup>132</sup> ISA, s107-109.

<sup>133</sup> ISA, s111-112.

<sup>134</sup> ISA, s115

<sup>135</sup> Pt XII, See also ISA, s13 (p).

<sup>136</sup> ISA, s284.

#### **4.5.2.2 The Nigerian Stock Exchange Listing Requirements**

Companies desiring to be listed on the Nigerian Stock Exchange (NSE), in addition to complying with CAMA, ISA and other industry specific rules and regulations, must also comply with the NSE listing requirements. The NSE listing requirements stipulate the conditions for listing and other requirements that listed companies must comply with. Companies applying for listing must be registered public companies in Nigeria and the securities to be listed must be registered with the Securities and Exchange Commission. With regards to corporate governance, the listing requirements 'encourages' companies to comply with the SEC Code of Corporate Governance 2011.<sup>137</sup>

#### **4.5.3 Code of Corporate Governance in Nigeria**

Nigeria, in keeping up with international best practice, has adopted various corporate governance codes over the past couple of years. The first corporate governance code in Nigeria was the Code of Best Practices on Corporate Governance in Nigeria 2003. However due to its inadequacies in dealing with the corporate governance problems in Nigeria, it was replaced by the Code of Corporate Governance in Nigeria 2011 (SEC Code) which commenced on the 1<sup>st</sup> of April 2011. Much recently, however, the Financial Reporting Council of Nigeria released the new National Code of Corporate Governance 2016 (NCCG).<sup>138</sup> The NCCG is made up of three separate codes:

- the code of corporate governance for the private sector (the private sector code)
- the code of corporate governance for not for profit entities (NFPO code)

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<sup>137</sup> As will be seen below, the SEC Code of Corporate Governance 2011 has been replaced with a National Code of Corporate Governance.

<sup>138</sup> Note that the NCCG was recently suspended in January 2017 based on the directive of the Federal Government of Nigeria. Nevertheless, it remains necessary to examine its provisions.

- the code of corporate governance for the public sector. (the public sector code)

Prior to the release of the NCCG, Nigeria had a general corporate governance code as well as three other industry specific corporate governance codes.<sup>139</sup> There was however a need to harmonize the various industry specific codes in light of the confusion occasioned by conflicting provisions in the different codes. The NCCG therefore redresses this problem by providing a unified corporate governance code.

The code of corporate governance for the private sector (the private sector code) which recently came into operation on the 17<sup>th</sup> of October 2016 is applicable to all public companies whether or not they are listed.<sup>140</sup> This chapter will therefore focus on this code as it applies to public listed companies in Nigeria, which are the subject of concern in this thesis. The private sector code is aimed at promoting accountability, transparency, integrity and importantly minority shareholder and stakeholder protection.<sup>141</sup> Compliance with the private sector code is *mandatory*; violations of the code may therefore result in both personal sanctions against the persons who have breached its provisions as well as sanctions against the companies who are involved in the violation.<sup>142</sup>

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<sup>139</sup> These were the Code of Corporate Governance for Banks in Nigeria Post Consolidation 2006 issued by the Central Bank of Nigeria and applicable to all banks operating in Nigeria; the Code of Corporate Governance for Licensed Pensions Operators 2008 issued by the National Pension Commission and applicable to all Pension Fund Administrators and Pension Fund Custodians operating in Nigeria; and the Code of Corporate Governance for Insurance Industry in Nigeria 2009 issued by the National Insurance Commission and applicable to insurance and re-insurance companies operating in Nigeria.

<sup>140</sup> See the private sector code, s2.1. Note however that the code applies to certain private companies, see further s2.1.

<sup>141</sup> The private sector code, s1.2.

<sup>142</sup> The private sector code, s37.



### **4.5.3.1 Features of the Private Sector Code**

#### **4.5.3.1.1 Board of Directors.**

The private sector code makes comprehensive provision for the composition, responsibilities and role of the board of directors. The main purpose of the board is to provide leadership to companies and ensure that management act in the best interests of the shareholders and other stakeholders. The private sector code provides for the composition and structure of the board. The board is required to have not less than eight members and it ought to have a mix of both executive and non-executive directors. The majority of the board members are also required to be non-executive members; however, at least half of these non-executive members should be independent directors.<sup>143</sup> The main purpose of having independent non-executive directors is to ensure the level of objectivity required to maintain investors' trust and confidence in the company.<sup>144</sup> Consequently, where a majority of independent non-executive directors dissent on an issue discussed by the board, that decision can only be valid where at least 75% of the full board vote in favour of it.<sup>145</sup>

The private sector code fills up some lacunae in the provisions of CAMA, hence it covers certain areas where the Act is silent or inadequate. Thus, while CAMA does not explicitly set out the role of the board and the directors, the code makes provision for this. It makes explicit provision for the responsibilities and duties of the board as a whole, as well as that of the chairman, the chief executive officer, executive directors, and non-executive directors.<sup>146</sup>

In accordance with international corporate governance standards, the private sector code also requires the separation of the position of the Chairman and the Chief

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<sup>143</sup>ibid s5.

<sup>144</sup> Ibid s6.7.1.

<sup>145</sup> ibid s7.3

<sup>146</sup>See generally the private sector code, s6.

Executive Officer.<sup>147</sup> This is in order to avoid over concentration of powers in one individual. For better clarity of the chairman's role in the company, the private sector code explicitly provides that the chairman is to be a non-executive director. He is also required to avoid getting involved in the company's day-to-day operations, as this is the main responsibility of the chief executive officer and the management team. It also particularly provides that the managing director or chief executive officer shall not go on to be the chairman of the same company.<sup>148</sup> This provision is especially important in order to preserve the independence and impartiality of the chairman.

In order to preserve the independence of the board, the private sector code requires that no more than two members of the same or extended family should be on the board of a company at the same time.<sup>149</sup> Cross memberships on the boards of two or more companies is also particularly discouraged.<sup>150</sup> The board is required to meet at least once every quarter and the private sector code recommends that directors be required to attend at least two third of those board meetings. Good attendance record at board meetings is therefore included as a criterion for re-nomination of directors at general meetings.<sup>151</sup> Directors are also required to present themselves for re-election at regular intervals of at least every three years.<sup>152</sup> In order to guide shareholders' decision on re-election of directors, names and biographical details of directors nominated for re-election as well as their performance evaluation should be made available to shareholders<sup>153</sup>. This provision potentially serves to ensure that shareholders are able to make informed decisions regarding re-election of directors thereby protecting their interests.

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<sup>147</sup> Ibid s5.9.

<sup>148</sup> Ibid s6.1.1 & 6.1.2.

<sup>149</sup> Ibid s5.1.2.

<sup>150</sup> Ibid s5.10.

<sup>151</sup> Ibid s7.1.

<sup>152</sup> Ibid s14.1.

<sup>153</sup> Ibid.

#### 4.5.3.1.2 Shareholders Protection

Provisions protecting shareholders are also contained in the private sector code. It provides for shareholder meetings, which are the primary avenue for interaction between shareholders, management and the board. Shareholder meetings are required to be conducted in a manner that will allow full participation by shareholders.<sup>154</sup> Members must also be given sufficient notice of meeting (21 days) and the meetings when held should be at a location which is easily accessible to shareholders.<sup>155</sup> The private sector code also provides for protection of shareholder rights and equal and fair treatment of all shareholders. The board is charged with the responsibility of ensuring that shareholders rights are protected and preserved. This particularly includes the right to appoint and remove directors.<sup>156</sup> All shareholders are therefore expected to be treated equally irrespective of the size of their shareholding; they are also entitled to equal access to information.<sup>157</sup> The private sector code also particularly provides that minority shareholders should be adequately protected from ‘abusive action’ by controlling shareholders.<sup>158</sup> In order to further protect minority shareholders and other external stakeholders, the private sector code prohibits insiders from transferring assets and profits out of the company for their personal benefit or for the benefit of those in control of the company.<sup>159</sup>

The important role that institutional shareholders play in corporate governance is also recognised in the private sector code. Therefore, institutional shareholders are encouraged to actively participate in the companies in which they invest in order to

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<sup>154</sup> *ibid* s21.

<sup>155</sup> *ibid* s23 &24.

<sup>156</sup> *Ibid* s 22.1.

<sup>157</sup> *Ibid* s22.2.

<sup>158</sup> *Ibid* s22.3.

<sup>159</sup> *Ibid* s28.1.

ensure good corporate governance.<sup>160</sup> In particular, they are expected to demand compliance with the provisions of the private sector code and report incidences of non-compliance to the regulator. Shareholder associations are also recognised by the code. Consequently, companies are required to ensure that dealings with shareholder associations are transparent.<sup>161</sup>

#### **4.5.3.1.3 Other Features**

The private sector code makes clear provision on companies audit requirements including the role of the audit committee, internal and external audit functions.<sup>162</sup> It also makes provision for whistleblowing. Companies are required to have a whistleblowing policy which should be known to employees, shareholders, other stakeholders and the general public. The board has the duty for implementing this whistleblowing policy, as well as a whistleblowing mechanism, in order to provide a channel for reporting illegal or unethical behaviour.<sup>163</sup> The private sector code also prohibits insider trading. A comprehensive definition of persons who are considered insiders is therefore also provided by the code.<sup>164</sup>

### **4.6 Regulatory Agencies**

Nigeria has a number of regulatory agencies that govern and monitor the activities of companies. Some of these apply only to companies within specific industries, and are therefore beyond the remit of this thesis. Two, however, apply to companies generally and it is on these that this section shall focus.

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<sup>160</sup> *ibid* s 27.1.

<sup>161</sup> *Ibid* s26.1

<sup>162</sup> See generally the private sector code, part D. See also s8.14.

<sup>163</sup> *Ibid* s18.3.

<sup>164</sup> See *ibid* s29 & 40.1.9.

#### **4.6.1 The Corporate Affairs Commission**

The Corporate Affairs Commission (otherwise known as the CAC) was established by the Companies and Allied Matters Act (CAMA) 1990. It was created in order to administer the Act and regulate the formation and management of companies. The CAC was appointed to replace the Companies Registry, a department within the Federal Ministry of Trade and Commerce which was responsible for administering the previous Companies' Act of 1968.<sup>165</sup> The need for a separate body to properly administer the Act arose due to the fact that the Companies registry was unable to effectively carry out its duties partly as a result of its lack of independence.<sup>166</sup>

The CAC's headquarters is located in the Country's Federal Capital Territory. However, it is still required to have offices in all the states of the Federation.<sup>167</sup> It consists of members drawn from different sectors of the commercial world and is headed by the chairman. Its members are as follows:

1. The chairman

One representative from the following associations

2. Nigerian Association of Chamber of Commerce, Industries, Mine and Agriculture
3. Nigerian Labour Congress
4. Nigerian Bar Association
5. Institute of Chartered Accountants of Nigeria
6. Manufacturers Association of Nigeria
7. Nigerian Association of Small Scale Industries
8. Institute of Chartered Secretaries and Administrators

Other members include

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<sup>165</sup> Corporate Affairs Commission, <<http://new.cac.gov.ng/home/>> accessed 26/01/15.

<sup>166</sup> Sofowora (n 56) 15.

<sup>167</sup> See CAMA, s1 (3).

9. A representative of the Securities and Exchange Commission
10. One representative each from the following federal ministries:
  - Trade and Tourism
  - Finance and Economic Development
  - Justice
  - Industry,
  - Internal Affairs, and finally
11. The Registrar-General of the Commission.<sup>168</sup>

The members of the CAC are appointed for three years and may be reappointed for another term of two years. Any of the members may however be removed by the minister on the approval of the president.<sup>169</sup>

#### **4.6.1.1 Functions of the CAC**

The functions of the Commission include:

1. The regulation and supervision of companies including its formation, registration, management and winding up.
2. Conducting investigation into companies' affairs where the interest of shareholders and the public requires it.
3. Performing other functions specified by any Act or enactment.
4. Carrying out all activities that may be required in order to give full effect to the provisions of the CAMA.<sup>170</sup>

As we can see from No. 2 above, the CAC is responsible for investigating the affairs of companies. It can therefore appoint inspectors to investigate a company's affairs

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<sup>168</sup> CAMA, s2.

<sup>169</sup> CAMA, s3(2).

<sup>170</sup> CAMA, s7.

and report on them based on the application of members holding at least one quarter of the issued shares. Where the company has no share capital, investigations may be conducted on the application of not less than one quarter of members on the company's register or on the application of the company itself.<sup>171</sup> The CAC may also appoint inspectors to investigate a company's affairs and report on them based on a court order to do so. If the inspector appointed to investigate in this regard considers it necessary to investigate the affairs of the company's subsidiary or holding company he is permitted to do so.<sup>172</sup> The inspector appointed to investigate has the power to access all the company's books and documents, he also has the power to examine on oath the officers and agents of the company both past and present. Similarly, the inspectors have the right to access documents relating to directors' bank accounts where there is reasonable ground to believe that the account has been used for some illegal purpose.<sup>173</sup>

#### **4.6.2 The Securities and Exchange Commission**

The Securities and Exchange Commission (SEC) is the main regulator of Nigeria's capital market and therefore plays an important role in its corporate governance. Its origin can be traced back to 1962 when the Capital Issues Committee (CIC) was established. The CIC was established under the umbrella of the Central Bank of Nigeria and was responsible for examining the application of companies seeking to raise funds from the capital market and give recommendations for the right timing for those issues. It was also merely a consultative and advisory body without any

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<sup>171</sup> CAMA, s314.

<sup>172</sup> CAMA, s 314 & 315.

<sup>173</sup> CAMA, s318.

regulatory framework.<sup>174</sup> However due to an increase in economic activities in Nigeria and the promulgation of the Nigerian Enterprises Promotion Decree in 1972, it soon became apparent that there was a need for establishment of a formal body to regulate the capital market. This led to the establishment of the Capital Issues *Commission* to replace the CIC.

In order to enable the Capital Issues *Commission* cope with emerging challenges and further develop the market, the Financial System Review Committee was set up. The recommendations of that Committee led to the establishment of SEC by the Securities and Exchange Commission decree no 71 of 1979. SEC effectively commenced operation on the 1<sup>st</sup> of January 1980 and was granted powers to regulate the Nigerian Capital Market.<sup>175</sup>

SEC is led by a nine-member board which consists of the chairman, the director-general, three full time commissioners, a representative of the federal ministry of finance, a representative of the CBN and two part time commissioners.<sup>176</sup> Its headquarters are located in the Federal Capital Territory; it however has offices in seven other zones. It operates through four major directorates which are the office of the director general, operations, finance and administration, and legal and enforcement.<sup>177</sup>

#### **4.6.2.1 Functions of SEC**

SEC is responsible for both the regulation and the development of the Nigerian capital market. As far as its *regulatory* role is concerned, this is carried out through

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<sup>174</sup> Securities and Exchange Commission, Nigeria, < <http://sec.gov.ng/about/what-we-do/> > accessed 25/08/2016.

<sup>175</sup> *ibid.*

<sup>176</sup> See ISA, s3 (1).

<sup>177</sup> Securities and Exchange Commission, Nigeria  
<<http://www.sec.gov.ng/index.php/bulletins/templates/Modern/styles/files/directorates.html>>  
accessed 26/01/15



making rules to guide the capital market, registration of securities and market intermediaries, and surveillance of the capital market to ensure early detection of illegal activities. It is also responsible, in this regard, for investigation of alleged breaches of the rules and regulations of the capital market as well as enforcement of breach of these rules and regulations.<sup>178</sup> With regards to its enforcement function, SEC is responsible for ensuring that enforcement action is taken against any market operator who is found culpable of a breach of capital market rules. In cases where the breach is of a criminal nature, the case may be forwarded to the Nigerian Police Force, the Economic and Financial Crimes Commission (EFCC) or the Attorney General of the Federation. In other cases, SEC may convene a meeting of the affected parties in order to reach a resolution. However, where the case is more serious or where parties have failed to reach a resolution or failed to comply with the decision reached at the meeting, the erring party will be called to appear before the Administrative Proceedings Committee, which is a quasi-judicial court with civil jurisdiction. Appeals from the Administrative Proceeding Committee go to the Investment and Securities Tribunal.

As noted above, the second major role of SEC is to ensure *development* of the capital market. In order to achieve this, it encourages investor participation in the market by ensuring increased publicity for its activities through dissemination of information to the public. This is achieved through television and radio programmes to promote awareness, organisation of workshops and seminars, publications, town hall meetings, arranging quiz and essay competition in secondary schools and introduction of capital market studies in tertiary institutions.<sup>179</sup> SEC's website also contains relevant

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<sup>178</sup> Securities and Exchange Commission Nigeria, 'What We Do' <<http://sec.gov.ng/about/what-we-do/#tab-what-we-do>> accessed 09/09/2016. See also s13 ISA.

<sup>179</sup> Ibid. See also E.K Aigbekaen, 'The Challenges of Establishing an Efficient Securities Settlement System in an Emerging Market' (2010) 15 Uniform Law Review. 639,648; SEC, 'A Roadmap for

information which can be useful for investors seeking better knowledge of the capital market.

#### **4.7 Conclusion**

On paper, Nigeria's corporate law appears reasonably comprehensive and detailed. It addresses the same functions - incorporation, management, shareholder protection, and securities – as the comparable corporate laws of other countries such as the UK and Australia. It has substantive provisions addressing the central issue of agency costs, as well as both regulatory and governance strategies for mitigating these costs. In addition to this, Nigeria has two major regulatory agencies charged with overseeing this regulatory landscape and ensuring compliance. In spite of all this, however, as will be seen in next three chapters, corporate law in Nigeria is barely enforced. The central difficulty in Nigeria therefore rests in the disparity between the law and its enforcement. As discussed in the previous chapter, enforcement of corporate law is important for various reasons including securing the growth of equity markets as well as the overall financial development of a country.<sup>180</sup> There is therefore a crucial need to ensure that corporate law is effectively enforced in Nigeria. Consequently, the next three chapters will examine the different enforcement regimes in corporate law which were identified in chapter 3.<sup>181</sup> Specifically, the criminal enforcement regime, private civil enforcement regime and public civil enforcement regime will be the subject of analysis in chapters five, six, and seven respectively.

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Transforming the Nigerian Capital Markets (Ms Arunma Oteh, SEC Former Director General, SEC Press Briefing 2010) 5.

<sup>180</sup> See s3.4, chapter 3.

<sup>181</sup> See table 3.1, chapter 3.

# **CHAPTER 5: CRIMINAL ENFORCEMENT IN NIGERIA**

## **5.1 Introduction**

The previous chapter discussed the Nigerian corporate landscape. It examined the laws and regulations governing companies in Nigeria as well as the regulatory agencies in charge of securing compliance with those statutory provisions. Chapter 5 now turns to examine the first of the three enforcement categories identified in chapter 3.<sup>1</sup> The chapter will highlight the difficulties with the use of the criminal enforcement regime in Nigeria and the reasons why the criminal enforcement regime cannot be relied on to deliver effective enforcement of corporate law. A caveat is necessary here. The criminal enforcement regime encompasses a wide range of offences. We cannot hope to examine them all here. Instead, our focus is an analytical one; to analyse (and explain) why criminal proceedings are currently, and inevitably, unable to deliver effective enforcement of corporate law. To achieve this analytical purpose, this chapter will concentrate its examination to two significant criminal provisions, namely insider dealing and fraud. These two substantive provisions will be used to illustrate the inherent shortcomings in reliance on criminal proceedings as a means of securing effective enforcement of corporate law in Nigeria.

The chapter starts in section 5.2 by giving a brief overview of the offences for which criminal sanctions are imposed on company directors in Nigeria. It then moves on in section 5.3 and 5.4 to examine the Nigerian context of criminal enforcement as well

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<sup>1</sup> See table 3.1.

as the different issues and challenges which affect the criminal enforcement regime for corporate law in Nigeria. Some of the issues identified include corruption, lack of judicial independence, institutional and infrastructural deficiencies as well as procedural difficulties. Section 5.5 focuses on examining the deterrent effect, compensatory benefit, and cost effectiveness of the criminal enforcement regime in Nigeria. It argues that the current regime lacks a deterrent effect, is unable to secure effective compensation for victims and is not cost effective. Section 5.6 therefore argues that the criminal enforcement regime cannot be relied on to deliver effective enforcement of corporate law in Nigeria and offers some concluding remarks.

## **5.2 Overview of the Nigerian Criminal Enforcement Regime**

Nigeria, like most other countries, relies on criminal sanctions where considered necessary in the public interest. Although corporate law essentially belongs to private law and has been described by some scholars as a nexus of contracts,<sup>2</sup> there are however instances where government intervention is needed in the public interest. The activities of companies can, and indeed do often, have a direct effect on countries' economic stability, it therefore becomes necessary to regulate and impose criminal sanctions on corporate executives where necessary to preserve the country's economic interest. Nigeria, in recognition of this, imposes criminal sanctions for certain misconducts by directors.

Offences for which criminal sanctions may be imposed on directors in Nigeria include insider dealing, false trading and market rigging, securities market manipulation, making false or misleading statements, fraudulently inducing others to deal in securities, disseminating illegal information and fraudulent means. These

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<sup>2</sup> See E F Fama & M C Jensen 'Separation of Ownership and Control' (1983) 26(2) *Journal of Law and Economics* 301-325; M C Jensen and W H Meckling, 'Theory of the Firm: Managerial Misbehaviour, Agency Costs and Ownership Structure' 1976(3) *Journal of Financial Economics* 305-360.

offences are contained in the Investments and Securities Act 2007 (ISA) and the penalty for breach is a fine of not less than N500,000 or an amount equal to double the amount of profit made or loss averted by using the information or imprisonment for a term not more than seven years by imprisonment.<sup>3</sup>

More specifically, in relation to financial institutions, the Banks and other Financial Institutions Act Cap B3 LFN 2004(BOFIA) prohibits managers and officers of the bank from having any personal interest either directly or indirectly in any advance, loan or credit facility. Any interest in loans or credit facilities must be declared to the bank. Loans or credit facilities should also not be granted without due compliance with the rules and regulations of the bank neither should any manager or director benefit as a result of a grant of loan or credit facility by the bank.<sup>4</sup> Failure to comply with these provisions is an offence, which is liable on conviction to a fine of N100,000 or imprisonment for a term of three years. Any gain or benefit gotten as a result of breach will also be forfeited.<sup>5</sup>

It is worth noting here that some of the offences listed above especially the ones contained in ISA, do not strictly belong to company law. Rather they can be regarded as issues which properly belong to securities laws. Persons who are outsiders in the company such as auditors, stockbrokers, or even government officials may commit these offences. It has therefore been said that these issues or offences exist only at the ‘margin of company law’.<sup>6</sup> In spite of this, however, it is proper to address these issues within the scope of this thesis as oftentimes insider dealing and other forms of

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<sup>3</sup> See generally ISA, part XI. See also ISA, s315. For a further discussion of Nigeria’s market abuse provisions see O Orojo, *Company Law and Practice in Nigeria* (5<sup>th</sup> edn, Lexis Nexis 2008) Ch. 25.

<sup>4</sup> BOFIA 2004, s18(1).

<sup>5</sup> BOFIA 2004, s18(2).

<sup>6</sup> P L Davies and S Worthington, *Gower’s Principles of Modern Company Law* (10<sup>th</sup> edn, Sweet & Maxwell 2016) 30-1.

market abuse are committed by directors in breach of companies laws and their duties to the company. The company therefore has a key interest in curbing activities of this sort.

### **5.3 The Nigerian context**

As noted in the previous chapter, Nigeria has a comprehensive legal framework governing the activities of companies.<sup>7</sup> While these laws regulating companies in Nigeria are imperfect and in need of significant review, many would agree that they are nevertheless sufficient to ensure a reasonable level of compliance. The fundamental problem with Nigeria is however not the laws themselves, rather with the enforcement of those laws. Any attempt to improve these laws without addressing this fundamental problem would therefore be an effort in futility.

Insider dealing by company executives has long been a problem in Nigeria and is indeed credited to have been one of the main causes of the financial crisis and stock market crash that occurred between 2008 and 2009 in Nigeria.<sup>8</sup> The crash resulted in a drastic decline of the Nigerian stock market from N12.6 trillion in March 2008 to N3.99 trillion in February 2009. As expected, many new investors lost practically all their investments.<sup>9</sup> Information obtained after the stock market crash revealed that some directors of listed companies had engaged in large-scale insider dealing and

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<sup>7</sup> See generally Chapter 4 on the Nigerian Corporate Landscape.

<sup>8</sup> See S.L Sanusi, 'The Nigerian Banking Industry – What Went Wrong and The Way Forward' (Convocation Lecture by Mr Sanusi Lamido Sanusi, Governor of the Central Bank of Nigeria, to mark the annual convocation ceremony of Bayero University, Kano 26 February 2010) <[http://www.cenbank.org/out/speeches/2010/the%20nigerian%20banking%20industry%20what%20went%20wrong%20and%20the%20way%20forward\\_final\\_260210.pdf](http://www.cenbank.org/out/speeches/2010/the%20nigerian%20banking%20industry%20what%20went%20wrong%20and%20the%20way%20forward_final_260210.pdf) > accessed 16<sup>th</sup> October 2015.

<sup>9</sup> Punch Editorial Board, 'Preventing another Capital Market Crash' October 7 2013 <<http://www.punchng.com/editorials/preventing-another-capital-market-crash/>> accessed 20th July.

grant of unprotected loans to family members and friends.<sup>10</sup> In spite of the devastating effects of the crash, there are suggestions that insider dealing still occurs in Nigeria although, until date, there has been no record of any conviction for insider dealing.<sup>11</sup>

Similarly, over the years there have been various allegations of fraud and gross misconduct against company directors in Nigeria. However, few of these cases have ever been prosecuted. A well-publicised instance of fraud and financial manipulation by a company director in Nigeria was the case of Cadbury Nigeria Plc. In June 2006, the Securities and Exchange Commission (SEC) upon receipt of Cadbury's annual report and accounts expressed concerns on issues in the report such as declining profitability, worsening leverage ratio, deteriorating cash flow, inadequate disclosure, non-compliance with corporate governance code and obtaining loans to pay shareholder dividends contrary to SEC regulations. Subsequently the company's chairman engaged the services of an independent firm (PWC) to investigate the allegations. SEC also constituted a committee to investigate the issue, which confirmed misstatements in Cadbury's account worth approximately N13 Billion.<sup>12</sup> Investigations revealed that the company's CEO - Mr Bunmi Oni - in collaboration with the company's board had since 2002 manipulated the financial reports that were being issued to the public and filed with SEC using 'stock buyback, cost deferrals,

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<sup>10</sup> See T Salako, 'Shareholders still Licking the Wounds of Meltdown' May 18 2015 <<http://thenationonlineng.net/shareholders-still-licking-the-wounds-of-meltdown/>> accessed 20<sup>th</sup> July 2015.

<sup>11</sup> A Garba, 'Impediments to Effective Enforcement of Insider Trading Regulations in Nigeria' (2013) 3(1) International Journal of Management 13, 17.

<sup>12</sup> See T Osundolire, 'SEC blacklists Oni, Akadiri over Cadbury's doctored account', 10<sup>th</sup> April 2008 <[http://www.thenationonlineng.net/archive2/tblnews\\_Detail.php?id=48570](http://www.thenationonlineng.net/archive2/tblnews_Detail.php?id=48570)> accessed 3<sup>rd</sup> July 2015.

trade loading and false suppliers' stock certificates'.<sup>13</sup> Cadbury Nigeria Plc also had an offshore account into which offshore remuneration was paid to directors which was not recorded at all in the company's books. These payments were also made without the approval of the remuneration committee.<sup>14</sup> As a result of this, a fine of N13.88 million was imposed on Cadbury for falsifying its accounts.<sup>15</sup> The CEO (Bunmi Oni) and the finance director (Ayo Akadiri) were banned from operating in the Nigeria Capital market, being employed in the financial services sector and holding any directorship positions in any public company in the country. Other directors and management staff involved in the fraud were also suspended from operating in the Nigerian capital market, being employed in the financial services sector and holding directorship in any public company in Nigeria for a varying number of years. The offending CEO and other erring directors and managers were then referred to Economic and Financial Crimes Commission (EFCC) for further investigation and prosecution.<sup>16</sup> However to date there is no evidence that the offenders were ever prosecuted by the EFCC.

In addition to this, there have been various other publicized allegations of fraudulent conduct against directors, particularly in the banking industry. In 2009, the Central Bank of Nigeria's (CBN) audit of Nigerian banks revealed large-scale fraud perpetrated by several bank executives in their various roles. The audit revealed poor corporate governance at banks coupled with fraud and 'unserviced' loans worth

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<sup>13</sup> Reuters, 'Nigeria Fines Cadbury Unit for False Accounting', 11<sup>th</sup> April 2008 <<http://www.reuters.com/article/2008/04/11/cadbury-nigeria-sec-idUSL1181158820080411>> accessed 3<sup>rd</sup> July 2015.

<sup>14</sup> S.C Okafor, G.O Okafor and G Ofoegbu, 'Corporate Fraud in Nigeria: A Two Case Study' (2013) 6(3) International Journal of Research in Management Issue 9, 14.

<sup>15</sup> The Cadbury Nig. Plc fraud and false financial reporting saga caused its stock price to crash drastically from an all-time high of N65.52 in December 2005 to N8.65 by October 2009. See Okafor, Okafor & Ofoegbu (n 14) 12.

<sup>16</sup> Osundolire, (n 12).



billions of naira. Insider abuse was also rife at several banks and many CEOs had established special purpose vehicles to lend money to themselves in order to enable them manipulate stock prices and purchase properties all over the world.<sup>17</sup> Several governance malpractices went unchecked in banks for example one bank borrowed money to purchase private jets, which were registered in the CEO's son's name. Another bank set up fake companies to enable perpetration of fraud.<sup>18</sup> The sheer enormity of the fraud perpetrated by these directors left everyone highly dismayed.

In order to save the banking system from collapse, the Central Bank of Nigeria (CBN) had to take over five banks and injected N620 billion into the banking system. The resulting banking crisis had devastating effects on the Nigerian capital market which led to a loss of over N7 trillion worth of share values.<sup>19</sup> Consequently, the executive officers of eight banks in Nigeria were sacked by the CBN, five of which were arraigned before the court by the EFCC for various offences ranging from outright fraud, market manipulation, concealment and grant of credit facilities without adequate security. In spite of this however, the manner in which this high profile criminal cases have been prosecuted have shown the deficiencies within the criminal enforcement system in Nigeria. In light of this, the next section would examine some of the issues and challenges which beset the effective use of criminal sanctions in enforcing corporate law.

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<sup>17</sup> S.L Sanusi (n 8) 5.

<sup>18</sup> *ibid* 5.

<sup>19</sup> Editorial Board Punch newspaper, 'Tighten Laws on Bank Fraud' 31<sup>st</sup> May 2013 <<http://www.punchng.com/editorials/tighten-laws-on-bank-frauds/>> accessed 20<sup>th</sup> July 2015.

## **5.4 Issues and Challenges besetting Criminal Enforcement in Nigeria**

As noted above, the Nigerian criminal enforcement regime is lacking in certain respects, it is therefore worth considering some of these issues which prevents effective use of the criminal enforcement regime.

### **5.4.1 Corruption and Lack of Judicial Independence**

According to Transparency International, corruption is defined as the ‘abuse of entrusted power for private gain. It can be classified as grand, petty and political, depending on the amounts of money lost and the sector where it occurs’.<sup>20</sup> The World Bank also defines corruption as ‘the abuse of public office for private gain’.<sup>21</sup> Corruption is a major problem for many developing nations of the world and Nigeria is no exception to this. Corruption in Nigeria has a long history and has been in existence even before the country’s independence in 1960. The successive military regimes further institutionalised corruption in Nigeria causing it to eat deep into its moral fabric.<sup>22</sup> It is generally believed that corruption pervades every sector of the Nigerian society and is widely considered to be the bane of its development.<sup>23</sup> It has also seriously affected the country’s image thereby adversely affecting its ability to attract much needed foreign investment.<sup>24</sup> In the 2014 corruption perception index by Transparency International, Nigeria was ranked 136 out of 174 countries; it also

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<sup>20</sup> Transparency International, ‘What is Corruption’ <<http://www.transparency.org/what-is-corruption/>> accessed 20<sup>th</sup> October 2015.

<sup>21</sup> World Bank, ‘Helping Countries Combat Corruption: The Role of the World Bank’ Sept 1997 <<http://www1.worldbank.org/publicsector/anticorrupt/corruptn/coridx.htm>> accessed 20<sup>th</sup> October 2015.

<sup>22</sup> A.Y.Shehu, ‘Combating Corruption in Nigeria- Bliss or Blister?’ (2004) 12(1) *Journal of Financial Crime* 69, 70.

<sup>23</sup> N.A Goodling, ‘Nigeria’s Crisis of Corruption-Can the U.N Global Programme Hope to Resolve this Dilemma’ (2003) (36) *Vanderbilt Journal of Transnational Law* 997.

<sup>24</sup> A Nwabuzor, ‘Corruption and Development: New Initiatives in Economic Openness and Strengthened Rule of Law’ (2005) 59(1) *Journal of Business Ethics* 121,123.

scored 27 points out of 100.<sup>25</sup> This shows that corruption remains a major problem in Nigeria. While the country has over the years attempted to tackle this scourge of corruption,<sup>26</sup> the general perception is that these initiatives have been relatively unsuccessful in curtailing corruption in Nigeria. Several factors are responsible for the pervading corruption in Nigeria; however, those seeking to explain the causes of corruption in developing nations have often pointed their fingers at the large scale poverty in those nations.<sup>27</sup> However while poverty may explain what may be described as ‘petty corruption’, corruption on a low scale by low level government officials, it does not explain the more serious incidents of corruption perpetuated by top government officials such as judges.<sup>28</sup>

An independent, fair and efficient judiciary is considered a key aspect of any country’s rule of law and the courts are expected to be the last hope of aggrieved persons for getting justice. It is however generally believed that the incidents of corruption in Nigeria extends to judges as well.<sup>29</sup> In a country where ostentatious display of wealth earns one respect in the society, it appears that some judges have traded their integrity and honour for amassment of wealth. Therefore, those who can pay or potentially influence a judge’s career may be able to dictate the outcome of the

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<sup>25</sup> Transparency International, ‘Corruption Perceptions Index 2014: Results’ <<http://www.transparency.org/cpi2014/results>> accessed 26th August 2016.

<sup>26</sup> Some of the past initiatives to combat corruption in Nigeria include the War Against Indiscipline (WAI) 1984, Recovery of Public Property (Special Military Tribunals) Decree 1984, the Public Officers(Investigation of Assets) Decree (no 5 of 1966), Public Complaints Bureau, the Corrupt Practices Decree (No 38 of 1975) and consequent establishment of the Corrupt Practices Bureau, the Code of Conduct Decree and establishment of Code of Conduct Bureau and Tribunal in 1989, Recovery of Public Property (Special Military Tribunals) Decree 1984 and the National Committee on Corruption And Economic Crimes in 1989. See also s98 of The Criminal Code, section 99 of the Criminal Code and s115-122 Penal Code. More recently, in 2002, the EFCC Act was enacted and it established the EFCC which is vested with wide powers with regards to financial and economic crimes. See section 6 of the EFCC establishment Act.

<sup>27</sup> Nwabuzor, (n 24) 123.

<sup>28</sup> Ibid 124.

<sup>29</sup> O Oko, ‘Seeking Justice in Transitional Societies: An Analysis of the Problems and Failures of the Judiciary in Nigeria’ (2005-2006) 31(1) Brooklyn Journal of International Law 9, 24.

court's decision.<sup>30</sup> Although judicial corruption exists in many countries of the world, in Nigeria, it has been described by one commentator as a 'full-blown national plague' and a common feature of the Nigerian judicial system.<sup>31</sup> Similarly, Adeleke and Olayanju opine that 'corruption is a virus that does not spare any level in the judiciary. From the lowest court to all the courts of record, cases or instances of corruption are legion'.<sup>32</sup> It is suggested that many judges in Nigeria adopt the attitude of other public officials in Nigeria who use their public position as an opportunity to acquire wealth. As Oko noted that 'judicial corruption - abuse of judicial power for private gain - is no longer an aberration or isolated conduct. It is disturbingly a dominant and recurrent feature of the Nigerian judicial system'.<sup>33</sup>

Over the years, there have been various allegations of corruption in the Nigerian judiciary commonly played out on the pages of Nigerian newspapers. In 2013, two High Court judges were suspended and recommended for retirement by the National Judicial Council for misconduct bordering on corruption.<sup>34</sup> Again, in 2013, the Economic and Financial Crimes Commission (EFCC) revealed that it had uncovered illicit funds in the accounts of some judges running into hundreds of millions as well as multimillion assets.<sup>35</sup> The former president of the Court of Appeal, Justice Isa Ayo Salami, also noted that 'The problem of corruption in the judiciary is real and has

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<sup>30</sup> *ibid* 15.

<sup>31</sup> *ibid* 25.

<sup>32</sup> F.A.R Adeleke and O.F Olayanju, 'The Role of the Judiciary in Combating Corruption: Aiding and Inhibiting Factors in Nigeria' (2014) 40(4) Commonwealth Law Bulletin 589,604.

<sup>33</sup> Oko (n 29) 25.

<sup>34</sup> K Ogundele, 'NJC suspends Justices Naron, Archibong' February 22, 2013 <<http://thenationonlineng.net/njc-suspends-justices-naron-archibong-2/>> accessed 9<sup>th</sup> Sept. 2015.

<sup>35</sup> The Daily Independent, 'EFCC and the war against corrupt judges in the daily independent' Nov 21 2013 <<http://dailyindependentnig.com/2013/11/efcc-and-the-war-against-corrupt-judges/>> accessed 9<sup>th</sup> sept 2015.

eaten deep into the system...'<sup>36</sup> He further suggested that some judges (current and retired) act as middlemen by collecting money from litigants and using it to bribe the presiding judge or intimidate judges to alter the course of justice.<sup>37</sup> In 2015, the Chief Justice of Nigeria revealed that in the past five years, 64 out of the 1020 superior court judges have been sanctioned for corruption.<sup>38</sup> More recently, a raid carried out by the Department of State Services (DSS) revealed that the sum of \$800,000 (£645,200) in cash was found in the homes of certain senior judges who had been suspected of corruption. The DSS revealed that the raid was considered necessary due to the luxurious lifestyle of certain judges as well as complaints received from members of the public over judgements procured fraudulently.<sup>39</sup> While it would clearly be an exaggeration to indict all judges in Nigeria for corruption, it seems plausible to conclude that corruption remains a problem in the Nigerian judiciary particularly with regards to high profile cases.

Closely related to the issue of corruption in the Nigerian judiciary is the problem of the lack of judicial independence which leaves judges vulnerable to political influences. Corruption in the Nigerian judiciary has been blamed on several factors which primarily include the influence of politicians, businessmen and monarchs.<sup>40</sup> The United Nations basic principles on the independence of judiciary states that 'The judiciary shall decide matters before them impartially, on the basis of facts and in

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<sup>36</sup> A Olesin, 'Corruption: Justice Salami Slams Nigerian Judges, Lawyers' April 20<sup>th</sup> 2014, <<http://leadership.ng/news/366879/corruption-justice-salami-slams-nigerian-judges-lawyers>> accessed 9<sup>th</sup> sept 2015.

<sup>37</sup> Ibid.

<sup>38</sup> A Onanuga, 'Weeding out Corrupt Judges' June 30, 2015 <<http://thenationonlineng.net/weeding-out-corrupt-judges/>> accessed 9<sup>th</sup> sept 2015.

<sup>39</sup> BBC, 'Nigeria Seizes \$800,00 in 'Anti-Corruption Raids' On Judges' 9<sup>th</sup> October 2016 <<http://www.bbc.co.uk/news/world-africa-37603857>> accessed 10<sup>th</sup> October 2016.

<sup>40</sup> See The Will Nigeria, 'Judicial Corruption Blamed on Undue Influence from Politicians, Monarchs' October 4 2013, <<http://thewillnigeria.com/news/judicial-corruption-blamed-on-undue-influence-from-politicians-monarchs/>> accessed 9<sup>th</sup> sept 2015.

accordance with the law, without any restrictions, improper influences, inducements, pressures, threats or interferences, direct or indirect, from any quarter or for any reason'.<sup>41</sup> The judiciary therefore ought to be an independent arm of government free from any form of external pressure. This is however not the case in Nigeria as the judiciary receives a crucial part of its funding from the executive arm of government. The appointment of judges is also done by the president - or governor of the state - based on the recommendation of the National Judicial Council, subject to the approval of the legislature.<sup>42</sup> Judges are therefore subject to pressure from the executive arm of government. In a measure of country's judicial independence by the World Economic Forum in its Global Competitiveness Report 2014-2015, Nigeria was ranked 102 out of 144 countries and scored 3.1 out of 7 points.<sup>43</sup> This data shows that the Nigerian judiciary cannot be considered to be fully independent and free from external influence. The U.S Department of State also noted this problem and stated that 'Although the constitution and law provide for an independent judiciary, the judicial branch remained susceptible to pressure from the executive and legislative branches and the business sector. Political leaders influenced the judiciary, particularly at the state and local levels...'<sup>44</sup>

The likelihood of political influence is greater in high profile cases and although this is more prevalent with cases involving political office holders, it nevertheless occurs

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<sup>41</sup> United Nations Human Rights Office of the High Commissioner, 'Basic Principles on the Independence of the Judiciary' (1985) Principle 2

<<http://www.ohchr.org/EN/ProfessionalInterest/Pages/IndependenceJudiciary.aspx>> accessed 27<sup>th</sup> September 2016.

<sup>42</sup> See generally the Constitution of the Federal Republic of Nigeria 1999, Ch. VII.

<sup>43</sup> World Economic Forum, 'Competitiveness Ranking'

<<http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/>> accessed 10<sup>th</sup> September 2015.

<sup>44</sup> U.S Department of State, 'Country Reports on Human Rights Practices for 2014' available at <<http://www.state.gov/j/drl/rls/hrrpt/humanrightsreport/index.htm#wrapper>> accessed 10<sup>th</sup> September 2015.

in commercial cases as well. Company executives of large companies often have good connections with political office holders. They therefore enjoy political goodwill which means that attempts to prosecute them may end up being frustrated as the outcome of those cases can be influenced by their political godfathers. This has led to suggestions among the Nigerian populace that the few directors who have been prosecuted for their wrongdoings merely fell on the wrong side of their godfathers otherwise, they would not have been prosecuted. An example of the political goodwill that company executives enjoy is seen in the grant of a state pardon by the former president Goodluck Jonathan to Muhammed Bulama, the former CEO of the defunct Bank of the North, who had been jailed for stealing from the bank and abuse of office.<sup>45</sup> One wonders why a state pardon was granted in this case and it can be suggested that the convicted former CEO simply had the right political connections to enable him be let off even after committing fraud in the course of his executive position.

At its most basic level, widespread corruption erodes the public's confidence in the country's justice system. This lack of confidence means that incidences of wrongdoings are less likely to be reported given the general belief that justice is unlikely to be done. Similarly, investigators and prosecutors may have less incentive to carry out proper investigations, institute criminal proceedings and prepare diligently for the trial due to the perception that all the efforts made would be futile if the presiding judge is corrupt. Judicial corruption therefore has a ripple effect which affects not just judges but also all other parties involved in the enforcement process. The criminal enforcement regime relies on a well-functioning and independent judiciary. Therefore, where the judiciary is corrupt and lacks independence it has a

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<sup>45</sup> The Editorial Board Punch Newspaper, 'Tighten Laws on Bank Fraud' May 13 2013 <<http://www.punchng.com/editorials/tighten-laws-on-bank-frauds/>> accessed 21st July 2015.

knock-on effect on criminal enforcement as it significantly reduces the likelihood that offenders would be detected and successfully prosecuted.

#### **5.4.2 Institutional Defects in the Nigerian Judicial System**

Beyond the problems of judicial corruption and the lack of judicial independence, addressed above, the Nigerian judicial system also faces a range of other, what we might call, ‘institutional problems’ which impact on its ability to administer justice and enforce laws effectively. One of the major institutional problems is the endemic delay which plagues trials in Nigerian courts. Although the Nigerian constitution provides for fair and speedy trials,<sup>46</sup> speedy trials are incredibly rare in Nigeria and cases are hardly treated with any sense of urgency. Delay therefore represents one of the major problems plaguing enforcement through the court system in Nigeria. Oko’s research shows that an average trial at a court of superior record in Nigeria can take as long as 5 to 6 years, with another 3 to 4 years spent on appeal proceedings.<sup>47</sup> Criminal trials of accused persons are also often adjourned for varying reasons. Some accused persons may not be brought to court or may be brought late to court due to reasons such as the lack of an available vehicle to convey the accused persons to court.<sup>48</sup>

Frynas’ empirical research likewise revealed delay in the disposal of cases to be one of the factors affecting access to courts in Nigeria. He noted that

Delay in the disposal of cases is perceived as the fourth most important problem of access to courts in Nigeria. This appears to be due primarily to the congestion in the courts, which manifests itself

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<sup>46</sup> Constitution of the Federal Republic of Nigeria 1999, ss 36 and 294(1).

<sup>47</sup> Oko, (n 29) 39.

<sup>48</sup> A.J Alewo Musa, ‘Delay in the Administration of Criminal Justice in Nigeria: Issues from a Nigerian Viewpoint’ (2014) 26 *Journal of Law, Policy and Globalization* 130, 132.



through the high number of pending cases. Cases in Nigerian courts including appeals may take over 10 years before reaching a final verdict. Sometimes the original litigants will have died by the time the judgement is made.<sup>49</sup>

This delay in disposal of cases coupled with the uncertainties about the outcome of the case has the potential to discourage prosecutors from instituting criminal proceedings against directors. Delay in the Nigerian judicial system is attributable to different sources. Some delay can be attributed to the lack of necessary infrastructure while others are due to the ineptitude of the lawyers and perhaps the enforcement agencies. Incessant strike actions by the Nigerian judiciary due to the failure of the government to meet its demands further compounds this problem. In January 2015, the Judiciary Staff Union of Nigeria commenced on an indefinite nationwide strike which involved all the courts in the country. The strike was due to the failure of the government to implement the orders of a Federal High Court granting financial autonomy to the judiciary.<sup>50</sup> The strike went on for several months in many states of the country and four months into the strike, fifteen out of the thirty-six states in Nigeria had failed to reach an agreement and were still on strike.<sup>51</sup> Many states did not suspend the strike action until June 2015,<sup>52</sup> thereby effectively paralysing the state's judicial system for about six months. These institutional problems with the

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<sup>49</sup> J.G Frynas, 'Problems of Access to Courts in Nigeria: Results of a Survey of Legal Practitioners' (2001) 10(3) *Social and Legal Studies* 397,410.

<sup>50</sup> A Adesomoju, 'Autonomy: Judiciary Workers begin Strike Today' January 5 2015 <<http://www.punchng.com/news/autonomy-judiciary-workers-begin-strike-today/>> accessed 18<sup>th</sup> sept 2015.

<sup>51</sup> M Oche, 'Judiciary Workers still on Strike in 15 states' April 10 2015 <<http://leadership.ng/news/424370/judiciary-workers-still-on-strike-in-15-states>> accessed 18<sup>th</sup> Sept 2015.

<sup>52</sup> Channels Television, 'Osun Judicial Workers suspend Strike' June 8 2015. <<http://www.channelstv.com/2015/06/08/osun-judicial-workers-suspend-strike/>> accessed 18<sup>th</sup> sept 2015. Enugu state and Edo state suspended the strike in June.

Nigerian judiciary which result in delays in disposal of cases affect administration of justice, and potentially discourage the use of the court system in enforcement of corporate law.

#### **5.4.3 Infrastructural problems**

Another problem with the Nigerian judicial system is the lack of necessary infrastructure for quick and efficient dispensation of justice. Infrastructural deficiencies such as dilapidated court rooms, outdated technological equipment (such as the use of typewriters in some courts) and lack of research facilities all hinder the speedy administration of justice. One can hardly expect judges to work effectively and at a fast pace when they lack the necessary facilities to do so.<sup>53</sup> Judges in some states in Nigeria still have to record court proceedings and their subsequent judgement in long hand and many court libraries are outdated. The absence of jury trials in Nigeria means that judges have to determine both issues of fact and issues of law during proceedings. This task is however inherently difficult due to the lack of stenographers. Hence, a Nigerian judge has to record all the evidence adduced in long hand while still trying to deduce the true facts from the attitude of the parties.<sup>54</sup> It is therefore not surprising that trials in Nigerian courts take such a long time.

Infrastructural deficiencies in the courts hinder speedy and consequently fair trial in Nigeria and the absence of modern facilities provides an enabling environment for corrupt practices to thrive. Many Nigerian courts are not equipped with modern technological facilities. Consequently, they cannot make use of audio or visual presentations or power point slides which will be useful in fully understanding the case and reaching a suitable conclusion. This would be especially useful in criminal proceedings against directors who may have committed the crime using sophisticated

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<sup>53</sup> Oko (n 29) 42.

<sup>54</sup> *ibid* 44.

means, which would require expert evidence and other forms of visual presentation to ease the judge's understanding. The inability to present the required technical evidence due to the lack of necessary infrastructure means that the prosecution who is expected to discharge the requisite burden of proof is already placed at a disadvantage.<sup>55</sup> Other issues such as the irregular power supply means that court proceedings may be interrupted or even suspended due to lack of power supply. Repeated adjournments are therefore a norm in Nigerian courts and lawyers sometimes prey on this in order to lengthen trials and perhaps frustrate the opposing parties.

A study conducted by the Human Rights Watch highlighted the problems plaguing the Nigerian judicial system. It noted that

Court facilities are hopelessly overcrowded, badly equipped, and underfunded. Interpreters may be non-existent or badly trained. Court libraries are inadequate. There are no computers, photocopiers, or other modern equipment; and judges may even have to supply their own paper and pens to record their judgments in longhand...There are long delays in bringing both criminal and civil cases to court... Corruption is a pervasive feature of court cases, whether criminal or civil.<sup>56</sup>

While the state of affairs in the Nigerian judiciary has definitely improved in the years since this human rights watch report was published, it can be said that some of the problems highlighted here still plague several courts around the country. The U.S

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<sup>55</sup> *ibid* 43-44.

<sup>56</sup> Human Rights Watch, *The Price of Oil: Corporate Responsibility and Human Rights Violations in Nigeria's Oil Producing Communities* (1999 Human Rights Watch) 189.

Department of State more recently noted the problems facing the Nigerian Judiciary in the following words

...Understaffing, underfunding, inefficiency, and corruption prevented the judiciary from functioning adequately. Judges frequently failed to appear for trials, often because they were pursuing other sources of income or due at times to threats against them. In addition, court officials often lacked the proper equipment, training, and motivation to perform their duties, with their lack of motivation primarily due to inadequate compensation.

There was a widespread perception that judges were easily bribed and that litigants could not rely on the courts to render impartial judgments. Citizens encountered long delays and alleged receiving requests from judicial officials for bribes to expedite cases or obtain favorable rulings.<sup>57</sup>

The Nigerian court system is therefore plagued with several difficulties which hinder enforcement through the court system. The judiciary is not adequately funded and as such, it cannot effectively carry out its job of administering justice. Speedy and impartial trials cannot occur in the absence of an enabling environment. In the absence of relevant infrastructure such as conducive court rooms, regular power supply, well stocked and up to date libraries and provision of IT equipment such as computers, audio and visual aids,<sup>58</sup> the Nigerian courts may continue to fall short of its duties to enforce laws. This is especially so with the trial of economic crimes

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<sup>57</sup> U.S Department of State, 'Country Reports on Human Rights Practices for 2014' <[Http://Www.State.Gov/J/Drl/Rls/Hrrpt/Humanrightsreport/Index.Htm#Wrapper](http://www.state.gov/j/drl/rls/hrrpt/humanrightsreport/index.htm#wrapper)> accessed 18<sup>th</sup> Sept 2015.

<sup>58</sup> P.C Aka, 'Judicial Independence under Nigeria's Fourth Republic: Problems and Prospects' (2014) 45 California Western International Law Journal 1, 64.

which are inherently difficult to follow and interpret and as such require technological assistance to ease understanding.

#### **5.4.4 Ineffective or Lax Prosecution**

The Economic and Financial Crimes Commission (EFCC) is the financial intelligence unit in Nigeria charged with investigation and enforcement of all economic and financial crimes. It has power to prevent, investigate and prosecute economic and financial crimes.<sup>59</sup> The prosecution of company directors who have engaged in fraud, market abuse or other forms of financial malpractice is therefore within its power. This government agency has however been unable to, in most cases, successfully prosecute offences by company directors. The EFCC was responsible for the prosecution of the bank executives, mentioned earlier, who were indicted for various misconducts. It however was largely unsuccessful as many of the cases were dismissed based on technicalities which the prosecutors ought to have been aware of. An example of this is the case of the former Managing Director of the defunct Bank PHB, Francis Atuche who was charged with stealing N25.7 Billion meant for the bank's shareholders. The EFCC instituted a twenty-seven count charge which included stealing and conspiracy against Francis Atuche, his wife and the bank's chief financial officer. The accused persons were however discharged and the case struck out after the judge ruled that the EFCC failed to prove that the case falls within the jurisdiction of the State High Court.<sup>60</sup>

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<sup>59</sup> See EFCC, 'The Establishment Act' <<https://efccnigeria.org/efcc/index.php/about-efcc/the-establishment-act>> accessed 16th October 2015.

<sup>60</sup> See B Ezeamalu, 'N25.7bn Fraud: Why Court Freed Former Bank PHB Boss, Atuche, others' June 22 2015 <<http://www.premiumtimesng.com/news/headlines/185504-n25-7bn-fraud-why-court-freed-former-bank-phb-boss-atuche-others.html>> accessed 3<sup>rd</sup> July 2015. Note that Francis Atuche is now standing trial again on a 45 count charge before the Federal High Court for another alleged N125 billion fraud, conspiracy, reckless granting and approval of loans and money laundering. See L Olabiyi, 'Alleged N125b Fraud: Atuche's other trial commences Oct. 28' June 30 2015

A similar case was instituted by the EFCC against Okey Nwosu, the former Managing Director of Finbank Plc, for several crimes including grant of reckless loans worth over N9.3 billion, securities market manipulation, insider abuse, economic crimes and money laundering. The case was however struck out by the appellate court in November 2014 on the grounds that matters arising out of the capital market are within the exclusive jurisdiction of the Federal High Court. In the same vein. Erastus Akingbola, the former Managing Director of Intercontinental bank was prosecuted on a twenty-two count charge which included money laundering, market manipulation, and conspiracy to grant unsecured credit facilities. Seven other non-executive directors and members of the board of directors were also arraigned on an eighteen-count charge for conspiring with Akingbola to grant loans without security worth over N36 billion to companies in which they were directors. They were also accused of taking \$10,000 as holiday allowances contrary to the CBN code of conduct for banks.<sup>61</sup> In December 2014, the Court of Appeal however struck out the charge against Erastus Akingbola on the ground that the subject matter of the alleged offences was within the exclusive jurisdiction of the Federal High Court and not the Lagos State High Court in which it had been instituted.<sup>62</sup>

In light of all these, some commentators have accused the judiciary of frustrating the war against corruption. It has been argued that the judiciary ought to be more concerned with substantial justice rather than allowing legal technicalities to pervert

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<http://guardian.ng/news/alleged-n125b-fraud-atuches-other-trial-commences-oct-28/> accessed 30<sup>th</sup> August 2016.

<sup>61</sup> O.O Otusanya, S Lauwo and S.O Ajibolade, 'An Investigation of Corporate Executive Fraud by CEOs in the Nigerian Banking Sector' (2013) 2(1) African Journal of Accounting, Auditing and Finance 65,81.

<sup>62</sup> See L Olabiyi, 'N47.1bn theft: Appeal Court sets Akingbola, Dada free' Jan 1<sup>st</sup> 2015 <http://sunnewsonline.com/new/n47-1bn-theft-appeal-court-sets-akingbola-dada-free/> accessed 19<sup>th</sup> October 2015.

the cause of justice.<sup>63</sup> However, compliance with legal technicalities and procedural rules such as rules on jurisdiction and acceptable evidence are essential to ensure that justice is not only done, but also seen to have been done.<sup>64</sup> It therefore behoves the prosecution to ensure that it does its due diligence in adhering to all the required rules of criminal trials.

A skilled prosecutor is expected to have good technical knowledge of the law and should therefore know which court has the jurisdiction to try its cases. It is therefore surprising that the EFCC prosecutors instituted criminal proceedings in courts that lacked the requisite jurisdiction to try the case. It may also be argued that there has also been some lack of diligence in the manner in which the EFCC conducts its prosecutions thereby contributing to the delay in the disposal of cases. During the trial of Sebastian Adigwe, one of the five indicted bank executives, the judge expressed disappointment over the manner in which the trial was being handled by the EFCC. It was reported that the EFCC on one occasion failed to produce its witness thereby forcing the court to adjourn proceedings. At the adjourned date, the trial was again stalled due to the fact that the name of the prosecution's witness who was being called to testify was not included in the witnesses list served on the defendant's counsel.<sup>65</sup> One would expect that the EFCC being a specialist agency in charge of financial and economic crimes would be more diligent in its prosecution, this however does not appear to be the case. It is also common in Nigeria for

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<sup>63</sup> See G Okojie, 'Nigeria: Judiciary frustrating War against Corruption' 21<sup>st</sup> July 2015 available at <<http://allafrica.com/stories/201507220125.html>> accessed 8th sept 2015.

<sup>64</sup> See *R v Sussex Justices, Ex p McCarthy* [1924] 1 KB 256.

<sup>65</sup> Ade Adesomoju, 'Judge berates EFCC over ex-bank MD's trial' May 22 2012 <<http://www.punchng.com/news/judge-berates-efcc-over-ex-bank-mds-trial/>> accessed 19<sup>th</sup> October 2015

prosecutors to file charges which are clearly unrelated to the available evidence or to have a misjoinder of offences and offenders.<sup>66</sup>

In the absence of prosecutors who have good knowledge of the law and are well skilled and diligent in prosecuting economic crimes, cases that have reasonable substance would be easily dismissed by the court on the basis of legal technicalities or lack of diligent prosecution. Where there is very little likelihood of successful prosecution for misconducts by company directors, the law prescribing criminal sanctions is made of no effect in deterring offenders thereby defeating its very purpose.

#### **5.4.5 General Procedural Difficulties with Criminal Sanctions**

Due to the punitive nature of criminal sanctions, the law often requires standards which are higher than required for civil trials. Criminal procedure laws, evidence laws and even human rights laws therefore imposes different checks on criminal trials.<sup>67</sup>

One major example of the distinction between criminal trials and civil trials in this regard is the burden and standard of proof required. The ‘burden of proof’ is used to refer to the duty which rests on a party to establish a case or establish the facts in a specific issue while the ‘standard of proof’ refers to the ‘degree to which the proof must be established’.<sup>68</sup> The burden of proof in any proceedings rests on the person who would fail if no evidence were adduced by either side.<sup>69</sup> In criminal cases, the general rule is that the prosecution bears the burden of proving the defendant’s

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<sup>66</sup> A Odusote and T Osipitan, ‘Nigeria: Challenges of Defence Counsel in Corruption Prosecution’ (2014) 3Acta Universitatis Danubius. Juridica 71,79 <<http://www.ceeol.com/>> accessed 19<sup>th</sup> October 2015.

<sup>67</sup> E Lomnicka, Capital Markets Regulation in Nigeria and the UK: The Role of the Courts’ (2002) 46(2) Journal of African Law 155,159.

<sup>68</sup> H.M Malek & others (eds), *Phipson on Evidence* (16<sup>th</sup> edn, Sweet & Maxwell 2005) 125.

<sup>69</sup> See Evidence Act 2011, s132.



guilt.<sup>70</sup> Hence, in a criminal prosecution for fraud, insider dealing or other forms of market abuse, the prosecutor has the burden of proving that the defendant carried out the act in question with the intention of committing the offence or that he committed the said act recklessly or negligently.<sup>71</sup>

In addition to proving the necessary facts, the prosecution is also required to prove its case beyond reasonable doubt.<sup>72</sup> Reaching this required standard of proof is however often very difficult when prosecuting offences in corporate law as some of the breaches may have gone undetected for several years. Adducing the required evidence may therefore require dealing with piles of documents, examination of different corporate and personal bank accounts and may necessitate the testimony of several witnesses who may be unavailable or even reluctant to testify.<sup>73</sup> The high standard of proof required also means that several factors can easily lead to a dismissal or acquittal in such cases. Issues such as failure to prove intention, unreliable witnesses, difficulty in obtaining expert evidence, inconsistencies in expert witness, lack of jurisdiction and other technicalities may be fatal to the prosecution's case.

In recognition of the difficulties in using criminal laws to enforce economic crimes, Rider argues that the criminal law has *not* proven itself to be an efficient means of battling economic crimes due to different technical, practical, procedural and institutional reasons.<sup>74</sup> He argues that criminal law requires a very high burden of proof, is generally slow, excessively procedural, highly restrictive in terms of

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<sup>70</sup> See *Woolmington v DPP [1935] A.C 462*.

<sup>71</sup> The state of mind required depends on the wordings of the laws proscribing each offence.

<sup>72</sup> See Evidence Act 2011, Part IX for the burden and standard of proof required in both civil and criminal cases.

<sup>73</sup> H Croall, *White Collar Crimes: Criminal Justice and Criminology* (Open University Press 1992) 93.

<sup>74</sup> B.A.K Rider, 'Policing the International Financial Markets: An English Perspective' (1990) 16 *Brooklyn Journal of International Law* 179,194.

acceptable evidence and very inflexible. Consequently, only few jurisdictions have been successful in relying mainly on criminal sanctions in regulating financial markets. He noted that even the Royal Commission sitting under Lord Penzance in 1878 recognised the fact that the criminal law is ‘inflexible and slow’.<sup>75</sup> In addition to this, the current global economy has far reaching effects on detection, investigation and prosecution of misconducts in the financial market due to the fact that some witnesses and necessary evidence may be out of reach or incredibly expensive to obtain.<sup>76</sup>

Insider dealing has proven to be especially difficult to prosecute in many countries. In a survey by Olayiwola, on the effectiveness of insider dealing regulation, 85% of the respondents noted that while insider dealing is prohibited in Nigeria, compliance and enforcement is ‘inconsistent’.<sup>77</sup> Even in the UK, experience has shown that it is difficult to obtain a conviction for the offence of insider dealing due to difficulties in detecting the offence coupled with the standard of evidence and proof required in criminal trials.<sup>78</sup> Successful criminal prosecution of insider dealing is therefore often a herculean task for many prosecutors. As noted by Linda Thomsen, former director of the enforcement division at the US Securities and Exchange Commission ‘it is important to understand how difficult it is to build an insider trading case. They are, unquestionably, amongst the most difficult cases we are called upon to prove, and

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<sup>75</sup> Ibid 195.

<sup>76</sup> Ibid 195.

<sup>77</sup> W.K Olayiwola, ‘Practice and Standard of Corporate Governance in the Nigerian Banking Industry’ (2010) 2(4) *International Journal of Economics and Finance* 178, 185.

<sup>78</sup> Davies & Worthington (n 6) 30-11.

despite careful and time-consuming investigations, we may not be able to establish all of the facts necessary to support an insider dealing charge.<sup>79</sup>

In light of this, Tomasic and Pentony in their analysis of the obstacles to the use of criminal law to enforce insider dealing noted that the problems with proving insider dealing make regulatory authorities reluctant to prosecute insider dealing cases.<sup>80</sup>

Offences such as insider dealing and market abuse often involve certain technicalities which make them increasingly complex to prosecute. Defendants in such cases also typically have good access to legal and expert advice which can have the effect of protracting and unduly complicating prosecution of such crimes.<sup>81</sup> The complexity of such crimes therefore means that they are often dismissed for lack of evidence.<sup>82</sup>

The law of evidence in several respects also applies differently to criminal proceedings and civil proceedings. Criminal proceedings are generally guided by certain legal rules and conducted in specific legal language. Hence, rules regarding presumption of innocence, the accused's character, hearsay rule, confessions, and privilege against self-incrimination all form an important part of criminal proceedings<sup>83</sup> and may make criminal convictions more difficult to secure. The court may therefore be asked to disregard relevant incriminating evidence about the defendant when it does not conform to the rules of evidence. The legal arguments,

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<sup>79</sup> FSA, 'Insider dealing in the city, (Speech by Margaret Cole, director of enforcement, FSA, London school of economics quoting Linda Thomsen)

<[http://www.fsa.gov.uk/library/communication/speeches/2007/0317\\_mc.shtml](http://www.fsa.gov.uk/library/communication/speeches/2007/0317_mc.shtml)> accessed 15th sept 2015.

<sup>80</sup> R Tomasic and B Pentony, 'The Prosecution of Insider Trading: Obstacles to Enforcement' (1989)22 Australian & New Zealand Journal of Criminology 5, 66.

<sup>81</sup> Council of Europe, *Economic Crimes* (Council of Europe, European Committee on Crime Problem 1981) 31.

<sup>82</sup> *ibid* 31.

<sup>83</sup> A Keane and P McKeown, *The Modern Law of Evidence* (9<sup>th</sup> edn OUP 2012) 6.

evidence and witness testimony must also comply with the rules of evidence.<sup>84</sup> Failure to comply with any of the technicalities associated with criminal trials may potentially lead to a dismissal of the case. Directors who are the subject of criminal prosecution are also likely to be able to spend more resources in hiring well skilled lawyers who can dispute the prosecution's evidence and devise different strategies to defeat the prosecution's case.<sup>85</sup> There are therefore general procedural difficulties with successfully securing a criminal conviction and these difficulties are no less acute in criminal proceedings for breach of directors' duty or other requirements.

#### **5.4.6 Mens Rea Requirement for Criminal Convictions**

The Mens Rea requirement for criminal convictions represents another difficulty with using criminal sanctions to enforce corporate law. It is an important principle of criminal law that a person cannot be convicted of a crime unless the prosecution has proven beyond reasonable doubt that the defendant acted in a certain way which is contrary to criminal law and that the defendant had a 'defined state of mind' in regard to the proscribed activity.<sup>86</sup> The action or behaviour of the defendant is called the *Actus Reus* while the state of mind is referred to as *Mens Rea*. The principle of *Mens Rea* requires that defendants can only be held criminally liable for offences which they intentionally committed. The basis of this principle is that criminal liability should only be imposed on persons who are well aware of their actions and its possible consequences and can therefore be said to have chosen this course of action and its consequences.<sup>87</sup> This is based on the principle that human beings are autonomous persons with the capacity to choose between different courses of action.

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<sup>84</sup> Croall, 'White Collar Crimes' (n 73) 95.

<sup>85</sup> See further *ibid* 96.

<sup>86</sup> D Ormerod, *Smith and Hogan's Criminal Law* (14<sup>th</sup> edn, OUP 2015) 50.

<sup>87</sup> A Ashworth and J Horder, *Principles of Criminal Law* (7<sup>th</sup> edn, OUP 2013) 155.

As such, they should be held liable for whatever actions they take.<sup>88</sup> There are different forms of Mens Rea which form some sort of hierarchy. At the very top is intention followed by recklessness, belief and suspicion.<sup>89</sup>

In order for a director to be successfully prosecuted and convicted for fraud, insider dealing or other misconduct under ISA, it must be shown that there was some form of guilty mind. This is a common theme which runs through the securities offences proscribed under ISA.<sup>90</sup> Therefore, in order to secure a conviction for insider dealing, it needs to be shown that the defendant traded in the securities with knowledge that the information was ‘unpublished price sensitive information’.<sup>91</sup> The implication of this is that the prosecutor in a criminal charge for insider dealing needs to prove beyond reasonable doubt that the defendant knew that the information in his possession was unpublished price sensitive information and he traded based on this knowledge. In this instance, expert witness would usually be required to prove that the information traded in was price sensitive information. This expert witness may however be difficult to obtain and where gotten, the evidence given may become too technical for the judge to follow and fully understand.<sup>92</sup>

Similarly, it is a defence to an offence of false trading that the trade was done without the intent or purpose of creating a false or misleading appearance of trading.<sup>93</sup> Hence, it needs to be shown that there was an intent to create a false appearance of trading in order to be found guilty of this offence. A person is also not liable for making false or

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<sup>88</sup> *ibid* 155.

<sup>89</sup> Ormerod (n 86) 116.

<sup>90</sup> The guilty mind stipulated under Part XI ISA includes intention, dishonesty, recklessness and negligence. See generally part XI ISA.

<sup>91</sup> See ISA, s111.

<sup>92</sup> FSA, ‘Insider Dealing in the City’ (speech by Margaret Cole, director of enforcement, FSA, London school of economics) <[http://www.fsa.gov.uk/library/communication/speeches/2007/0317\\_mc.shtml](http://www.fsa.gov.uk/library/communication/speeches/2007/0317_mc.shtml)> accessed 15th sept 2015.

<sup>93</sup> ISA, s105 (4).

misleading statements unless it is shown that the person ‘knowingly, recklessly or negligently’ made or disseminated the false information.<sup>94</sup> In the same vein, the offence of market manipulation also requires some evidence of ‘intent’. Hence, the defendant needs to have carried out the said transaction with an intent to induce others to trade in the securities of the company.<sup>95</sup>

As noted earlier the burden of proving facts necessary for conviction in a criminal trial rests on the prosecution. The prosecutor is therefore faced with the difficult task of proving that the defendant had the intention of committing the said offences. Establishing intention in securities offences without any documentary evidence such as emails or other overt evidence could however prove to be enormously difficult for the prosecutor. The job of the prosecutor in proving a guilty mind in this regard therefore becomes a herculean one. While negligence and recklessness may be relatively easy to prove, the same cannot be said with proof of intention or knowledge. Hence, the difficulty with successfully prosecuting insider dealing lies in proving that the person had knowledge that the information in his possession was inside information and consequently traded on the basis of that knowledge. A person cannot be convicted of insider dealing unless there is evidence that he knew that the information in his possession was inside information.<sup>96</sup> The defendant may however easily claim that the timing of his trading was merely coincidental and not as a result of inside information. Hence, in the English case of *R v Holyoak, Hill and Mori*,<sup>97</sup> the prosecution could not establish that the defendants had knowledge that the information they held was price sensitive information when they dealt in the shares of a takeover target just seven minutes before the takeover deal was announced. This is

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<sup>94</sup> ISA, s107.

<sup>95</sup> See ISA, s106.

<sup>96</sup> FSA (n 92).

<sup>97</sup> Unreported UK case in FSA, (n 92).

usually the case with prosecuting offences of this nature as the prosecution would usually have no direct evidence that a person had inside information and was aware of the nature of the information.<sup>98</sup> Imputing knowledge to an accused person is very difficult in the absence of an admission by the accused person and even very strong circumstantial evidence would often be insufficient to prove guilt beyond reasonable doubt in such circumstances.

#### **5.4.7 Difficulties with Detection and Investigation of Offences**

Another problem militating against enforcement of corporate law using criminal sanctions is the difficulty with detecting and investigating such offences. A regime of criminal sanctions for insider dealing or any form of fraud or market abuse can only be truly effective where there is an efficient system for detecting and investigating suspected cases.<sup>99</sup> Such offences however belong to the category of white collar crimes which are generally difficult to detect as they are usually carried out using complicated transactions which can only be detected by staff skilled in that area.<sup>100</sup> This is perhaps why insider dealing and market abuse is rarely detected in Nigeria even though it occurs on a regular basis and is credited to have been one of the main causes of the stock market crash.

White collar crimes are generally unreported due to the inability of its victims to detect that an offence has been committed.<sup>101</sup> This is especially true of misconducts committed by directors of companies in the course of their duty. This is particularly due to the information asymmetry existing in large public companies which makes it difficult for shareholders to have access to full information on issues regarding the

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<sup>98</sup> FSA, (n 92)

<sup>99</sup> Davies & Worthington (n 6) Ch. 30.

<sup>100</sup> Council of Europe, (n 81) 53.

<sup>101</sup> Croall, 'White Collar Crimes' (n 73) 23.

company. Directors are generally aware of their wrongdoing and the harm caused by it while shareholders often do not have access to this information.<sup>102</sup> Hence, shareholders are often unaware that an offence which is liable to criminal sanctions have been committed. Although the board of directors are likely to know when a director has acted in a way that is liable to criminal prosecution, they are unlikely to take any step that may lead to criminal prosecution of a fellow director. This is because the board of directors are a group and are subject to ‘group dynamics’.<sup>103</sup>

Another category of persons who may have information about criminal misconduct by directors are the employees of the company. These category of persons are however also unlikely to report the wrongful conduct for fear of losing their jobs. This is especially so in a country like Nigeria which lacks proper laws to protect whistle-blowers from victimization or makes provision to compensate them.<sup>104</sup> With the harsh economic climate in Nigeria and the high level of unemployment, it is unlikely that incidences of fraud or other criminal practice will be reported by employees who have knowledge of them due to fear of reprisals. The only option available is therefore for the regulators to detect and investigate such offences themselves. This is however very difficult to do as many white-collar offences can

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<sup>102</sup> A Reisberg, *Derivative Actions and Corporate Governance: Theory and Operation* (OUP 2007) 86.

<sup>103</sup> See A Keay, ‘The Authorising of Directors’ Conflict of Interest: Getting A Balance? (2012) 12(1) *Journal of Corporate Law Studies* 129, 140. See also s6.2.1, chapter 6 for the difficulty in getting the board of directors to sue.

<sup>104</sup> The Nigerian Stock Exchange in 2014 established ‘X-Whistle’ which is a whistle blowing portal which allows anonymous submissions of information on any violation of capital market rules. Section 306 ISA also gives employees of capital market operators and public companies the right to disclose information regarding the commission of a criminal offence. These are however insufficient as there are no comprehensive laws protecting whistle blowers or providing incentive for whistleblowing. This is unlike the situation in the USA for example where the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) 12 U.S.C and the Financial Institutions Anti-Fraud Enforcement Act of 1990 (FIAFEA) 12 U.S.C protects whistle blowers with knowledge of banking fraud and also makes it possible for them to be rewarded for their information.



only be detected through inspections and investigations that are costly and time consuming.<sup>105</sup>

The Corporate Affairs Commission (CAC) and the Securities and Exchange Commission (SEC) are in charge of regulating and supervising companies in Nigeria. The CAC is granted power to appoint inspectors to investigate the affairs of a company and report back to it.<sup>106</sup> If from the inspector's investigation report, there is evidence that any person has in relation to the company been guilty of an offence for which he may be criminally liable; such cases are to be referred to the Attorney General of the Federation.<sup>107</sup> In spite of these investigatory powers conferred on CAC, there is no evidence that it uses these powers. The fraudulent activities of bank executives in Nigeria which led to their prosecution was exposed by CBN audit of banks. Perhaps if this audit had not been done, their fraudulent practices might have gone on unchecked.

SEC on the other hand generally lacks powers to conduct routine investigations into the affairs of companies. Its powers to conduct routine inspections and investigations are restricted to capital market operators.<sup>108</sup> Hence, the investigative powers do not extend to the directors of public listed companies who may be involved in insider dealing or other forms of fraud. While the Nigerian Stock Exchange (NSE) has a market surveillance team whose duty it is to closely monitor the market to identify potential abuse, the absence of any reported detection of insider abuse suggests that

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<sup>105</sup> D Nelken, 'White-Collar and Corporate Crime' in M Maguire, R Morgan and R Reiner(eds), *The Oxford Handbook of Criminology* (4<sup>th</sup> edn, OUP 2007) 753; H Croall, *Understanding White Collar Crime* (Open University Press 2001) 110.

<sup>106</sup> CAMA, s314 (1).

<sup>107</sup> CAMA, s322 (1 &2).

<sup>108</sup> ISA, s45(9) provides that 'this part of the act applies to any capital market operator who is involved in the administration, management or custody of funds for and on behalf of clients including the management and operation of a collective investment scheme or the soliciting of investment in a collective investment scheme'.

the team may be lacking the expertise and tools necessary for detection. In the absence of any avenues for detecting criminal misconduct by company directors, there is unlikely to be any enforcement activity. Potential offenders can therefore carry on their wrongful activities unabated, as there is little likelihood of being detected and prosecuted.

## **5.5 Deterrence Effect, Compensatory Benefit and Cost- Effectiveness of the Nigerian Criminal Enforcement Regime**

Having examined the difficulties with the criminal enforcement regime, we are now in a position to measure the success – or failure – of this regime specifically against the criteria for determining effective enforcement which was described and defended in chapter 3.<sup>109</sup> This section will therefore examine the deterrent effect, the compensatory benefit, and cost effectiveness of the criminal enforcement regime in Nigeria.

### **5.5.1 Deterrent Effect of the Criminal Enforcement Regime**

In addition to providing retribution for offences committed, criminal sanctions generally aim at deterring further offences. It is often argued that criminal sanctions compared to other forms of sanctions would deter prospective offenders and ensure compliance.<sup>110</sup> According to the European Commission, there are three main reasons why criminal sanctions – including imprisonment – are considered by some national regulators to have a stronger deterrent effect than administrative or civil sanctions.<sup>111</sup>

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<sup>109</sup> See s3.7.

<sup>110</sup> J Oberg, 'Is It "Essential" to Imprison Insider Dealers to Enforce Insider Dealing Laws? (2014) 14(1) Journal of Corporate Law Studies 111,114

<sup>111</sup> See European Commission, Commission Staff Working Paper, Impact Assessment, accompanying the document Proposal for a Regulation of the European Parliament and of the Council on insider dealing market manipulation (market abuse) and the Proposal for a Directive of the European Parliament and of the Council on criminal sanctions for insider dealing and market manipulation SEC (2011) 1217 Final, 165 available at

Firstly, making the most serious market abuse offences subject to criminal sanctions sets clear boundaries in law that these behaviours are unacceptable, and therefore sends a clear message to the public that the society takes these offences seriously. Secondly, successful prosecution of such offences usually leads to wide media coverage thereby deterring potential offenders by showing that the relevant authorities are serious about tackling these offences. Thirdly, research has shown that criminal sanctions have a strong deterrent effect due to the negative stigma associated with criminal conduct. The strongest argument for introducing criminal sanctions to enforce insider dealing and other forms of market abuse is therefore based on its deterrent effect.

Offences committed by directors in the course of their duty belong to a category of offences that are generally described as ‘white collar crimes’. According to Sutherland, a white collar crime can be defined as ‘a crime committed by a person of respectability and high social status in the course of his occupation’.<sup>112</sup> While this definition has been criticized by several scholars, it is nevertheless sufficient for the purposes of this thesis as it captures crimes committed by company directors as a result of their position in the company. It has been suggested by some scholars that white collar offenders are more ‘detrable’ than other offenders.<sup>113</sup> Hence, it is frequently argued that the deterrence theory is more applicable to white collar offenders than ordinary offenders because their offences are usually rationally motivated.<sup>114</sup> Chambliss in his research findings on the deterrent influence of punishment also noted that white collar offenders belong to a category of persons

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<[http://ec.europa.eu/internal\\_market/securities/docs/abuse/SEC\\_2011\\_1217\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/abuse/SEC_2011_1217_en.pdf) > accessed 10th sept 2015.

<sup>112</sup> E.H Sutherland, *White Collar Crime* (foreword by Donald R Cresssey, Holt, Rinehart and Winston 1949) 9.

<sup>113</sup> See Croall, ‘Understanding White Collar Crime’ (n 105) 147.

<sup>114</sup> *ibid* 133.

who are most likely to be deterred by punishment or the threat of it.<sup>115</sup> This is because they fulfil two conditions; firstly, they have a low commitment to crime as a way of life and secondly, their actions or offences are merely instrumental. Because committing crimes is not a way of life for many white collar offenders, it is argued that they are very likely to be deterred by punishment or its threat.

Similarly, Geerken and Gove argued that the deterrence theory is more applicable to upper and middle class individuals than those in the lower class.<sup>116</sup> According to them, ‘the effectiveness of the deterrence system will increase as the individual’s investment in and rewards from the social system increases’.<sup>117</sup> Persons who are future oriented and think of factors like their career and family are therefore usually more concerned with the consequences of being caught for committing an offence perhaps because they have more to lose from a criminal conviction. Individual corporate criminals are therefore more ‘deterable’ because they have more to lose from a criminal conviction such as their social status, respectability, income, job and a comfortable family life.<sup>118</sup>

In order for deterrence to apply, the prospective offender must be able to rationally calculate the costs and benefits of his actions. As discussed in chapter 3,<sup>119</sup> directors easily fall into this category as many of their actions are motivated by economic calculations. Their social background also means that they can rationally calculate

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<sup>115</sup> W.J Chambliss, ‘Types of Deviance and the Effectiveness of Legal Sanctions’ (1967) *Wisconsin Law Review*. An act is instrumental if it is committed to attain some other goal. Examples of instrumental acts are parking violations and white collar crimes. On the other hand, an act is expressive if it is committed because it is pleasurable in itself, not necessarily as a means to attain some other goal. An example of an ‘expressive’ act is drug addiction See Chambliss 708.

<sup>116</sup> M.R Geerken and W.R Gove, ‘Deterrence: Some Theoretical Considerations’ (1975) 9(3) *Law and Society Review* 497,509.

<sup>117</sup> *ibid* 509.

<sup>118</sup> J Braithwaite and G Geis, ‘On Theory and Action for Corporate Crime Control’ (1982) 28(2) *Crime & Delinquency* 292,302.

<sup>119</sup> See s3.5.2.

the cost and benefit of the crime based on the punishment for the crime and the probability of being caught.<sup>120</sup> Hence, they are likely to consider the cost of losing their employment, comfort, reputation, and social status as well as the public shame and stigma associated with criminal prosecution and conviction. The shame that comes from criminal prosecution and conviction can therefore deter misconduct by directors. Similarly, the thought of being sent to prison can also be a strong deterrent in light of the negative publicity which comes with jail sentences.<sup>121</sup> The imprisonment of a corporate director could therefore serve as a powerful deterrence to other directors as they become aware that such crimes are not taken lightly by the society.<sup>122</sup>

In spite of all the scholarly evidence citing the deterrence potential of criminal sanctions, it is important to pause and remind ourselves of the factors that really influence deterrence. As discussed in chapter 3, there are four main factors which determine the deterrent effect of any sanction or enforcement regime. These are severity, certainty, celerity and variety of punishment'.<sup>123</sup> Therefore, in order for any sanction to deter a prospective offender, it must be sufficiently severe and fit the offence in question.<sup>124</sup> In addition to this, there must be a significant likelihood that the wrongdoing will be detected and punished.<sup>125</sup> The prescribed sanctions must also

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<sup>120</sup> R Kadir and S Muhamad, 'Insider Trading in Malaysia: Sanctions and Enforcement' (2012) 6(6) *Advances in Natural and Applied Sciences* 904.

<sup>121</sup> J.M Ivancevich, T.N Duening, J.A Gilbert and R Konopaske, 'Deterring White Collar Crime' (2003) 17(2) *The Academy of Management Executive* (1993-2005) 114,121; M Levi, 'Suite Justice or Sweet Charity? Some Explorations of Shaming and Incapacitating Business Fraudsters' 2002 4(2) *Punishment & Society* 147,155.

<sup>122</sup> Oberg, (n 110) 119.

<sup>123</sup> See s3.5.1, Chapter 3. See also J M Ivancevich & others, (n 121) 121.

<sup>124</sup> In order for the sanction to fit the offence, there must be a good *variety* of sanctions from which the enforcer can select the appropriate one.

<sup>125</sup> This is known as certainty of punishment. See D M Becker, 'What More Can Be Done to Deter Violations of the Federal Securities Laws?' (2012) 90 *Texas Law Review* 1849,1868.

be imposed swiftly.<sup>126</sup> All these factors need to be present in order for an enforcement action to effectively deter. Hence, the threat of imprisonment will lack a deterrent effect if there is little or no risk of detection and conviction.<sup>127</sup> This is irrespective of the severity of the sanctions on paper as there is little risk of the sanction being imposed. Similarly, where the sanction imposed is not swiftly applied, it affects the deterrent effect of the punishment. Therefore, while criminal prosecution could potentially provide good deterrence, this deterrent potential can be seriously undermined by these key factors.

Nigeria currently faces challenges in successfully detecting, prosecuting and convicting company directors for offences committed in the course of duty. In recent times, there has been only one successful prosecution and conviction of a company director in Nigeria. In that case, Cecilia Ibru, the former Chief Executive Officer and Managing Director of Oceanic International Bank Plc, was charged with money laundering offences on a three count charge of negligence, reckless grant of credit facilities worth billions of dollars and mismanagement of depositors' funds. On conviction, she was sentenced to just six months in prison and required to forfeit shares and other acquired assets worth over N191 billion (£617,154,000).<sup>128</sup> Two of the three offences to which the accused person pleaded guilty to are punishable by an imprisonment term not exceeding five years without an option of fine, nevertheless she was sentenced to just six months. Ibru's sentence for the offences committed left many Nigerians outraged and highly disillusioned in the country's justice system. Besides from the apparent injustice of this, it is clear that the severity of the sanction imposed in this case is significantly low. Where the punishment upon

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<sup>126</sup> This is known as Celerity of Punishment.

<sup>127</sup> Oberg (n 110) 124.

<sup>128</sup> I Anaba, 'Cecilia Ibru goes to Jail' 9<sup>th</sup> October 2010 <<http://www.vanguardngr.com/2010/10/cecilia-ibru-goes-to-jail/>> accessed 19<sup>th</sup> June 2015

conviction is low or disproportionate to the offence committed, it removes its deterrent effect.

Asides from the inadequacy of the sanction imposed, there is also very little likelihood of being detected and successfully prosecuted for such offences in Nigeria. It is almost impossible to secure a conviction against a company director in Nigeria even in the unlikely event that the criminal misconduct is discovered. Following the audit of banks by the Central Bank of Nigeria in 2009, many bank executives were indicted for various criminal offences. However, Cecilia Ibru's case, mentioned above, remains the only one where a conviction has been recorded. The other cases were dismissed for various reasons. Hence, in Nigeria, the likelihood of being successfully prosecuted for an offence as a director is very slim. This problem is then coupled with all the inherent difficulties with criminal enforcement such as the high burden of proof and *mens rea* requirement. The criminal enforcement regime therefore scores very low with regards to the 'certainty of sanctions'. The variety or range of sanctions available under the criminal enforcement regime for offences committed by directors in the course of their duty is also restricted to imprisonment and fines.<sup>129</sup> The range of sanctions available is therefore quite limited.

In addition to this, the endemic delay and other difficulties with the Nigerian judicial system also mean that in the unlikely event that criminal prosecution of such offences succeed, there would have been a long lapse of time between the commission of the offence and the imposition of sanctions. Hence, the 'celerity'<sup>130</sup> of sanctions also rank very low. Therefore, while the criminal enforcement regime may generally have potential to provide good deterrence, in Nigeria this is not the case. The additional problems, which have been discussed in the previous section, such as corruption, lack

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<sup>129</sup> For an example, see ISA 2007, s115.

<sup>130</sup> 'Celerity' of sanctions refers to the speed with which sanctions are imposed.

of judicial independence, infrastructural problems and procedural difficulties also serve to exacerbate the problem. The Nigerian criminal enforcement regime therefore lacks a deterrent effect. The situation is unlikely to change in the short term, as many of the problems hindering the deterrent effect of criminal enforcement are endemic and deep-rooted.<sup>131</sup> Consequently, Nigeria cannot, and should not, rely on the criminal enforcement regime to deliver effective enforcement of corporate law as it lacks the elements which will assure effective deterrence.

### **5.5.2 Compensation and the Nigerian Criminal Enforcement Regime**

As discussed in chapter 3, compensation is a key purpose of enforcement in corporate law.<sup>132</sup> However, as mentioned, whether or not an enforcement action meets a compensatory purpose generally depends on its nature. Criminal enforcement actions are primarily targeted at punishing offenders and deterring future offences. They are therefore not generally focused on compensating victims of the offence. In spite of this however, a country's criminal justice system may allow the courts to award compensation orders to victims. This compensation order will often be awarded in addition to any other criminal penalty imposed on the defendant. This is the case in Nigeria.

The Administration of Criminal Justice Act 2015 (ACJA) is the legislation which provides for the administration of criminal justice in the Federal Capital Territory and other federal courts in Nigeria.<sup>133</sup> Section 319 of this Act provides that the court may, in the course of criminal proceedings or while passing judgement, order the defendant

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<sup>131</sup> See s5.4 above for a discussion of these problems. Issues such as corruption, problems with the Nigerian judiciary, ineffective prosecution and difficulties with detecting criminal offences are deep-rooted problems which are reflective of the state of the Nigerian society.

<sup>132</sup> See s3.7.1

<sup>133</sup> See ACJA 2015, s2 (1). Matters relating to companies incorporated under CAMA fall within the exclusive jurisdiction of the Federal High Court of Nigeria, hence the ACJA applies to criminal proceedings brought against directors. See Constitution of the Federal Republic of Nigeria 1999, s251 (1) e.



or convict to pay compensation to persons who have been injured by the offence where the court considers that substantial compensation would be recoverable if a civil action were brought in respect of the case.<sup>134</sup> Hence, in theory, victims of offences committed by directors may be compensated for loss suffered as a result of the breach. The ACJA is however a relatively new provision there is therefore no evidence that it has been applied by the courts in respect of offences committed by directors in the course of their duty.<sup>135</sup>

Asides from the fact that the ACJA is relatively new, it is also doubtful whether it can, on its own, secure effective compensation for victims of offences committed by directors. As discussed in the previous section,<sup>136</sup> the Nigerian criminal enforcement regime is generally beset with several difficulties. While some of these difficulties are applicable to criminal enforcement proceedings generally, many others are specific difficulties faced by the Nigerian criminal enforcement regime. Nigeria therefore faces immense difficulties in successfully detecting offences, prosecuting, and convicting directors for offences committed. Payment of compensation to the victims of an offence committed by a director however directly depends on detection and successful prosecution of the said offence. Therefore, where the offence itself goes undetected or is not successfully prosecuted, the victims inherently do not obtain any compensation. Consequently, the difficulties in the Nigerian criminal enforcement regime which hinders its deterrent effect, also interfere with its compensatory

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<sup>134</sup> See ACJA 2015, s319. If a subsequent civil suit is commenced in respect of the cause of action, the court in that instance must take into consideration any compensation already paid by the defendant or convict under this section. See ACJA 2015 s319 (3).

<sup>135</sup> A search of the law reports database –the law pavilion- revealed no case where a compensation order was imposed under the ACJA 2015. This is directly related to the fact that successful conviction of company directors for offence committed in the course of their duty have been very rare in Nigeria. Award of a compensation order is however directly dependent on a successful prosecution of the criminal action itself.

<sup>136</sup> See generally section 5.4 above.

benefits. The situation is unlikely to change in the short term due to the several inherent difficulties with the regime. The Nigerian criminal enforcement regime is therefore unable to deliver compensatory benefits to persons who have suffered loss as a result of directors' breach.

### **5.5.3 Cost effectiveness of the Criminal enforcement regime**

As noted in chapter 3, in order for an enforcement action or regime to be regarded as effective, its benefits must outweigh its costs.<sup>137</sup> The enforcement regime must therefore be cost-effective. Where the costs of an enforcement action outweigh its benefits it remains unattractive to the potential enforcer irrespective of the status of the enforcer. In private enforcement actions, the decision to litigate rests with the company and its shareholders who would usually make those decisions based on a cost benefit analysis. In criminal cases however, the decision whether or not to prosecute rests with the prosecutors. Prosecutors often have limited resources as such they cannot validly prosecute every crime.<sup>138</sup> They therefore have to make their own cost benefit analysis. It is therefore worth considering the potential costs and benefits of criminal enforcement and whether it is an effective means of enforcing corporate law.

Criminal sanctions have several benefits and costs. On the benefit side, the major advantage of criminal sanctions is its deterrent effect. As noted above, criminal sanctions have the potential to deter further offences partly due to their punitive nature and the shame associated with criminal trials and convictions.<sup>139</sup> Many people would agree that imprisonment is more unpleasant than fines or other civil penalties; it therefore has a potential deterrent effect. In addition to this, some of the other

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<sup>137</sup> See s3.7.2.

<sup>138</sup> C.A Schipani, 'Falling Off the Corporate Ladder: Prosecution for Financial Fraud in the United States' (2011) 32(11) *Company Lawyer* 336-342.

<sup>139</sup> See 5.5.1

potential benefits of using criminal sanctions are improved accountability by directors, retribution for the offending directors, improved corporate governance, enhanced confidence in the financial market, better protection for shareholders, and increased investments in the financial markets thereby promoting economic growth.<sup>140</sup> On the other side of the equation, the costs of criminal enforcement can be classified into tangible and intangible costs. The tangible costs of criminal enforcement include the cost of acquiring the necessary expertise and technological equipment for detecting fraudulent practices, the cost of conducting investigations, the cost of acquiring the necessary evidence and witnesses required for proving the case in court, the cost of prosecuting the case,<sup>141</sup> and the financial costs of imprisonment.<sup>142</sup> The intangible costs of criminal enforcement includes the time expended in criminal trials, the potential negative publicity for the company and the possible chilling effect on the willingness of qualified persons to take up executive positions.

While the intangible costs of criminal sanctions may be more easily defended or waived aside on the grounds of its overall public benefit, the same cannot be said of the tangible costs. Detection, investigation and prosecution of corporate law offences requires investment of considerable resources. Insider dealing, for example, can only be detected and prosecuted if the regulators have the skills, training and tools needed to detect any unusual transaction in securities and price movement.<sup>143</sup> This requires

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<sup>140</sup> The benefits listed here include both public and private benefits.

<sup>141</sup> This includes out of pocket expenses to expert witnesses and the costs paid to the prosecutors. It is also more expensive to prosecute a case than to deal with it informally outside the court system. See also M Levi, *Regulating Fraud: White Collar Crime and the Criminal Process* (Tavistock publications 1987) 183.

<sup>142</sup> Keeping prisoners in prison imposes costs on the government as such this costs needs to be factored into the general cost of enforcement.

<sup>143</sup> O.O Oladele, 'Disclosure in Secondary Securities Transactions in Nigeria' 2008 19(8) *International Company and Commercial Law Review* 264.

investment of millions in hiring manpower and obtaining the sophisticated computer systems needed to detect any form of unusual trading activity. For instance, it is reported that the UK Financial Conduct Authority has spent tens of millions of pounds in hiring staff and developing computer systems to enable identification of suspicious trading.<sup>144</sup> This shows that undertaking the task of detecting these offences is not a cheap task for any regulator. In the absence of such detection devices, the regulator would either have to rely on conducting routine investigations into the activities of companies or wait until it gets some notification from other parties that some wrongful act is being perpetrated. As noted earlier, the likelihood of getting such third party information is slim especially in Nigeria.<sup>145</sup> Similarly conducting routine investigation of companies is an expensive activity for any regulator. Criminal enforcement of corporate law in Nigeria is therefore a costly venture as it would require huge investment of financial resources in order for it to have any deterrent effect.

Many government agencies in Nigeria are underfunded, hence criminal enforcement for corporate or securities offences have to compete for scarce enforcement resources with other conceivably more serious crimes.<sup>146</sup> In a country like Nigeria which still grapples with crimes such as terrorism, oil bunkering, kidnapping and armed robbery to mention a few, policy makers are likely to give more priority to these other crimes than breaches of corporate and securities laws. Therefore, while effective criminal enforcement can be immensely beneficial, the costs of attaining this level of enforcement in Nigeria are great and may outweigh its benefits in the eyes of the

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<sup>144</sup> D Enrich and H Agnew, 'U.K Agency Struggles in Fight Against Insider Trading' (Wall Street Journal) January 4, 2014

<<http://www.wsj.com/articles/SB10001424052702303640604579296520563211360>> accessed 30th July 2015.

<sup>145</sup> See s5.4.7

<sup>146</sup> Lomnicka, (n 67) 159.

potential enforcers. In light of the high costs associated with this enforcement regime, it is argued that the criminal enforcement regime in Nigeria cannot, and should not, be relied on to deliver effective enforcement of corporate law.

## **5.6 Conclusion**

This chapter has examined the criminal enforcement regime in Nigeria and the difficulties which currently pervade it. As discussed in the course of this chapter, criminal enforcement generally has potential to provide effective deterrence. In spite of this however, the problems besetting Nigeria's criminal enforcement regime prevents it from being of much use in enforcing corporate law in Nigeria.

The costs of criminal enforcement, its limited deterrent and compensatory benefit, the lack of judicial independence, institutional and infrastructural deficiencies in Nigeria, as well as procedural difficulties associated with the criminal enforcement system all come together to make this enforcement regime a somewhat unattractive and ineffective one. This does not imply that the criminal enforcement regime for breach of corporate law requirements should be totally ignored. Rather it suggests that it should be used only as a supplementary enforcement method in light of the fact that it suffers from significant difficulties. This is further compounded by the fact that the difficulties which plague this enforcement regime are only a reflection of general problems within the Nigerian society. They are therefore deep-rooted problems which are unlikely to disappear in the shorter term. Consequently, criminal enforcement *cannot* be relied on to deliver effective enforcement of corporate law in Nigeria. In light of this, the next two chapters will examine other enforcement regimes for corporate law in Nigeria. Consequently, chapter 6 would examine the private civil enforcement regime while chapter 7 looks at the public civil enforcement regime. These enforcement regimes would be examined with a view to discovering whether

they offer any advantage over the criminal enforcement regime discussed in this chapter, and can therefore potentially deliver effective enforcement of corporate law in Nigeria.

# **CHAPTER 6: PRIVATE CIVIL ENFORCEMENT IN NIGERIA**

## **6.1 Introduction**

The previous chapter examined the criminal enforcement regime in Nigeria. It argued that the criminal enforcement regime in Nigeria is incapable of delivering effective enforcement in Nigeria due to several inherent difficulties. This chapter now turns to examine the second of our three enforcement regimes, namely private civil enforcement. As with chapter 5, it likewise argues that this form of enforcement currently is, and inevitably will remain, largely ineffective in Nigeria. As with the criminal enforcement regime, some of the problems in respect of private civil enforcement might appear to be merely temporary difficulties, or merely contingent on remediable shortcomings within the Nigerian justice system. However, as with chapter 5, the purpose of this chapter is to demonstrate that some of these difficulties are inherent in the very nature of private civil enforcement. This chapter therefore argues that whilst the private civil enforcement regime in Nigeria can, and should doubtless, be improved, these improvements are unlikely to lead to much significant improvement in its effectiveness as an enforcement regime in corporate law. Consequently, private civil enforcement cannot, and should not, be substantially relied on to deliver effective enforcement of corporate law in Nigeria.

The chapter starts in section 6.2 by overviewing four major private civil enforcement actions. These are corporate actions, actions by administrators and liquidators, personal actions and finally derivative actions. It undertakes some critique of the first three enforcement actions before moving on to focus on derivative actions which

section 6.3 then examines in detail. The focus on derivative actions is justified and appropriate given that so many countries seem to place such significant reliance on derivative actions as a private enforcement mechanism in corporate law.<sup>1</sup> It is therefore worth examining whether this enforcement action can indeed deliver effective enforcement in Nigeria. Section 6.3 examines various aspects of the Nigerian statutory derivative actions regime. It examines CAMA's requirements regarding those who may apply to bring derivative actions under the regime. It further examines the procedure for commencing derivative actions as well as CAMA's position on the effect of shareholder approval on an application for leave to commence a derivative action. Section 6.4 then discusses the inherent difficulties with derivative actions as an enforcement mechanism. Section 6.5 analyses whether derivative actions have significant potential to be an effective enforcement mechanism. It considers its effectiveness in light of its ability to provide effective deterrence and compensation as well as its cost effectiveness. It argues that while the derivative action is considerably better than the criminal enforcement regime in terms of its ability to provide effective enforcement, it nevertheless falls short in several regards. It is therefore unable to, on its own, secure effective enforcement of corporate law. Section 6.6 offers some concluding remarks and provides a signpost to the next chapter.

## **6.2 Overview of Private Civil Enforcement Actions**

As the name suggests, private civil enforcement actions are civil proceedings that are instituted by private parties in respect of breach or wrongdoing by directors. There are four major types of civil enforcement proceedings that may be instituted where

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<sup>1</sup> For example, the UK has historically relied significantly on derivative actions as a private enforcement mechanism for breach of directors' duties. See A Keay, 'An Assessment of Private Enforcement Actions for Directors Breaches of Duty' (2014) 33(1) *Civil Justice Quarterly* 76, 84.



there has been a breach: corporate actions, action by administrators or liquidators, personal actions and derivative actions. The next sections will examine each of these enforcement actions and identify the difficulties with each one of them.

### **6.2.1 Corporate Actions**

Directors duties are generally owed to the company. Therefore, where there has been a breach, it is the company itself which has power to take proceedings to redress the wrong. This is the effect of the rule in *Foss v Harbottle*.<sup>2</sup> This common law rule is also preserved in section 299 of the Companies and Allied Matters Act 1990 (CAMA). Hence, the company is required to be the one to seek redress for wrongs done to it. The company is an artificial legal entity; therefore, its decisions are taken through its organs – generally the board and the general meeting. Power within the company is generally divided between these two organs and neither organ can usurp the power which has been conferred on the other organ. The power to bring legal proceedings on the company's behalf is however generally vested in the board of directors. Therefore, where there has been a breach by a director (or any other party), the board has the power to decide whether or not to sue.<sup>3</sup>

In spite of this general litigation power which is conferred on the board, there are several reasons why the board might not, and are indeed unlikely to, institute enforcement action against a director who has committed a breach. These reasons may be broadly classified into two different categories. The first category will be referred to as '*altruistic*' reasons. These are reasons which are genuinely in the company's interests. Thus, the board may believe that legal action is not in the company's best interest. For example, the board may decide not to take enforcement

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<sup>2</sup> (1843) 2 Hare 461

<sup>3</sup> See CAMA, s 63(3) which provides that the board of directors may exercise all the powers of the company except those which have been expressly vested by the in the general meeting.

action in respect of an actionable breach because it considers it costly to do so. These costs may include monetary costs as well as intangible costs such as the time and effort which will be required to pursue the action. The board may also consider that the enforcement action is not in the company's interests<sup>4</sup> or that the action has little chance of succeeding.<sup>5</sup>

The second category of reasons why directors may decide not to take enforcement action will be referred to as '*self-interested*' reasons. These are reasons which are purely in the board or its directors' self-interests and may generally be contrary to the company's interests. For example the board may refuse to sue because they feel some loyalty towards the wrongdoing director or because they consider that such actions may reflect poorly on them.<sup>6</sup> Directors also often develop friendship and loyalty ties to each other similar to those found among family members or members of a society and are therefore unlikely to decide to sue fellow directors whom they may regard as friends.<sup>7</sup> In addition to this, the board of directors are a group and are therefore subject to 'group dynamics'. As Key has pointed out that, it is difficult for members of a group to be totally objective when dealing with something that has or may be done by a member of the group.<sup>8</sup> There is also a risk of 'back scratching' whereby directors ignore another director's breach in the hope that they will get the same treatment if they found themselves in a similar situation.<sup>9</sup> Directors are therefore unlikely to make the litigation decision against the erring director as a

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<sup>4</sup> This could be due to reasons such as the distraction to management, loss of managerial resources or even its potential effect on the company's reputation. See H Hirt, 'The Company's Decision to Litigate against Its Directors: Legal Strategies to deal with The Board of Directors' Conflict of Interest' [2005] *Journal of Business Law* 159,165-166.

<sup>5</sup> Key 'An Assessment of Private Enforcement Actions' (n 1) 79.

<sup>6</sup> *ibid*

<sup>7</sup> D Kershaw, *Company Law in Context: Text and Materials* (2nd edn, OUP 2012) 591.

<sup>8</sup> A Key, 'The Authorising of Directors' Conflict of Interest: Getting A Balance? (2012) 12(1) *Journal of Corporate Law Studies* 129, 140.

<sup>9</sup> Kershaw (n 7) 591.

means of protecting their own interest in case they fall into the same position, and even where they do they may fail to pursue it diligently such that the action will fail. These reasons explain why corporate actions against directors are rare. Hence, while corporate actions may be instituted for directors' breach, in practice this is rarely the case.<sup>10</sup> Corporate actions are therefore generally ineffective as an enforcement mechanism for redressing directors' breach.

### **6.2.2 Action by Administrator or Liquidator of an Insolvent Company.**

Private enforcement actions may also be commenced by the administrator or liquidator of an insolvent company. A liquidator or administrator's investigations may reveal that the company directors have breached their duties to the company. They may therefore commence enforcement action against the offending director. The power of a liquidator to bring an action in the company's name or on its behalf is preserved by Section 425(1)a CAMA. Hence, in the event of a winding up, a liquidator may bring an action against a director for breach which occurred in the course of managing the company.

Liquidators may however face certain difficulties in bringing private enforcement actions. For example, they may find it difficult to obtain the funds required to commence private actions. Similarly, the breach may have occurred long before the liquidators' appointment such that the necessary evidence for proving the case might no longer exist.<sup>11</sup> In addition to these difficulties, the reality is that liquidators are often more keen on saving as much of the corporate estate for the creditors' benefit rather than commencing enforcement action against the badly behaved directors. Therefore, while a liquidator may be keen on retrieving corporate assets which have

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<sup>10</sup> D Ahern, 'Directors' Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum' (2011) 33 Dublin University Law Journal 116.

<sup>11</sup> Keay, 'An Assessment of Private Enforcement Actions' (n 1) 81.

been wrongfully transferred to directors, he is likely to be less enthusiastic in pursuing other ‘speculative’ claims like negligence against directors where the outcome is less assured.<sup>12</sup>

### **6.2.3 Personal Actions**

Shareholders may in certain restricted circumstances bring personal actions against directors. In personal actions, the wrong in question needs to have been suffered by the shareholder(s) personally and not the company. Hence, the anxiety surrounding the rule in *Foss v Harbottle* do not apply here. As mentioned earlier, directors’ duties are owed to the company and not individual shareholders,<sup>13</sup> therefore many jurisdictions restrict the bringing of personal actions by shareholders against directors. In the UK, for example, in order to bring a personal action against a director, a shareholder must prove two conditions. First, the shareholder must be able to show that the defendants breached a legal duty owed to him personally (perhaps under the law of contract or torts). Hence there must have been a ‘special factual relationship’ between the director and shareholder which gave rise to fiduciary duties owed by the director to the shareholder. Second, the shareholder has to show that the loss suffered as a result of the breach is ‘separate and distinct’ from that of the company and not merely reflective.<sup>14</sup> The shareholder’s loss must therefore not merely be a reflection of the company’s loss.<sup>15</sup>

With respect to Nigeria, Section 300 CAMA preserves shareholders’ general rights to bring personal actions. In addition to personal actions, shareholders may also bring

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<sup>12</sup> Pursuing private actions in these circumstances are also unlikely to be cost effective. See J.E Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (OUP 1993) 239.

<sup>13</sup> *Percival v Wright [1902] 2 Ch. 421 Ch D.*

<sup>14</sup> R Cheung, ‘The No Reflective Loss Principle: A View from Hong Kong’ (2009) 20(7) *International Company and Commercial Law Review* 223,228.

<sup>15</sup> See *Johnson v Gore, Wood & co [2002] 2 A.C 1, HL.*

representative actions. Where a representative action is brought, a shareholder is suing on behalf of himself and other members who have the same right which is alleged to have been infringed. Where a member brings a personal action or representative action, he or she will not be entitled to any damages against the company but only to a declaration or injunction restraining the company and directors from the particular act.<sup>16</sup> It must be noted that personal actions are intended for the benefit of the claimant shareholder and not the company. Therefore, enforcement of directors' breach through personal actions are unlikely to result in any significant gain for the company.

Another action which may be classified as 'personal' actions are those which are brought on the grounds that the company's affairs are being conducted in a manner which is oppressive or unfairly prejudicial. Section 310 CAMA gives standing to a range of specified persons to make a petition to the court on the basis of unfair prejudice.<sup>17</sup> In an unfair prejudice action, the core of the action is not the wrong done to the company; rather the action is premised on the fact that the action is prejudicial to the claimant. Hence, the reliefs that are claimed in an unfair prejudice action are also personal remedies and not corporate relief.<sup>18</sup>

While actions based on unfair prejudice may be brought by shareholders of any company, whether private or public, these actions are however more often used in the case of small private companies. This is due to the fact that members of such

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<sup>16</sup> CAMA, s301. Costs may also be awarded by the courts in respect of personal or representative actions. See CAMA, s301(3).

<sup>17</sup> The persons who may apply to the court on the basis of 'unfair prejudice' are members of the company, directors or officers of the company (present and former), the Corporate Affairs Commission, and any other person who the court considers to be a proper person to commence the action. CAMA, s310.

<sup>18</sup> The most frequent relief granted in an unfair prejudice action is an order for a purchase of the petitioner's shares. The unfair prejudice action therefore does not seek to enforce directors' obligation to adhere to their duties or other statutory requirements. See Andrew Keay, *The Corporate Objective* (Edward Elgar 2011) 253-254.

companies can clearly establish that they had certain ‘legitimate expectations’ when joining the company which have not been met.<sup>19</sup> While shareholders of public listed companies may, in principle, commence an unfair prejudice petition, the concept of ‘legitimate expectations’ does not generally apply to them.<sup>20</sup> Shareholders in public listed companies are less able to show that they were given certain expectations by the directors or managers and may therefore be unsuccessful in unfair prejudice petitions.<sup>21</sup> In light of this, the unfair prejudice petition would not be the subject of further analysis in this chapter as this thesis is generally concerned with public listed companies and not private companies.

#### **6.2.4 Derivative Action**

The fourth and arguably most important private civil enforcement action is the derivative action. In light of the difficulties with the earlier discussed forms of private civil enforcement proceedings, the rest of this chapter would focus largely on derivative actions. A derivative action is a means by which shareholders (usually minority shareholders) can enforce the company’s rights where directors have breached their duties to the company.<sup>22</sup> It was developed as an equitable remedy in order to prevent a wrong done to the company from going un-redressed.<sup>23</sup>

A discussion on derivative actions necessarily starts from the rule in *Foss v Harbottle*<sup>24</sup> as it established the legal position of minority shareholders in respect of

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<sup>19</sup> A Keay, ‘Company Directors Behaving Poorly: Disciplinary Options for Shareholders’ (2007) *Journal of Business Law* 656,678.

<sup>20</sup> See *Re Astec (BSR) Plc* [1998] 2 *BCLC* 556, 589. A.J Boyle, *Minority Shareholders’ Remedies* (Cambridge University Press 2002) 111. While in widely held corporations, shareholder ‘legitimate expectations’ on issues such as management, employment or other matters are possible, they are unlikely to arise. See further Daniel Attenborough, ‘Enforcement of Corporate Conduct under the Equitable Maximisation and Viability Principle’ (2013) 33(4) *Legal Studies* 650,672.

<sup>21</sup> Keay, ‘Company Directors Behaving Poorly’ (n 19) 679.

<sup>22</sup> A Reisberg, *Derivative Actions and Corporate Governance: Theory and Operation* (OUP 2007) 1.

<sup>23</sup> See *Smith v Croft (no 2)* [1988] *Ch* 114,185.

<sup>24</sup> (1843) 2 *Hare* 461.

court claims. The rule in *Foss v Harbottle* is to the effect that when a wrong has been done to the company, it is only the company that can bring an action to redress such a wrong. Thus, a shareholder generally has no right to bring an action on behalf of the company to redress a wrong done to the company.<sup>25</sup> This rule is based on two fundamental principles of law, which are the principles of a company's separate legal personality and the principle of majority rule.

As mentioned earlier in section 6.2.1, power to bring corporate actions are vested in the board of directors who, for various reasons discussed earlier, are unlikely to bring action to redress wrongs committed by other director(s). As a result of the difficulties with getting the board to commence action where the directors are themselves the wrongdoers, exceptions to the rule in *Foss v Harbottle* were developed by the common law courts to permit derivative actions.

Derivative actions under the common law were permitted where

1. The wrong done amounted to 'fraud on the minority'; and
2. The wrongdoers are in control of the company and as such are unlikely to pursue a claim to redress the wrong done.<sup>26</sup>

By virtue of Nigeria's colonial history, the English Common Law and Doctrines of Equity are applicable in Nigeria.<sup>27</sup> Cases decided by English courts are also of persuasive authority in Nigeria although they are not binding.<sup>28</sup> Consequently, the rule in *Foss v Harbottle* and its exceptions under common law have been applied by

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<sup>25</sup> V Joffe QC and others, *Minority Shareholders: Law, Practice and Procedure* (OUP 2011) 32.

<sup>26</sup> *Edwards v Halliwell* [1950] 2 All E.R 1064, *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch. 204.

<sup>27</sup> See for example The Law (Miscellaneous Provisions) Law Lagos Laws 1973 cap 65, s 2. The applicability of received English laws to Nigeria is however subject to the existence of equivalent Nigerian legislation. Hence, where there is a local enactment on any matter, the received English law will not apply. See A.O Obilade, *The Nigerian Legal System* (Spectrum Books Limited 1979) 77

<sup>28</sup> Obilade *ibid* 135.

Nigerian courts as a means of providing equitable relief to minority shareholders where the wrongdoing would otherwise have escaped redress. In the case of *Edokpolo v Sem-Edo Wire Industries Ltd*<sup>29</sup> the court (in its lead judgement delivered by Nnamani J.S.C) established the operation of the rule in *Foss v Harbottle* in Nigeria to the effect that the court will not interfere with a company's internal management. Consequently, where a wrong has been done to the company, it is the company that must sue for redress. The rule in *Foss v Harbottle* has also been applied by the Nigerian Courts in several other cases.<sup>30</sup> In 1990, the Nigerian provisions on derivative actions were codified in the Companies and Allied Matters Act 1990 (CAMA). These will be the subject of analysis in the next section.

### **6.3 The Statutory Derivative Actions Regime in Nigeria**

In 1990, the Nigerian rules on derivative actions were codified in the Companies and Allied Matters Act (CAMA). Section 299 restates the common law 'proper plaintiff' rule,<sup>31</sup> and provides that, where an irregularity has been committed in the course of a company's affairs or any wrong done to the company, only the company can sue to remedy that wrong or ratify the irregular conduct. Sections 303-309 CAMA then contain a number of provisions regarding the bringing of actions on behalf of the company.

Section 303(1) empowers applicants to apply to the court for leave to bring derivative actions while section 303(2) contains conditions, all of which must be satisfied before leave can be granted. Those conditions are:

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<sup>29</sup> (1984) LPELR-1017(SC).

<sup>30</sup> See *Sparks Electronics Nig. Ltd. v. Ponnile* (1986) 2 NWLR (Pt. 23) 516; *Mbene v. Ofili* (1968) NCLR 293; *Yalaju-Amaye v A.R.E.C. Ltd.* (1990) NWLR (Pt. 145) 422; *Omisade v. Akande* (1987) 2 NWLR (Pt. 55).

<sup>31</sup> See *Foss v Harbottle* (n 2).



- a) The wrongdoers are the directors who are in control, and will not take necessary action;
- b) The applicant has given reasonable notice to the directors of the company of his intention to apply to the court;
- c) The applicant is acting in good faith; and
- d) It appears to be in the interest of the company that the action be brought, prosecuted, defended or discontinued.<sup>32</sup>

Before going on to analyse these provisions, it must be noted here that the goal of the Nigerian Law Reform Commission ('the Nigerian Commission') in codifying the derivative actions regime was to give shareholders a 'wider scope within which to enforce their rights and also the company's'.<sup>33</sup> It seems however that the Nigerian Commission has been unable to achieve this goal. The difficulties with the criteria for bringing derivative actions under the statutory regime will be the subject of further analysis in this chapter.

### **6.3.1 Applicants for leave to bring Derivative Actions**

Section 309 CAMA provides for persons who may apply for leave to bring derivative actions. These are:

- 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 Commission; or

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<sup>32</sup> CAMA, s303 (2).

<sup>33</sup> The Nigerian Law Reform Commission, 'Working Papers on the Reform of Nigerian Company Law Volume 1-Review and Recommendations' (1987) 239.

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

### **6.3.1.1 Registered Holders and Beneficial Owner of Securities (Present and Former)**

CAMA allows both present and former shareholders (including beneficial owners) to institute derivative actions. One knotty issue here is whether former shareholders ought to be regarded as holding sufficient interest in the company to justify bringing a derivative action. This question is very important as it borders on the proper plaintiff rule which is fundamental to company law. In order to have *locus standi* to commence any action, the plaintiff is expected to have sufficient interest in the matter. Therefore ‘A cannot as a general rule, bring an action against B to recover damages or secure other relief on behalf of C for an injury done by B to C’.<sup>34</sup> The problem then is whether a former member can be regarded as having sufficient interest in a company in order to justify bringing a derivative action.

Breaches of directors’ duties may sometimes have profound negative effect on a company forcing some shareholders to try to mitigate their losses by selling their shares and leaving the company. In those circumstances, where the shareholder feels compelled to sell her shares in order to avoid complete loss, those shares may be sold at less than their optimal value. There is therefore a case for arguing that it is reasonable to allow former members to commence action to redress the directors’ breach which forced them to sell their shares. Derivative actions are however intended for the company’s benefit, their proceeds therefore go to the company and not the shareholder who institute the action. In light of this, it is difficult to see how a former shareholder can have sufficient interests in a company where it is no longer a

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<sup>34</sup> *Prudential Assurance Co Ltd* (n 26) 210.

member and would therefore not benefit from any award made to the company. There is therefore arguably no reasonable basis for allowing past members to institute derivative actions.

While it may be argued that this stage is merely the application for leave stage and should be made as open as possible, there is still a need to curb unnecessary applications which are potentially distracting for the directors who have to defend them. Past members are more likely to commence derivative actions for reasons such as personal vendetta rather than more altruistic reasons. There is therefore a need to reduce the likelihood of this happening by restricting such actions to only current members who potentially have interests in the company's welfare rather than past members who may not be genuinely concerned about its interests.

#### **6.3.1.2 Directors or Officers of the Company (Present and Former)**

CAMA allows both present and former directors and officers of the company to bring derivative actions. The first question here is whether former directors of a company have sufficient interest in it to justify bringing a derivative action. The argument stated in the previous section in respect of granting former shareholders permission to bring derivative actions also applies here. Former directors are more likely to bring derivative actions due to personal vendetta or to get even with some other directors rather than due to genuine interest in the company. Hence, they should be disallowed from bringing derivative actions as they cannot be regarded as having sufficient interest in the corporation.

Concerning current directors' rights to bring derivative action, the first issue that comes to mind is whether this is justifiable in light of the general litigation powers which have already been granted to the board as a whole.<sup>35</sup> One therefore wonders

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<sup>35</sup> See CAMA, s 63(3).

whether directors, who are not shareholders, should be given standing to commence derivative actions. While the board generally has litigation powers, there is a case for allowing individual directors to bring derivative actions. Certain groups of directors within the board may control board decisions and may therefore be able to effectively prevent the board from bringing enforcement action against a director who has committed a breach. This would be the case where, say, several board members have familial relationship with the director who has committed a breach. In this instance, there would be a general reluctance to redress the wrong. Informational asymmetries also exist in many companies, especially large public listed companies;<sup>36</sup> shareholders are therefore unlikely to be aware that a breach has occurred. In such circumstances, it would be beneficial for the director who is aware of the breach to commence a derivative action to redress a breach.

### **6.3.1.3 The Corporate Affairs Commission**

The Corporate Affairs Commission (CAC) is allowed to apply for leave to bring derivative actions. As noted in chapter 4, the CAC has powers to investigate the affairs of a company.<sup>37</sup> In the course of investigating the company's affairs, it may gain knowledge of certain wrongdoing to the company by the directors, which the members may not even be aware of. This power granted to the CAC to bring derivative action is therefore a potentially important enforcement tool, which may be of great advantage to the company. Minority shareholders, especially in large public listed companies, are unlikely to have knowledge of wrongs done to the company by directors. Knowledge of the wrongdoing is however perhaps the most important factor in any enforcement attempt. The CAC may therefore leverage on the

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<sup>36</sup> See W.W Bratton & M. L. Watcher, 'The Case against Shareholder Empowerment' (2010) 158(3) *University of Pennsylvania Law Review* 653, 666 who argue that 'dispersed, diversified shareholders labour under informational asymmetries...'

<sup>37</sup> See s4.6.1.1.

knowledge obtained in the course of investigating the company's affairs in order to seek redress on behalf of the minority shareholders who cannot do so themselves.

#### **6.3.1.4 Proper Persons**

Section 309(d) allows the court to permit any other person who in its discretion it believes to be a 'proper person' to apply to bring a derivative action. What this provision essentially means is that any person may be allowed to bring a derivative action as long as the court considers him or her to be a proper person to do so. This 'proper persons' category is however quite ambiguous. It contains no criteria which will guide the courts in its decision on whether or not a person is a 'proper person' to bring a derivative action. While the courts have the discretion to refuse permission in cases where it does not consider the applicant a proper person, the presence of this provision in CAMA potentially leaves directors open to litigation from different parties. Some criteria to guide the courts in its decision would therefore be preferable.<sup>38</sup>

#### **6.3.2 Procedure for Commencing Statutory Derivative Actions**

In order to bring a derivative action, the applicant must first apply for leave of court to do so. The application for leave to bring a derivative action is required to be by originating summons on notice to the directors. This was the decision of the court in *Agip Nig. Ltd v Agip Petrol Int'l*<sup>39</sup> where the applicant had applied for leave to bring a derivative action by means of a writ of summons and ex parte application to prevent

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<sup>38</sup> An example of a criteria that can be used to determine a proper person would be that of 'direct financial interest' which was used in the Canadian case of *Re Daon development corporation* (1984) 54 B.C.L.R 235 (S.C) where it was held that 'proper persons' '...have a direct financial interest in how the company is being managed and are in a position – somewhat analogous to minority shareholders – where they have no legal right to influence or change what they see to be abuses of management of conduct contrary to the company's interest'.

<sup>39</sup> (2010) 5 NWLR (pt. 130). This decision is in line with Rule 2 of the Companies Proceedings Rules 1992 which provides in s2(1) 'except in the case of the application mentioned in rules 5 and 6 of these rules and application made in proceedings related to the winding up of companies, every application under the Act, shall be made by originating summons'.

the alienation of the company's shares to another party. The court held that an applicant for leave of court to commence derivative action must do so by originating summons on notice to the company in order to enable the company or its directors present their view of the case. The company must also be made a defendant to the claim in order to ensure that it will be bound by any judgement given.<sup>40</sup> As mentioned in section 6.3, applicants for leave to bring derivative actions are required to satisfy certain criteria. These will be discussed in turns below.

### **6.3.2.1 Wrongdoer Control**

As noted above, an applicant seeking to bring a derivative action is required to establish wrongdoer control. The 'wrongdoer control' requirement is derived from the common law position where minority shareholders seeking to bring derivative actions were required to show that the wrongdoers themselves are in control and would not take any action to redress their own wrong.<sup>41</sup> The wrongdoer control requirement was intended to provide an avenue for minority shareholders to seek redress against directors' breach in circumstances where the wrongdoers are in control and would ordinarily not allow the company to sue.<sup>42</sup> Therefore where the shareholder bringing a derivative action holds a majority of shares (51% and above) there would presumably be no justifiable reason why a derivative action should be allowed. The majority shareholder can simply bring the action in the name of the company in exercise of powers granted by s63 (5)b CAMA.<sup>43</sup> In this regard, the wrongdoer control requirement prevents shareholders from suing derivatively in circumstances which would amount to an abuse of the derivative action remedy.

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<sup>40</sup> See also *Abubakri v Smith* (1973) 6 S.C 24.

<sup>41</sup> See *Edwards v Halliwell* (n 26).

<sup>42</sup> See *Prudential Assurance Co Ltd* (n 26) 211.

<sup>43</sup> CAMA, s63 (5) b allows members in general meeting to institute proceedings on the company's behalf where the board of directors refuse to do so.

While the wrongdoer control requirement has its benefits in preventing abuse of the derivative action remedy, it nevertheless produces several difficulties and therefore acts as an obstacle in the path of shareholders seeking redress for the company. The major difficulty with the wrongdoer control requirement is that the concept itself is quite vague and imprecise. The pertinent question is what exactly is wrongdoer control and how can it be proven? Traditionally under the common law, the wrongdoer control condition required that the wrongdoers had ‘de jure’ control, meaning a majority of voting shares,<sup>44</sup> and were using that majority to secure a particular course of action in spite of the plaintiff’s expressed objections.<sup>45</sup> The difficulty with this approach is however particularly evident where the company is ‘widely’ owned.<sup>46</sup> In small private companies, it is conceivably easier to prove ‘de jure’ control by the wrongdoing directors. In larger companies, however, it would be especially rare for the directors, either singly or collectively, to own a majority of shares. Strict *de jure* control by the wrongdoing directors is therefore highly unlikely.<sup>47</sup> Worse still, in larger companies it is common for many shares to be held by nominees and trustees, such that it becomes extremely difficult for an individual shareholder to prove who controls the shares, or whether some shareholders are connected with, or have been influenced by, the wrongdoers.<sup>48</sup> Similarly in any listed company there will always be a significant number of shareholders who do not vote

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<sup>44</sup> See K.W Wedderburn, ‘Derivative actions and Foss v Harbottle’ (1981) 44 Modern Law Review 202, 205.

<sup>45</sup> S Watkins, ‘the Common Law Derivative Action: An Outmoded Relic’ (1999) 30 Cambrian Law Review 40, 51.

<sup>46</sup> ‘Widely’ owned means that ownership is in the hands of very many shareholders, each of whom likely owns only a small proportion of the total share capital.

<sup>47</sup> A.J Boyle, *Minority Shareholder Remedies* (Cambridge University Press) 27.

<sup>48</sup> Reisberg, *Derivative Actions* (n 22) 92.

at all, such that control can often easily be exercised with as little as 20% or 30% of votes.<sup>49</sup>

Directors may also exert significant control over the outcome of a shareholder meeting even without holding any substantial shares in the company. Control could be attained by coercion, undue influence, familial relationship, friendship ties to majority shareholders, bribery of majority shareholders to mention a few. For example, in a public company, a person can control votes if shareholders are made to believe that he can turn around good profit for the company. In such cases, although the shareholders exercise their right to vote, those votes have been tainted by the wrongdoers inducement as the shareholders are unlikely to vote against the wishes of that person.<sup>50</sup> Independent shareholders can also be coerced or pressured to vote in a particular way or may be made to vote on a resolution in respect of which they lack complete information.<sup>51</sup>

The difficulty with the wrongdoer control requirement was recognised in the case of *Prudential Assurance Co Ltd v Newman Industries Ltd (no 2)*<sup>52</sup> where the Court of Appeal stated that control ‘...embraces a broad spectrum extending from an overall absolute majority of votes at one end, to a majority of votes at the other end made up of those likely to be cast by the delinquent himself plus those voting with him as a result of *influence* or apathy’. The Court of Appeal in that case therefore expanded the concept of control from strictly de jure, to ‘de facto’<sup>53</sup>, control.

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<sup>49</sup> Ibid 93.

<sup>50</sup> Ibid 92.

<sup>51</sup> Watkins, (n 45) 51.

<sup>52</sup> [1982] Ch 204, 219.

<sup>53</sup> ‘De-facto’ control may include situations where the directors manipulate the proxy voting system to their advantage, or where they exercise some control over the manner in which votes are cast, or where they deceive the voters by distorting their view of the facts of the case such that they are unable to make an informed decision. See L.S Sealy, ‘Foss v Harbottle- a Marathon where Nobody Wins’ (1981) 40(1) Cambridge Law Journal 29, 30.



However, even this idea of ‘influence’ advocated by the Court of Appeal is itself ambiguous and cannot be easily proven. It is very difficult to conceive of all the means through which wrongdoing directors can influence a general meeting and obtain a favourable decision. Furthermore, fundamental information asymmetry problems exist in many public companies such that directors usually possess more information than shareholders do.<sup>54</sup> While in small private companies, it might be easier to prove *de facto* control, the same cannot be said of large public companies. Except in very small companies where the shareholders may, presumably, know each other’s personal circumstances, it would be hard for a shareholder to know whether other shareholders have been subject to some influence or control by the directors. This problem is further exacerbated by a system where bribery and corruption are familiar problems. Directors can therefore easily pay bribes to majority shareholders ahead of general meetings in order to secure a favourable vote.

The requirement to prove wrongdoer control poses many practical difficulties as highlighted above and places applicants seeking to bring derivative action in an incredibly difficult and disadvantageous position. It is extremely burdensome and an unnecessary hurdle in the way of shareholders seeking redress for wrongs done to the company. It is also merely a relic of Nigeria’s common law heritage and should therefore be expunged from CAMA in order to properly meet the ends of justice.

#### **6.3.2.2 Reasonable Notice**

CAMA provides that an applicant for leave to bring a derivative action must show that reasonable notice has been given to directors of the intention to bring a derivative action if they (the directors) fail to institute legal proceedings.<sup>55</sup> Derivative actions have the effect of depriving directors of the right to exercise their powers to make

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<sup>54</sup> See Bratton & Watcher, (n 36) 666.

<sup>55</sup> CAMA, s303(2) b.

litigation decisions; hence, it is arguably justifiable that they should be given notice of an intention to commence derivative actions. Directors should be given the opportunity to exercise their power to institute litigation themselves before any other person does so on the company's behalf.<sup>56</sup> It can also be argued that the reasonable notice requirement is beneficial as it can help prevent frivolous and unfounded litigation. The major problem with this reasonable notice requirement however is that it fails to specify what exactly constitutes 'reasonable notice'. Several questions also arise in this regard such as who should be given the notice? Is it sufficient to serve notice on the erring director or should the entire board be put on notice? What form should the notice take? How much notice period should be given to directors? These are questions which require answers that are not found in the CAMA or Nigerian case law. Hence an applicant seeking leave to bring a derivative action is left confused as to the right steps to take and also faces a huge possibility that leave will be refused for failing to give reasonable notice; even though no guidance is given regarding what exactly this means. This provision might be contrasted with the Canadian provision on the subject. Section 239(2a) of the Canada Business Corporations Act (CBCA) 1985 specifies both the length of notice that must be given (at least fourteen days'), and the addressee of the notice (the directors of the corporation or its subsidiary). A similar provision would be highly beneficial in providing guidance to prospective claimants in Nigeria.

Another possible concern with the reasonable notice requirement to directors is that it may give directors ample opportunity to cover their tracks or to reorganize their

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<sup>56</sup> Allowing the board to sue, where it is willing to do is also in line with section 63(3) CAMA which provides that the board of directors may exercise all the powers of the company except those which have been expressly vested by the articles in the general meeting.

affairs in a way that will prevent detection of their wrongdoing.<sup>57</sup> Directors may also exercise their powers to take over such proceedings with the intention of doing so in a sloppy manner thereby preventing any proper redress of the wrong done. One further concern with the 'reasonable notice' requirement is that it is absolute. CAMA does not provide exceptions or flexibility in cases where it will be impracticable to give notice to the directors. There may however be instances where it is practically impossible to serve notice on directors or where it will be a futile venture to expect directors to make an independent and unbiased decision in respect of the issue.<sup>58</sup> Some flexibility to enable the court waive this requirement where necessary would be therefore more helpful than a compulsory requirement for all applicants to give notice.

### **6.3.2.3 Good Faith**

An applicant for leave to bring a derivative action must show that she is acting in good faith. The good faith requirement appears to have been derived from the equitable doctrine that he who comes to equity must come with clean hands. Applicants will therefore generally be disallowed from benefitting from their own misconduct.<sup>59</sup> Hence, in *Towers v African Tug Co*<sup>60</sup> it was held that a shareholder in a company who has benefitted from the proceeds of an *ultra vires* act committed by the directors with full knowledge of the facts could not then maintain an action against those directors. The good faith requirement is common in most common law

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<sup>57</sup> K Aina, 'Current Developments in The Law on Derivative Action in Nigerian Company Law' <[http://www.academia.edu/7175946/CURRENT\\_DEVELOPMENTS\\_IN\\_THE\\_LAW\\_ON\\_DERIVATIVE\\_ACTION\\_IN\\_NIGERIAN\\_COMPANY\\_LAW](http://www.academia.edu/7175946/CURRENT_DEVELOPMENTS_IN_THE_LAW_ON_DERIVATIVE_ACTION_IN_NIGERIAN_COMPANY_LAW)>, 13 accessed 24<sup>th</sup> August 2016.

<sup>58</sup> *ibid* 13.

<sup>59</sup> E.C Mujih, 'The New Statutory Derivative Claim: A Paradox of Minority Shareholder Protection: Part 2' (2012) 33(4) *Company Lawyer* 99,101.

<sup>60</sup> [1904] 1 *Ch.* 558.

jurisdictions that have a statutory derivative action regime.<sup>61</sup> The term good faith is not described in CAMA and indeed can hardly be defined with precision. As Reisberg notes that ‘the definition of good faith is somewhat tortuous and indirect’.<sup>62</sup> Its exact meaning would usually depend on the context of the case and as such, its determination is better left to the court’s discretion.

In Nigeria, there are no reported cases on good faith within the context of derivative actions, however generally the courts have held that an action is in good faith where it has been done ‘honestly’, irrespective of whether it has been done negligently.<sup>63</sup> In examining what good faith means within the context of derivative actions, it is helpful to examine decisions on the subject from courts in other jurisdictions. In determining ‘good faith’ for the purposes of a derivative action, the court may consider two issues. First, the court may consider whether the applicant has an honest belief that there are good grounds for the complaint and that the action has a reasonable chance of success. Second, it will consider whether the claimant has some collateral purpose in bringing the action which would amount to an abuse of process.<sup>64</sup> In order to satisfy the ‘good faith’ condition, it has been held that the derivative action should be brought *bonafide* in the company’s interests and not for some ulterior purpose. Hence, in the English case of *Barrett v Duckett*<sup>65</sup> the Court of Appeal held that the claimant had an ulterior motive in bringing the derivative action which was not being pursued in the company’s best interest but rather as a result of

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<sup>61</sup> See Canada Business Corporations Act RSC 1985 c C-44, s 239(2) b; UK Companies Act 2006, s263(3) a.

<sup>62</sup> A Reisberg, ‘Theoretical Reflections on Derivative Actions in English Law: The Representative Problem’ (2006) 3(1) European Company and Financial Law Review 69,102.

<sup>63</sup> See *Shodeinde v Reg. trustees of Ahmadiya* (1983) LPELR-3064 (SC).

<sup>64</sup> J.P Sykes, ‘The Continuing Paradox: A Critique of Minority Shareholder and Derivative Claims under the Companies Act 2006’ (2010) 29(2) Civil Justice Quarterly 205-234, 219. See also A Keay and J Loughrey, ‘Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action under the Companies Act 2006’ (2008) 124 Law Quarterly Review 469, 489.

<sup>65</sup> [1995] B.C.C 362.

the matrimonial dispute between the applicant's daughter and the defendant. The action was refused because it was not brought *bonafide* rather it was brought because of personal vendetta.

Ill feelings alone would however usually not be considered as evidence of bad faith as to decide otherwise would frustrate derivative actions in a large number of cases.<sup>66</sup> As Palmer J noted in the Australian case of *Swansson v Pratt*<sup>67</sup> that 'it is not the law that only a plaintiff who feels goodwill towards a defendant is entitled to sue'. Hence, the fact that there is some animosity between the applicant and the defendant is not sufficient evidence of bad faith. However where the action is solely motivated by personal vendetta, good faith would be considered absent.<sup>68</sup> The court in determining an applicant's good faith may also consider whether the applicant has come with clean hands.<sup>69</sup> An applicant will not be regarded as a proper person to bring a derivative action where the applicant's conduct is tainted or where the applicant has knowingly benefitted from the wrongdoing that is now being complained.<sup>70</sup>

In addition to this, it has been held by the English Court of Appeal that a derivative action ought to be brought for the company's benefit and not for some other purpose.<sup>71</sup> In spite of this however, the fact that the applicant would get some personal benefit from bringing the derivative action is often not necessarily an evidence of bad faith as long as the main purpose of the action is to benefit the

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<sup>66</sup> J Tang, 'Shareholder Remedies: Demise of the Derivative Claim' 2012 1(2) UCL Journal of Law and Jurisprudence 178,193.

<sup>67</sup> [2002] NSWSC 583; (2002) 42 A.C.S.R 313 @ [41].

<sup>68</sup> One possible problem here is the difficulty in differentiating between an action which is motivated by malice or animosity and that which is motivated by personal vendetta. See Keay and Loughrey (n 64) 487-488.

<sup>69</sup> The 'clean hands' requirement has been criticized by Payne who opines that a derivative action is brought for the benefit of the company therefore the minority shareholder's behavior ought to be irrelevant to the court's decision. See J Payne, "'Clean Hands" in Derivative Actions' (2002) 61(1) Cambridge Law Journal 76, 81.

<sup>70</sup> See *Nurcombe v Nurcombe* (1984) 1 B.C.C 99269.

<sup>71</sup> *ibid* 99273.

company. This was the decision of the court in the English case of *Iesini v Westrip Holdings Ltd*<sup>72</sup> where Lewinson J held that ‘if the claimant brings a derivative claim for the benefit of the company, he will not be disqualified from doing so if there are other benefits which he will derive from the claim’. The most important issue is that the applicant must bring the claim for the company’s benefits even if there are other personal benefits to be derived from bringing the action.<sup>73</sup> It follows therefore that the determination of good faith lies more in the intent or motive behind the derivative action and can only be judged based on individual facts.

#### **6.3.2.4 Interest of the Company**

In order to grant leave to bring derivative action, the court must be satisfied that it ‘appears’ to be in the company’s interests to do so. It is important that derivative actions be allowed only where it is in the company’s interest. This requirement is therefore important in order to sift out vexatious suits or actions that are just intended to harass directors for decisions made in the course of business. Directors may sometimes make business decisions which go awry, they cannot however be dragged to court for every business decision that goes wrong. Hence, it is important to distinguish those actions that may be in the company’s interest from those just intended to subject directors to unnecessary scrutiny. Derivative actions which are not in the company’s interest would lead to a waste of time and resources. They could also make directors overtly cautious and risk averse in making business decisions, which could have an adverse effect on companies as a whole.<sup>74</sup>

In spite of the many benefits of this requirement, it nevertheless comes with its own unique challenges. The first problem here is the difficulty with determining that an

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<sup>72</sup> [2010] BCC 420, 448.

<sup>73</sup> *ibid* 422

<sup>74</sup> See Reisberg, (n 22) 49.

action is in the company's interest at the preliminary stage when the main claim is yet to be litigated. Determination of this issue would invariably entail delving into the merits of the case itself leading to a mini trial at the leave stage, and perhaps even involving the examination and cross-examination of witnesses.<sup>75</sup> This has been the experience in Canada. Kaplan and Elwood note that the 'interests of the corporation' test under the British Columbia Company Act<sup>76</sup> has become a 'significant, costly and time-consuming battleground in leave proceedings'.<sup>77</sup> Parties often 'produce voluminous affidavits, apply for and receive orders to cross-examine on the affidavits, pursue document production motions and opposition' thereby wasting a large amount time and money.<sup>78</sup> Having such a lengthy and inevitably costly trial merely to determine whether an action is in the company's interest is itself hardly in the company's best interests. The very point of applying the 'interest of the company' criterion is to protect the company from being burdened by the cost of unnecessary litigation, not to add to those costs.<sup>79</sup>

A second problem with this criterion lies with the difficulty in the exact determination of the phrase 'interest of the company'. While it is important that a derivative action be allowed only where it is in the company's interest, that 'interest' can hardly be judged with certainty or precision. The interest of the company may be subject to different interpretations depending on the criteria used to judge it. The determination of a company's interest in a derivative action also raises different factual and legal

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<sup>75</sup> F.A. Gevurtz, 'Who Represents the Corporation? In Search of a Better Method for Determining the Corporate Interest in Derivative Suits' (1985) 46 University of Pittsburgh Law Review 265,302. An example of the potential that a preliminary process could lead to a lengthy hearing is seen in the hearings conducted to approve settlement of derivative actions in the USA which have sometimes dragged on as long as proper trials.

<sup>76</sup> Note that the British Columbia Company Act is now replaced by the Business Corporations Act 2002 which came into force in 2004.

<sup>77</sup> W Kaplan Q.C and B Elwood, 'The Derivative Action: A Shareholder's "Bleak House"?' (2003) 36 (3) University of British Columbia Law Review 443,460.

<sup>78</sup> Ibid.

<sup>79</sup> Gevurtz (n 75) 304.

issues for the court's consideration. Some of the issues to be considered include the probability of the plaintiff's success in the action, the potential size of recovery, and the different costs to the company.<sup>80</sup> The costs to the company would include both the financial cost of defending the action as well as other intangible costs such as the potential distraction to the company's personnel, the time lost in defending the action and its impact on the company,<sup>81</sup> the effect of the suit on the employee's morale and the possible negative publicity which might accrue to the company.<sup>82</sup> Another intangible cost that may be considered is the possibility of strained relations with the defendants and the availability of other qualified personnel to replace the defendant if necessary.<sup>83</sup>

All of the issues to be considered by the court in determining the interest of the company would involve substantial discovery and can barely be done without delving into the merits of the case. There are also substantial difficulties in assessing the extent of the intangible costs which will be incurred in bringing a derivative action. Intangible costs such as time lost in pursuing a derivative action and its impact or the adverse effects of the action on the company's employees can hardly be calculated with precision. An additional difficulty with this criterion lies in the wide discretion given to judges to determine whether or not an action is in the company's interest. No criteria are given which may guide the courts in their decision. It therefore leaves room for judicial arbitrariness.

The discussion in this section has shown that each criterion which a prospective applicant is required to satisfy comes with its own unique difficulty. While some such

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<sup>80</sup> Ibid 298.

<sup>81</sup> The directors may be tied up in litigation for a lengthy period detracting them from their real responsibilities to the company.

<sup>82</sup> *Gevurtz* (n 75) 299

<sup>83</sup> *ibid* 299.



as the ‘wrongdoer control’ requirements are inherently problematic and should be expunged, others such as the ‘reasonable notice’ and ‘interests of the company’ requirement are in need of some clarification. Although it is necessary to have some mechanism for screening out frivolous derivative actions intended to waste the company and its directors time and resources, the approach adopted by CAMA is ineffective as it places an undue burden on potential applicants. It is also highly ambiguous leaving room for judicial arbitrariness and corruption to thrive. The Nigerian statutory derivative actions regime is therefore in need of significant reform.

### **6.3.3 Shareholder Approval and Derivative Actions under CAMA**

The preceding section has identified the various weaknesses of the Nigerian statutory derivative actions regime. It is however important to also identify its strengths, if any. One particular strength of the Nigeria’s statutory derivative action is its provision on the effect of shareholders’ approval on derivative actions. This is found in section 305 CAMA which provides that

An application made or an action brought or intervened in under section 303 of this Act shall not be stayed or dismissed by reason only that it is shown that an alleged breach of a right or a duty owed to the company has been or may be approved by the shareholders of such company, but evidence of approval by the shareholders may be taken into account by the court in making an order under section 304 of this Act.

Shareholder approval may generally be in the form of an authorisation or ratification. ‘Authorisation’ occurs where a prospective breach is approved before it occurs (*ex ante*) while ‘ratification’ is said to have taken place where a past breach is approved after its occurrence (*ex post*). The provision of section 305 is to the effect that

shareholder approval is merely a ‘discretionary factor’ that the courts may take into account in deciding whether to grant leave, but which does not preclude leave being granted. Majority shareholders are therefore, in effect, deprived of the power to decide which breaches will be enforced and which ones will be forgiven. In light of this, it may be argued that this provision is prejudicial to the time honoured principle of majority rule which is to the effect that once the majority approves of a breach committed against the company then an individual shareholder is precluded from bringing an action in respect of that breach.<sup>84</sup>

In spite of this however, an argument may be made in support of this provision. Indeed, it can be argued that section 305 is highly beneficial as it prevents the majority from retaining the power to determine which breaches will be enforced thereby potentially compromising the company’s interests.<sup>85</sup> It is easy to imagine instances where the majority will have selfish interests in approving a breach of duty to the detriment of the company’s interests. This is more so in a country like Nigeria where some companies have majority shareholders holding a large percentage of shares.<sup>86</sup> It is therefore possible that one or two majority shareholders who have personal relations with directors may use their large shareholdings to prevent redress of a breach in their own personal interest thereby neglecting the company’s interests. While the principle of majority rule remains a core part of company law and should not be discarded, it should however be applied with some flexibility. Section 305 does not discard this fundamental rule rather it refrains from making it a bar to derivative actions choosing instead to allow judges exercise their discretion in the matter.

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<sup>84</sup> See *Edwards v Halliwell* (n 25).

<sup>85</sup> I.O Bolodeoku, ‘Corporate Governance: The Law’s Response to Agency Costs in Nigeria’ (2006-2007)32 Brooklyn Journal of International Law 467,517.

<sup>86</sup> See section 4.4, chapter 4.

In addition to this, the issue of shareholder approval particularly ratification in derivative actions has been the subject of much debate and uncertainty. Section 305 is therefore highly commendable in its flexible approach as it avoids all the problems associated with an absolute bar approach. Hence all the legal arguments regarding what constitutes a valid ratification and whether the wrongdoers can vote to ratify their wrong do not apply here.<sup>87</sup> The decision is left to the court who can then judge each case on its individual facts rather than a generic bar to derivative actions where the breach has been approved which might lead to injustice in certain cases. Admittedly, the discretion given to the court in this regard may be criticized for its subjective nature which produces some level of uncertainty;<sup>88</sup> nevertheless this does not defeat the beneficial effect of this provision. There will always be some conflict between the need to promote certainty in derivative actions and the need to ensure the ends of justice are met. As noted by Watkins ‘... the balancing of these two legitimate interests may perhaps be seen as the greatest ideological challenge facing proponents of derivative action reform’.<sup>89</sup> In this regard, the need to meet the ends of justice perhaps trumps the need for legal certainty.

The discussion in the last three sections have shown that there are difficulties with the Nigerian statutory derivative actions regime which hinders their effectiveness as an enforcement mechanism. The Nigerian statutory derivative action regime is therefore in need of significant reforms. The pertinent question to ask however is whether these reforms, if executed, would significantly improve the effectiveness of derivative actions as an enforcement regime in Nigeria. This question must be answered negatively. The problems with derivative actions as an enforcement mechanism in

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<sup>87</sup> See C Riley, ‘Derivative Claims and Ratification: Time to Ditch Some Baggage’ [2014] *Legal Studies* 34(4) 582-608 for analysis of the argument on ratification of breaches of directors’ duties.

<sup>88</sup> See Watkins (n 45) 58.

<sup>89</sup> *ibid* 58

corporate law are not limited to the substantive provisions of the law. Derivative actions are generally fraught with other *inherent* difficulties, which prevents their effective use as an enforcement action in corporate law. Hence, even if necessary reforms were carried out to the Nigerian statutory derivative actions regime, the future still looks bleak in terms of its ability to serve as an effective enforcement mechanism in corporate law. These inherent difficulties will be the subject of discussion in the next section.

## **6.4 Inherent Difficulties with Derivative Actions as an Enforcement Mechanism.**

Derivative actions are generally fraught with certain inherent difficulties. Several commentators have identified these difficulties. Indeed Parkinson argues that ‘there are motivational and technical problems that deter the bringing of private proceedings, notwithstanding that an action might self-evidently be beneficial to the company’.<sup>90</sup> These ‘problems’ which include lack of incentive, the funding problem and information asymmetry will be discussed in this section.

### **6.4.1 Lack of Incentive**

The fundamental difficulty which hinders shareholders from instituting derivative actions or other private enforcement actions is the lack of incentive to do so. Minority shareholders generally do not have the incentive to bring derivative actions. This incentive problem arises from the fact that a derivative action is an enforcement action brought on the company’s behalf. The company is the real plaintiff in a derivative action and therefore in most cases any damages or other relief obtained

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<sup>90</sup> Parkinson, (n 12) 238.

goes directly to the company.<sup>91</sup> Hence, even when the derivative action is successful, it is the company that benefits from the damages awarded and the claimant may only receive an indirect benefit in the event that the proceedings lead to a rise in share price.<sup>92</sup> This sort of pro rata gain is not even guaranteed as a successful derivative action may lead to a reduction in share value and not an increase possibly due to bad publicity associated with the case or loss of confidence in the directors' abilities.<sup>93</sup> Hence, shareholders generally lack the incentive to commence litigation for claims in respect of which they cannot directly benefit.<sup>94</sup>

In addition to the fact that claimant shareholders do not directly benefit from instituting derivative actions, they are further faced with the 'free rider' problem. The free rider problem arises because shareholders who do not participate in bringing the litigation or bear any risk involved in litigating will benefit from the claim if it is successful. This may cause shareholders to refrain from litigating in order to prevent other shareholders from benefitting from their efforts or even in the hope that someone else will commence the enforcement action.<sup>95</sup> A minority shareholder who seeks to bring a private enforcement action would have to spend considerable time and effort in investigating the board's activities and then pursuing the enforcement action.<sup>96</sup> After expending the time and effort involved in litigating, other shareholders easily freeride on the activist shareholders' efforts. Therefore, where the action

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<sup>91</sup> A Reisberg, 'Funding Derivative Actions: A Re-Examination of Costs and Fees as Incentives to Commence Litigation' (2004) 4(2) *Journal of Corporate Law Studies* 345,347.

<sup>92</sup> See Reisberg, 'Derivative Actions and Corporate Governance' (n 21) 222. See further B R Cheffins, 'Reforming the Derivative Action: The Canadian Experience and British Prospects' (1997) 2 *Company Financial and Insolvency Law Review* 227, 257-258.

<sup>93</sup> A Reisberg, 'Derivative Actions and the Funding Problem: The Way Forward' (2006) *Journal of Business Law* 445,446.

<sup>94</sup> J Lee, 'Shareholders Derivative Claims under the Companies Act 2006: Market Mechanism or Asymmetric Paternalism?' (2007) 18(11) *International Company and Commercial Law Review* 378,389.

<sup>95</sup> *ibid* 389.

<sup>96</sup> Parkinson (n 12) 241.

succeeds, all the shareholders benefit including those who did nothing. A prospective plaintiff who is aware that the company and other shareholders will free ride on his efforts is unlikely to have an incentive to sue. He is more inclined to leave it to someone else to do the 'dirty work'. However if all shareholders share this view, then the likelihood of getting a shareholder who will take the bold steps to institute litigation is quite slim.<sup>97</sup> The incentive problem is therefore one of the biggest difficulties preventing shareholders from bringing derivative actions which cannot be resolved even by reform of the rules governing derivative actions.

#### **6.4.2 The Cost Problem**

The question of costs in derivative actions is an important issue in any discussion of derivative actions. This is because it affects, to a large extent, the impetus to use derivative actions as a mean of seeking redress for directors' misconducts. As Reisberg has pointed out that 'litigation is expensive' and cost represents a major obstacle preventing shareholders from bringing derivative actions to enforce rights due to the company.<sup>98</sup> The question of cost will therefore often be the first factor which would influence a shareholder's decision whether or not to pursue a derivative action.<sup>99</sup> The significance of the cost issue was also recognised by Kershaw who argued that the extent to which derivative actions would function as an effective enforcement mechanism depends not only on the rules providing access to derivative actions but also on the rules which determine who bears the legal costs of instituting derivative actions.<sup>100</sup>

CAMA makes some provision for reimbursing the costs incurred in bringing derivative actions. Section 304(2)d CAMA provides that the company may be

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<sup>97</sup> Arad Reisberg, 'Derivative Actions and the Funding Problem' (n 93) 446.

<sup>98</sup> Reisberg, 'Derivative Actions and Corporate Governance' (n 22) 222.

<sup>99</sup> Tang, (n 66) 202.

<sup>100</sup> Kershaw (n 7) 631.

ordered to pay ‘reasonable legal fees’ incurred by the applicant in connection with the derivative action. The court is also given the power to order the company to pay ‘interim costs’ to the applicant even before the final disposition of the action.<sup>101</sup> There are however certain problems with this indemnity provision contained in CAMA. The first is in regards to the fact that the court’s power in indemnifying the plaintiff for costs incurred is merely discretionary. Hence, there is no guarantee that the court will order reimbursement of legal fees. This is a major problem for an applicant considering bringing a derivative action because in the event that the court decides not to make an indemnity cost order, the applicant will be faced with a mountain of legal fees to deal with. This provision also does not specify whether the outcome of the case may have any bearing on the grant of the cost order.<sup>102</sup> In addition to this, the provision clearly stipulates that the company will only be ordered to pay ‘reasonable legal fees’. This is however problematic as the term is itself ambiguous, one therefore wonders what amount would be considered ‘reasonable’ by the courts.

Aside from the specific difficulty with the indemnity cost order provision in CAMA, indemnity cost orders generally do not provide any incentive for shareholders to bring derivative actions. Therefore, while it is sometimes believed that indemnity cost orders can provide a substantial incentive to use derivative actions, this is not the case. As argued by Reisberg that the view that indemnity cost orders can increase shareholders’ incentive to litigate ‘ignores the realities of derivative action litigation’.<sup>103</sup> He argues that providing an indemnity order does not cure the funding problem neither does it provide a strong incentive to litigate. Shareholders who bring

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<sup>101</sup> CAMA s308.

<sup>102</sup> The Nigerian Law Commission’s recommendation was however that an individual who brings a derivative action should be indemnified for costs whether he wins or not. This is however subject to the discretion of the court. See Nigerian Law Reform Commission Working Paper (n 32) 239.

<sup>103</sup> Reisberg: ‘Derivative Actions and the Funding Problem’ (n 93) 447.

derivative actions have very little to gain from it even if the action is successful.<sup>104</sup> A derivative action, as noted earlier in this chapter, is intended to be used to redress wrongs done to the company as a whole. Hence, even when the litigation is successful, the damages are awarded to the company. The applicant in a derivative action is therefore in a very precarious position, as there are no direct personal benefits from bringing a derivative action rather the applicant faces the prospects of incurring significant costs. If the derivative action is successful the company as a whole benefits, however the increase in the value of the shareholder's shares is unlikely to be sufficient to justify all the efforts involved in bringing the derivative action.<sup>105</sup> In addition to this, the applicant is faced with the prospects of paying not only his own legal fees but also that of the other party if he loses the case. This is based on the fact that in many common law jurisdictions, including Nigeria, 'costs follow events'.<sup>106</sup> Thus, the applicant may have to pay not only his own legal costs, but also that of the other party. In these circumstances, there is a real incentive for prospective applicants to decide to do nothing, but rather wait for someone else to take action to redress the wrong done.

The cost problem causes general difficulty with the derivative actions regime even in the presence of a suitable legal framework governing it. Commenting on this difficulty with regards to Australia, Tomasic opines that the failure of private enforcement actions for breaches of Australian corporations' law has been attributed to the costs of bringing such enforcement actions and the evidentiary problems faced by those who litigate such cases.<sup>107</sup> The cost problem is therefore a fundamental

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<sup>104</sup> *ibid* 447.

<sup>105</sup> Parkinson (n 12).

<sup>106</sup> See *Akinbobola v Plisson Fisko (1991) 1 NWLR (pt 167) 270; NNPC V CLIFCO Nig. Ltd. (2011) 4 S.C (Pt 1) 108.*

<sup>107</sup> R Tomasic, 'Corporations Law Enforcement Strategies in Australia: The Influence of Professional, Corporate and Bureaucratic Cultures' (1993) 3(2) Australian Journal of Corporate Law 192,221.



aspect of private enforcement actions which cannot be easily resolved. Attempts to increase private enforcement actions simply by indemnifying the plaintiffs for their costs or lowering the procedural requirements faced by shareholders are therefore unlikely in themselves to secure a significant increase in private enforcement actions.<sup>108</sup>

### **6.4.3 Information Asymmetries**

Another problem which makes it difficult to effectively enforce breach of corporate law using derivative actions is the lack of access to information by potential litigant shareholders. Enforcement of a standard requires not only information regarding the standard but also information about its breach.<sup>109</sup> Shareholders however often lack sufficient information about directors' misconduct to enable proper enforcement. Information asymmetries exist in companies, especially public listed companies, which makes it difficult for shareholders to get access to full information about any issue.<sup>110</sup> Management, to a certain extent, determine the type of information that shareholders receive hence shareholders may feel that they are too uninformed or not in the best position to question management.<sup>111</sup> Directors also know the amount of harm caused by their misconduct while shareholders do not.<sup>112</sup> Therefore, even where shareholders have become aware of a problem possibly through press speculation or 'whistle blowing', they are faced with the difficulty of gathering sufficient information to enable them prove the wrongdoing. This can be particularly important in derivative actions as most of the information would be in the hands of the

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<sup>108</sup> Parkinson (n 12) 242.

<sup>109</sup> V Finch, 'Company Directors: Who Cares About Skill and Care?' (1992) 55(2) *The Modern Law Review* 179, 180.

<sup>110</sup> G Proctor and L Miles, 'Unresponsive Shareholders in Public Companies: Dial "M" For Motivate?' (2000) 21(5), *Company Lawyer* 142,143.

<sup>111</sup> *ibid* 143.

<sup>112</sup> Reisberg, 'Derivative Actions and Corporate Governance' (n 22) 86.

directors.<sup>113</sup> Shareholders therefore often lack the information which is needed to build a strong derivative action case. Directors on the other hand have access to all the information and in house counsels (legal advice) to which shareholders do not have access. Consequently, shareholders are in a particularly weak position with regards to assessing the strength of their claim against directors.<sup>114</sup>

Although shareholders receive information about the company through the company's annual reports and other company documents circulated to them as well as through the general meetings, these sources of information are often inadequate.<sup>115</sup>

While the profit and loss account may reveal poor performance, it will not identify the particular businesses or transactions that resulted in that poor performance.<sup>116</sup> The directors' report is also unlikely to be of help in this regard. Cases of directors' malpractice are therefore not likely to be brought to the members' attention. Similarly, auditors owe no duty to investigate management's effectiveness or to comment on business decisions made by directors. Therefore, even auditors are unlikely to be a good source of information about managerial misconduct.<sup>117</sup>

In addition to this, shareholders do not have a general right to information about the company's affairs besides from information which the company is statutorily required to disclose. Shareholders also often have only limited rights with respect to inspection of company documents and indeed have no right to inspect certain company files. Similarly, opportunities to ask questions at the annual general meeting are unlikely to

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<sup>113</sup> *ibid* 86.

<sup>114</sup> Lee (n 94) 390.

<sup>115</sup> These sources of information will not provide a claimant shareholder with the evidence needed to bring a lawsuit. See further LCB Gower, 'Some Contrasts between British and American Corporations Law' (1956) 69(8) *Harvard Law Review* 1369, 1387.

<sup>116</sup> Parkinson (n 12) 243.

<sup>117</sup> *Ibid* 244.

be of much use in these instances.<sup>118</sup> Therefore shareholders suffer from severe ‘informational disadvantages’ when compared to the board.<sup>119</sup>

In the face of all this overwhelming difficulties the incentive problem, the cost problem, and information asymmetries, most shareholders would consider it better to transfer their shares rather than litigate. The question then is if most shareholders would rather not litigate as it is considered a better option to transfer the shares, how is effective enforcement to be attained using derivative actions? While Nigeria’s statutory derivative actions regime suffers from several defects and is in need of substantial reform, these reforms, if done, are still unlikely to lead to any significant increase in the use of this enforcement mechanism. Derivative actions, as an enforcement mechanism, are inherently problematic due to the various issues which have been discussed above. It is therefore doubtful whether it can be an effective enforcement mechanism in corporate law.

## **6.5 Effectiveness of Derivative Actions as an Enforcement Mechanism in Nigeria**

This section will examine whether derivative actions have the potential to be, an effective enforcement mechanism. The criteria which will be used to judge the effectiveness of derivative actions as an enforcement mechanism are those set out in section 3.7 of chapter 3. These are deterrence, compensation and cost-effectiveness.

### **6.5.1 Deterrence and Compensation**

As discussed in chapter 3, for an enforcement mechanism to be considered effective, it must be able to deter the offenders and/or compensate the victims of the

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<sup>118</sup> Ibid 245.

<sup>119</sup> Reisberg, ‘Derivative Actions and Corporate Governance’ (n 22) 86.

wrongdoing. It is therefore worth considering whether the derivative actions remedy can be an effective means of deterring offenders or obtaining compensation.

Deterrence generally depends on the severity, certainty, variety and celerity of sanctions.<sup>120</sup> In order for an enforcement action to sufficiently deter, the sanctions accompanying it must be sufficiently severe. Similarly, the variety, certainty and celerity of sanctions must be sufficiently high.<sup>121</sup> As seen in chapter 5, criminal enforcement falls short with regards to these criteria as the certainty of sanctions in the criminal enforcement regime is very low. Similarly, delays in the judicial process also means that criminal sanctions are very often not swiftly applied. Therefore, while criminal sanctions are severe, they fall short with regards to the other criteria.

Derivative actions are a civil enforcement mechanism. Therefore, they are not plagued with some of the difficulties confronting criminal enforcement. For example, the standard of proof in civil proceedings is generally based on the balance of probabilities, rather than proof beyond reasonable doubt, which obtains in criminal proceedings.<sup>122</sup> Similarly, most of the other protections available to a defendant in criminal proceedings do not apply in civil litigation.<sup>123</sup> Therefore, derivative actions are arguably in a better position as an enforcement mechanism in comparison to criminal enforcement actions.

In spite of this however, there are several reasons which hinder the deterrent effect of derivative actions as an enforcement mechanism. The first factor to be considered is the severity and variety of sanctions. Derivative actions are a private civil

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<sup>120</sup> See section 3.5.1, Ch. 3.

<sup>121</sup> Certainty of sanctions refers to the probability or likelihood that breach will be enforced and punished while ‘celerity’ of sanctions refers to the speed with which sanctions are imposed after a breach.

<sup>122</sup> See Part IX of the Evidence Act 2011 for the burden and standard of proof required in both civil and criminal cases. See also J Auburn, ‘Burden and Standard of Proof’ in Hodge M Malek & ors (eds), *Phipson on Evidence* (16<sup>th</sup> edn, Sweet & Maxwell 2005) chapter 6.

<sup>123</sup> For example, the principle of *mens rea* does not apply in civil proceedings.

enforcement action therefore, the reliefs, which are obtainable, include damages, injunctions or declarations. The sanctions available in respect of private civil enforcement actions are quite varied however; they have a limited range in terms of their varying level of severity. More particularly, damages in commercial cases (including derivative actions) are generally compensatory rather than punitive,<sup>124</sup> therefore they are unlikely to be sufficiently severe to deter future offenders, as they are not intended to punish.

Certainty of sanctions is also a crucial determinant of the deterrent effect of an enforcement action. In order for an enforcement action to have a deterrent effect, there has to be a good likelihood that a sanction will actually be imposed where an offence is committed. Therefore, where there is little or no probability that the sanction will be imposed; the enforcement action is unlikely to reasonably deter potential offenders. A search of the law reports database in Nigeria has however revealed that there has been *no* successful derivative action case brought under the statutory derivative actions regime.<sup>125</sup>

As discussed in section 6.3, the statutory derivative actions regime in Nigeria has several shortcomings, which hinder its use as an enforcement mechanism. Section 6.4 has however further revealed that the difficulties with the derivative action regime are not limited to the legal framework governing it. Therefore, while changes in the legal framework-governing derivative actions may slightly improve the use of this enforcement mechanism, as will be seen in chapter 10, they are unlikely to lead to any substantial increase. This is because the difficulties discussed in section 6.4 above do not relate to the substantive provisions of the law governing derivative

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<sup>124</sup> Jill Poole, *Textbook on Contract Law* (9<sup>th</sup> edn, OUP 2008) 351.

<sup>125</sup> Search was carried out through the law pavilion database which is considered to be the most comprehensive law reports database in Nigeria.

actions, rather they are problems which are inherent in derivative actions. Therefore, even if Nigeria were to reform its current derivative action regime, this is unlikely to lead to a significant increase in effective enforcement of corporate law. The ‘certainty of sanctions’ associated with derivative actions is therefore low. In light of the low certainty of sanctions which pervades derivative actions in Nigeria, it follows that the ‘celerity’ of sanctions (speed with which sanctions are imposed) is also low. This problem is further compounded by the fact that the Nigerian judicial system is characterised by delay in disposal of cases.<sup>126</sup> Consequently, in the unlikely event that a derivative action is instituted in the court, they are unlikely to be quickly determined.

Derivative actions in Nigeria therefore lack a deterrent effect on potential offenders; consequently, they cannot be regarded as an effective enforcement mechanism in Nigeria. While it may be argued that the defects in the Nigerian statutory derivative action regime can be redressed through a comprehensive reform process, the discussion in this chapter has shown that the difficulties with derivative actions as an effective enforcement mechanism run very deep. They cannot therefore be fully redressed simply by changing the content of statute. This conclusion will be further reinforced in chapter 10 when we examine the UK as a case study of a country, which has undergone a comprehensive reform of its derivative action regime. Therefore, while some may argue that the deterrent effect of the derivative action regime can be improved by changing the law in that regard, evidence from other jurisdictions that have attempted similar reforms shows that this is not the case.

With regards to derivative action’s compensatory effect, it must be noted that the availability of compensation generally depends on the claimant’s success in the legal

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<sup>126</sup> For a further discussion of this, see s 5.4.2, Ch. 5.

action. Therefore, where derivative actions are very rarely brought or only unsuccessful where brought, there is no likelihood that compensation will be obtained. This appears to be the case with derivative actions. Hence derivative actions and indeed private civil enforcement generally, cannot be relied on to deliver either effective deterrence or compensation. It is therefore not a primarily effective enforcement regime for corporate law in Nigeria as it is unable to meet the key purposes of enforcement.

### **6.5.2 Cost Effectiveness**

As discussed in section 3.7.2, an effective enforcement action must be cost effective. In terms of benefits offered, private civil enforcement actions may offer both deterrence and compensatory benefits to the company. They may therefore deter both the misbehaving director and other directors from breaching their duties to the company. They may also in certain circumstances offer compensatory benefits to the company.<sup>127</sup> As mentioned above, the derivative actions regime in Nigeria currently lacks both deterrence and compensatory benefits. Similarly, as argued, this is unlikely to change due to the inherent difficulties which hinder the effectiveness of this enforcement mechanism. Therefore, the private enforcement regime in Nigeria currently offers little benefit to the company and its shareholders. This situation is unlikely to change in the near future as discussed in the previous section.

In spite of this apparent lack of benefits, it is still worth considering what the tangible and intangible costs of private enforcement actions are. Private enforcement actions generally have both intangible and tangible costs. The intangible costs would include the potential negative publicity for the company, the ‘chilling effect’ that litigation

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<sup>127</sup> Note Reisberg’s argument about the fact that the compensatory rationale cannot fully justify derivative actions. See A Reisberg, ‘Shareholders’ Remedies: The Choice of Objectives and The Social Meaning of Derivative Actions’ (2005) 6(2) *European Business Organisation Law Review* 227,249

may have on the company's directors causing them to become risk averse<sup>128</sup>, the effect of litigation on directors' productivity,<sup>129</sup> and the possibility of strained relations with the director who has been sued. The tangible costs here connote the financial cost of bringing private enforcement actions. Due to the difficulty with calculating the exact extent of the intangible costs mentioned, focus would be placed here on the tangible costs. It may be argued that private enforcement actions such as derivative actions would generally be more financially cost effective than criminal enforcement actions.<sup>130</sup> In spite of this however, private civil enforcement actions are also very costly to procure. Private civil enforcement actions make use of the judicial system. Therefore, all the financial costs, which are generally associated with legal proceedings, are present. The costs here would include court fees, lawyer's fees, costs of investigating and acquiring necessary evidence as well as other miscellaneous expenses. As mentioned earlier litigation is expensive,<sup>131</sup> it is therefore not generally the most financially cost effective enforcement mechanism.

With regards to the cost- benefit balance of private civil enforcement actions in Nigeria, the costs of bringing this enforcement action clearly outweighs its benefits. As seen in the previous section, the derivative actions regime in Nigeria currently has no deterrent or compensatory benefit. The benefit side of the balance is therefore lacking. With regards to its costs, while the intangible costs of private civil enforcement actions may be ignored on the basis that they may never occur, the same cannot be said of the tangible costs. As mentioned earlier, the financial costs of bringing litigation are significant. An enforcement mechanism which avoids the

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<sup>128</sup> Ibid 252.

<sup>129</sup> For example, litigation may prevent directors from overseeing the company's operation effectively due to the distraction caused. See further Daniel Attenborough, 'Enforcement of Corporate Conduct under the Equitable Maximisation and Viability Principle' (2013) 33(4) *Legal Studies* 650,664. For a full discussion of the demerits (costs) of derivative actions see Reisberg, 'Derivative Actions and Corporate Governance' (n 22) 47-50.

<sup>130</sup> See s5.5.3 chapter 5 for a discussion on the costs of criminal enforcement actions.

<sup>131</sup> Reisberg, 'Derivative Actions and Corporate Governance' (n 22) 222.



financial costs associated with litigation is therefore a more cost effective option when compared to private civil enforcement actions.

In light of this, it has become clear that the private civil enforcement regime falls short with regards to its deterrent effect, compensatory benefit and cost effectiveness. This is however unlikely to change in the future due to the inherent problems with this enforcement regime. The private civil enforcement regime therefore fails to offer a potentially effective regime for enforcement of corporate law in Nigeria. This is not to imply that the private civil enforcement regime plays *no* role in the enforcement of corporate law, however the benefits it offers in terms of increased and effective enforcement of corporate law are sub optimal.

## **6.6 Conclusion**

Many countries rely on private enforcement of corporate law,<sup>132</sup> possibly due to the private nature of this area of law; Nigeria is no exception to this. In spite of this, however, derivative actions have not been particularly successful in securing effective enforcement in Nigeria. In this chapter, we noted a number of problems that currently exist in respect of the Nigerian version of derivative actions, namely the range of persons allowed to bring derivative actions, retention of the common law wrongdoer control requirement, the reasonable notice requirement, and the difficulties which arise as a result of the interest of the company requirement. However, we also noted that, even if these problems were addressed, there would remain a series of difficulties *inherent* in derivative actions as an enforcement mechanism. These include the lack of incentive to bring derivative actions, the cost problem and information asymmetries. The conclusion is inevitable. Irrespective of however ‘well’

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<sup>132</sup> The UK, for example, also relies predominantly on private enforcement of its rules and standards.

derivative actions in Nigeria are reformed, these inherent weaknesses and shortcomings would remain.

Therefore, although derivative actions have certain advantages over the criminal enforcement regime, they cannot, on their own, secure any significant increase in overall enforcement of corporate law in Nigeria. While much of the analysis in this chapter has focused on derivative actions, as it is the key private civil enforcement mechanism in respect of actions against directors for their breach of duty, the shortcomings identified are generally inherent in, and apply to, other private civil enforcement actions. Private civil enforcement, like criminal enforcement, is unable to deliver effective enforcement. Consequently, there is an important need to seek an alternative enforcement regime which has greater potential for delivering effective enforcement of Nigerian corporate law. While it is somewhat impossible to create a perfect enforcement regime, one must seek to create, and focus on, that which offers the greatest potential for effective enforcement. In light of this, the next chapter (chapter 7) will examine the public civil enforcement regime with a view to discovering whether it offers any advantages over both the criminal enforcement and private civil enforcement regimes.

# CHAPTER 7: PUBLIC CIVIL ENFORCEMENT IN NIGERIA

## 7.1 Introduction

As seen in the last two chapters, the criminal enforcement and private civil enforcement regimes suffer from significant weaknesses. While these enforcement regimes are not without their benefits and can indeed make very useful contributions to a country's enforcement system, they are unable to secure effective enforcement of corporate law in Nigeria.<sup>1</sup> This chapter, therefore, turns to the third of our three enforcement regimes, namely the public civil enforcement regime which offers the best potential for effective enforcement of corporate law in Nigeria. It argues that compared to the other enforcement regimes, the public civil enforcement regime is able to deliver effective enforcement of corporate law. It offers effective deterrence, greater potential for securing compensation for victims, and is the most cost effective enforcement regime. It is therefore the best option in terms of meeting the criteria for effective enforcement. In addition to this, the public civil enforcement regime can avoid, or mitigate, many of the difficulties which plague the different enforcement regimes in Nigeria. It is therefore the best and most feasible option for achieving effective enforcement of corporate law in Nigeria within a shorter time frame. Consequently, in reforming its corporate law enforcement regime, there is need for Nigeria to focus those reform activities on *improving* its public civil enforcement regime as it offers the greatest potential for delivering effective enforcement. While this does not preclude subsequent reforms to the criminal and private civil

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<sup>1</sup> As discussed in chapter 3, an effective enforcement regime is one which delivers effective deterrence, compensation, and is cost effective for the enforcer.

enforcement regimes, these are currently less of a priority in light of the fact that they offer less increase in the overall effectiveness of Nigeria's corporate law enforcement.

The term public civil enforcement in this thesis generally refers to *civil* enforcement actions that are undertaken or instituted by *public* regulatory bodies. The sanctions imposed under this regime are considered *civil* in the sense that a lesser standard of proof is generally applicable to actions brought under this regime.<sup>2</sup> The *public* nature of the enforcement regime is also defined by the fact that an official regulatory or enforcement body institutes the enforcement actions in this regime. It is crucial to note that the public civil sanctions discussed under this enforcement regime refer to sanctions that are imposed by regulatory agencies, quasi-judicial bodies as well as the courts.<sup>3</sup> A regime would therefore count as public civil enforcement irrespective of whether or not the sanctions are imposed by the court. Indeed, a key advantage of this regime lies in the fact that sanctions can be imposed by regulatory bodies. The discussion in this chapter is therefore *not* restricted to sanctions imposed by the courts and is indeed largely focused on civil enforcement by regulators.

The chapter begins in section 7.2 by examining the existing public civil enforcement regime in Nigeria, and specifically the public civil sanctions which are imposed on directors under the Investments and Securities Act 2007 (ISA). It also examines the regulatory bodies which are responsible for implementing and enforcing the public civil enforcement regime. Section 7.3 critically analyses the potential theoretical advantages of public civil enforcement over both criminal enforcement and private civil enforcement in terms of the criteria for determining effective enforcement discussed in chapter 3. It argues that the public civil enforcement regime offers

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<sup>2</sup> See Evidence Act 2011, Part IX for the standard of proof required in both civil and criminal cases.

<sup>3</sup> The terms public civil sanctions and public civil enforcement are used interchangeably in this chapter.

several advantages over both the criminal enforcement and private civil enforcement regimes. It is therefore the best enforcement regime for corporate law in Nigeria in terms of delivering effective enforcement. Section 7.4 then specifically examines the Nigerian public civil enforcement regime with regards to the imposition of public civil sanctions on directors for breach of corporate law. It views the Nigerian regime through the lens of its deterrent effect, compensatory benefits and cost effectiveness. It argues that the Nigeria public civil enforcement regime falls short in terms of ‘certainty of sanctions’ as sanctions are hardly imposed on directors. It therefore moves on in section 7.5 to examine the possible reasons for the deficiencies in the Nigerian public civil enforcement regime. In spite of the challenges with the current public civil enforcement regime in Nigeria, Section 7.6 nevertheless argues that the public civil enforcement regime will work in Nigeria. It makes this argument based on the fact that it avoids many of the difficulties which undermine the other enforcement regimes discussed in the last two chapters. It therefore argues that the public civil enforcement regime offers the best potential for increasing, and securing, effective enforcement of corporate law in Nigeria. Finally, it offers some concluding remarks in section 7.7.

## **7.2 Existing Public Civil Enforcement Regime in Nigeria**

Certain public civil sanctions are imposed on directors in Nigeria. These sanctions include disqualification orders, pecuniary penalties, forfeiture, compensation orders and public censure. The provisions of the law imposing these sanctions will be briefly examined here. Similarly, the public regulatory authorities charged with the responsibility of imposing these sanctions will be identified.

### **7.2.1 The Investments and Securities Act 2007 (ISA)**

The Investments and Securities Act 2007 (ISA) imposes civil sanctions on directors for breach of its provisions. Besides from the criminal sanctions imposed by ISA for market abuse offences which have been discussed in chapter 5, ISA also imposes certain public civil sanctions. Section 305 ISA provides that where a person (corporate or individual) has engaged in any form of market abuse or other violation of ISA, or has encouraged another person to engage in such behaviour, the Securities and Exchange Commission (SEC) may impose a pecuniary penalty or other penalty it considers appropriate on the offender.<sup>4</sup> In addition to this, SEC may also publish a statement notifying the public that the offender has engaged in market abuse or other forms of violation.<sup>5</sup>

SEC also has the power to require persons who have breached its laws or regulations to compensate any person who has suffered a direct loss as a result of the breach. Where appropriate, it may also require the offender to forfeit to the victim any direct benefit or advantage derived from the breach.<sup>6</sup>

### **7.2.2 Disqualification Orders**

In addition to ISA mentioned above which imposes penalties on directors for breach of its provisions, one enforcement action which is worth mentioning separately is the disqualification order. This is necessary as disqualification orders are commonly regarded as an important enforcement action.

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<sup>4</sup> ISA, s305 (3).

<sup>5</sup> Ibid.

<sup>6</sup> See ISA, s303.

In many countries, including the UK, director disqualification orders are imposed only by the court.<sup>7</sup> This is however not the case with Nigeria as disqualification orders in Nigeria may be imposed by SEC as well as the courts. Section 254 of the Companies and Allied Matters Act (CAMA) generally provides for disqualification of persons from being directors or taking part in the management of the company.<sup>8</sup> A disqualification order under this section can only be imposed by the court and is not to exceed a period of ten years.

In addition to the court's disqualification powers mentioned above however, SEC also has the power to impose disqualification orders on directors of public companies. This power has been confirmed by the Nigerian Court of Appeal in the case of *Olubunmi Oladapo Oni v Administrative Proceedings Committee of Securities and Exchange Commission & Anor.*<sup>9</sup> In that case Bunmi Oni, the former Managing director of Cadbury Nig. Plc, filed an appeal against the decision of the Administrative Proceedings Committee of the SEC disqualifying him from operating in the Nigerian capital market, being employed in the financial services sector and holding directorship in any public company. Section 13z (bb) of ISA gives SEC the power to 'disqualify persons considered unfit from being employed in any arm of the securities industry'. Part of the appellant's grounds of appeal in that case was whether the power of the Administrative Proceedings Committee and SEC in that regard extends to members of board of directors of companies registered under CAMA. The Court of Appeal held that any public company that issues stocks, shares and debentures is part of the securities industry. Consequently, SEC has the power to

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<sup>7</sup> See Company Directors' Disqualification Act 1986 (CDDA). Note that the CDDA allows directors to give disqualification undertakings which allows the directors to voluntarily disqualify themselves without need for court action.

<sup>8</sup> See generally CAMA, s 254 for the circumstances in which a person may be disqualified. See also CAMA s257.

<sup>9</sup> (2013) LPELR-20795(CA).

check the activities of directors of public companies as they are part of the securities industry. The Court therefore held that SEC has the power to disqualify persons it considers unfit from being employed in the securities industry. These include directors of public companies.<sup>10</sup> The exercise of this power does not however detract from the disqualification powers conferred on the courts by CAMA. Hence, both SEC and the courts have powers to disqualify directors of public companies in Nigeria.

### **7.2.3 Public Civil Enforcement Agencies in Nigeria**

As noted earlier, SEC is granted power by ISA to impose civil sanctions on directors for breach of its laws and regulations. It carries out its enforcement activity through its Administrative Proceedings Committee (APC) and the Investments and Securities Tribunal (IST). The APC is an administrative body which is established for the purpose of hearing cases regarding violations of the ISA and SEC rules and regulators. Similarly, the IST is a quasi-judicial tribunal which is vested with exclusive jurisdiction to hear and determine questions of law or disputes generally arising from the operation of ISA.<sup>11</sup> It has civil jurisdiction to hear cases and impose sanctions, and appeals from its decisions goes straight to the Court of Appeal.<sup>12</sup> It can therefore impose civil sanctions on directors of public listed companies for breach of any provision of ISA or any other breach relating to the operation of the securities industry.<sup>13</sup> In addition to its exclusive original jurisdiction, the IST also has exclusive jurisdiction to hear appeals from the decisions of the APC.<sup>14</sup> This was the decision of the Court of Appeal in the case of *Mufutau Ajayi v Securities and Exchange*

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<sup>10</sup> Ibid.

<sup>11</sup> ISA, ss. 284(1) and 294.

<sup>12</sup> See ISA, ss. 290 & 295.

<sup>13</sup> See Court of Appeal decision in *Oni v Administrative Proceedings Committee (2013) LPELR-20795(CA)* which confers jurisdiction on SEC in respect of directors of public companies.

<sup>14</sup> ISA, s289.



*Commission*.<sup>15</sup> The IST is also granted the power to impose a range of sanctions including fines, suspensions, withdrawal of registration or licences, specific performance and restitution.<sup>16</sup>

In addition to SEC's enforcement powers, the Nigerian Corporate Affairs Commission (CAC) has oversight responsibilities with regards to incorporated companies in Nigeria. Besides from its role as a companies' registry, the CAC is responsible for conducting investigations into the affairs of companies where the shareholder and the public's interest demand.<sup>17</sup> It is also expected to perform other activities necessary for giving full effect to the provisions of CAMA.<sup>18</sup> This would include ensuring that companies and their directors comply with the requirements of CAMA with regards to reporting requirements.

### **7.3 Theoretical Advantages of Public Civil Enforcement**

Civil enforcement by public authorities theoretically has several advantages over both private civil enforcement and criminal enforcement thereby making it a potentially more suitable enforcement system in several circumstances. In section 3.7 of chapter 3, it was argued that an effective enforcement regime should pursue two purposes, namely deterrence and/or compensation. It was also argued that, in addition to fulfilling the purpose of enforcement, an ideal enforcement regime should be cost effective. The costs of instituting an enforcement action must therefore not outweigh its benefits.

In this section, it is argued that public civil enforcement enjoys several theoretical advantages over both criminal enforcement and private civil enforcement regimes in

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<sup>15</sup> (2007) LPELR-4533 (ca).

<sup>16</sup> See ISA, s293.

<sup>17</sup> CAMA, s7 (1).

<sup>18</sup> Ibid.

respect of fulfilling the conditions for effective enforcement. This section will therefore examine the potential advantages of public civil enforcement with regards to its deterrent effect, its compensatory benefit and its cost effectiveness.

### **7.3.1 Deterrence**

In chapter 3 it was argued that, in order for an enforcement regime to be regarded as effective, it must have the ability to deter potential offenders. Moreover, we noted that deterrence generally depends on four factors namely severity, celerity, certainty and variety of sanctions.<sup>19</sup> These factors have been discussed in Chapter 3 and do not bear repeating here. This section will however examine how the public civil enforcement regime fares in relation to those factors which commonly determine deterrence. The factors, which will be discussed in this section in relation to deterrence, are the variety of sanctions, severity of sanctions, celerity of sanctions and certainty of sanctions.

#### **7.3.1.1 Variety of Sanctions**

One factor which potentially affects deterrence is the variety of sanctions available for enforcement. In order to effectively enforce, it is necessary for regulators to have a wide range of sanctions available for their use.<sup>20</sup> Giving regulators a wide range of sanctions to choose from will enable them to choose which sanction best fulfils their purpose while still preserving the rights of the directors suspected of the breach.<sup>21</sup> In light of this, Lochner and Cain argue that one of the components of effective regulatory enforcement is the enforcement agency's ability to impose a wide range of

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<sup>19</sup> See s3.5.1, Chapter 3. See also J.M Ivancevich and others, 'Deterring White-Collar Crime' (2003) 17(2) *The Academy of Management Executive* (1993-2005)114, 121.

<sup>20</sup> M. Gething, 'Do We Really Need Criminal and Civil Penalties for Contraventions of Directors Duties?' (1996) 24(5) *Australian Business Law Review* 375, 380.

<sup>21</sup> Commonwealth of Australia, 'Review of Sanctions in Corporate Law' (2007) discussion paper <[http://archive.treasury.gov.au/documents/1182/PDF/Review\\_of\\_Sanctions.pdf](http://archive.treasury.gov.au/documents/1182/PDF/Review_of_Sanctions.pdf)>, 2.33 accessed 13th November 2015.

enforcement sanctions thereby ensuring that the agency is not forced to choose between ‘low-cost, low impact remediation and high cost, high impact criminal sanctions’.<sup>22</sup>

Similarly, Ayres and Braithwaite argue that a regulator should have a range of sanctions at its disposal.<sup>23</sup> Where the only sanctions available are drastic ones, the regulator is likely to use those sanctions only for the most serious offences as it will be morally unfair to impose serious penalties for minor infractions.<sup>24</sup> Failure to use sanctions imposed by laws or regulations however makes those sanctions to lack any deterrent effect. In the same vein, where the only sanctions available to regulators are threats of criminal sanctions with its connected costs and procedural restrictions, the recipients are likely to view the threat of sanctions as an empty threat.<sup>25</sup> This invariably reduces the deterrent effect of the sanctions contained in the books. It is therefore worth considering whether the variety of sanctions under a public civil enforcement regime are wider or narrower than what is available under both the criminal enforcement and private civil enforcement regimes.

#### **7.3.1.1.1 Comparison between *variety* of sanctions available under the criminal enforcement and public civil enforcement regimes**

It is arguable that the public civil enforcement regime offers a greater variety of sanctions than the criminal enforcement regime. Generally, with criminal enforcement actions, the usual sanctions imposed are imprisonment, fines, public

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<sup>22</sup> T. Lochner and B. E Cain, *Equity and Efficacy in the Enforcement of Campaign Finance Laws* (1998-1999) 77 *Texas Law Review* 1891, 1902.

<sup>23</sup> I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (OUP 1992) 35.

<sup>24</sup> *ibid* 36.

<sup>25</sup> Lochner and Cain (n 22) 1902.

shaming and in rare extreme cases, corporal and capital punishment.<sup>26</sup> However, for public civil enforcement the sanctions that can be imposed include stiff pecuniary penalties, compensation orders, restitution orders, disqualification orders, injunctions, suspensions, specific performance, disgorgement of profits, and public censure. This wider range available to regulators ensures imposition of appropriate sanctions in different circumstances. Hence, for example, where a disqualification order is considered inappropriate because the director is an otherwise fit and proper person to manage the company, an alternative penalty such as a high level of fine will usually be appropriate to deter the director from further misconduct.<sup>27</sup> With criminal enforcement regimes however, the enforcer is restricted in the sanction which can be imposed on the offender and is indeed often restricted to imprisonment or fines.

It is also essential for sanctions to fit the offence as otherwise they are unlikely to have any deterrent effect. Criminal sanctions are however often only appropriate where criminality is involved or where directors have acted fraudulently or dishonestly.<sup>28</sup> They are therefore usually used for offences that society considers serious or substantial.<sup>29</sup> Within the corporate law context, this may mean that the misconduct is ‘intentional or repeated’, or may affect the market in such a way that it necessitates punishment to provide good deterrence or retribution.<sup>30</sup> Extension of criminal sanctions for all breaches or violations could however result in

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<sup>26</sup> T. C. Newkirk and I.L Brandriss, ‘The Advantages of a Dual System: Parallel Streams of Civil and Criminal Enforcement of the US Securities Laws’ (1999) 3(2) *Journal of Money Laundering Control* 176,178.

<sup>27</sup> Gething, (n 20)387-388.

<sup>28</sup> Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, ‘Company Directors’ Duties: Report on the Social and Fiduciary Duties and Obligations of Company Directors’ (1989) (Cooney Report), 13.16.

<sup>29</sup> Commonwealth of Australia, ‘Review of Sanctions in Corporate Law’ (n 21) para 2.18.

<sup>30</sup> *Ibid* 2.18.

‘overcriminalization’.<sup>31</sup> Hence, in those circumstances where criminal sanctions are considered unnecessary due to the fact that the misconduct is not sufficiently serious, public civil sanctions ought to be used.<sup>32</sup> Public civil sanctions therefore play a huge role in ensuring enforcement in circumstances where criminal sanctions are unsuitable or where rules of criminal proceedings would prevent redress.

Similarly, public civil sanctions may also be useful where the available evidence is insufficient to sustain a criminal conviction or where the offence committed clearly lacks culpability.<sup>33</sup> In these circumstances, public civil sanctions may be considered the more appropriate enforcement system. Imposition of criminal penalties in the absence of fault or in respect of wrongdoings that are not morally blameworthy reduces the efficiency and fairness of the legal system. The use of public civil sanctions in these circumstances therefore potentially helps to reduce the chances of over deterrence and under deterrence thereby creating a balance.<sup>34</sup>

#### **7.3.1.1.2 Comparison between *variety* of sanctions available under the private civil enforcement and public civil enforcement regimes.**

The range of sanctions available in a public civil enforcement regime is also wider than those in the private civil enforcement regime. Although the private civil enforcement regime offers a reasonable variety of sanctions which include specific performance, injunctions, declarations, and award of damages, it is still arguable that they do not offer as much variety as the public civil enforcement regime. Sanctions such as directors’ disqualification, suspensions and public censures are generally unavailable in private civil enforcement actions. Similarly, the range of sanctions

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<sup>31</sup> J. C Coffee Jr, ‘Paradigms Lost: The Blurring of the Criminal and Civil Law Models. And what can be done about It.’ (1992) 101(8) Yale Law Journal 1875, 1880.

<sup>32</sup> Commonwealth of Australia (n 21) 2.35.

<sup>33</sup> S Simpson, *Corporate Crime, Law and Social Control* (CUP 2002) 63.

<sup>34</sup> *ibid* 74.

available in public civil enforcement actions range from very severe to modestly severe. This is unlike the private civil enforcement regime where most of the sanctions available fall within a similar range, in terms of their severity. Hence, public civil enforcement regimes still offer some advantages over private civil enforcement in respect of the wide variety of sanctions available.

### **7.3.1.2 Severity of Sanctions**

#### **7.3.1.2.1 Comparison between *severity* of sanctions available under the criminal enforcement and public civil enforcement regimes**

Certainly, criminal enforcement regimes can offer the most severe sanctions. Imprisonment is the clearest example of this as only very few people would consider a fine of any amount to be as severe as imprisonment for life or say twenty years.<sup>35</sup> The possibility of imposing a severe prison sentence on an offender gives the criminal enforcement regime a clear advantage over other civil enforcement regimes in terms of the severity of its sanctions. Imprisonment is generally unavailable under a public civil enforcement regime; this is largely due to its retributive and severe nature. Civil enforcement actions must therefore rely on alternative and potentially less severe forms of punishment.

In addition to the severity of prison sentences, it is also argued that sanctions imposed under a criminal enforcement regime attract greater stigma than sanctions imposed under alternative enforcement regimes.<sup>36</sup> According to Galbiati and Garoupa, criminal convictions generally attract higher stigma due to two main reasons.<sup>37</sup> The

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<sup>35</sup> R Posner, 'Optimal Sentences for White Collar Criminals' (1979-1980) 17 American Criminal Law Review 409,411.

<sup>36</sup> A Keay and M Welsh, 'Enforcing Breaches of Directors' Duties by a Public Body and Antipodean Experiences' (2015) 15(2) Journal of Corporate Law Studies 255,260.

<sup>37</sup> R Galbiati and N Garoupa, 'Keeping Stigma out of Administrative Law; An Explanation of Consistent Beliefs' (2007) 15 Supreme Court Economic Review. 273,274.

first is due to the *publicity* of convictions. Criminal proceedings and convictions are often in the public sphere and are therefore generally judged in the court of public opinion. This is unlike civil sanctions which may be imposed quite privately. They therefore attract greater public stigma. The second reason is the *information about guilt* which is transmitted by a criminal conviction. Galbiati and Garoupa argue that due to the higher standard of proof required in criminal law, criminal convictions more reliably convey information about guilt and therefore impose higher stigma.<sup>38</sup> Thus even if the fines imposed under a criminal regime are not as severe as civil pecuniary penalties, the former nevertheless still carry greater stigma.

In light of this, it can be argued that criminal enforcement regimes impose more severe sanctions than public civil enforcement regimes. Nevertheless, criminal sanctions are not invariably more severe than public civil sanctions. There may be instances where the consequences of imposing a civil penalty will be more severe than the consequences of a fine imposed criminally.<sup>39</sup> For example, a disqualification order imposed on a director may bar that person from being employed in that position for a very lengthy period. This penalty may then justifiably be regarded as being more severe than a small criminal fine<sup>40</sup> even with its associated stigma. Indeed, evidence given in the Australian Cooney's report showed that disqualification orders represented the greatest threat to directors in spite of the existence of other sanctions such as imprisonment and fines.<sup>41</sup> It was therefore an effective deterrence.

Similarly, fines imposed under the public civil enforcement regime may be greater, and impose more costs on offenders, than fines imposed as criminal sanctions. A

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<sup>38</sup> *ibid* 274

<sup>39</sup> R Tomasic, 'Corporate Crime' in D Chappell and P Wilson, *The Australian Criminal Justice System: The Mid 1990s* (Butterworths 1994) 257.

<sup>40</sup> *Ibid* 257.

<sup>41</sup> Senate Standing Committee on Legal and Constitutional Affairs, Parliament of Australia, 'Company directors' (n 28) 13.26.

regulatory authority can order payment of compensation, impose fines and order payment of enforcement costs such as attorney's fees and court costs.<sup>42</sup> These costs can quickly add up, imposing very severe financial punishments and consequently increasing the possibility of deterrence. This further adds credence to the claim that public civil penalties where effectively used may have an arguably greater deterrent effect than criminal sanctions.

#### **7.3.1.2.2 Comparison between *severity* of sanctions available under the private civil enforcement and public civil enforcement regimes**

Sanctions imposed under a public civil enforcement regime are quite similar to the ones available for private enforcement actions. Nevertheless, the availability of certain severe sanctions, which are generally unavailable under the private civil enforcement regime, offers the public regime an advantage in this regard. One key example is directors' disqualification. As mentioned above, disqualification orders can deprive the director of her livelihood; they therefore represent a very potent threat. Similarly, enforcement actions by regulators often attract more publicity, and moral condemnation than private enforcement actions which are often kept in the private sphere. They therefore impose greater stigma. While private enforcement actions may be seen merely as an internal company dispute between directors and disgruntled shareholders, an enforcement action by a public authority is likely to be viewed differently.<sup>43</sup> Hence, while the sanctions available under both regimes are very similar, overall public civil enforcement is more severe.

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<sup>42</sup> Simpson (n 33)74.

<sup>43</sup> A. Keay, 'The Public Enforcement of Directors' Duties: A Normative Enquiry' (2014) 43 Common Law World Review 89,110.



### **7.3.1.3 Certainty of Sanctions**

Certainty of sanctions refers to the probability or likelihood that sanctions or punishment will be imposed after committing an offence or misconduct. According to Simpson, certainty of sanctions is the most important factor that determines deterrence.<sup>44</sup> This is because the higher the likelihood that punishment will be imposed, the greater its deterrent effect. It is therefore worth considering whether the public civil enforcement regime offers greater certainty than the criminal and private civil enforcement regimes.

#### **7.3.1.3.1 Comparison between *certainty* of sanctions available under the criminal enforcement and public civil enforcement regimes**

As noted above, criminal sanctions are generally considered to be more severe than civil sanctions and should consequently have a better deterrent effect, this is however not the case. There is often a very low probability that offenders will be criminally punished. This is generally due to the difficulties involved in successfully obtaining a criminal conviction thereby undermining the deterrent effect of criminal sanctions. Therefore, while in theory criminal sanctions should have a greater deterrent effect, the reality is often far from this.

One of the major reasons for this is the procedural requirements imposed on criminal proceedings by the law which makes it difficult to secure a conviction. As seen in chapter 5,<sup>45</sup> the punitive nature of criminal sanctions requires that criminal procedure laws, evidence laws and even human rights law sets standards which are higher than what is commonly required for civil sanctions.<sup>46</sup> Criminal convictions are therefore

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<sup>44</sup> Simpson, (n 33) 23.

<sup>45</sup> See s 5.4.5, Chapter 5.

<sup>46</sup> See E Lomnicka, 'Capital Markets Regulation in Nigeria and the UK: The Role of the Courts' (2002) 46(2) *Journal of African Law* 155,159.

often difficult to obtain reducing the certainty of criminal sanctions. Civil sanctions do not always face the same procedural restrictions. Therefore, one of the major advantages of a public civil enforcement regime is the procedural flexibility and ease it offers. For example while the burden of proof required in criminal trials is proof beyond reasonable doubt, civil trials only require proof on balance of probabilities.<sup>47</sup> This potentially increases the chances of success in civil trials compared to criminal trials.<sup>48</sup>

Similarly, criminal law's focus on intent and subjective awareness potentially affects the deterrent effect of criminal enforcement, as the courts are unlikely to impose a criminal sanction in the absence of intent or some other form of guilty mind. Its insistence on 'greater evidentiary certainty', compared to that expected in civil proceedings, may also reduce the chances of success for prosecutors.<sup>49</sup> The ease of proof and procedural flexibility available under the public civil enforcement regime therefore increases the likelihood that sanctions will be imposed thereby potentially enhancing its deterrent effect.<sup>50</sup>

#### **7.3.1.3.2 Comparison between *certainty* of sanctions available under the private civil enforcement and public civil enforcement regimes**

The public civil enforcement regime generally offer more certainty of sanctions than the private civil enforcement regime. While private enforcement actions do not encounter the same procedural difficulties as criminal enforcement actions, they nevertheless face other types of procedural and substantive restrictions. For example,

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<sup>47</sup> See Evidence Act 2011, Part IX for the burden and standard of proof required in both civil and criminal cases in Nigeria.

<sup>48</sup> J. Oberg, 'Is It "Essential" to Imprison Insider Dealers to Enforce Insider Dealing Laws? (2014) 14(1) Journal of Corporate Law Studies 111,128.

<sup>49</sup> J. C Coffee Jr, 'Paradigms Lost: The Blurring of the Criminal and Civil Law Models. And What Can Be Done About It.' (1992) 101(8) Yale Law Journal 1875, 1878.

<sup>50</sup> Keay and Welsh (n 36) 262. See also M Gillooly and N.L Wallace-Bruce, 'Civil Penalties in Australian Legislation' (1994) 13(2) University of Tasmania Law Review 269, 270.

many jurisdictions require the fulfilment of stringent conditions before shareholders can bring derivative actions reducing the likelihood of success in such private enforcement actions.<sup>51</sup> Similarly, cost problems, free rider problem and information asymmetries all act as disincentives to private parties (such as shareholders) in commencing private enforcement actions.<sup>52</sup> Public civil enforcement actions however less often face such restrictions thereby increasing the chances of success. In addition to this, public civil sanctions can often be imposed by regulators without recourse to court. This greatly reduces all the procedural requirements and technicalities associated with court proceedings thereby potentially increasing the chances of success.

#### **7.3.1.4 Celerity of Sanctions**

Finally, in order for an enforcement action to deter, the sanction or punishment must be swiftly applied to ensure that there is a clearer association between the wrongful act and its costs (the punishment) in the minds of potential offenders.

##### **7.3.1.4.1 Comparison between the *celerity* of sanctions available under the criminal enforcement, private civil enforcement and public civil enforcement.**

Public civil enforcement regimes seems to have an advantage over both the criminal and private civil enforcement regimes in this regard. Since public civil enforcement regimes often confer on regulatory agencies the power to impose sanctions,<sup>53</sup> enforcement can be secured without recourse to the courts. This can accelerate the imposition of punishment as the procedural formalities associated with the court system are avoided. This is especially true for a country like Nigeria, where the

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<sup>51</sup> See for example UK Companies Act 2006, Part 11. For a full discussion of these restrictions with regards to Nigeria see generally chapter 6.

<sup>52</sup> For further discussion of these difficulties, see s6.4, Chapter 6.

<sup>53</sup> F. E. Zimring, 'The Multiple Middlegrounds between Civil and Criminal Law' (1992) 101(8) Yale Law Journal 1901, 1906.

judiciary suffers from delay in the disposition of cases.<sup>54</sup> In addition to this, lower evidentiary burdens required by regulators for imposing public civil sanctions may allow less time to be spent preparing for the case, thereby ensuring that sanctions are more swiftly applied.

Asides from the procedural flexibility offered by public civil enforcement, it also offers greater powers to regulators. Regulators therefore have greater autonomy over the enforcement process and can control, to some extent, the speed with which cases are resolved. This can be contrasted with the criminal enforcement regime where regulators may experience less control over the enforcement process due to the powers which have been vested in the prosecutors and the courts. Therefore, failings on the part of the prosecutors or the court officials are likely to significantly reduce the speed with which the sanctions are applied. Similarly, with private civil enforcement, much of the power lies with the courts. Therefore, general delays in resolution of court cases affect the speed with which such private actions are resolved. The advantage offered by the greater powers vested in regulators under the public civil enforcement regime has been identified by Zimring who emphasises that the main advantage of the civil penalty regime over criminal sanctions does not necessarily lie in its ease of proof or procedural flexibility, rather its main advantage lies in the greater power conferred on administrative agencies.<sup>55</sup> The greater powers conferred on the regulator could therefore have some effect on the speed with which sanctions are applied, thereby enhancing the deterrent effect of the public civil enforcement regime.

To sum up, public civil enforcement ‘scores’ better overall than either criminal enforcement or private civil enforcement in terms of deterrence. Only on the measure

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<sup>54</sup> See section 5.4, Chapter 5 for a discussion of this issue in Nigeria.

<sup>55</sup> F. E Zimring (n 53) 1906.

of ‘severity’ of sanctions is public civil enforcement outscored by criminal enforcement. However, even on this, the problems otherwise besetting criminal enforcement more than negate this slight advantage. Similarly, while private civil enforcement actions such as derivative actions could potentially deter, their effectiveness is still somewhat limited.<sup>56</sup> As noted by Parkinson that ‘deterrence, and the creation and refinement of standards of conduct and performance, have the quality of ‘public goods’ which private enforcers, pursuing only private gains, are liable to under-produce’.<sup>57</sup> Public civil enforcement therefore outscores both the criminal and private enforcement actions. It therefore generally has a greater deterrent effect than both criminal and private civil enforcement regimes.

**Table 7.1**

**Summary Table on Deterrence**

	<b>Criminal Enforcement Regime</b>	<b>Private Civil Enforcement Regime</b>	<b>Public Civil Enforcement Regime</b>
<b>Variety of Sanction</b>	Very narrow range of sanctions available due to their retributive nature.	Wider variety of sanctions than criminal enforcement. Range of sanctions however still restricted to ‘non-punitive’ sanctions.	Offers greatest variety of sanctions ranging from modestly severe to very severe sanctions. This ensures that appropriate sanctions can be imposed in

<sup>56</sup> See A. Keay, ‘The Public Enforcement of Directors’ Duties: A Normative Enquiry’ (2014) 43 Common Law World Review 89,110.

<sup>57</sup> J.E Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (OUP 1993) 238.

	<b>Criminal Enforcement Regime</b>	<b>Private Civil Enforcement Regime</b>	<b>Public Civil Enforcement Regime</b>
			different circumstances
<b>Severity of Sanction</b>	Sanctions are often very severe and attract great stigma.  However, where fines are imposed, the severity of criminal sanctions are significantly whittled down.	Sanctions available are not very severe due to their private nature.	Sanctions such as disqualification orders imposed under a public civil enforcement regime are very severe. Pecuniary penalties imposed under the civil regime may be greater, and impose more costs, than fines levied in the criminal regime  Public enforcement actions attract more publicity and consequently greater moral condemnation and stigma than private actions.
<b>Certainty of Sanction</b>	Stringent requirements imposed by criminal procedure laws, evidence	Statutory requirements which are imposed on private civil enforcement	Public civil enforcement actions do not face the same

	<b>Criminal Enforcement Regime</b>	<b>Private Civil Enforcement Regime</b>	<b>Public Civil Enforcement Regime</b>
	<p>laws, and human rights laws on criminal proceedings reduces the chances of success. Consequently, the certainty of sanctions in criminal enforcement is low.</p>	<p>actions (e.g. derivative actions) reduces the incidences of such actions. Private parties also generally lack the incentive to commence private enforcement actions.</p>	<p>restrictions imposed by statute on criminal enforcement and private civil enforcement actions. The ease of proof and procedural flexibility also increases the likelihood that civil sanctions will be imposed.</p>
<b>Celerity of Sanction</b>	<p>Procedural restrictions mentioned above may also occasion delay in disposal of cases.</p>	<p>General delays in resolution of court cases affects the speed with which sanctions are imposed.</p>	<p>Sanctions can be imposed without recourse to courts thereby eradicating inherent delays in the court system  Regulators have greater autonomy over the enforcement process and can ensure speedy disposal of cases.</p>

### **7.3.2 Compensation**

In chapter 3, compensation was identified as one of the main purposes of enforcement in company law. Directors may in certain circumstances be required to pay compensation to persons who have suffered losses due to their misconduct. In that chapter, it was also noted that not all enforcement actions are capable of fulfilling a compensatory purpose. Nevertheless, in those circumstances where an enforcement action compensates in addition to deterring future breaches, it is highly beneficial particularly to the victims of the breach.<sup>58</sup>

#### **7.3.2.1 Comparison between compensation in the criminal enforcement and public civil enforcement regimes.**

As discussed in chapter 5,<sup>59</sup> criminal enforcement actions are primarily targeted at punishing offenders and deterring future offenders. They are therefore not focused on compensating victims of the offence. Although the court may in certain circumstances order compensation for the victim of the crime, in addition to other sanctions, this is not always the case.<sup>60</sup> Public civil enforcement regimes have an advantage over criminal enforcement in this regard as courts and regulators are often granted the power to award compensation to victims of the breach. Compared to criminal enforcement, public civil enforcement often focuses more directly on compensation rather than just punishing or deterring offenders. Compensation orders in these circumstances are also sometimes imposed in addition to other sanctions thereby ensuring that the enforcement action fulfils both deterrence and compensatory

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<sup>58</sup> See section 3.7.1 of chapter 3. It is worth noting that a failure to meet a compensatory purpose does not imply that the enforcement action is ineffective. Certain enforcement actions, by design, can only fulfil a deterrence or indeed retributive purpose.

<sup>59</sup> See s5.5.2.

<sup>60</sup> For an example, see ACJA 2015, s319.



purposes.<sup>61</sup> This availability of compensation orders under a public civil enforcement regime potentially increases its effectiveness compared to criminal enforcement as it not only deters further offences but also compensates the victims for losses suffered.

### **7.3.2.2 Comparison between compensation in the private civil enforcement and public civil enforcement regimes.**

Private civil enforcement actions such as derivative actions are often aimed at redressing wrongs done to the company. Directors' duties are owed to the company. Therefore, where there has been a breach, the company should be the beneficiary of the award and not individual shareholders.<sup>62</sup> The implication of this is that victims, who are often the shareholders, are generally not compensated for losses suffered as a result of directors' mismanagement or other misconduct. In light of this, Reisberg in his analysis of the purpose of derivative actions argues that the compensatory rationale cannot fully justify derivative actions.<sup>63</sup> Shareholders do not actually enjoy compensatory benefits from bringing derivative actions. Hence, for him, the primary rationale or justification for derivative actions is its deterrent benefits and not compensation.

In addition to this lack of direct compensation, private individuals also have to pay to bring private enforcement actions. Therefore, in addition to not getting direct compensation for losses suffered, they may also incur additional expenses for bringing the private action. This can be contrasted with public civil enforcement actions where the costs are borne by the regulator or the government. Consequently, where breaches are enforced through public civil enforcement, the victims of the

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<sup>61</sup> The UK, for example, makes provision for compensation orders to be made in addition to disqualification orders or undertakings. See Small Business, Enterprise and Employment Act 2015, s110.

<sup>62</sup> See *Foss v Harbottle* (1843) 2 Hare 461.

<sup>63</sup> See A Reisberg, *Derivative Actions and Corporate Governance: Theory and Operation* (OUP 2007) 60.

breach are generally better off financially than if either criminal or public enforcement actions are pursued.

**Table 7.2: Summary Table on Compensation**

<b>Criminal Enforcement Regime</b>	<b>Private Civil Enforcement Regime</b>	<b>Public Civil Enforcement Regime</b>
Criminal enforcement actions are primarily targeted at punishing and deterring offenders. They are therefore not generally focused on compensating victims of the offence.	Private civil enforcement actions are aimed at redressing wrongs done to the company. However, individual shareholders do not often get <i>direct</i> compensation for losses suffered. Private shareholders also incur litigation expenses.	Regulators are often granted explicit powers to award compensation to victims of the breach. Victims of breach are also likely to be better off financially as enforcement costs are borne by the public enforcement agency.

### 7.3.3 Cost Effectiveness

As noted in chapter 3, the cost of enforcement remains a very important factor in the determination of its effectiveness.<sup>64</sup> An optimal enforcement regime should therefore be cost effective for the potential enforcers. Many public regulators often have

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<sup>64</sup> See s 3.7, Ch. 3.

insufficient resources as such they cannot detect, investigate and enforce every breach that occurs.<sup>65</sup> They would therefore usually be required to exercise their discretion in determining which breach is worth formally enforcing. Consequently, where the costs of an enforcement action are excessive or outweigh its benefits, regulators are unlikely to be incentivized to pursue that course of action.

### **7.3.3.1 Comparison between the costs of criminal enforcement and public civil enforcement**

In chapter 5, it was noted that criminal enforcement actions are often not a cost effective option as they involve several tangible and intangible costs.<sup>66</sup> It is therefore worth considering how public civil enforcement measures in regards to the cost of enforcement.

Public civil enforcement regimes are generally less financially costly than criminal enforcement.<sup>67</sup> This is due to the fact that the different costs involved in investigating the offence, acquiring the required evidence to prove guilt, prosecuting the offence, and then perhaps imprisoning the offender do not arise in civil enforcement actions. Several reasons may be responsible for the higher tangible costs associated with criminal enforcement. These may include the requirements imposed by different laws on criminal proceedings. Regulators would generally need to incur several costs in order to satisfy the law's requirements regarding *mens rea*, the burden and standard of proof, acceptable evidence, and witness testimony. In addition to these costs, which must be incurred to increase the chances of obtaining a successful conviction, the requisite court fees, prosecutor's fees and other legal fees still need to be paid.

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<sup>65</sup> M Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42 Federal Law Review 217,232.

<sup>66</sup> See s5.5.3, Ch 5.

<sup>67</sup> Keay and Welsh (n 36)262. This section focuses on financial costs due to the fact that the extent of intangible costs cannot be easily calculated.

Another factor that makes criminal enforcement actions more financially costly is the fact that offences that attract criminal penalties such as insider dealing are often committed using sophisticated means. Hence, regulators need to invest resources in acquiring the requisite skills, equipment and human resources needed to successfully detect them.<sup>68</sup> With public civil sanctions however, these costs are often reduced. While the regulators still need to conduct some level of further investigation into allegations or suspicions of misconduct, these costs are likely to be lesser than would be required for criminal trials. Besides from the reduced cost of investigation, all the other tangible costs associated with successfully prosecuting a criminal case do not arise in public civil enforcement actions. As noted earlier, corporate regulators often have the power to impose civil sanctions without need for recourse to the courts. This effectively eradicates all the costs associated with the court and prosecution fees which are necessary for criminal trials.

On the benefit side, however, in addition to the deterrent and compensatory benefits of public civil enforcement, the fines collected in a public civil enforcement regime are socially beneficial as they are a source of revenue. Although fines may also be imposed under a criminal regime, where the imprisonment sanction is chosen it imposes the costs of maintaining the prisoners on the society while yielding no social revenue.<sup>69</sup> It is therefore argued that public civil enforcement regimes are a more cost effective option than criminal enforcement thereby making them more functional to regulators.

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<sup>68</sup> See s5.5.3, Ch. 5.

<sup>69</sup> R Posner, 'Optimal Sentences for White Collar Criminals' (1979-1980) 17 *American Criminal Law Review* 409,410.

### **7.3.3.2 Comparison between the costs of private civil enforcement and public civil enforcement.**

Although many of the costs involved in criminal trials do not apply to civil actions, nevertheless private civil enforcement actions impose other costs which are not present in public civil enforcement actions. Due to the fact that private civil enforcement actions make use of the court system, certain tangible costs inherently arise. Some of these costs would include the court fees, lawyer's fees, deposition fees and cost of obtaining necessary evidence, including hiring an expert witness where necessary, to mention a few. These costs are inherent in any private enforcement action. However as Reisberg rightly notes litigation is expensive,<sup>70</sup> it is therefore not always the most cost effective enforcement option. This problem is further exacerbated by the 'loser pays' rule which is common in many common law jurisdictions.<sup>71</sup> Therefore, if the claimant loses she is liable for all her costs as well as the other party's own. This makes litigation a particularly costly and risky enforcement option. Therefore, while it may be argued that private civil enforcement actions are not as costly as criminal enforcement actions, they nevertheless still impose substantial tangible costs on the person who institutes the action. Public civil enforcement actions on the other hand are more cost effective as sanctions can be imposed by the regulators without recourse to courts. This effectively saves the costs which would have been expended at the court.

**Table 7.3: Summary table on Cost Effectiveness**

<b>Criminal Enforcement</b>	<b>Private Civil</b>	<b>Public Civil Enforcement</b>
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<sup>70</sup> Reisberg, *Derivative Actions* (n 63) 222.

<sup>71</sup> For Nigeria's application of 'loser pays' rule see *Akinbobola v Plisson Fisko (1991) 1 NWLR (pt 167) 270; NNPC V CLIFCO Nig. Ltd. (2011) 4 S.C (Pt 1) 108.*

Regime	Enforcement Regime	Regime
<p>Higher costs generally associated with criminal enforcement due to stringent requirements imposed by various laws. Offences that attract criminal penalties often require immense resources for successful detection and proof. The imprisonment sanction imposes costs on society without yielding any revenue.</p>	<p>Certain costs are inherent in private civil enforcement actions. These costs include court fees, lawyers' fees, deposition fees and costs of acquiring sufficient evidence. Litigation is also generally an expensive option.</p>	<p>Costs associated with the court system are avoided as regulators can impose sanctions without recourse to the court system. Pecuniary penalties imposed under a public civil enforcement regime are a source of social revenue.</p>

The analysis in this section has revealed that the public civil enforcement regime offers several advantages over both the criminal and private civil enforcement regime. The public civil enforcement regime is cost effective, offers the greatest potential for effective deterrence, and compensation for victims. This thesis therefore crucially argues that the public civil enforcement regime offers the *best* potential for delivering effective enforcement of corporate law in Nigeria in comparison to the alternative regimes

## **7.4 The Nigerian Experience of Public Civil Enforcement**

As noted earlier on, an effective enforcement regime ought to fulfil certain criteria. It is therefore worth examining whether Nigeria's civil enforcement regime currently meets the criteria for effective enforcement. This section therefore examines how Nigeria's civil enforcement regime stands in relation to that criteria. It particularly examines the current enforcement situation in Nigeria and identifies whether corporate and securities regulators are pulling their weight in enforcement.

As mentioned previously, Nigerian corporate and securities laws stipulates sanctions for various infractions. The sanctions that may be imposed for those breaches include pecuniary penalties (fines), compensation orders, injunctions, forfeiture orders, public censures, suspensions, specific performance, and disqualification orders.<sup>72</sup> These sanctions clearly cover a good range therefore the Nigerian regulator, in theory, has a good variety of sanctions which can be used to redress instances of breach. Nigerian securities law also provides for severe civil sanctions. Some of the public civil sanctions which can be regarded as severe under Nigerian corporate and securities law include disqualification orders, fines, and compensation orders. SEC is therefore in a good position in terms of the variety and severity of sanctions in its arsenal.

In spite of this good variety and severity of sanctions available under Nigerian corporate and securities laws, instances of actual enforcement actions are however very sparse. As noted in section 7.2, SEC has powers to enforce some breaches and impose sanctions on directors. While the Nigerian Corporate Affairs Commission (CAC) also has oversight responsibilities with regards to incorporated companies, it has arguably failed in its compliance duties. CAC's inadequacies with regards to its oversight responsibilities is the subject of further discussion in the next section.

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<sup>72</sup> See generally ISA, ss. 293 (1), 303, 305 (3) 2007. See CAMA, s254.

Similarly, while SEC is in a better position when compared to CAC, its enforcement activities in respect of directors' misconducts are also very few and far between. There are therefore only very few cases where sanctions have been imposed by SEC for breach by directors. One of the well-publicised enforcement actions by SEC against company directors is the suspension and disqualification of the CEO and some other directors of Cadbury Nig. Plc for fraud and manipulation of its financial reports.<sup>73</sup> Similarly in 2009 the Managing director of Afroil Plc, Mr I.O Sanni was disqualified from taking a directorship position in any public quoted company for five years and further referred to the EFCC for further investigation and prosecution. He was also ordered to refund the sum of N185, 224,660.22 (about £625,000) which he had fraudulently converted. Some other directors of the company were also ordered to pay a fine of N100, 000 (about £337) each for approving the filing of the annual report and accounts.<sup>74</sup>

Another well-publicised case where public civil sanctions were imposed on a company executive is seen in the case of Mufutau Ajayi, the former finance and accounts manager of African Petroleum Plc (AP). In that case Ajayi, had in association with the company's auditors prepared a fraudulent prospectus in respect of an offer for sale of shares. In 2001, Sadiq Petroleum, after subscribing to part of the shares found that AP Plc's former management had been fraudulent as it failed to disclose debts worth N22.5 billion owed to different creditors. Consequently, Ajayi was charged with authorising a prospectus containing untrue statements contrary to

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<sup>73</sup> See T Osundolire, 'SEC blacklists Oni, Akadiri over Cadbury's Doctored Account', 10<sup>th</sup> April 2008 <[http://www.thenationonlineng.net/archive2/tblnews\\_Detail.php?id=48570](http://www.thenationonlineng.net/archive2/tblnews_Detail.php?id=48570)> accessed 2<sup>nd</sup> September 2016. See also SEC, 'SEC Annual report' (2008) 56 <[http://www.sec.gov.ng/files/Annual%20reports/SEC%20ANNUAL%20REPORTS%20AND%20ACCOUNTS%202008\\_lite.pdf](http://www.sec.gov.ng/files/Annual%20reports/SEC%20ANNUAL%20REPORTS%20AND%20ACCOUNTS%202008_lite.pdf)>, 56 accessed 13<sup>th</sup> November 2015.

<sup>74</sup> SEC, 'SEC Annual report' (2009) <[http://www.sec.gov.ng/files/Annual%20reports/SEC%20ANNUAL%20REPORTS%20%20ACCOUNTS%202009\\_lite.pdf](http://www.sec.gov.ng/files/Annual%20reports/SEC%20ANNUAL%20REPORTS%20%20ACCOUNTS%202009_lite.pdf)>, 79-80 accessed 13<sup>th</sup> November 2015.



the provisions of ISA. The Administrative Proceedings Committee (APC) found that Ajayi had played a major role in concealing the said debts and disqualified him from being employed or participating in any capacity in the securities industry.<sup>75</sup>

In spite of the aforementioned cases of enforcement, an examination of SEC Annual reports spanning over the past six years,<sup>76</sup> reveals that such instances of enforcement action against company directors are very few. One must however not be quick to conclude that SEC has failed in regards to all its enforcement duties. There is clear evidence of enforcement activities by SEC in its Annual Reports. These enforcement actions are however in respect of other capital market operators such as stockbrokers, issuing houses and investment advisors, which are also regulated by SEC. A quick snapshot of SEC's enforcement activities in its 2013 Annual Report revealed that seventeen capital market operators were suspended, thirty-one matters were referred to the police, fifty-eight cases were resolved, twenty-one illegal operators were shut down and seventy other cases were pending.<sup>77</sup> None of the enforcement actions however related to directors of public listed companies, rather they were in respect of other securities issues such as unauthorised sale of clients' shares, mismanagement of clients' portfolio accounts, non-allotment of shares, non-execution of mandates, failure to remit proceeds of sale and illegal operation of fund managers.<sup>78</sup> The same scenario is repeated in its previous annual reports.<sup>79</sup>

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<sup>75</sup> O. K Obayemi, 'Protecting Nigerian Investors' 23 August 2010

<<http://www.thisdaylive.com/articles/protecting-nigerian-investors/80380/>> accessed 12<sup>th</sup> January 2016. It is worth noting that Ajayi appealed the decision of the APC, his appeal was rejected at the Court of Appeal but is still pending at the Supreme Court. This also highlights the delay problem in the Nigerian court system.

<sup>76</sup> SEC, SEC Annual Reports, < <http://www.sec.gov.ng/annual-reports.html> > accessed 13<sup>th</sup> November 2015.

<sup>77</sup> SEC, 'SEC Annual report' (2013)

<http://www.sec.gov.ng/files/Annual%20reports/2013%20Annual%20Report%20of%20SEC.pdf>108 accessed 13<sup>th</sup> November 2015.

<sup>78</sup> *ibid* 107.

<sup>79</sup> See SEC, 'SEC Annual Reports' (2011)

**Table 7.4: Statistics of SEC Enforcement Activities in 2013**

Suspended Operators	17
Matters referred to the Police	31
New cases received	34
Resolved cases	58
Pending Cases	70
Illegal Operators Closed down	21

Table 7.4: Snapshot of Enforcement Activities in 2013 (Sec Annual Reports 2013, <<http://www.sec.gov.ng/files/Annual%20reports/2013%20Annual%20Report%20of%20SEC.pdf>>, 108 accessed 13<sup>th</sup> November 2015.

**Table 7.5: Statistics of SEC Enforcement Activities in 2012**

Suspensions	12
Cases referred to law enforcement	18

<<http://www.sec.gov.ng/files/Annual%20reports/SEC%20ANNUAL%20REPORTS%20%20ACCOUNTS%202011.pdf>> and ‘SEC Annual Report’ (2012) <<http://www.sec.gov.ng/files/Annual%20reports/2012%20Annual%20Report%20of%20SEC.pdf>> accessed 13<sup>th</sup> November 2015.

agencies (Police & SSS)	
Cases referred for enforcement action	31
Resolved cases	12
Withdrawals of Registration of CMOs	35
Illegal Operators closed down	29

Table 7.5: Statistics of Enforcement Activities in 2012 (SEC Annual Reports 2012, <<http://www.sec.gov.ng/files/Annual%20reports/2012%20Annual%20Report%20of%20SEC.pdf>>, 94 accessed 13<sup>th</sup> November 2015.

The tables above reveal evidence of some enforcement activities by SEC; however, these enforcement activities are not in respect of directors' misconduct. Indeed in an empirical study by Okpara, respondents to the survey noted that the existing securities laws and regulations in Nigeria are ineffective as there is very little enforcement.<sup>80</sup> Several reasons may be responsible for this state of affairs and this will be the subject of analysis next section. However, the implication of this limited use of public sanctions in Nigeria is that the certainty of sanctions with regards to the public civil enforcement regime in Nigeria is low. The limited number of public civil enforcement actions in Nigeria implies that the likelihood of a public civil sanction being imposed on a wrongdoing director is quite low. Therefore, while there is a good variety of sanctions as well as severity of sanctions imposed, these sanctions are not frequently used by public regulators thereby preventing the public civil enforcement regime from having a strong deterrent effect. Similarly, while ISA makes provision

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<sup>80</sup> J. O Okpara, 'Corporate Governance in a Developing Economy: Barriers, Issues and Implications for Firms' (2011) 11(2) Corporate Governance: The International Journal of Business in Society 196.

for compensation orders, there is no evidence that compensation has been granted to those who have suffered loss as a result of directors' breach.

With regards to cost effectiveness, as discussed in section 7.3.3 above, the public civil enforcement regime is generally less costly than both the criminal and private civil enforcement regime. However, it is currently difficult to estimate the actual costs and consequent cost effectiveness of the current public civil enforcement regime in Nigeria. SEC Annual reports and accounts show no indication of the portion of its budget which is allocated to enforcement or how much it expends on enforcement annually. The exact financial costs of public civil enforcement in Nigeria is therefore unknown. In spite of this however, it is clear that the Nigerian public civil enforcement regime is in need of reforms in order to harness the potential of this enforcement regime. As discussed earlier, the main difficulty with the current public civil enforcement regime lies in its limited use. It is therefore *currently* unable to have a significant deterrent effect or to compensate victims who have suffered loss. The next section will therefore examine the issues and challenges which may be responsible for this lack of effective use of the public civil enforcement regime in Nigeria.

## **7.5 Issues and Challenges Besetting Public Civil Enforcement in Nigeria**

Notwithstanding the theoretical superiority of public civil enforcement and the actual powers conferred on corporate and securities regulators in Nigeria to impose sanctions on directors, the reality is that these enforcement powers have rarely been used in Nigeria resulting in under enforcement. This section therefore examines why public civil enforcement in Nigeria has been under-used to date. It suggests that the factors that are primarily responsible for the lack of effective public enforcement in Nigeria include the shortcomings of the CAC, lack of powers to enforce breach of

directors' duties, corruption, and difficulties experienced by regulators in obtaining relevant information about directors' breach.

### **7.5.1 CAC's Shirking of its Oversight Responsibilities**

The CAC must bear a significant share of the blame for the lack of proper enforcement of corporate law in Nigeria. In spite of the oversight and investigatory powers vested on the CAC,<sup>81</sup> its enforcement activities have been very negligible to say the least. The CAC has mostly shirked its oversight responsibilities choosing instead to focus only on its role as a companies' registry. While improvements have admittedly been made, over the years, in the manner with which it provides its services as a companies' registry, nothing has been done to enhance its oversight function or to ensure that it actually ensures compliance with the provisions of CAMA.

In the 2004 World Bank Report on Observance of Standards and Codes (ROSC), it was reported that the CAC lacks the capacity to effectively monitor and enforce CAMA's requirements regarding accounting and financial reporting.<sup>82</sup> The report stated that 'there are significant weaknesses in the enforcement mechanism which is accentuated by a degree of corruption and poor recordkeeping by the Corporate Affairs Commission'.<sup>83</sup> The situation does not appear to have improved much since the publication of the 2004 ROSC. The 2011 Report on the Observance of Standards and Codes (ROSC) noted that while CAMA authorises the registrar of companies at the CAC to monitor compliance with financial reporting requirements, it fails to do

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<sup>81</sup> See 7.2.3

<sup>82</sup>The World Bank's Report on the Observance of Standards and Codes is a report which gives a summary of member countries' compliance with some internationally recognised standards and codes which includes corporate governance. Reports are prepared and published at the instance of member countries. The published reports are regularly updated and fresh reports are produced every few years. See World Bank, 'Report on the Observance of Standards and Codes (ROSC) Nigeria 2004' June 17 2004, <[https://www.worldbank.org/ifa/rosc\\_aa\\_nga.pdf](https://www.worldbank.org/ifa/rosc_aa_nga.pdf)> accessed 18<sup>th</sup> December 2015.

<sup>83</sup> *ibid* 8

this effectively. It also reported that many companies fail to comply with CAMA's requirements regarding financial statements and that in spite of the statutory penalties for noncompliance enforcement is weak.<sup>84</sup>

Despite the damning ROSC 2004 country report, in a study conducted by Adegbite, a senior official of the CAC stated that 'the Commission has been effective in satisfying its mandate and can comparatively compete with the company's registry of other jurisdictions. I will rate the performance of the Commission 70 percent in the last ten years'.<sup>85</sup> While one may agree that the CAC has been reasonably effective in its role as a companies' registry, it falls far short in respect of its compliance and enforcement responsibilities. Aside from the two ROSC reports which reveal failings in CAC's compliance activities, the lack of any evidence of CAC's oversight activities shows that the Commission is in serious need of reform in this regard. The shortcomings of the CAC were accepted by a senior official of the CAC who noted that 'the Commission's capacity is constrained by myriad internal and environmental problems. Internal problems include corruption and the lack of human expertise. One of the environmental problems which also confronts the CAC is the lack of independence from the polity and politicians'.<sup>86</sup> CAC therefore falls short in regards to ensuring compliance with corporate law requirements stipulated by CAMA.

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<sup>84</sup>World Bank, 'Report on the Observance of Standards and Codes (ROSC) Nigeria' (2011) June 6 2011 <[http://www.worldbank.org/ifa/rosc\\_aa\\_nigeria\\_2011.pdf](http://www.worldbank.org/ifa/rosc_aa_nigeria_2011.pdf)>, 13 accessed 18<sup>th</sup> December 2015.

<sup>85</sup> E Adegbite, 'The Determinants of Good Corporate Governance: The Case of Nigeria' (PHD Thesis, Cass Business School 2010) 157.

<sup>86</sup> E Adegbite, 'Corporate Governance Regulation in Nigeria' (2012) 12(2) Corporate Governance 257, 264.

### **7.5.2 Lack of Powers to Enforce Breach of Directors' Duties**

As noted in chapter 4, CAMA generally makes provisions for directors' duties. However as many scholars have rightly pointed out, these directors duties alone are unlikely to have any deterrent effect unless they are properly enforced.<sup>87</sup>

Currently, Nigerian corporate law is silent on the subject of enforcement of directors' duties; as such, no explicit powers are conferred on corporate or securities regulators to enforce breach of those duties. The question then is whether the existence of the power to enforce breach of directors' duties may be implied. The simple answer to this question is presumably No. Nigeria's common law origin and its reception of UK Companies law suggest that the intent of the legislature was to leave enforcement of directors' duties within the private realm, as is the position in the UK. As noted by Jackson and Roe 'the tool of public enforcement (as opposed to fiduciary-oriented private litigation before judges) has not usually been strongly associated with the common law'.<sup>88</sup> Therefore, Nigeria, like its UK counterpart, has often relied on private enforcement actions such as derivative actions to enforce directors' duties. In addition to this, there has been nothing in Nigerian case law over the years which can lead to an inference that regulators have implied powers to enforce directors' duties. It can then be said that corporate and securities regulators in Nigeria lack powers to enforce breach of directors' duties.

Although SEC has the power to regulate the activities of public listed companies and their directors,<sup>89</sup> it lacks explicit enforcement powers regarding breach of directors' duties. Shareholders are therefore expected to enforce directors' duties through their

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<sup>87</sup> See A Keay, 'An Assessment of Private Enforcement Actions for Directors' Breaches of Duty' (2014) 33(1) *Civil Justice Quarterly* 76.

<sup>88</sup> H. Jackson and M. Roe, 'Public and Private Enforcement of Securities Laws: Resource-Based Evidence' (2009) 93 *Journal of Financial Economics* 207,237.

<sup>89</sup> See *Oni v APC* (n 13).

control mechanisms and private enforcement actions. The question however is whether this approach is effective in securing enforcement of directors' duties. The previous chapter has shown the shortcomings with complete reliance on derivative actions as an effective enforcement regime.<sup>90</sup> The ineffectiveness of derivative actions as an enforcement mechanism has also been identified by many commentators and is not peculiar to Nigeria as noted by Keay in his analysis of the UK position.<sup>91</sup> The situation in Nigeria with regards to derivative actions is however considerably worse than the UK as there are hardly any reported cases on derivative actions in Nigeria.

Asides from the difficulties with the current Nigerian derivative action regime which are discussed in the previous chapter,<sup>92</sup> there are several other problems in Nigeria which prevent effective use of this enforcement system. One of these is the problem with Nigerian courts. Private enforcement actions generally depend for their success on functioning and effective court systems in addition to other factors. As noted in chapter 5 however, the Nigerian judicial system is plagued with different issues including overburdened court systems, delay in the disposal of cases, corruption and infrastructural deficiencies.<sup>93</sup> It is therefore not as effective as it ought to be. It therefore stands to reason that reliance on private enforcement actions, as a means of securing enforcement of directors' duties, are likely to be ineffective.

The general lack of public enforcement actions by corporate and securities regulators in Nigeria could therefore be partly attributed to the lack of powers to enforce breach of directors' duties. A grant of explicit powers to SEC to enforce breach of directors'

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<sup>90</sup> See chapter 6 for a proper analysis of derivative actions in Nigeria.

<sup>91</sup> See A Keay, 'The Public Enforcement of Directors' Duties' (n 56). The difficulties with derivative actions as an effective enforcement mechanism even in the UK will be discussed in Chapter 10.

<sup>92</sup> See Ch. 6.

<sup>93</sup> See s5.4, chapter 5 for a full discussion of these issues.



duties where necessary is a more effective alternative to private enforcement. It would also provide the desired push and increase regulators' incentive to actively pursue effective enforcement. In the absence of this type of explicit regulatory powers, regulators are unlikely to take any steps in redressing breach of directors' duties. In light of the disincentives faced by shareholders in bringing private civil enforcement actions, it is necessary to rely on public civil enforcement of directors' duties as a means of ensuring that company directors adhere to their statutory duties.

### **7.5.3 Lack of Information by Regulators on Directors' Misconducts**

One possible cause of a lack of public civil enforcement actions in Nigeria is the fact that such misconducts are rarely reported. Although regulators do not have the power to enforce breach of directors' duties, they nevertheless have enforcement powers over directors in respect of some other forms of breach. SEC particularly has enforcement powers over company directors in respect of financial misconducts and breach of securities laws. It also has authority to examine the records and affairs of any entity covered by the ISA. In spite of this however, it is practically difficult and infeasible for SEC to conduct routine investigations into the activities of all companies. It must therefore rely on information obtained from shareholders, whistle-blowers, misstatements and inconsistencies in the company annual reports or some other evidence of mismanagement or misconduct.<sup>94</sup> Evidence obtained from SEC annual reports revealed that SEC carries out reviews of the annual reports, quarterly returns and accounts submitted to it.<sup>95</sup> Hence, any inconsistencies or issues of concern should presumably be subject to some further investigation, which may result in enforcement actions. It must however be noted that financial statements and

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<sup>94</sup> SEC, SEC Rules and Regulations (2013) Rule 9.

<sup>95</sup> See SEC, 'SEC Annual Reports', <<http://www.sec.gov.ng/annual-reports.html>> accessed 1/12/2015.

accounts may sometimes fail to reflect misconducts by directors. Hence, regulators would have to rely on other sources of information such as reported breaches.

While, judging from its Annual Reports, there is evidence that SEC commonly receives reports of misconduct and breach with respect to other capital market operators such as stockbrokers, issuing houses and investment advisers; there are few reported cases in respect of directors.<sup>96</sup> Hence, there is some evidence that such breaches are not commonly reported. This could be due to ignorance by shareholders about directors' misconducts as a result of information asymmetry. It could also be due to lack of proper laws to protect whistle-blowers from reprisals. Section 306 ISA provides that employees of capital market operators and public companies have a right to disclose information regarding the commission of a criminal offence or failure of any person in the workplace to comply with legal obligations to which he is subject. It also provides that where a disclosure has been made in that regard the employee is not to be subjected to any detriment by reason of the disclosure made and may make a complaint to SEC if he suffers any detriment.<sup>97</sup> While this provision provides some protection for the whistle-blowers, it does not contain any inducements which may encourage disclosure of the information. Similarly, people who are likely to be in the position to make such disclosures are unlikely to be aware of the protection available to them under this section hidden in ISA. More publicity with regards to the existence of protection for whistle-blowers and preferably a separate legislation in this regard would therefore be useful in informing the public about the availability of this reporting channel.

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<sup>96</sup> One reported case of director misconduct was a complaint filed by the Onitsha Shareholders Association against the managing director of Okomu Oil Palm Plc for misappropriation and financial impropriety. See 'SEC Annual Report 2010'

<[http://www.sec.gov.ng/files/Annual%20reports/SEC%20ANNUAL%20REPORTS%20&%20ACCOUNTS%202010\\_lite.pdf](http://www.sec.gov.ng/files/Annual%20reports/SEC%20ANNUAL%20REPORTS%20&%20ACCOUNTS%202010_lite.pdf)>, 160 accessed 1/12/2015. Cases like this are however rare.

<sup>97</sup> See generally ISA, s306.

#### 7.5.4 Corruption

The issue of corruption as it affects the judiciary and public officials have been fully discussed in chapter 5. Although corruption is generally associated with the activities of public officials and is sometimes restrictively defined in that regard,<sup>98</sup> its prevalence in Nigeria means that it also affects the actions and decisions of private parties. Within the context of corporate law enforcement, corruption is reportedly seen in the activities of shareholder associations. CAMA is highly dependent on shareholder activism to enforce its provisions, shareholders in Nigeria are however commonly assumed to be ignorant. This nevertheless appears to be a wrong belief as Okike argues that this assumption is misguided. She opines that contrary to the general belief that shareholders in Nigeria are ignorant, the evidence of actions by shareholder associations shows that this is not entirely correct.<sup>99</sup>

Nigeria has various shareholder associations such as the Independent Shareholders' Association of Nigeria (ISAN), the Nigerian Shareholders' Solidarity Association (NSSA), and the Association for the Advancement of the Rights of Nigerian Shareholders (AARNS).<sup>100</sup> These shareholder associations are expected to protect the interests of shareholders in companies by ensuring accountability and enforcing breaches of directors' duties and other requirements. Similarly, misconducts that require the attention of regulatory authorities also ought to be reported in order to ensure proper enforcement. A study carried out by Adegbite, Amaeshi and Amao on shareholder activism in Nigeria however reveals that shareholder associations in

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<sup>98</sup> For example, the World Bank defines corruption as 'the abuse of public office for private gain'. See the World Bank, 'Helping Countries Combat Corruption: The Role of the World Bank' Sept 1997 <<http://www1.worldbank.org/publicsector/anticorrupt/corruptn/coridx.htm>> accessed 20th October 2015.

<sup>99</sup> E. N.M Okike, 'Corporate Governance in Nigeria: The Status Quo' (2007) 15(2) Corporate Governance: An International Review 173,187.

<sup>100</sup> E Adegbite, K Amaeshi and O Amao, 'The Politics of Shareholder Activism in Nigeria' (2012) 105 Journal of Business Ethics 389,392.

Nigeria engage in bullying and corruption similar to what operates in Nigerian politics. There have therefore been reports of unnecessary disruptions to Annual general meetings by executives of shareholder associations.<sup>101</sup>

Executives of these shareholder associations also allegedly use their position for personal benefits by collecting bribes.<sup>102</sup> One of the respondents in the study noted that ‘shareholder associations are not very effective because all their executives want is money. Once you give them some money, they shut up and things continue as usual’.<sup>103</sup> There was therefore some evidence of corrupt collaborations between the executives of shareholders associations and company directors. In return for their silence, these shareholder association executives reportedly receive inducements such as share allotments, bribes and personal favours. It was also reported that a president of one of the shareholder associations was even appointed as a director of the company.<sup>104</sup> In light of these allegations of bribery and corruption among shareholder associations, one cannot then expect them to institute any private enforcement action or more importantly, report incidences of breach to the appropriate authorities. It is therefore easy to imagine instances where such misconduct is covered up and remain unreported to regulators

## **7.6 The Public Civil Enforcement Regime Can Be Made to Work in Nigeria**

As discussed in section 7.3, the public civil enforcement regime has several potential advantages over both the criminal enforcement and the private civil enforcement regimes. It therefore offers the best potential for securing effective enforcement of

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<sup>101</sup> *ibid* 396.

<sup>102</sup> O Amao and K Amaeshi, ‘Galvanising Shareholder Activism: A Prerequisite for Effective Corporate Governance and Accountability in Nigeria’ (2008) 82 *Journal of Business Ethics* 119,122.

<sup>103</sup> Adegbite, Amaeshi and Amao (n 99) 397.

<sup>104</sup> *Ibid* 397.

corporate law in Nigeria. In spite of the many advantages of the public civil enforcement regime, these advantages would remain a ‘potential’ if Nigeria fails to develop its public civil enforcement regime. As mentioned earlier, Nigeria has a public civil enforcement regime, which has not been fully utilised. Therefore, while the public civil enforcement regime is the *best* option for securing effective enforcement of corporate law in Nigeria, the pertinent question is whether this proposed enforcement regime could be made to function effectively within the country.

In the last two chapters, it was seen that the criminal enforcement and private civil enforcement regimes suffer from varying difficulties. While some of these difficulties are due to the nature of these enforcement regimes, others are due to peculiar social, political and cultural problems which exist in the Nigerian society. The key issue then is whether the public civil enforcement regime can successfully side step these difficulties in order to harness the potential benefits of this regime and attain effective enforcement of corporate law. This section will therefore examine some of these difficulties which have been discussed. It argues that the public civil enforcement regime avoids many of these issues and can therefore function effectively in Nigeria.

#### **7.6.1 Difficulties with the Nigerian Judicial System**

As discussed in chapter 5,<sup>105</sup> the Nigerian judiciary is faced with a myriad of problems including corruption, lack of judicial independence, endemic delay, infrastructural defects and institutional difficulties. Many of these problems are only a reflection of the problems which assail the Nigerian society. They are deep-rooted and are unlikely to be easily resolved in the short term. An enforcement regime that fully relies on an efficient judiciary is therefore currently *unworkable* and therefore

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<sup>105</sup> See s5.4

not the best enforcement option for Nigeria's corporate law at the moment. This is not to suggest that the difficulties confronting the Nigerian judiciary cannot be resolved, they are however likely to take a longer period. In light of this, there is need to rely on an enforcement regime which can still be effective in the absence of a fully effective judiciary. The public civil enforcement regime offers this. While the public civil enforcement regime requires an active and functioning regulator to secure its effectiveness, it does not rely on a fully functioning court system. Therefore, with the public civil enforcement regime, effective enforcement can be achieved in Nigeria without recourse to courts. Within the Nigerian context, SEC can independently impose public civil sanctions on directors without the need for lengthy court proceedings. Similarly, as discussed in section 7.2 above, SEC has its own in-house quasi-judicial tribunal which has exclusive jurisdiction to hear cases arising out of ISA. This tribunal can therefore successfully and effectively impose public civil sanctions on directors. This effectively avoids the problems associated with the Nigerian judicial system while ensuring that breach of directors' duties or other corporate law requirements are effectively enforced through the mechanism of public civil enforcement.

#### **7.6.2 Lack of Information or Difficulties with Detecting Breach**

Another problem which hinders effective use of both the criminal enforcement and public civil enforcement regimes is the lack of information by regulators and the difficulties experienced in detecting breach by directors. As mentioned in section 7.5.3 above, there is some evidence to suggest that misconduct by directors are rarely reported. SEC therefore does not receive information which is required in order to enforce breach of directors' duties. Similarly, while companies' annual reports and accounts may reveal some information, it cannot be solely relied on to reveal

information about breach of duty. While this issue poses a problem for the public civil enforcement regime, this problem can be very easily resolved through the use of appropriate legislations which will improve reporting channels and ensure that breaches of duty can be successfully enforced. This will be the subject of further discussion in chapter 8 where proposals for reform of Nigeria's public civil enforcement regime are made.

### **7.6.3 The Incentive Problem**

As seen in Chapter 6, shareholders generally lack the motivation to bring private enforcement actions due to the several disincentives which they face.<sup>106</sup> This incentive problem significantly undermines the private civil enforcement regime. This is however arguably not a problem for the public civil enforcement regime. Public officials generally have better incentives for pursuing enforcement actions. While it might be argued that public enforcers also have 'mixed incentives' for doing their job well, they nevertheless have greater incentives than private enforcers.<sup>107</sup> For example, public officers may have their promotion tied to their output at work, thereby increasing their incentive to pursue enforcement actions where necessary. Similarly, as suggested by Keay, many officers gain their job satisfaction from achieving good results, they are therefore likely to draw motivation from the prospects of receiving commendation for achieving good results.<sup>108</sup> In addition to this, public officers' incentives may be enhanced by ensuring accountability at work and adequate monitoring of work output. Where public officers know that their enforcement output will be subject to periodic reviews, they are more likely to put in their best even if solely motivated by the desire to keep their jobs. Therefore, while

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<sup>106</sup> See s 6.4 for a discussion of the various disincentives.

<sup>107</sup> A. Keay, 'The Public Enforcement of Directors' Duties' (n 56) 106.

<sup>108</sup> *Ibid.*

public officials may also have ‘mixed incentives’ to do their jobs well, they can be adequately motivated to carry out their enforcement duties effectively.

#### **7.6.4 Difficulties in Proving Breach**

One of the major impediments to the effectiveness of the criminal enforcement regime is the standard of proof required by the law for a successful conviction. The standard of proof required for a criminal conviction is proof beyond reasonable doubt. However, as discussed in Chapter 5, attaining this required standard of proof is very difficult particularly when prosecuting offences in corporate law. In addition to this, the prosecution is required to prove that the defendant had some sort of ‘guilty mind’ in relation to the offence committed.<sup>109</sup> All these make it difficult to successfully enforce corporate law using the mechanism of the criminal enforcement regime. These difficulties are easily avoided in the public civil enforcement regime, as a guilty mind is not required to impose sanctions under this regime. Similarly, the standard of proof required is generally based on the ‘balance of probability’.<sup>110</sup> Therefore, in addition to the other advantages of the public civil enforcement regime, it also lends itself to ease of proof thereby ensuring that effective enforcement can be more easily achieved.

#### **7.6.5 Corruption**

Corruption is a major problem which affects several aspects of the Nigerian society. Although the problem is pervasive in the Nigerian society, its effect on the public civil enforcement regime can be mitigated through the use of appropriate and effective enforcement agencies. SEC particularly has proven itself to be an effective public regulator in light of its enforcement track record with capital market

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<sup>109</sup> See s5.4, Ch. 5.

<sup>110</sup> See Evidence Act 2011, Part IX for the standard of proof required in both civil and criminal cases.



operators.<sup>111</sup> The corruption problem is also more amenable to control within the context of SEC than within the court or judicial system. SEC as a regulatory authority can be easily made accountable through checks and controls from the legislature. This sort of regulatory accountability can significantly mitigate any potential corruption issues. This can be contrasted with the judiciary which is an independent organ of the government and therefore cannot be easily controlled, at least in the short time. Similarly, as will be seen in the next chapter, SEC has already been the subject of significant successful reforms. It can therefore still deliver effective enforcement of corporate law if significant reforms are made within this enforcement agency. While it cannot be conclusively asserted that the public civil enforcement regime avoids the corruption problem, this problem can be significantly mitigated through effective monitoring of enforcement officers and ensuring accountability at SEC. This will be further discussed in the next chapter.

## **7.7 Conclusion**

The public civil enforcement regime generally has several significant advantages over both the criminal enforcement and the private civil enforcement regime. These advantages lie in its deterrent effect, compensatory benefits and cost effectiveness. The analysis in this chapter has however shown that the public civil enforcement regime in Nigeria falls short in certain regards. The Nigerian public civil enforcement regime has a good range of public civil sanctions as well as the regulatory agency which can ensure that these sanctions are imposed on directors who have committed a breach, however there are still certain issues which hinder the effectiveness of the public civil enforcement regime. These have been discussed in the course of this chapter.

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<sup>111</sup> See Tables 7.4 & 7.5 above on SEC enforcement record.

Nevertheless, this chapter has argued that the public civil enforcement regime remains the *most effective* option for enforcing corporate law in Nigeria. This is due to the several advantages it offers over both the criminal and private civil enforcement regimes. These have been discussed in this chapter. In addition to these advantages, the public civil enforcement regime avoids, or at least mitigates, many of the difficulties which plague the other enforcement regimes. It therefore offers the *best* potential for ensuring effective enforcement of Nigerian corporate law. Having said that however, there is still need for reform of the current public civil enforcement regime in Nigeria. The next chapter will therefore examine proposals for reform of the public civil enforcement regime in order to improve its effectiveness. It will also examine the feasibility of these proposed reforms.

## CHAPTER 8: PROPOSALS FOR REFORM

### 8.1 Introduction

The previous chapter analysed the potential theoretical advantages of public civil enforcement over both private civil enforcement and criminal enforcement in Nigeria. In that chapter, it was argued that public civil enforcement offers a better and potentially more effective enforcement mechanism in Nigeria in comparison to both criminal enforcement and private enforcement actions. Public civil enforcement better fulfils the criteria for effective enforcement in terms of its deterrent effect, compensatory benefits and cost effectiveness. It also, as we saw, avoids many of the difficulties and shortcomings which undermine the criminal enforcement and private civil enforcement regimes. Therefore, it offers the best prospects for achieving effective enforcement of corporate law in Nigeria.

Consequently, this chapter makes proposals for the reform of the public civil enforcement regime in Nigeria in order to obtain the potential ‘theoretical’ benefits of the regime. The focus here is on the public civil enforcement regime because, as discussed in the previous chapter, it offers significant advantages over its alternatives and is able to secure an overall more effective enforcement regime. It should therefore be offered a more dominant enforcement role. It is however key to note here that the arguments in favour of a larger role for the public civil enforcement regime and the recommendations for reform of this regime, do *not* suggest that improvements cannot, or should not, be made to the other enforcement regimes. Indeed, these other enforcement regimes can complement the public civil

enforcement regime and therefore have a part to play in the overall enforcement regime. However, reforms to these other enforcement regimes are less of an immediate priority because, as seen in previous chapters, they are unlikely to yield fewer increases to the overall effectiveness of Nigeria's corporate law enforcement regime. Accordingly, this thesis focuses on reforms to the public civil enforcement regime, as this is the *priority* for ensuring overall effective enforcement of corporate law in Nigeria.

This chapter starts in section 8.2 by identifying the reforms which need to be made in order to improve public civil enforcement. These include identification of an effective enforcement agency, conferment of power to enforce breach of directors' duties on the Securities and Exchange Commission (SEC), clear whistleblowing laws and reporting channels, increase in regulatory oversight, overhaul of the Companies and Allied Matters Act (CAMA), regulatory accountability (i.e. accountability of the regulator itself), and adequate funding for public regulators. It then examines in section 8.3 whether these reforms are possible within the context of the Nigerian society. In doing this, it examines examples of other successful reforms in Nigeria and argues that the suggested reforms are indeed achievable in Nigeria. Section 8.4 provides some concluding remarks.

## **8.2 Reform Proposals**

### **8.2.1 Identification of an Effective Enforcement Body**

In order to attain the potential benefits of the public civil enforcement regime, as seen in chapter 7, it is essential to have a functioning and effective public civil enforcement agency. The first essential reform to the Nigerian public civil enforcement regime is therefore a clear identification of a regulatory agency in charge of administering the public civil enforcement regime.

As discussed in chapter 4, the public regulatory agencies in charge of companies in Nigeria are the Corporate Affairs Commission (CAC) and the Securities and Exchange Commission (SEC).<sup>1</sup> As seen in chapter 7, the CAC has failed to effectively monitor and enforce CAMA's requirements regarding accounting and financial reporting.<sup>2</sup> There is therefore no evidence that the CAC can undertake this huge task of securing public civil enforcement of corporate law. The situation with SEC is however different as it has shown greater potential as an enforcement agency. As noted in chapter 7,<sup>3</sup> SEC Annual reports and even newspaper articles<sup>4</sup> reveal evidence of good enforcement activity in respect of capital market operators. Therefore, with the right reforms, SEC can build on this enforcement success which it has achieved with capital market operators in ensuring effective enforcement of directors' duties.

In addition to its relative success as an enforcement agency, SEC has generally proven itself a better and more proactive regulator than the CAC. This is evidenced by the fact that it has a greater presence in Nigeria. It regularly engages in activities targeted at developing the capital market, educating the members of the public about the capital market and encouraging active investor participation. This takes the form of media campaigns, press releases and public warnings. An example of its proactive approach is seen in the fact that it recently issued a warning about a Ponzi scheme, which was making the rounds in Nigeria and was primarily targeted at members of

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<sup>1</sup> See s4.6 Ch. 4.

<sup>2</sup> See s7.5.1 Ch. 7.

<sup>3</sup> See s7.4 Ch. 7.

<sup>4</sup> See N Nnorom, 'SEC revokes licences of 84 inactive capital market operators' December 21<sup>st</sup> 2015 <<http://www.vanguardngr.com/2015/12/sec-revokes-licences-of-84-inactive-capital-market-operators/>> accessed 11<sup>th</sup> January 2016. See also SEC, 'SEC Annual Report 2013', <<http://www.sec.gov.ng/files/Annual%20reports/2013%20Annual%20Report%20of%20SEC.pdf>> accessed 11<sup>th</sup> January 2016.

the public.<sup>5</sup> In addition to this, SEC regularly issues new rules and makes amendments to existing rules in order to keep up to date.<sup>6</sup> There is therefore a strong case for appointing SEC as the enforcement agency in charge of administering the public civil enforcement regime. It is therefore argued that SEC is the preferred regulatory agency for effectively administering Nigeria's public civil enforcement regime.

### **8.2.2 Grant of Enforcement Powers to SEC in Relation to Breach of Directors' Duties**

An essential, and perhaps the most important, reform, which is needed in order for Nigeria to properly capture the benefits of public civil enforcement, is a conferment of the power to enforce breach of directors' duties on SEC. The previous section has identified SEC as the preferred regulatory agency for administering the Nigerian public civil enforcement regime. However, there is still a difficulty here as SEC currently lacks the power to enforce directors' duties. As discussed in section 7.5.2, this is a significant problem and represents one of the major challenges undermining the effectiveness of the Nigerian public civil enforcement regime. There is therefore a need to reform the Investments and Securities Act 2007 (ISA) in order to include clear provisions regarding public civil enforcement of directors' duties. The amendment to ISA should include a clear grant of power to enforce breach of directors' duties on SEC. Additionally the ISA should make clear provisions for the sanctions which may be imposed by SEC on directors for breach.

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<sup>5</sup> SEC, 'Public alert on the activities of the "MMM Federal Republic of Nigeria" (Nigeria.mmm.net)' 30<sup>th</sup> August 2016 <<http://sec.gov.ng/the-attention-of-the-securities-and-exchange-commission-nigeria-sec-has-been-drawn-to-the-activities-of-an-online-investment-scheme-tagged-mmm-federal-republic-of-nigeria/>> accessed 28<sup>th</sup> October 2016.

<sup>6</sup> See SEC, 'SEC exposes new rule and sundry amendments to the rules and regulations of the commission' 21<sup>st</sup> October 2016 <<http://sec.gov.ng/sec-exposes-new-rule-and-sundry-amendments-to-the-rules-and-regulations-of-the-commission/>> accessed 21<sup>st</sup> October 2016.

In conferring the power to enforce breach of directors' duties on SEC, certain other ancillary powers must also be granted to SEC with regards to company directors. The first power, which must be granted to SEC in this regard, is the power to gather information. Information gathering powers are necessary in order for SEC to obtain information which is needed to make its enforcement decisions. Clear information gathering powers will enable SEC to obtain any information which is needed for its judicial or quasi-judicial proceedings. It is important to stress that this information gathering powers must be made 'compulsory'. Therefore, SEC should be able to require production of necessary information or documents. This power is necessary as individuals and companies may be generally unwilling to voluntarily supply relevant information or document to SEC. Therefore, SEC should be able to require persons or entities to provide it with necessary information and documents or to disclose certain relevant information. In addition to this, SEC should be given the power to apply for search warrants in order to enable it to search premises for relevant information or document.<sup>7</sup>

Another ancillary power which should be granted to SEC in relation to enforcement of directors' duties is the power to impose sanctions on directors without recourse to courts. This is an essential power in order to ensure that Nigeria reaps the potential benefits of the public civil enforcement regime. Indeed, one of the major advantages offered by the public civil enforcement regime lies in the fact that sanctions can be imposed by the regulators thereby avoiding all the problems traditionally associated with court proceedings.<sup>8</sup> As discussed in chapter 7, SEC carries out its enforcement activity through its Administrative Proceedings Committee (APC) and the

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<sup>7</sup> For an example of a public civil enforcement agency with comprehensive information gathering powers see the Australian securities and investments commission. ASIC, 'ASIC's compulsory information gathering powers' <<http://asic.gov.au/about-asic/asic-investigations-and-enforcement/asic-s-compulsory-information-gathering-powers/>> accessed 26<sup>th</sup> October 2016.

<sup>8</sup> For a further discussion of this, see Chapter 7.

Investments and Securities Tribunal (IST).<sup>9</sup> There is therefore a need to grant specific powers to the APC or the IST to hear matters concerning breach of directors' duties and to impose sanctions as appropriate.

### **8.2.3 Clear Whistle Blowing Laws and Reporting Channels**

Another measure which would improve public civil enforcement in Nigeria is the enactment of a proper whistleblowing law and creation of clear reporting channels for whistle-blowers. As mentioned in section 7.6.2, lack of information on directors' misconduct is a possible reason for inadequate public civil enforcement in Nigeria. This is however a crucial determinant of effective enforcement. In order for any sort of enforcement to take place, the enforcer must first obtain information about the said breach. Therefore, where there is a lack of information or absence of appropriate reporting channels, effective enforcement is inherently impossible. A comprehensive whistleblowing law together with appropriate reporting channels can resolve the problem of lack of information. The importance of proper whistleblowing laws cannot therefore be overemphasised. As noted by the US Securities and Exchange Commission that 'Assistance and information from a whistleblower who knows of possible securities law violations can be among the most powerful weapons in the law enforcement arsenal...'<sup>10</sup> This is true of any corporate regulator engaged in public civil enforcement. It is therefore essential to develop proper avenues for reporting suspected breaches.

The current situation where Nigeria's provision on whistleblowing is contained in an isolated section of ISA is highly inadequate.<sup>11</sup> The average person is unlikely to be

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<sup>9</sup> See s7.2.3

<sup>10</sup> US Securities and Exchange Commission Office of the Whistle blower, 'Welcome to the Office of the Whistle blower' <<https://www.sec.gov/whistleblower>> accessed 11th January 2016.

<sup>11</sup> Note that the private sector code, s18.3 also contains a provision requiring companies to have a whistle blowing policy which should be known to employees and other stakeholders.



aware of this provision. An explicit and well-publicised whistleblowing law is therefore essential in bridging the information gap. In addition to this, the proposed whistleblowing law should offer substantial protection and inducement to whistleblowers. This will increase the incentive for employees, shareholders and other third parties who obtain information regarding a breach to report suspected incidences. This is especially so in a country like Nigeria where employees lack labour protection. While Nigeria is a member of the International Labour Organisation (ILO), and has ratified several of its conventions, available evidence suggests that employees in Nigeria remain vulnerable. An empirical study carried out by Adewumi and Adenugba, on the state of workers' rights and labour standards in Nigeria reveals that the level of compliance by employers in Nigeria with labour laws is low.<sup>12</sup> Indeed, there is evidence which suggests that employers deliberately avoid compliance and take advantage of the vulnerability of workers amidst the current unstable economic conditions.<sup>13</sup> With an unemployment rate of 13.3%,<sup>14</sup> unemployment and job insecurity is rife in Nigeria. In light of this, it is difficult to expect employees to report suspected breach by directors thereby putting their jobs at risk in an economy suffering from significant unemployment.

Proper development of whistleblowing channels and protection including full anonymity for whistle blowers would therefore encourage reporting. Reward where the information leads to an enforcement action could also be offered in order to enhance the incentive to report incidences of breach. Implementation of this reform would ensure that an open line of communication is maintained between the regulators and potential whistle-blowers. This would consequently provide public

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<sup>12</sup> F Adewumi and A. Adenugba, *The State of Workers' Rights in Nigeria: An Examination of the Banking, Oil and Gas and Telecommunication Sectors* (Friedrich-Ebert-Stiftung 2010).

<sup>13</sup> Ibid 71

<sup>14</sup>National Bureau of Statistics, 'Unemployment/Underemployment Report Q2 2016' <<http://www.nigerianstat.gov.ng/report/426>> accessed 26<sup>th</sup> October 2016.

regulators with the necessary information for commencing action against the erring directors.

#### **8.2.4 Increasing Regulatory Oversight**

In addition to introducing clear whistleblowing laws and other channels for reporting misconducts to regulators, there is need for increased regulatory oversight by corporate and securities regulators. Regulatory oversight here does not just connote that regulators provide constant monitoring and inspection of companies. While it is necessary for regulators to provide some monitoring and surveillance, it cannot effectively monitor all companies because this is unlikely to be cost effective for the regulator. As discussed in previous chapters, cost effectiveness is an important determinant of effective enforcement. Where an enforcement action is not cost effective, it remains a wholly unattractive option for the potential enforcer. Regulatory oversight in this context therefore requires that regulators pay closer attention to the content of statutory reports submitted by directors, auditors and insolvency practitioners. There is need for proper monitoring and surveillance in order to ensure that financial reports and accounts comply with the standards required by CAMA and give a true and accurate view of companies' state of affairs.

The CAC has oversight responsibilities in respect of companies' financial statements and accounting records which are submitted to them. However, as discussed in the previous chapter, there is no evidence that the CAC takes this duty seriously.<sup>15</sup> There is therefore a fundamental need for the CAC to take up its oversight responsibilities in order to ensure that misstatements or inaccuracies in the financial statements or accounting records can be spotted. While there is evidence that SEC carries out reviews of annual returns and reports submitted to this, there is still room for

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<sup>15</sup> See s7.5.1

improvement in this regard. Hence, it is not enough to simply accept companies' financial reports and accounts as a box ticking exercise, rather there is need to carry out a proper review of the accounts submitted in order to potentially identify inconsistencies or misstatements which may be evidence of some misconduct or breach by directors. While whistleblowing and other reporting channels are important sources of information regarding breach, there is need for corporate and securities regulators in Nigeria to improve their oversight in order to complement these other sources of information.

### **8.2.5 Overhaul of CAMA**

Any reform of the public civil enforcement regime in Nigeria will be incomplete without an overhaul of the current company law – CAMA. This overhaul is necessary for two major reasons. The first is the 'legal transplant effect', which is arguably present in Nigerian corporate law. Legal transplants refer to the 'moving of a rule or system of law from one country to another or from one people to another'.<sup>16</sup> The legal transplant debate will be further discussed in the next chapter. This problem arises specifically in relation to Nigerian corporate law. Nigeria's companies' legislation including the current Companies and Allied Matters Act 1990 (CAMA) have been closely patterned after UK companies law. This however raises the question of its suitability to Nigeria's corporate landscape.

As noted in previous chapters, Nigeria faces different issues and challenges which impacts on the enforceability of its laws. Issues such as corruption, institutional problems, regulatory weaknesses, and infrastructural deficiencies which are prevalent in Nigeria are not problems which developed countries like the UK

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<sup>16</sup> A Watson, *Legal Transplants: An Approach to Comparative Law* (2<sup>nd</sup> edn. University of Georgia Press 1993) 21.

commonly face. It is therefore not surprising that company laws intended for the UK do not function effectively in Nigeria. Okike in noting the difficulty with the transplant of UK company law into Nigeria opined that ‘...this mimicking of UK’s Companies Act meant that company legislation in Nigeria failed to deal with company law problems that were peculiar to Nigeria’s socio-cultural and political environment’.<sup>17</sup>

In order for a country’s corporate laws to be effective and well enforced, it must address the social, political, infrastructural and institutional problems that the country faces. As Black and Kraakman opine ‘effective corporate law is context-specific, even if the problems it must address are universal. The law that works for a developed economy, when transplanted to an emerging economy, will not achieve a sensible balance...’<sup>18</sup> Corporate laws in developed countries are often a reflection of the peculiarities of that country and are therefore unlikely to be efficient when transplanted to another country.<sup>19</sup> A developing country’s corporate law should therefore be designed to work and function within the context of the country’s available infrastructure and institutions. The UK, for example, relies heavily on private enforcement of corporate law through derivative actions.<sup>20</sup> This preference for private enforcement has been transplanted into Nigerian corporate law. It is however arguable that this mode of enforcement is more workable for countries with better value systems as well as well-developed and effective courts. For a country like Nigeria, which still faces institutional and infrastructural difficulties in its court system, reliance on private enforcement makes it difficult to achieve effective

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<sup>17</sup> E.N.M Okike, ‘Corporate Governance in Nigeria: The Status Quo’ (2007) 15(2) *Corporate Governance: An International Review* 173,175.

<sup>18</sup> B Black and R Kraakman, ‘A Self-Enforcing Model of Corporate Law’ (1996) (109) 8 *Harvard Law Review* 1911, 1914.

<sup>19</sup> *ibid* 1913.

<sup>20</sup> See A Keay, ‘The Public Enforcement of Directors’ Duties: A Normative Enquiry’ (2014) 43 *Common Law World Review* 89, 90.

enforcement. There is therefore need for an overhaul of this transplanted law in order to bring it in tune with prevailing social and economic realities.

The second reason why an overhaul of CAMA is necessary is due to the fact that the legislation is seriously outdated. Although the Act was enacted in 1990, more than two decades later it is yet to undergo any form of extensive review. It will therefore be obvious to even a casual observer that it would be unable to tackle contemporary company law issues. While CAMA contains some fines for breach of its provisions, these fines are extremely low. This is due to the fact that CAMA itself is outdated; therefore the penalties imposed under it are inherently obsolete. Hence, for example, the penalty for the failure of an officer of the company to comply with CAMA's requirements regarding the companies' accounting records is imprisonment for a term not exceeding 6 months or a fine of N500 (£1.7).<sup>21</sup> Similarly, if the financial statements do not comply with CAMA's requirement, the penalty for the director of the company is a fine of N100 (33 pence). In the case of a group financial statement, the penalty for the directors is N250. (83 pence).<sup>22</sup> Some fines imposed under CAMA are even as low as N10 (about 3 pence).<sup>23</sup> It therefore makes it difficult for the fines and penalties it contains to have any deterrent effect, as they are very low.

It is important to note here that Nigeria has very recently taken steps to redress some of the issues identified above. Consequently, the Corporate Affairs Commission is in the process of repealing and replacing CAMA 1990. The bill for an act to repeal CAMA significantly increases the fines currently imposed for breach of its

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<sup>21</sup> CAMA, s333.

<sup>22</sup> CAMA, s348.

<sup>23</sup> CAMA, s339

provisions.<sup>24</sup> This is a welcome development and definitely represents a step in the right direction in ensuring effective enforcement of corporate law in Nigeria.

### **8.2.6 Regulatory Accountability**

A key element that many successful public regulators or agencies possess is regulatory accountability.<sup>25</sup> Regulatory accountability here connotes that the regulators themselves are made accountable and subject to some higher authority. In light of the substantial power which SEC possesses, and will possess, there is a need to ensure that they are monitored and made accountable in order to mitigate corruption and ensure that the interests of justice are met. The need for regulatory accountability cannot therefore be overemphasised. The importance of accountability has been noted by the UK House of Lords in its report on regulatory accountability where it stated that ‘accountability is a control mechanism through which effective regulation is maintained (and endorsed), and failing or ineffective regulation is identified and exposed’.<sup>26</sup> This statement captures the essence of regulatory accountability. There is need to ensure that regulators are monitored and made accountable to a superior authority. The elements of accountability have been summarised by the House of Lords as the duty to explain, exposure to scrutiny and

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<sup>24</sup> For specific details of the changes made to CAMA, See CAC, ‘A bill for an Act to repeal the Companies and Allied Matters Act 1990 and enact the Companies and Allied Matters Act 2016 to provide for incorporation of companies, registration of business names together with incorporation of trustees of certain communities, bodies, associations and incidental matters’ <<http://new.cac.gov.ng/home/wp-content/uploads/2016/07/Draft-Bill-for-the-Repeal-of-CAMA-and-Enactment-of-New-Act.pdf>> accessed 19<sup>th</sup> January 2017.

<sup>25</sup> For example, the FCA reports to the treasury and parliament. See FCA, ‘Reporting to Treasury and Parliament’ <<https://www.fca.org.uk/about/reporting-treasury-parliament>> accessed 31<sup>st</sup> October 2016. Similarly, the Australian Securities and Investment Commission is also accountable to the parliament. See ASIC, ‘Annual Report 2014-2015, about ASIC’ <<http://download.asic.gov.au/media/3438469/asic-annual-report-2014-15-section-1-30-10.pdf>> accessed 17<sup>th</sup> October 2016.

<sup>26</sup> See Select Committee on the Constitution, *The Regulatory State: Ensuring Its Accountability - Volume 1 Report* (2003-04 HL 68-1) Para 53.

the possibility of independent review.<sup>27</sup> All three have to be effective in order to ensure regulatory accountability.

SEC currently operates under the general supervision of the Ministry of Finance; however, there is need for SEC to be made *specifically* accountable to a higher body. This higher body may be the legislature or a special legislative committee to which it would directly report. This ensures that there is an effective system of control thereby preventing arbitrary exercise of power, and corruption, potentially leading to a loss of confidence in the regulator. More specifically, a duty should be imposed on SEC to periodically explain its activities to this higher authority. It could also be required to explain the basis for its enforcement actions when required to do so. The possibility of an independent review of SEC's activities should also be left open thereby ensuring that SEC is kept 'on its toes'. In addition to this, information about its surveillance activity and enforcement outcomes, including reasons for its decisions, should be made publicly available in its published annual reports. This will ensure a good degree of openness, accountability and transparency. It will also crucially ensure a high level of public confidence in its regulatory and enforcement activities which is necessary in order for members of the public to make reports of suspected breach.

### **8.2.7 Adequate Funding**

In order to operate effectively, a public regulator must be appropriately funded. Therefore, the final, but certainly not least important, reform which must take place in order for Nigeria to obtain the benefits of the public civil enforcement regime is that SEC must be adequately funded. In order for any form of effective public civil enforcement to take place, the public regulator must have sufficient finances to

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<sup>27</sup> Ibid Para 75.

undertake enforcement actions. In the absence of adequate funding for SEC, all the other proposed reforms mentioned earlier would only amount to a ‘waste of time’.<sup>28</sup> As noted by Keay that ‘...any form of public enforcement will be of little value as far as effectiveness is concerned if the budget is minuscule and as a result the staffing is thin’.<sup>29</sup> Lack of adequate resources is a problem which many regulators repeatedly grapple with. Adequate funding is however necessary in order for regulators to hire qualified staff, undertake surveillance or investigation, and carry out enforcement actions. In the absence of adequate resources, all these are impossible.

While there is currently no evidence on the amount of funding which SEC receives from the federal government,<sup>30</sup> the current state of affairs in Nigeria with regards to public agencies implies that SEC may be in need of better funding. Currently in Nigeria, several public agencies and sectors lack adequate funding. These include vital sectors such as the public healthcare system,<sup>31</sup> public education sector,<sup>32</sup> and the judicial system.<sup>33</sup> It is therefore necessary to emphasise that SEC needs to be adequately funded in order for Nigeria to reap the benefits associated with the public civil enforcement regime.

In order to ensure adequate funding, there is an essential need for SEC to become creative in generating resources. It is important for SEC not to rely on the Nigerian government for all its funding. Full reliance on the Federal Government for adequate funding of SEC may lead to a situation where it continues to fall short of its

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<sup>28</sup> See Keay (n 20) 101.

<sup>29</sup> Ibid 102.

<sup>30</sup> A search of SEC’s annual reports and accounts does not reveal how much funding it receives from the federal governments

<sup>31</sup> See S Hargreaves, ‘Time to Right the Wrongs: Improving Basic Health Care in Nigeria’ (2002) 359(9322) *the Lancet* 2013.

<sup>32</sup> See L.O Odia &S. I Omofonmiwan, ‘Educational System in Nigeria: Problems and Prospects’ (2007) 14(1) *Journal of Social Sciences* 81-86.

<sup>33</sup> For a further discussion of this, see s5.4.3.



enforcement responsibilities due to inadequate resources. This is in light of the fact that, as seen above, even crucial sectors in Nigeria lack sufficient public funding. Hence, it would be presumptuous to assume that SEC would receive a windfall of funding from the Nigerian government in order to discharge its enforcement responsibilities. There is therefore a need for SEC to get creative in securing alternative sources of finance. SEC may be able to raise significant internally generated funds through pecuniary penalties imposed on offenders as well as by imposing levies on companies and other entities which it regulates. Examples abound of regulators who either generate a significant portion of their funding from firms they regulate or are entirely funded by these firms. A key example is the UK's Financial Conduct Authority (FCA) which is an independent public body which is entirely funded by the fees charged to the firms it regulates.<sup>34</sup> Similarly, between 2015 and 2016, the Australian Securities and Investments Commission (ASIC) raised approximately \$876 million in fees and charges.<sup>35</sup> It therefore raised a significant portion of its funding internally. It is therefore highly plausible for SEC to raise a significant amount of its funds from fees, levies and charges. This will ensure that it does not totally rely on the federal government for its funding as this may lead to an inability to fulfil its enforcement functions due to inadequate funding.

It is important to note here that it is highly unlikely that any regulator would have infinite resources to use for enforcement purposes. Regulators often have insufficient resources with which to investigate and enforce all breaches. The same will be true for SEC. Hence, the call for adequate funding of SEC does not imply that it should formally investigate every matter reported to it or formally enforce every breach.

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<sup>34</sup> FCA, 'About the FCA' 04/09/2016 <<https://www.fca.org.uk/about/the-fca>> accessed 31<sup>st</sup> October 2016.

<sup>35</sup> ASIC, 'Annual Report 2015-2016 –About ASIC' <<http://download.asic.gov.au/media/4058638/asic-annual-report-2015-2016-section-1.pdf>> accessed 31<sup>st</sup> October 2016.

This would be practically impossible and definitely cost ineffective. As discussed in Chapter 3, cost effectiveness is a crucial element of an effective enforcement regime.<sup>36</sup> There is therefore need for some balance in ensuring that SEC carries out its oversight and enforcement responsibilities in a cost effective manner while ensuring that the key purposes of enforcement are met.

### **8.3 Feasibility of Proposed Reforms**

One question, which would be in the minds of many readers at this point, is whether these reforms are truly achievable in Nigeria. Reforms which are infeasible are incapable of achieving any change in the status quo. This thesis argues that these reforms are very feasible and achievable in Nigeria. There is nothing inherent in Nigeria which makes it impossible for it to capture the benefits of public civil enforcement. As reiterated severally in the previous chapter, the public civil enforcement regime, unlike the other two enforcement regimes, does not depend on an efficient court system for its success. Any reform of an enforcement regime in Nigeria that depends for its success on a reform of the judicial system is likely to end up being a long and convoluted process in light of the inherent and deep-seated problems faced by the Nigerian judicial system. This is therefore a clear advantage for the public civil enforcement regime. Also the reforms suggested are not radical and do not suggest a change in the entire Nigerian polity, rather it suggests a shift in enforcement focus in order to give way to a more viable option. These reforms are therefore achievable. A comparison with similar past reforms in Nigeria also suggests that a successful reform is not a farfetched ideal.

An example of a similar reform in the Nigerian private sector which has achieved the desired effect is seen in the banking sector reforms by the former central bank

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<sup>36</sup> See s3.7, Ch. 3.

governor Sanusi Lamido Sanusi. Between 2008 and 2009, Nigeria experienced a banking crisis which resulted in the Central Bank of Nigeria (CBN) having to rescue the financial system by injecting N620 billion of liquidity into the banking sector and removing the top executives of some of the banks. An investigation into what went wrong revealed macroeconomic instability caused by several factors including major failings in corporate governance at banks, major gaps in the regulations and regulatory framework, and uneven supervision and enforcement.<sup>37</sup>

Following this, the banking regulatory authorities embarked on a series of fundamental reforms in the banking industry aimed at stabilising the financial system and restoring confidence back. The reforms yielded a number of positive results including improved corporate governance and risk management at banks as well as significant improvements in transparency and disclosure. It also greatly improved the international standing of Nigerian banks as they are now among the main players in the global financial market and many of them are among the top 20 banks in Africa and top 1000 banks in the world.<sup>38</sup> The reforms also greatly enhanced confidence in the country's banking system. According to the former CBN governor, Sanusi, the success recorded by these reforms can be credited to 'greater collaboration and commitment of purpose among key stakeholders'.<sup>39</sup> This demonstrates that even drastic reforms are possible and achievable in Nigeria. The most important factor, which will determine the success or failure of those reforms, is the commitment and the political will to follow through with them.

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<sup>37</sup> S L Sanusi, 'Banking Reforms and its Impact on the Nigerian Economy' lecture delivered at the university of Warwick economic summit, UK 17<sup>th</sup> February 2012, 116  
<[http://www.recruitment.cbn.gov.ng/Out/2012/CCD/CBN%20JAS%20Vol%202%20No%202\\_Document%20Two.pdf](http://www.recruitment.cbn.gov.ng/Out/2012/CCD/CBN%20JAS%20Vol%202%20No%202_Document%20Two.pdf)> accessed 18<sup>th</sup> February 2016.

<sup>38</sup> *ibid* 120-121.

<sup>39</sup> *ibid* 122.

More closely related to the subject of our study, SEC has also undergone some reforms in the past. These reforms have included strengthening the SEC's Administrative Proceedings Committee in order to enhance enforcement. SEC also collaborated with other government enforcement agencies such as the Nigerian police force and the Attorney general of the Federation's office in order to improve enforcement.<sup>40</sup> These reforms have led to an increase in the number of enforcement actions taken against capital market operators.<sup>41</sup> It can therefore be argued that similar reforms aimed at enhancing public civil enforcement of corporate law are not farfetched as long as there is the political will to do so. Strengthening the public civil enforcement regime has the potential to dramatically improve accountability by directors. It will also significantly improve deterrence thereby reducing incidences of breach by directors.

The stock market crash and banking crisis in Nigeria, which almost caused a collapse of the entire financial system, was a wakeup call to the regulators that drastic reforms were necessary in order to restore confidence and stability to the banking system. Similar reforms have however not been done in respect of ensuring accountability, compliance and enforcement in public listed companies. Corporate governance failings and lack of enforcement of corporate law however have very great potential to cause severe damage to any nation's economy and financial system. They erode confidence in the country's financial markets thereby preventing both domestic and foreign investors from investing in the economy. This is evidenced from the last

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<sup>40</sup> A Oteh, 'The Nigerian Capital Market: Preserving our Success and Enabling our Potential through Managing Emerging Risks' keynote address by Arunma Oteh, Director General, Securities and Exchange Commission, Nigeria at Standard Chartered Banks' Capital Market Forum 8<sup>th</sup> October 2013 <[http://sec.gov.ng/files/Speech\\_THE%20ROLE%20OF%20THE%20SEC%20IN%20MANAGING%20RISK%20%20IN%20THE%20NIGERIAN%20CAPITAL%20MARKET\\_SECNigeriaOct2013.pdf](http://sec.gov.ng/files/Speech_THE%20ROLE%20OF%20THE%20SEC%20IN%20MANAGING%20RISK%20%20IN%20THE%20NIGERIAN%20CAPITAL%20MARKET_SECNigeriaOct2013.pdf)> accessed 18<sup>th</sup> February 2016.

<sup>41</sup> This day Live, 'X-raying SEC's Capital Market Reforms' 10<sup>th</sup> December 2014. <<http://www.thisdaylive.com/articles/x-raying-sec-s-capital-market-reforms/196261/>> accessed 18<sup>th</sup> February 2016.

stock market crash, which led to a general loss of investors' confidence in Nigeria's financial markets. Domestic investors are yet to fully regain this confidence.<sup>42</sup> There is therefore a significant need for effective reform of the current enforcement system. It is important to note that all the reforms cannot be achieved in one go, there is however a need to take a step in the right direction by kick starting the reform process.

## **8.4 Conclusion**

The previous chapters have critically examined the criminal enforcement, private civil enforcement and public civil enforcement regimes. The public civil enforcement regime has been found to be the most effective option for enforcing breach of corporate law in Nigeria. However, in order for the Nigerian public civil enforcement regime to attain this effective enforcement, it needs to be substantially reformed and improved. Seven specific reforms have been identified and explained in the course of this chapter. These reforms, if implemented, have the potential to significantly enhance the public civil enforcement regime and ensure that it works effectively in the enforcement of corporate law in Nigeria. Similarly, as seen in this chapter, these reforms are feasible and achievable in Nigeria, given the political will and desire to secure them.

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<sup>42</sup> K Ighomwenghian, 'Nigeria's Stock Market needs more Domestic Investors- Afolayan' 1<sup>st</sup> March 2015 <<http://allafrica.com/stories/201503020716.html>> accessed 25<sup>th</sup> February 2016.

## **PART 3 - LESSONS FROM OTHER JURISDICTIONS**

### **CHAPTER 9: LEARNING FROM OTHER JURISDICTIONS – THE LEGAL TRANSPLANT DEBATE**

#### **9.1 Introduction**

Part 2 of this thesis critically analysed the various enforcement regimes in Nigerian corporate law. It crucially argued that the public civil enforcement regime offers the greatest potential for ensuring effective enforcement of corporate law in Nigeria. This argument was made based on the significant advantages it offers over its alternatives in terms of increased enforcement effectiveness.<sup>1</sup> A number of proposals were also made for reforms of the *current* public civil enforcement regime in Nigeria in order fully to realise the potential benefits which public civil enforcement offers.<sup>2</sup>

The arguments made, so far, for the superiority of the public civil enforcement regime have been largely ‘theoretical’, in the following sense. They have been based on logical arguments about how the essential characteristics of a public civil enforcement regime ought to deliver superior deterrence and compensation, and in a cost effective way, than can alternative mechanisms. The use of empirical evidence, so far, has been limited to describing the current enforcement situation in Nigeria, and

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<sup>1</sup> See generally Ch. 7.

<sup>2</sup> See Ch. 8

showing what ‘empirical realities’ (in terms of institutional problems, corruption, funding problems, and the like) reform to this situation therefore confronts.<sup>3</sup>

Part 3 of this thesis now intends to use some (admittedly limited) empirical evidence in a rather different way, namely to help *to prove* – or at least, to make more persuasive – the theoretical claim about the greater enforcement potential of civil public enforcement. More specifically, this part of the thesis seeks to draw on empirical evidence in the form of three cases studies, two from the UK, one from Australia, each of which, it argues, demonstrates the superiority of public civil enforcement.

The case studies themselves are presented in chapter 10. However, this chapter addresses a number of questions or ‘concerns’ that are often raised when comparative work – such as the comparative case studies employed here – is relied upon. Such concerns are usually subsumed under the heading of the ‘legal transplants debate’. To simplify a little at this stage, the core question or concern is this: can one country really borrow legal rules, processes or institutions from another? Now, it should be made clear that, in one sense at least, this thesis does not in fact propose any such borrowing or transplant. It does *not* advocate a transplant of any enforcement regime – say that now found in the UK, or in Australia – to Nigeria. Indeed, it very clearly proposes ‘home grown’ reforms.<sup>4</sup> Instead, the goal in using comparative insights here is much more modest. It seek only to show that the enforcement experiences of the UK and Australia provide *compelling* evidence that public civil enforcement offers greater potential as an effective enforcement regime. It does this to support this thesis’ argument that much of Nigeria’s immediate reform efforts should be targeted at the public civil enforcement regime.

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<sup>3</sup> See generally chapters 5, 6 & 7.

<sup>4</sup> See Ch. 8.

Nevertheless, although this exercise in drawing comparative empirical evidence is indeed distinguishable from a true exercise in effecting legal transplants, what chapter 10 seeks to do does, admittedly, raise at least some of the same issues which typically arise in the legal transplant debate. For that reason, it is appropriate to begin this comparative part of the thesis by addressing the legal transplants debate.

Part of the purpose in doing so is ‘exegetical’ – to explain to the reader more clearly what this transplant debate is about, and how the concerns it raises may be seen as threatening to this comparative analysis. However, part of the purpose is also defensive – to show that many of the criticisms levelled against legal transplants do not apply to this thesis’ attempt to learn lessons, and draw empirical evidence, from the UK and Australia.

The chapter starts by examining the nature of legal transplants in section 9.2. It then moves on to examine Miller’s typology of legal transplants in section 9.3, whilst section 9.4 examines the pertinent debate regarding whether legal transplants are possible. It argues that legal transplants are possible therefore; the attempt to learn from the enforcement experience of the UK and Australia in the next chapter raises no concern in this regard. Having argued that legal transplants, and indeed any form of learning from abroad, are possible, section 9.5 examines whether legal transplants can be successful. It provides a definition of a successful transplant, section 9.6 then goes on to examine the factors that influence the success of a legal transplant. These factors are similarities in culture and norms between transplant and recipient countries, adaptation of transplant to suit local conditions and availability of necessary institutions and infrastructure. It notes that the Nigerian legal system shares several similarities with that of UK and Australia. Consequently, Nigeria can learn *very* useful lessons from the enforcement experience of these countries. Similarly, it



argues that the ‘adaptability’ factor does not apply to the reforms proposed in this thesis, as these reforms have not been transplanted from abroad. There is therefore no fear that they would be unsuited for Nigeria. Finally, it notes that the proposed reforms of the Nigerian public civil enforcement regime include improvements aimed at ensuring that the institutions and infrastructure needed for effective enforcement are in place. Consequently, there are no reasons why Nigeria cannot successfully learn from the enforcement experiences of the UK and Australia. Section 9.7 ends with some concluding remarks.

## **9.2 The Nature of Legal Transplants**

According to Alan Watson, legal transplants refer to the ‘moving of a rule or system of law from one country to another or from one people to another’.<sup>5</sup> Legal transplants may come in different forms and may take place at different levels. Legal transplants may occur between states in the same country, or between different countries. International conventions or laws may also be transplanted and become part of a nation’s laws. In addition to this, national or international laws could also be drawn from different sources and influenced by different municipal laws.<sup>6</sup>

Legal transplants may take place formally (e.g. by adoption of a statute) or informally (e.g. through a judicial decision, or receipt of legal ideas from informal agents). The object of transplant therefore need not be only legal rules or legal institutions, other less formal things may be transplanted such as ideologies, principles, or styles of drafting to mention a few.<sup>7</sup> A country may also informally

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<sup>5</sup> A Watson, *Legal Transplants: An Approach to Comparative Law* (2<sup>nd</sup> edn, University of Georgia Press 1993) 21.

<sup>6</sup> W Twining, ‘Diffusion of Law: A Global Perspective’ (2004) 49(36) *Journal of Legal Pluralism* 1, 13.

<sup>7</sup> *ibid* 20 & 21. See also A Watson, ‘Legal Transplants and European Private Law’ in J Smits (ed) *the Contribution of Mixed Legal Systems to European Private Law* (Intersentia Publishers 2001).

transplant certain ideas or standards from another country or international body without necessarily changing its laws. In this instance, it may be said that a legal transplant has implicitly taken place.

There have been several disagreements about the use of the term 'legal transplants'. Teubner for example argues that the term 'legal transplants' is a 'misleading metaphor' and opines instead that the term 'legal irritant' is a better alternative.<sup>8</sup> In the same vein many other authors have tried to replace the term 'legal transplants' with other supposedly more suited terms such as 'legal transposition',<sup>9</sup> 'legal transfer', 'legal reception', 'cross fertilization', 'influence', inspiration<sup>10</sup>, 'diffusion',<sup>11</sup> to mention a few. This work is however not overtly concerned with this semantic debate. For the purpose of this chapter, to ensure clarity and uniformity, the term 'legal transplants' and borrowing will be used.

There are different forms of transplants and different reasons why a country may borrow elements of a foreign system. Transplants could happen due to certain historical and political factors. For example, Watson opines that Roman law influenced much of Scots law due to the fact that the war between England and Scotland prevented England's influence on Scots law, thereby causing the Scots to turn to Roman law.<sup>12</sup> Laws may also be transplanted due to colonisation, conquest, or military operations.<sup>13</sup> For example, the British common law spread widely due to colonization such that laws of former British colonies still have very distinct common

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<sup>8</sup> G Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law ends up in New Divergences' (1998) 61(1) *The Modern Law Review* 11,12.

<sup>9</sup> E Orucu, 'Law as Transposition' (2002) 51(2) *The International and Comparative Law Quarterly* 205, 207.

<sup>10</sup> M Graziadei, 'Comparative Law as the Study of Transplants and Receptions' in M Reimann and R Zimmermann (eds), *Oxford Handbook of Comparative Law* (OUP 2006) 443-444.

<sup>11</sup> See W Twining, 'Diffusion of Law: A Global Perspective' (2004) 36(49) *Journal of Legal Pluralism* where the term diffusion was used.

<sup>12</sup> Watson, 'Legal Transplants' (n 5) 51.

<sup>13</sup> M Graziadei, 'Comparative Law as the Study of Transplants and Receptions' (n 10) 456-457.

features.<sup>14</sup> Similarly, many African countries have a common law or civil law system based on whether they were colonised by the British or French.

### **9.3 Miller's Typology of Legal Transplants**

Miller classifies legal transplants into four parts based on the motivations for their introduction. These are the cost-saving transplant, the externally-dictated transplant, the entrepreneurial transplant and the legitimacy-generating transplant.<sup>15</sup>

#### **9.3.1 The Cost-Saving Transplant**

A country may choose to borrow the laws of a foreign system to save the time and cost involved in creating and experimenting with one's own developed legal rules.<sup>16</sup> Indeed, Watson opines that most borrowing is as a result of practical utility because it is more economically efficient to borrow a law.<sup>17</sup> However, it seems implausible that a country would transplant a law solely to save costs. Similarly, if there are many alternatives from which to borrow, there must be some other positive reason, other than saving money, why a country would decide to borrow from country x and not from country y. Therefore, while cost saving may be a factor which influences transplants, it is unlikely to be the primary reason.

#### **9.3.2 Externally-Dictated Transplants**

A country may borrow foreign laws due to external factors such as a desire to please a foreign government or entity. An example of this would be where a foreign body or government dictates the adoption of a foreign model to another country as a condition

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<sup>14</sup> *ibid* 452.

<sup>15</sup> J. A. Miller, 'A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process' (2003) 51(4) *The American Journal of Comparative Law* 839-885.

<sup>16</sup> *ibid* 845.

<sup>17</sup> A. Watson, 'Aspects of Reception of Law' (1996) 44(2) *American Society of Comparative Law* 335.

for doing business with them.<sup>18</sup> A developed country or international institution may also decide to grant aid to a developing country on the condition that it transplants certain rules which may benefit the interests of investors from the developed country.<sup>19</sup> Consequently, many countries have adopted or borrowed foreign financial laws given by the IMF or World Bank as prerequisite for giving loans.

Some legislation may also be adopted due to threat of trade sanctions. For example, developing countries have adopted WTO's standards on intellectual property due to threat of sanctions from the United States.<sup>20</sup> Any transplant which is motivated by some external economic, social or political advantage offered by a foreign country or entity may therefore be described as an externally dictated transplant.

### **9.3.3 The Entrepreneurial Transplant**

A transplant may also be motivated by certain individuals in the recipient country who have interest in the country adopting certain foreign rules. This may be because they can gain some economic or political benefits. These individuals are therefore willing to invest in the transplanted legal rule due to the future benefits they may get.

### **9.3.4 The Legitimacy –Generating Transplant**

Transplants may also happen due to the prestige associated with a particular legal institution or legal system.<sup>21</sup> That prestige may be because of the perceived efficiency and success of that system. Countries usually desire to achieve legitimacy and copy the success stories of other countries.<sup>22</sup> The prestige associated with a foreign model

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<sup>18</sup> M Siems, *Comparative Law* (Cambridge University Press 2014) 847.

<sup>19</sup> *ibid* 193.

<sup>20</sup> Miller (n 15) 847.

<sup>21</sup> *ibid* 854.

<sup>22</sup> M Crouch, 'Asian Legal Transplants and Rule of Law Reform: National Human Rights Commission in Myanmar and Indonesia' (2013) 5 *Hague Journal on the Rule of Law* 146,151.

may therefore provide the authority needed to give the new law legitimacy in the receiving system.

While Miller's typology for legal transplants is useful in understanding the different motivations for legal transplants, they are however not directly relevant to what is being proposed in this thesis. As discussed earlier,<sup>23</sup> this thesis does not propose transplants of any enforcement regime or system to Nigeria. It however evaluates the experience of other countries - the UK and Australia - to see if their approach to enforcement provides evidence about the comparative effectiveness of private civil enforcement and public civil enforcement. That said, there is also admittedly, a cost saving element to this thesis 'proposals. Learning lessons from countries that have successfully implemented and used certain enforcement regimes would save Nigeria the costs which are otherwise inherent in experimenting with different enforcement regimes. It would also help to avoid the pitfalls which other countries have experienced in their quest for a suitable enforcement regime thereby saving regulatory costs.

#### **9.4 Legal Transplants: The Impossibility Debate**

One issue which has been the subject of debate, and which is worth considering, is whether legal transplants are possible. Watson, the main proponent of the legal transplantation thesis makes use of history to support his claims that legal transplants are possible. According to him, transplantation of rules or legal systems have been a very common phenomenon and are indeed an important means of development.<sup>24</sup> He argues that 'in most places at most times borrowing is the most fruitful source of legal

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<sup>23</sup> See s9.1

<sup>24</sup> Watson 'Legal Transplants' (n 5) 95.

change'.<sup>25</sup> Changes in most legal systems have therefore been as a result of borrowing.<sup>26</sup> Watson in his work cites several historical examples of legal transplants to show that transplants are possible and indeed very frequent. According to him, most of the private law of the western world and some non- western countries have been derived from either Roman civil law or English common law.<sup>27</sup> In further support of his transplantation thesis, Watson cites the example of the reception of English common law in countries like Canada, United States, Australia, New Zealand, India and even much of Africa.<sup>28</sup> Other examples include the influence of the French civil code on other civil law countries and also the manner in which the laws of different states in the United States influence each other.<sup>29</sup>

Watson notes that the concept of transplantation is not a recent phenomenon as an examination of some ancient rules of different provinces reveals similarities in the substance and style of those rules.<sup>30</sup> The extent of the similarities in substance and style of these rules is such that there is a high likelihood that they all emanated from the same source. He further opines that legal borrowing can successfully take place even between countries that have different legal systems and are at different levels of development and political orientation.<sup>31</sup> He therefore invariably argues against certain group of theories which may be described as 'mirror theories of law'.<sup>32</sup>

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<sup>25</sup> Watson, 'Aspects of Reception of Law' (n 17) 335.

<sup>26</sup> A Watson, 'Legal Change: Sources of Law and Legal Culture' (1983) 131(5) University of Pennsylvania Law Review 1121, 1125; Watson 'Legal Transplants' (n 5) 95.

<sup>27</sup> Watson, 'Legal Transplants' (n 5) 22.

<sup>28</sup> A Watson, 'Comparative Law and Legal Change' (1978) 37(2) Cambridge Law Journal 313-314.

<sup>29</sup> A Watson, 'Legal Change: Sources of Law and Legal Culture' (1983) 131(5) University of Pennsylvania Law Review 1121, 1125.

<sup>30</sup> Examples of these ancient rules are code of Eshnunna, Hammurabi and Exodus on death caused by a goring ox where the owner had been previously warned. See Watson, 'Legal Transplants' (n 5) 22-23.

<sup>31</sup> A Watson, 'Legal Transplants and Law Reform' (1976) 92 the Law Quarterly Review 79.

<sup>32</sup> W Ewald, 'Comparative Jurisprudence (II): The Logic of Legal Transplants' (1995) (43) 4 the American Journal of Comparative Law 489, 492.

The mirror theories of law view law not as an autonomous entity but as a ‘mirror of the society’.<sup>33</sup> The law is seen as a reflection of the society, therefore every aspect of the law is determined by the society within which it operates. This ‘law and society’ debate and mirror theory of law dates back to Montesquieu who in his seminal work ‘The Spirit of Laws’, published in 1748, concluded that the laws of each nation should be ‘so closely tailored to the people for whom they are made, that it would be pure chance if the laws of one nation could meet the needs of another’.<sup>34</sup> Watson, contrary to the mirror theories of law, however opines that law cannot be said to be a reflection of its people<sup>35</sup> because it may have been borrowed from a different place and still survived in new and different economic, social, and political conditions.<sup>36</sup>

Legrand, one of the strong supporters of Montesquieu’s view, however takes issue with Watson’s legal transplant thesis. For him, a rule is more than the mere words or statements and includes the meaning it receives from the particular culture. He argues that there can only be a true legal transplant when both the words of the rule and the meaning given to it by culture are moved from one culture to another.<sup>37</sup> It is however almost impossible for this to happen because when the words are transferred to another culture, they take on a meaning within that culture which is different from the original meaning. There is therefore no transplant because a key part of the rule which is its meaning stays behind.<sup>38</sup>

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<sup>33</sup> L M Friedman, *A History of American Law* (2<sup>nd</sup> edn, Simon & Schuster, inc 1985) 12.

<sup>34</sup> C Montesquieu, *The Spirit of the Laws* (Hafner Press 1949).

<sup>35</sup> Watson, ‘Legal Transplants’ (n 5)24.

<sup>36</sup> *ibid* 107.

<sup>37</sup> P Legrand, ‘The Impossibility of Legal Transplants’ (1997) 4 *Maastricht Journal of European and Comparative Law* 111, 117. See also P Legrand, ‘What “Legal Transplants”?’ In D Nelken & J Feest, *Adapting Legal Cultures* (1<sup>st</sup> edn Hart Publishing 2001).

<sup>38</sup> Legrand, ‘The Impossibility of Legal Transplants’ (n 37)118.

Legrand further disagrees with Watson's illustration of legal transplants using the rules on transfer of ownership and risk existing in Roman laws, French and German.<sup>39</sup> He argues that these rules are not the same because any similarity is merely in the words itself. The only thing that can be transplanted from one system to another is a 'meaningless form of words'.<sup>40</sup> Thus, legal transplants cannot happen because as the rule crosses boundaries it takes on a different meaning that affects the rule. He further argues that even where particular words have been borrowed from one jurisdiction there is still no legal transplant at the level of the words alone. To him, all that has happened is that law reformers found it easy to use some existing words from another jurisdiction the same way writers sometimes quote words from other authors including foreign ones.

While the disagreement between Watson and Legrand is definitely an interesting one, it seems however to be one based more on meaning rather than substance. Watson agrees that when a law is transplanted it usually undergoes some changes and takes on some characteristics from the recipient country.<sup>41</sup> In a later work, Watson further reiterated his view that a transplanted rule is not the same as it was in the original system. However, what is being transplanted is the rules and not the 'spirit of the legal system'.<sup>42</sup> Hence, Watson seems to be satisfied with a transplant at the level of words alone, something which Legrand refers to as a 'meaningless form of words'.<sup>43</sup> The disagreement between Watson and Legrand on legal transplants is therefore arguably a semantic misunderstanding based on whether legal transplants may be regarded as transplant of just the wordings of the law alone or whether a transplant

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<sup>39</sup> *ibid* 119. See Watson, 'Legal Transplants' (n 5) 82-83.

<sup>40</sup> Legrand, 'The Impossibility of Legal Transplants' (n 37)120.

<sup>41</sup> Watson, 'Legal Transplants' (n 5)31.

<sup>42</sup> A Watson, 'Legal Transplants and European Private Law' in J Smits (ed) the *Contribution of Mixed Legal Systems to European Private Law* (Intersentia Publishers 2001) 16.

<sup>43</sup> See Legrand, *Impossibility of Legal Transplants* (n 37) 120.



must include both the words of the law and the interpretation or meaning given to it. The view that Watson and Legrand's argument may be regarded as a semantic one is further supported by Siems who also questioned whether the disagreement between Watson and Legrand is not merely a 'terminological disagreement'.<sup>44</sup> Both of them agree that lawmakers sometimes copy texts of the law from foreign countries, whether or not one decides to name this a legal transplant.

Arguing that legal transplants within Watson's conception are inherently impossible is hardly realistic as several examples of legal transplants abound.<sup>45</sup> Legal transplants have been a common phenomenon for many centuries and especially in the nineteenth and early twentieth century there occurred large scale legal transplantation. As Levy puts it that 'the reception of legal ideas of one people by another is a universal phenomenon in world history'.<sup>46</sup> Several similarities also exist between different countries in certain aspects of laws that can usually only be explained by legal transplantation.<sup>47</sup> It can be said therefore that the view that legal transplants is impossible is clearly contradicted by several empirical evidence of legal transplants.<sup>48</sup> It is in light of this that Cruz argues that despite differences in interpretation and use of terminology, legal transplantation in some form has been a frequent occurrence

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<sup>44</sup> Siems, *Comparative Law* (n 18) 196.

<sup>45</sup> A good example of a legal transplant is the 'best interest of the child' test or 'welfare principle' which is usually used to determine the custody of a child. This test is used in several countries around the world. See P Cruz, 'Legal Transplants: Principles and Pragmatism in Comparative Family Law' in A Harding and E Orucu (eds) *Comparative Law in the 21<sup>st</sup> Century* (Kluwer Law International 2002) 109-115.

<sup>46</sup> E Levy, 'The Reception of Highly Developed Legal Systems by Peoples of Different Cultures' (1950) 25 *Washington Law Review and State Bar Journal* 233.

<sup>47</sup> See E Orucu, *Critical Comparative Law: Considering Paradoxes for Legal Systems in Transition* (Kluwer 1999) 80-81 which draws on the Turkish legal system as an example of legal transplants.

<sup>48</sup> H Kanda and C J Milhaupt, 'Re-Examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law' (2003) 51(4) *The American Journal of Comparative Law* 887,890.

between jurisdictions and will continue to be so.<sup>49</sup> Legal transplants are therefore possible.

Teubner's opinion takes a middle ground between the two extremes. He postulates that law's ties to society vary; some areas are closely tied to society while others are loosely tied. Therefore, law is no longer connected to all aspects of the society rather it is connected to different 'fragments of society'.<sup>50</sup> Total rejection of transplants is therefore unnecessary, as there is a need for countries to learn and gain ideas from each other. As Siems has noted that 'in today's world there are no pure legal systems; rather all legal systems have managed to incorporate ideas from various parts of the world'.<sup>51</sup> Borrowing is a common occurrence and exists in all aspects of social life, not just law.<sup>52</sup> Hence, a general categorization of transplants as impossible is erroneous. Consequently, Nigeria can indeed learn lessons, and draw empirical evidence, from other jurisdictions. Therefore, while this thesis does not advocate a transplant, Nigeria can nevertheless be guided by the enforcement experience of other countries.

### **9.5 Are Legal Transplants Successful?**

Having said that legal transplants are possible, it seems that the right question to focus on is whether legal transplants can be *successful* and what factors influence the success or failure of a legal transplant. Just as a medical transplant or a transplant of a crop from its native soil to another soil, the more important issue is whether that transplant succeeds or fails. The question about whether legal transplants are

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<sup>49</sup> P Cruz, 'Legal transplants: Principles and Pragmatism in Comparative Family Law' (n 45) 106.

<sup>50</sup> G Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law ends up in New Divergences' (1998) 61(1) *The Modern Law Review* 11,12.

<sup>51</sup> Siems, 'Comparative Law' (n 18) 197.

<sup>52</sup> E M Wise, 'The Transplant of Legal Patterns' (1990) 38 *the American Journal of Comparative Law* 16.

successful has been the source of much scholarly attention and is therefore the central debate on legal transplants. This debate is important here because, while this thesis does not recommend a transplant, a critic may still conversely argue that the enforcement experience of one country cannot be used as a case study to support the validity of another country's proposed reforms. This section would however reveal that this argument does not apply to this thesis' arguments, as legal transplants can indeed be successful. Consequently, the attempt to learn from the enforcement experience of other countries does not pose any problem. Similarly, insofar as this thesis does not advocate any form of wholesale legal transplants of enforcement regimes, these concerns associated with legal transplants do not apply here. It is therefore safe to draw lessons for Nigeria from the experiences of Australia and the UK.

Before going further to consider those factors that may influence the success or failure of a transplant, it is apt to try and gain an understanding of what 'success' means within the context of transplants. Different standards have been used by different commentators to judge the success or otherwise of a transplant thereby causing difficulty in finding the appropriate measurement criteria.<sup>53</sup> The question then is how do we determine whether a transplant has been successful. Similarly, should the success of a transplant be determined from the perspective of those making, or receiving, the transplant.<sup>54</sup>

Smits opines that a legal transplant is successful if it leads to some degree of uniformity between the laws of the importing and exporting country and unsuccessful if it does not lead to any uniformity or worse still threatens the consistency of the

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<sup>53</sup> J Gillespie, 'Towards a Discursive Analysis of Legal Transfers into Developing East Asia' (2008) 40 NYU Journal of International Law and Politics 657, 688.

<sup>54</sup> *ibid* 688.

importing system.<sup>55</sup> However, it must be noted that, the essence of legal transplants is not necessarily to ensure uniform laws between countries. A country may borrow another country's laws in order to redress certain problems it faces. In doing this, the recipient country may choose to borrow bits and pieces from different countries and then adapt it to fit its unique circumstances. In such circumstances, the result of the received law is unlikely to have any degree of uniformity with the laws of the foreign countries. It cannot however be said that the transplant has failed because the recipient country has been able to transplant laws and amend them to suit itself. Indeed, the ability of countries to borrow laws and amend them to suit their particular society is considered one of the important factors influencing success; this issue would however be discussed later on in this chapter.

According to Kanda and Milhaupt, a transplant is successful where the imported legal rule is used in the same way it was used in its origin country subject to adaptations.<sup>56</sup> This definition of success is however quite problematic and somewhat contrary to the way transplants actually function. A transplanted rule need not be used in the same way as it was in the origin country to be successful. Both countries may seek to achieve different ends; therefore, the rule may be used in different ways. The important factor is that it achieves the result intended by the importing country. As Gal has also noted that a law may be used in a different way in the transplanting jurisdiction and still promote social welfare.<sup>57</sup> Consequently, once a law is transplanted; it may take on a new meaning in the recipient country and be applied and used in a different way from the home country.

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<sup>55</sup> J Smits, 'On Successful Legal Transplants in a Future *Ius Commune Europaeum*' in A Harding and E Orucu (eds) *Comparative Law in the 21<sup>st</sup> Century* (Kluwer Law International 2002) 140.

<sup>56</sup> H Kanda and C J Milhaupt, 'Re-Examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law' (2003) 51(4) *The American Journal of Comparative Law* 887, 890.

<sup>57</sup> M S Gal, 'The 'Cut and Paste' of Article 82 of the EC Treaty in Israel: Conditions for a Successful Transplant' (2007) 9 *European Journal of Law Reform* 467, 471.

Gal, himself, defines success as the ‘ability of the transplanted law to achieve its goal in the transplanting country’.<sup>58</sup> This definition is quite apt as a law is usually intended to meet certain goals or ends. However even this ‘goal’ parameter proposed by Gal raises certain issues. As Nelken notes that it cannot be assumed that a transplanted law has just one goal or that it even has a distinct and attainable goal.<sup>59</sup> Therefore, it may be difficult in certain situations to ascertain with precision the goal of a transplanted law. If there are difficulties in identifying the exact goal of the transplanted law, then using this criterion, it becomes near impossible to judge its success or failure.

Gillespie, on his part, opines that one important factor in measuring the success of a transplant is that it must in some way lead to a change in legal behaviour in the recipient country. Otherwise, where there is no change in legal behaviour, all that has happened is a superficial replacement of indigenous laws or institutions with foreign ones.<sup>60</sup> Therefore, for him, a transplant is successful where it is able to lead to some change in behaviour. This definition is *fitting* as the ability of a transplanted law or system to lead to a change in behaviour determines whether or not it may be considered to be a successful transplant. Consequently, a transplanted law, or in this case enforcement regime, would be considered successful if it is able to lead to some change in behaviour. Hence where a legal transplant is able to secure compliance with the law, rules or standards by the persons to whom it applies, it will be regarded as successful.

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<sup>58</sup> *ibid.*

<sup>59</sup> D Nelken, ‘The Meaning of Success in Transnational Legal Transfers’ (2001)19 Windsor Year Book of Access to Justice 349,362.

<sup>60</sup> Gillespie (n 53) 688.

## **9.6 Factors That Influence the Success of Legal Transplants**

A legal transplant may succeed or fail based on different factors. These factors include similarity between transplant and recipient system, adaptation of transplants to fit local conditions and availability of necessary infrastructure and institutions. These are discussed in turns in this section.

### **9.6.1 Similarity in Culture, Values and Norms of Transplant and Recipient System**

One factor which has been severally identified by many commentators to influence the success of legal transplants is the degree of similarity in values, norms and cultures of both the transplant and recipient systems. The more compatible a received law or institution is with the pre-existing norms, values, customs and conventions of the recipient society, the more successful it is likely to be.<sup>61</sup> Law reforms that are inconsistent with the belief and practices of the people may be rejected.<sup>62</sup> Familiarity of the receiving system with the original system therefore increases the likelihood of success of a legal transplant.<sup>63</sup>

A classic example of an unsuccessful transplant is the failed attempt to export the British parliamentary system into countries that have a different history, social structure and political system.<sup>64</sup> These attempts failed because the British parliamentary system did not fit into those country's customs. Similarly, attempts to introduce the English jury system into some other countries have failed because it was contrary to the customs on distribution of power between the Bar and the Bench

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<sup>61</sup> M Chen-Wishart, 'Legal Transplant and Undue Influence: Lost in Translation or a Working Misunderstanding?' (2013) 62(1) *International and Comparative Law Quarterly* 12.

<sup>62</sup> M S Gal (n 57) 473.

<sup>63</sup> Chen-Wishart (n 61)10.

<sup>64</sup> O. Kahn- Freund, 'On Uses and Misuses of Comparative Law' (1974) 37(1) *the Modern Law Review* 17.

and was unacceptable to the legal profession in those countries.<sup>65</sup> Consequently, if a rule or system is transplanted which is contrary to the informal system and the culture of the people, it is likely to be unsuccessful. Hence, Watson's postulation that legal transplants can be successful even where the recipient society has fundamental differences from the donor country is not entirely correct.<sup>66</sup>

As will be seen in the next chapter, enforcement case studies are drawn from the UK and Australia to further support this thesis' claim for a more significant role for the Nigerian public civil enforcement regime. The choice of these two jurisdictions is based on several similarities they share with the Nigerian legal system. Nigeria is predominantly an English common law jurisdiction as are the UK and Australia.<sup>67</sup> Its legal system and laws are therefore largely based on UK law.<sup>68</sup> More particularly, its corporate law over the years have closely reflected UK corporate laws. Similarly, Australian corporate law is derived from UK law and its developments in this regard closely reflect that of the UK.<sup>69</sup> Directors' duties, for example, in both Australia and Nigeria are very similar to that of the UK.<sup>70</sup> Their private civil enforcement regimes also share certain similarities.<sup>71</sup> There are therefore very close similarities between the legal systems of these countries which denotes that Nigeria can successfully learn from the enforcement regimes of the UK and Australia.

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<sup>65</sup> *ibid* 18.

<sup>66</sup> See A Watson, 'Legal Transplants and Law Reform' (1976) 92 *The Law Quarterly Review* 79, 80-82.

<sup>67</sup> See Central Intelligence Agency, 'The World Fact Book' <<https://www.cia.gov/library/publications/the-world-factbook/fields/2100.html>> accessed 22/04/2016.

<sup>68</sup> See A. O Obilade, *The Nigerian Legal System* (Spectrum Books Limited 1979) 77.

<sup>69</sup> A Keay and M Welsh, 'Enforcing Breaches of Directors Duties by a Public Body and Antipodean Experiences' (2015) 15 (2) *Journal of Corporate Law Studies* 255,265.

<sup>70</sup> See part 2D.1 Corporations Act 2001 (Australia), ss 279,282, 283 Companies and Allied Matters Act 1990 (Nigeria), and ss171-177 of Companies Act 2006 (UK).

<sup>71</sup> See for example s303 Companies and Allied Matters Act 1990, pt. 11 Companies Act 2006 (UK) and Pt 2F.1A Corporations Act 2001.

### 9.6.2 Adaptation of Transplant to Fit Local Conditions

Closely linked to the first issue, another factor that may affect the success of a transplant is the degree of adaptation of the transplant to suit local conditions. Berkowitz, Pistor and Richard argue that in order for a legal transplant to be effective, it must be adapted to local conditions or there must be some degree of familiarity with the basic principle of the transplanted law.<sup>72</sup> Adaptability to suit local conditions means the transplanted law or system is amended and tuned to suit the recipient society. Where it is not amended to suit local condition or is imposed by colonization, and the recipient society is not familiar with the transplanted law or institution, it is unlikely to be well received or function effectively in that system. The country may then be said to be experiencing the ‘transplant effect’ because the law does not function effectively within the local system.

The ‘transplant’ effect may be described as the disparity between the recipient system’s existing structures and institutions, and the transplanted law which reduces the efficiency of the transplanted rules or system.<sup>73</sup> It arises because of the relationship between the formal written law and the unwritten cultures, norms and practices existing in the legal system.<sup>74</sup> A law or institution that originates from a foreign system is unlikely to fit into a different system unless it is *amended* to fit that system. There must therefore be some fit between a country’s formal laws and its more informal cultures, norms and values.

Berkowitz, Pistor and Richard also distinguish between receptive and unreceptive transplants. Receptivity here implies the country’s incentive to adapt the transplanted

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<sup>72</sup> D Berkowitz, K Pistor and J Richard, ‘The Transplant Effect’ (2003) 51 (1) American Journal of Comparative Law 163,168.

<sup>73</sup> *ibid* 171.

<sup>74</sup> T.T Arvind, ‘The “Transplant Effect” In Harmonization’ 2010 59(1) International and Comparative Law Quarterly 78.



laws to its local conditions.<sup>75</sup> A transplant is receptive where the transplanted law or system is very similar to the recipient country's legal system or is adapted to suit local conditions. Countries that have unreceptive transplants therefore usually suffer from the transplant effect.<sup>76</sup> 'Adaptation' here does not necessarily mean the transplanted law or system is changed substantially, rather that the law is transplanted based on an informed decision and understanding of alternative rules.<sup>77</sup> Legal transplants are therefore more likely to be successful where they are adapted to suit the local system. From Berkowitz, Pistor and Richard's empirical analysis, countries that adapted foreign laws to suit the recipient country and/or were familiar with the received foreign law experienced receptive transplant.<sup>78</sup> Where there was neither adaptation nor familiarity, such transplants were unreceptive.

An example of a situation where transplants were successful as a result of selective borrowing and adaptation is the case of Turkey. Turkey borrowed the foreign law of different countries; however these different models were amended and adjusted to suit the peculiar 'social and legal problems' of turkey.<sup>79</sup> Suitable adjustments were made to the imported law by both the Legislature and Judiciary especially in relation to personal areas like family law in order to bring the law in line with the culture and practices of the people. Consequently, wholesale transplants of laws or systems without adapting them to the recipient country should be generally avoided as these are likely to lead to unsuccessful or 'unreceptive' transplants.

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<sup>75</sup> Berkowitz, Pistor & Richard, 'The Transplant Effect' (n 72)179.

<sup>76</sup> *ibid* 190.

<sup>77</sup> D Berkowitz, K Pistor and J Richard, 'Economic Development, Legality and the Transplant Effect' (2003) 47 *European Economic Review* 165,180.

<sup>78</sup> Berkowitz, Pistor & Richard, 'The Transplant Effect' (n 72)194, table 3.

<sup>79</sup> E Orucu, 'Critical Comparative Law: Considering Paradoxes for Legal Systems in Transition' (n 47) 82.

As noted in the previous section Nigeria shares several similarities with the countries from which it seeks to learn lessons consequently the ‘familiarity’ condition is met. Similarly, it must be noted that the ‘adaptation’ factor does not *directly* apply to this thesis, as the reforms proposed in this thesis are *home-grown*.<sup>80</sup> The proposed reforms to the Nigerian public civil enforcement regime are based on an observation of those areas where the regime currently fall short, and improvements to these areas. They are therefore not primarily borrowed from, or based on, the reforms which have been adopted in the UK or Australia. Consequently, the concerns which arise in adapting a transplanted regime are not directly applicable here as what is being advocated in this thesis is ‘reflective learning from abroad’.<sup>81</sup>

### **9.6.3 Availability of Necessary Institutions and Infrastructures and Compatibility with Existing Ones**

Another factor that influences the success of transplants is the availability of institutions and infrastructures to put the law or system into effect, as well as the compatibility of the transplant with existing institutions and infrastructures. A transplanted law or system may have been well adapted to suit the culture and values of the recipient society, however in the absence of necessary institutions and infrastructures to effectuate it, the transplant may still be unsuccessful. For example, a country seeking to curb corruption may import certain good anti-corruption laws; however, this transplant will still fail in the absence of effective enforcement institutions. This factor has been recognised by some commentators as important in determining the success of transplants.

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<sup>80</sup> See Ch. 8

<sup>81</sup> Siems (n 18)197.

According to Kanda and Milhaupt, in order for an imported rule to be successful it has to fit the recipient environment.<sup>82</sup> ‘Fit’ here has two components which are macro and micro fit. ‘Micro-fit’ refers to how the imported rule complements already existing legal infrastructure in the recipient country while ‘macro –fit’ deals with how the imported rule complements the existing institutions of the political economy in the recipient country.<sup>83</sup> It is not sufficient to simply transplant laws or institutions as the new system might lack the ability to put this to effective use. Indeed, comprehensive legal protection contained in statutes does not necessarily affect the effectiveness of institutions needed to implement the statutes.<sup>84</sup> Hence, while Russia has a well-developed corporate law, there are still widespread breaches of shareholder rights. This is because Russia lacks an effective judiciary and trustworthy public institutions.<sup>85</sup>

Similarly, another instance of a failed transplant due to this factor is the transplantation of French takeover laws into Egypt. This transplant failed partly due to ‘institutional incompetence’. The Egyptian Financial Supervisory Authority (EFSA), which was the main regulator and supervisor of all non-banking financial markets, was not independent and needed to obtain the approval of the minister for investment for some decisions.<sup>86</sup> Therefore compared to similar bodies in France and the USA, the EFSA was not truly competent. The Judiciary also faced its own problems such as lack of quality judges to interpret and implement the law, as well as jurisdictional conflict between different courts on takeover disputes.<sup>87</sup>

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<sup>82</sup> H Kanda and C J Milhaupt, (n 56) 891.

<sup>83</sup> *ibid* 891.

<sup>84</sup> Berkowitz, Pistor & Richard, ‘The Transplant Effect’ (n 72)165.

<sup>85</sup> *ibid* 165.

<sup>86</sup> *ibid* 259.

<sup>87</sup> *ibid* 253-254.

The Egyptian case demonstrates the importance of legal and institutional infrastructures to the success of legal transplants. There is therefore need for competent and effective regulatory and enforcement institutions in order for a legal transplant to have a chance at succeeding. In light of the importance of this factor, the suggested reforms in this thesis have been primarily targeted at enhancing the effectiveness of the regulatory agency in charge of enforcing corporate law in Nigeria.<sup>88</sup> Consequently, the concern that Nigeria would lack the necessary institutions or infrastructure to ensure effective use of the public civil enforcement regime, even though these have worked in the UK and Australia, does not arise here. It is therefore safe for Nigeria to draw lessons from the enforcement experience of these other countries.

## **9.7 Conclusion**

Legal transplants are inevitable and have been a major source of legal change in many countries around the world. Countries often borrow laws, ideas, policies, and institutions from other countries for varied reasons. Indeed, *borrowing* is a general phenomenon which occurs in all spheres of social life, not only in law. Every society is influenced in one way or another by external influence and some parts of a society's cultures evolve by borrowing from others.<sup>89</sup> Legal transplants are therefore certainly possible. However, whether those transplants are successful in the long run is the key issue. Just like a human organ transplant, the organ is moved from one body to another and once this has happened there is a transplant, whether the transplant is successful in the new body is then another issue to be considered. Consequently, this chapter has examined the factors that influence the success of legal transplants.

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<sup>88</sup> See Ch. 8.

<sup>89</sup> E Wise (n 52) 16.

While it has been reiterated throughout this chapter that this thesis does not advocate legal transplants, to the extent that it uses case studies from other countries to provide empirical evidence of the effectiveness of public civil enforcement, this chapter has argued that the concerns surrounding unsuccessful legal transplants do not arise here. Nigeria shares several similarities with the countries from which this thesis seeks to draw empirical evidence. Similarly, the reforms proposed in the previous chapter are *home grown* and have taken into consideration the need for efficient and accountable regulatory agencies in order to ensure effective use of the public civil enforcement regime. Consequently, Nigeria can indeed gather empirical evidence, and learn, from the enforcement experience of these countries. The next chapter will therefore examine enforcement case studies drawn from the UK and Australia.

# **CHAPTER 10: ENFORCEMENT: THREE CASE STUDIES**

## **10.1 Introduction**

In order to reinforce the case for public enforcement, this chapter examines the enforcement experience in other jurisdictions using case studies from the United Kingdom and Australia. As noted in the previous chapter, the choice of these two jurisdictions is based on several similarities they share with the Nigerian legal system.<sup>1</sup> There is therefore very good basis for drawing on the Australian and UK experiences in any analysis of Nigeria's regulatory regime.

It is very important to note at this point that the analysis in this chapter is not intended to be a 'full' comparative study of the enforcement regime in these jurisdictions. Rather this chapter makes use of three specific enforcement case studies from the UK and Australia in order to draw valuable lessons. It is concerned only with examining the apparent effectiveness of these enforcement mechanisms in these two countries to see how well (or badly) they have worked in practice, and whether this experience supports, or undermines, the theoretical arguments developed in respect of Nigeria in part 2 of this thesis.

Consequently, this chapter is divided into three sections. Section 10.2 commences by examining the first case study which is the UK derivative claims regime. The development of the UK derivative claims regime supports the scepticism, expressed in chapter 6, that derivative actions can be made to work effectively in Nigeria. While

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<sup>1</sup> See s9.6.1, ch 9.

the UK derivative claims regime has been through a significant reform process in order to increase access for shareholders, the pertinent question is whether these reforms have achieved their desired effect. The discussion below will answer that question negatively. It therefore supports the claim made in chapter 6 that the private civil enforcement regime is fraught with *inherent* difficulties which can hardly be resolved even by amending the law on private civil enforcement actions in order to make it more accessible.

The second case study is the UK directors' disqualification regime. This case study supports this thesis' argument about the potential effectiveness and superiority of public civil enforcement. It starts by briefly examining the features of the UK disqualification regime before going on to analyse its practical effectiveness as an enforcement mechanism. It makes use of empirical data on the incidences of directors' disqualification derived from the UK insolvency services. It shows that the UK disqualification regime has been very effective in terms of actively disqualifying directors of insolvent companies.

Admittedly, that effectiveness is somewhat limited by the fact that the regime tends to concentrate on disqualifying directors of insolvent companies. The UK disqualification regime is therefore less impactful where the company is still solvent. Consequently, this chapter examines the third case study. The Australian civil penalty regime, which addresses that weakness. It examines the effectiveness of that regime in terms of the number of successful enforcement actions taken by the regulator and its likely deterrent effect. It suggests that the regime has indeed enjoyed considerable success as an enforcement mechanism.

These three case studies do not, of course, demonstrate unequivocally that public civil enforcement must *always* outperform a private civil enforcement or criminal

enforcement regime, in terms of delivering the most effective enforcement of corporate regulation either generally, or in Nigeria specifically. However, they do at least add *some* persuasive empirical support to the theoretical argument developed in part 2.

It therefore argues that there is overwhelmingly positive evidence in favour of public civil enforcement drawn from both the UK and Australian jurisdictions.

## **10.2 Case Study 1: The UK Derivative Claims Regime**

The UK makes comprehensive provision for directors' duties under the Companies Act 2006. It is however well recognised that these duties are unlikely to perform any deterrent function or be of any use in corporate governance unless they are well enforced.<sup>2</sup> In order to enforce these duties, the UK relies heavily on private enforcement actions. One key strand of the UK's private enforcement regime is derivative proceedings and this enforcement mechanism will be the subject of our analysis.

### **10.2.1 Background**

Derivative proceedings have long been a part of the UK's private civil enforcement regime. They were developed by the common law courts as exceptions to the rule in *Foss v Harbottle*<sup>3</sup> and were permitted where

1. The wrong done amounted to 'fraud on the minority'; and
2. The wrongdoers are in control of the company and as such are unlikely to pursue a claim to redress the wrong done.<sup>4</sup>

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<sup>2</sup> A Keay, 'An Assessment of Private Enforcement Actions for Directors Breaches of Duty' (2014) 33(1) Civil Justice Quarterly 76, 77.

<sup>3</sup> (1843) 2 Hare 461



Derivative proceedings under the common law regime were however severely criticised and considered wholly inadequate. The type of wrongs that fell within the ‘fraud on the minority’ exception was generally unclear under the common law.<sup>5</sup> Furthermore, it was difficult to prove wrongdoer control especially in public listed companies with several shareholders.<sup>6</sup> It was therefore commonly argued that the law regarding shareholder’s ability to bring derivative proceedings was obscure and complex making it difficult for shareholders to build a strong claim.<sup>7</sup>

Data obtained on derivative proceedings under the common law regime also revealed the difficulties with this enforcement mechanism as claims under the common law regime were very rarely successful. This problem was more acute with regards to listed companies as shown by Armour’s empirical study on decisions obtained in UK minority shareholder enforcement actions between 1990 and 2006.

**Table 10.1 Decisions on Derivative Actions in the UK between 1990 and 2006.**

<b>Year</b>	<b>All Companies</b>	<b>Listed Companies</b>
<b>1990</b>	0	0
<b>1991</b>	0	0
<b>1992</b>	0.5*	0
<b>1993</b>	0	0
<b>1994</b>	1	0

<sup>4</sup> *Edwards v Halliwell* [1950] 2 All E.R 1064, *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch. 204.

<sup>5</sup> D Kershaw, *Company Law in Context: Text and Materials* (2nd edn, OUP 2012) 604.

<sup>6</sup> A Reisberg, *Derivative Actions and Corporate Governance* (OUP 2007) 92.

<sup>7</sup> Law Commission, *Shareholder Remedies* (LC 246, 1997) para 1.4; Julia Tang, ‘Shareholder Remedies: Demise of the Derivative Claim’ (2012) 1(2) UCL Journal of Law & Jurisprudence 178,181.

<b>Year</b>	<b>All Companies</b>	<b>Listed Companies</b>
<b>1995</b>	1	0
<b>1996</b>	0	0
<b>1997</b>	1	0
<b>1998</b>	1	0
<b>1999</b>	2	0
<b>2000</b>	0	0
<b>2001</b>	2	0
<b>2002</b>	3.5*	0
<b>2003</b>	4.5*	0
<b>2004</b>	1	0
<b>2005</b>	5.5*	0
<b>2006</b>	2	0
<b>Mean</b>	1.5	0.0

\*scores of 0.5 indicate actions framed as both derivative action and petition for relief from unfair prejudice

Table 10.1: Data on derivative actions in the UK between 1990 and 2006 was taken and adapted from J. Armour, 'Enforcement Strategies in UK Corporate governance: A Roadmap and Empirical Assessment' in J Armour & J Payne, *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart Publishing 2009) 83.

The table above shows that successful derivative actions under the common law regime were a rare occurrence. This was especially so for public listed companies as Armour's study shows that there was no successful derivative action in a listed company during the period under review. It was therefore generally conceded that the common law requirements governing derivative proceedings represented a major difficulty. As a result of this, several calls were made for a statutory derivative claims regime as it was thought that this would resolve the difficulties which plagued common law derivative proceedings.<sup>8</sup> These difficulties with the common law requirements were also recognised by the Law Commission which opined that derivative proceedings under the common law were 'rigid, old fashioned and unclear'.<sup>9</sup>

In response to the inadequacies of the common law regime, the Law Commission recommended that there should be a new derivative procedure with 'more modern, flexible and accessible criteria' for determining when shareholders should be able to bring derivative actions.<sup>10</sup> The Law Commission's recommendations regarding a statutory derivative claim were subsequently considered and adopted by the Company Law Reform Steering Group (CLRSG) which published its final report in July 2001.<sup>11</sup> The government's response to this final report are covered in a white paper, 'modernising company law', published in 2012 where most of the recommendations in the final report were accepted.<sup>12</sup> The recommendations for a new statutory derivative claims regime are now set out in Pt. 11 of the Companies Act 2006.

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<sup>8</sup> See S Watkins, 'The Common Law Derivative Action: An Outmoded Relic?' (1999) 30 *Cambrian Law Review* 40.

<sup>9</sup> Law Commission, *Shareholder Remedies* (LC 246, 1997) para 1.4.

<sup>10</sup> *Ibid* para 1.23V

<sup>11</sup> See the Company Law Review Steering Group, 'Modern Company Law for a Competitive Economy: Final Report: Vols. I and II' (London: DTI, 2001)

<sup>12</sup> Cm 5553 – I and II. Note however that the white paper is silent on the final report's recommendations to introduce a statutory derivative actions regime. For a full discussion of the

### 10.2.2 The UK Statutory Derivative Claims Regime

As mentioned above, the UK statutory derivative claims regime is contained in Pt. 11 of the Companies Act 2006 (CA). Section 260(3) of the CA provides for the grounds on which derivative claims may be brought. Derivative claims in the UK may be brought in respect of a breach of duty, breach of trust and even negligence. The term ‘director’ is also defined to include former directors and shadow directors.<sup>13</sup> Claims under the statutory derivative claims regime have therefore been made significantly wider than the previous common law position. The instances in which a director may be held liable is also no longer limited to cases where there has been ‘fraud’ and ‘wrongdoer control’.<sup>14</sup> A derivative claim can therefore still be brought where the director acted in good faith and has not benefitted personally.<sup>15</sup>

The Act provides for a ‘two stage procedure’ for members who wish to bring a derivative claim. The two-stage process was introduced in order to enable frivolous claims to be dismissed at an early stage thereby preventing a misuse of the derivative claims procedure while still ensuring that minority shareholders have a remedy in appropriate cases.<sup>16</sup> At the first stage, after the derivative claim has been filed, the applicant must apply for permission to continue the action. At this stage, the court must decide whether the application and the evidence filed by the applicant disclose a prima facie case.<sup>17</sup> The applicant has the burden to prove that he has a prima facie case and where he fails to do so the application will be dismissed and the court may

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government’s ‘white paper’ see R.J Goddard, ‘Modernising Company Law’’: The Government’s White Paper’ (2003) 66(3) *Modern Law Review* 402-424.

<sup>13</sup> s.260 (5) Companies Act 2006.

<sup>14</sup> Under the common law regime, a shareholder seeking to bring a derivative action was required to prove ‘fraud on the minority’ and ‘wrongdoer control’. See *Edwards v Halliwell (n 4)*, *Prudential Assurance Co Ltd (n 4)*.

<sup>15</sup> A Dignam and J Lowry, *Company Law* (9<sup>th</sup> edn, OUP 2016) 189.

<sup>16</sup> HC Deb June 6 2006, vol. 447, col 131.

<sup>17</sup> Companies Act 2006, s.261 (2).

make any consequential order it considers necessary.<sup>18</sup> At this stage, the court would consider the issue based on the applicants evidence alone and the defendant is not required to file any evidence at this stage.<sup>19</sup>

At the second stage, the company will be required to file evidence and the court will determine whether to grant permission to continue the claim.<sup>20</sup> Permission must be refused if the court is satisfied that a person acting in accordance with s.172 of the Act would not seek to continue the action. Permission must also be refused where the course of action has been authorised or ratified by the company either before or after occurrence.<sup>21</sup> Where any of these factors are present, the court is *mandated* to refuse permission. Section 263 (3 & 4) further sets out certain *discretionary* factors which the court should consider in granting permission. It is worth noting that these discretionary factors apply only where none of the mandatory bars in s263(2) apply. The discretionary factors to be considered by the court are

- whether the member is acting in good faith in seeking to continue the claim
- the importance that a person acting in accordance with section 172 would attach to continuing the claim
- whether the act or omission that resulted in the cause of action has been authorised before it occurred or ratified after it occurs
- whether the company has decided not to pursue the claim
- whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than

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<sup>18</sup> *ibid*

<sup>19</sup> Explanatory notes to the Companies Act 2006, para 492.

<sup>20</sup> Civil Procedure Rules 1998/3132, rule 19.9a.

<sup>21</sup> Companies Act 2006, s263 (2).

on behalf of the company and the views of independent members of the company.<sup>22</sup>

It is worth noting that this list is not exhaustive and the court may consider other factors in determining whether to grant permission to continue the claim.

The provisions of the statutory derivative claims regime represent a vast improvement on the common law regime; the key question however is whether this has led to a significant improvement in its effectiveness as an enforcement mechanism. It is important to note that the UK derivative claims regime has been criticised for its substantive content as well as its practical effectiveness. The substantive content of the UK statutory derivative claims regime has been criticised on different grounds. One of its key criticisms is that the two stage procedure for bringing derivative claims under the Companies Act makes derivative claims unnecessarily ‘time consuming and arduous’<sup>23</sup> thereby potentially deterring prospective litigants. Other criticisms of the UK statutory derivative claims regime includes the ‘hypothetical directors’ test’ contained in s263(2)a and the confusion regarding ratification under the Companies Act 2006.<sup>24</sup> This chapter is however more concerned with the practical effectiveness of the statutory derivative claims regime in terms of its actual use rather than the inherent deficiencies in the substantive provisions of the law. It would therefore examine, in the next section, how practically effective the UK statutory derivative claims regime has been as an enforcement mechanism since its inception in 2007.

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<sup>22</sup> Companies Act, s 263 (3 & 4).

<sup>23</sup> S Griffin, ‘Alternative Shareholder Remedies following Corporate Mismanagement- Which Remedy to Pursue’ (2010) 28(1) Company Law Newsletter 1,3

<sup>24</sup> See C.A Riley, ‘Derivative Claims and Ratification: Time to Ditch Some Baggage’ (2014) 34(4) Legal Studies 582 for an analysis of the problems occasioned by the current position of the UK Companies Act on ratification.

### **10.2.3 Practical Effectiveness of the UK Statutory Derivative Claims Regime**

While the UK statutory derivative claims regime broadens the circumstances in which derivative claims may be brought making it more flexible than the common law regime, this has not substantially increased derivative claims in the UK. The evidence suggests little increase in derivative claims since the Companies Act came into effect.<sup>25</sup> This specifically includes public listed companies, the type of company which this thesis is concerned about. The statutory derivative claims regime began operation on the 1<sup>st</sup> of October 2007. Table 10.2 shows the relevant data. The ‘headline’ point is that there has been no significant increase in the use of derivative claims under the statutory regime in comparison to the situation under the common law. The fact that only few cases have been successfully brought under the statutory regime leads to an inference that it has not truly increased access to courts for minority shareholders.<sup>26</sup>

#### **Table 10.2 Reported UK Derivative Claims since 2008**

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<sup>25</sup> D Ahern, ‘Directors’ Duties: Broadening the Focus Beyond Content to Examine the Accountability Spectrum’ 2011 (33) Dublin University Law Journal 116,134

<sup>26</sup> A Keay, ‘An Assessment of Private Enforcement Actions for Directors Breaches of Duty’ (n 2) 84.

<b>PERIOD</b>	<b>TOTAL</b>	<b>PRIVATE LIMITED LIABILITY COMPANIES</b>	<b>PUBLIC LIMITED LIABILITY COMPANIES (LISTED COMPANIES)</b>	<b>PERMISSION GRANTED</b>	<b>PERMISSION REFUSED</b>
2008	3	2	0*	0	2**
2009	3	3	0	1	1^
2010	3	3	0	2	1
2011	3	3	0	1	2
2012	3	3	0	2	1
2013	2	2	0	1	1
2014	2	2	0	1	1
2015	3	2	1	2	1
2016	2	2	0	0	2
Total	24	22	1	10	12

\* One of the three cases listed for 2008 relates to a public limited company which was not recorded as a listed company.<sup>27</sup>

\*\* Decision in one case was adjourned pending determination of some other related claim.

<sup>27</sup> See *Mission Capital Plc v Sinclair* [2008] EWHC 1339.



^ Decision in the third case was adjourned pending board's decision. Note that one of the three cases listed for 2009 relates to a landlord association.<sup>28</sup>

Table 10.2: Data on derivative claims in the UK where permission to continue claim under s263 of the Companies Act 2006 was sought. Data were derived from Westlaw database of cases.

Table 10.2 shows that since the 1<sup>st</sup> of October 2007, permission to continue derivative claims under Section 261 of the Companies Act 2006 has only been sought in 24 cases. This is indeed a very small number and shows that in spite of the reforms of the derivative claims regime in the UK, it has not resulted in a substantial increase in the use of this enforcement mechanism when compared to the previous common law position.<sup>29</sup>

The situation is made bleaker by the fact that out of those 24 cases where permission has been sought, only 2 out of those cases relates to a public limited company. Of the two public limited companies where permission to continue derivative claims has been sought, only one of the companies was a listed company.<sup>30</sup> This means that more than 85 percent of derivative claims brought in the UK were in respect of private limited liability companies. The implication of this is that breach of directors' duties in public listed companies are not being enforced by derivative claims in the UK. Consequently, in the absence of alternative enforcement mechanisms, directors' breach in those companies are likely to go 'unredressed'. The data obtained here also corroborate the prior empirical study, conducted by Armour et al, which found that the likelihood that a director of a public listed company in the UK will be sued under

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<sup>28</sup> See *Stimpson v Southern Landlord Association* [2009] EWHC 2072 (ch).

<sup>29</sup> see Table 10.1

<sup>30</sup> See *Bridge v Daley* [2015] EWHC 2121 (Ch.). The company was listed on the Alternative Investment Market (AIM) of the Stock Exchange.

UK companies' legislation is almost none.<sup>31</sup> Private enforcement actions against directors of public listed companies in the UK were simply not filed. They therefore argued that directors of publicly listed companies in the UK face very little risk of being sued in an English court under UK company law.<sup>32</sup>

Therefore, in spite of the significant reforms made in the Companies Act 2006, intended to increase access to derivative proceedings for minority shareholders and ensure effective enforcement, the results in terms of actual increase in the use of derivative proceedings have been quite disappointing. This is particularly more so with regards to enforcement of breaches in public listed companies. These results corroborate our earlier claim in chapter 6 that derivative claims are fraught with *inherent* difficulties which hinders their effectiveness as an enforcement action in corporate law. Recall that these inherent difficulties discussed in chapter 6 include lack of incentive to bring claims, information asymmetries and the cost problem.<sup>33</sup> These difficulties undermine the effectiveness of derivative proceedings as an enforcement mechanism. Precisely because they are inherent in the very nature of derivative proceedings specifically and, to some extent, the nature of private civil proceedings more generally.

Consequently, while changes in the law and procedural requirements for bringing derivative proceedings may slightly improve the use of this enforcement action, they are unlikely to lead to any substantial increase as seen by the UK experience. Even if Nigeria were to reform its current derivative action regime, the UK experience suggests that this would likely make little difference to the number of derivative

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<sup>31</sup> J Armour, B Black, B Cheffins & Richard Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States. (2009) 6(4) Journal of Empirical Legal Studies 687,699.

<sup>32</sup> *ibid* 700.

<sup>33</sup> For a further discussion of these difficulties see s6.4.

actions. This is not to say that private enforcement actions do not play any role in enforcement of corporate law. Rather the argument is that their number will always be modest at best, and efforts to improve the effectiveness of enforcement of corporate law in Nigeria must be sought elsewhere. Public civil enforcement offers a potentially more effective enforcement regime, and more fruitful terrain for our reforming energies. In light of this, the next section will examine the UK disqualification regime.

### **10.3 Case Study 2: The UK Disqualification Regime**

The UK disqualification regime has its origin in the 1982 report of the Cork Committee.<sup>34</sup> The concern of the Cork Committee was the ease with which a director could potentially mismanage a company resulting in insolvency and then just move on to form a new company carrying on business as usual while leaving behind unpaid creditors.<sup>35</sup> As a result of the Cork Committee recommendations, the disqualification provisions previously contained in the Companies Act 1985 and the Insolvency Act 1985 were strengthened and consolidated in the Company Directors Disqualification Act 1986 (CDDA).<sup>36</sup> The principle behind the director disqualification regime in the UK is that persons who have abused their position in the company should be deprived of access to a similar position for a period of time. Hence, in *Re Blackspur Group Plc*,<sup>37</sup> it was held that the purpose of the Company Directors Disqualification Act of 1986 is to protect the public by deterring further

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<sup>34</sup> See Report of the Review Committee on Insolvency Law and Practice (The Cork Committee) Cmnd 8558, para 1813.

<sup>35</sup> Dignam and Lowry (n 15) 294.

<sup>36</sup> Note that the UK disqualification regime has been further extended and strengthened by the Insolvency Act 2000 as well as the Small Business, Enterprise and Employment Act 2015. See below for a further discussion.

<sup>37</sup> [1998] 1 WLR 422,426.

misconduct and encouraging higher standards of honesty and diligence in corporate management. It does this in two ways. First, it takes out of circulation those who have behaved badly, and are consequently unfit to take part in the management of a corporation.<sup>38</sup> Second, it deters further misconduct by incumbent directors under the threat of being disqualified.

Dignam and Lowry have classified the grounds for disqualification orders in the UK into two; these are discretionary orders and mandatory orders for unfitness.<sup>39</sup> A discretionary basis for which the court may issue a disqualification order is where a person has been convicted of an indictable offence in connection with the promotion, formation, management, liquidation, or striking off a company, and receivership of a company's property.<sup>40</sup> The offence therefore need not directly relate to the management of the company as long as it was committed 'in connection' with its management.<sup>41</sup> The maximum disqualification period is 5 years where the order is made by a court of summary jurisdiction and 15 years in any other case.<sup>42</sup> The court may also disqualify a person who appears to have persistently been in default of the companies' legislation regarding filing of certain documents with the registrar of companies.<sup>43</sup> The maximum disqualification period for this breach is 5 years.<sup>44</sup> A disqualification order may also be made against a person where, in the course of winding up, it appears that he is guilty of an offence of fraudulent trading, or is otherwise guilty of fraud or breach of duty while he was an officer, liquidator, receiver or manager of the company.<sup>45</sup> The maximum disqualification period for this

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<sup>38</sup> See *Re Stanford Services Ltd & ors* (1987) 3 BCC 326, 336.

<sup>39</sup> Dignam and Lowry (n 15) 296-305.

<sup>40</sup> CDDA 1986, s 2.

<sup>41</sup> Dignam and Lowry (n 15) 296.

<sup>42</sup> CDDA 1986, s 2(3).

<sup>43</sup> CDDA 1986, s 3.

<sup>44</sup> CDDA 1986, s3 (5).

<sup>45</sup> CDDA 1986, s4.

offence is 15 years.<sup>46</sup> Finally, the court may also make a disqualification order for a maximum of 15 years if, after investigation, it appears to the secretary of state that a disqualification order ought to be made in the public's interests.<sup>47</sup>

The mandatory ground for disqualification orders is based on the ground of 'unfitness'. Section 6(1) of the CDDA provides that the court *shall* make a disqualification order against a director of an insolvent company where the director's conduct at that company makes him unfit to be concerned in the management of a company. The court must therefore disqualify a director if it is shown that his conduct in relation to a company which is now insolvent makes him unfit. The minimum period of disqualification under this ground is 2 years and the maximum period is 15 years.<sup>48</sup> It is important to note that in contrast to the other disqualification grounds, disqualification under section 6 is restricted to directors or shadow directors.<sup>49</sup> An application under section 6 must also be brought by the Secretary of State or by the official receiver if the company is in compulsory liquidation.<sup>50</sup>

An important development in the UK's disqualification regime relates to the introduction of disqualification *undertakings*. The Insolvency Act 2000 introduced a procedure whereby in certain circumstances which are set out in sections 7 and 8 of the CDDA, the Secretary of State may accept a disqualification undertaking. This is an undertaking by a person that for a period specified in the undertaking, he will not in any way be a director of a company, act as a receiver of a company's property or 'directly or indirectly' take part in the promotion, formation or management of a

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<sup>46</sup> CDDA 1986, s4 (3).

<sup>47</sup> CDDA 1986, s8.

<sup>48</sup> CDDA 1986, s6 (4).

<sup>49</sup> CDDA 1986, s6(3c)

<sup>50</sup> CDDA 1986, s7 (1).

company unless he has the leave of the court to do so.<sup>51</sup> If the Secretary of State believes that the conditions set out in section 6(1) CDDA have been satisfied and it appears to be in the public's interest to do so, he will accept the disqualification undertaking.<sup>52</sup>

The basis for the introduction of disqualification undertakings was to avoid the necessity of having court hearings where the insolvency service and director could easily reach an agreement on the terms of the disqualification.<sup>53</sup> This therefore saves court time and costs. However, a court hearing can still take place at the director's costs if he refuses to accept the terms of the undertaking. A director who has accepted an undertaking may also later apply to court for the period of the disqualification to be reduced or for the disqualification undertaking to be cancelled.<sup>54</sup> The introduction of disqualification undertakings significantly reduced the caseload for disqualification court orders. It has therefore resulted in a marked decrease in the number of disqualification orders.<sup>55</sup>

The effect of a disqualification order or undertaking is that a person shall not, without the leave of the court, act as a director, insolvency practitioner, receiver of a company's property or take part in the 'promotion, formation or management of a company...'<sup>56</sup> It in effect takes the director out of circulation in relation to a company's management. Therefore, the director is not only disqualified from being a director, but also disqualified from taking part in any form of management activity whatsoever in relation to companies.

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<sup>51</sup> See Insolvency Act 2000, s6 (2); CDDA 1986, s1A.

<sup>52</sup> CDDA 1986, s7 (2A).

<sup>53</sup> P.L Davies and S Worthington, *Gower's Principles of Modern Company Law* (10<sup>th</sup> edn, Sweet & Maxwell 2016) 10-2.

<sup>54</sup> *ibid* 10-2.

<sup>55</sup> See below table 10.3 for data on disqualification orders and undertakings in the UK.

<sup>56</sup> See CDDA 1986, s1 (1) &1A (1).

The Small Business, Enterprise and Employment Act 2015 (SBEEA) has made some recent important reforms to the disqualification regime. Section 104 SBEEA provides that the court may now disqualify a person who has been convicted of certain company related offences abroad.<sup>57</sup> In addition to this, those who instructed or exercised influence over a disqualified director can also be disqualified.<sup>58</sup> Furthermore, in determining a person's unfitness for the purpose of disqualification, reference may now be made to the person's conduct as a director of other companies including overseas companies.<sup>59</sup> The period for applying for disqualification orders against unfit directors of insolvent companies is also now extended from 2 years to 3 years.<sup>60</sup>

A further significant reform of the disqualification regime is in respect of compensation orders and undertakings. Section 110 of the SBEEA<sup>61</sup> introduced the ability of the Secretary of State to apply for *compensation orders* to be made against, and to accept *compensation undertakings* from, disqualified directors under s.15A of the CDDA.<sup>62</sup> In order to obtain a compensation order, two conditions must be met. First, the person must be subject to a disqualification order or undertaking. Second, the conduct for which the person is subject to the disqualification order or

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<sup>57</sup> The offence committed must also be an indictable offence under the laws of England, Wales or Scotland. The maximum disqualification period under this section is 15 years. See further SBEEA, s104.

<sup>58</sup> SBEEA, s105.

<sup>59</sup> SBEEA, s106.

<sup>60</sup> SBEEA, s108.

<sup>61</sup> Note that s110 SBEEA inserted ss.15a-15c into the CDDA. This provision took effect on the 1<sup>st</sup> of October 2015. See further P Bailey, 'October Changes to Company Law and Corporate Insolvency Law Summarised' (2015) 376 Company Law Newsletter 1-4.

<sup>62</sup> The right to apply for variation or revocation of compensation undertakings was similarly provided by inserting s.15C into the CDDA from the same date.

See also the Compensation Orders (Disqualified Directors) Proceedings (England and Wales) Rules 2016 (SI 2016/890) which were issued on 13 September and came into force on 1 October 2016. The rules make provision in England and Wales for the procedure for bringing applications by the Secretary of State for compensation orders against disqualified directors and applications for the variation and revocation of compensation undertakings.

undertaking must have caused loss to one or more creditors of an insolvent company where the person was once a director.<sup>63</sup> Hence, the compensation order is intended for the benefit of creditors who have suffered loss as a result of a company's insolvency.

The introduction of the compensation order and undertaking has the potential to significantly strengthen the UK disqualification regime. Therefore, the UK disqualification regime not only has a deterrent effect, but also, potentially, provides a compensatory benefit. This is highly commendable as it enhances the overall effectiveness of the disqualification regime as an enforcement mechanism.<sup>64</sup>

### 10.3.1 Practical Effectiveness of the UK disqualification regime

Data derived from the Insolvency Service show that the disqualification regime has been effectively used to disqualify unfit directors.

**Table 10.3**

#### **Director Disqualification Orders and Undertakings (Great Britain)**

<b>PERIOD</b>	<b>TOTAL</b>	<b>ORDERS</b>	<b>UNDERTAKINGS</b>
2009	1,365	286	1,079
2010	1,509	286	1,223
2011	1,185	251	934

<sup>63</sup> See CDDA 1986, s15(a) 3.

<sup>64</sup> As discussed in chapter 3, an enforcement regime should be evaluated by reference to its ability to meet deterrence and compensatory purposes. For a further discussion and critique of the newly introduced compensatory provision, see R Williams, 'Civil Recovery from Delinquent Directors' (2015) 15(2) *Journal of Corporate Law Studies* 311-339.



2012	1,011	184	827
2013	1,245	227	1,018
2014	1,300	237	1,063
2015	1,060	207	853

Table 10.3: Insolvency Services, ‘Directors Disqualification Orders and Undertakings’ in ‘Insolvency Services Enforcement Outcomes – October to December 2015 – Tables (11<sup>th</sup> February 2016)

<<https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-experimental-statistics-october-to-december-2015>> accessed 4<sup>th</sup> April 2016.

**Table 10.4: Length of Directors Disqualification Orders and Undertakings**

Period	Average Length of Order	Length of Disqualification Order			Average Length of Undertaking	Length of Disqualification Undertaking		
		2 to 5 years	Over 5 to 10 years	Over 10 to 15 years		2 to 5 years	Over 5 to 10 years	Over 10 to 15 years
<b>2009</b>	7.7	99	120	67	5.8	585	377	117

Period	Average Length of Order	Length of Disqualification Order			Average Length of Undertaking	Length of Disqualification Undertaking		
		2 to 5 years	Over 5 to 10 years	Over 10 to 15 years		2 to 5 years	Over 5 to 10 years	Over 10 to 15 years
<b>2010</b>	7.8	81	135	70	5.8	670	448	105
<b>2011</b>	6.8	100	125	26	5.6	566	292	76
<b>2012</b>	7.1	72	78	34	5.4	531	232	64
<b>2013</b>	7.3	94	80	53	5.4	666	266	86
<b>2014</b>	7.5	88	92	57	5.2	718	273	72
<b>2015</b>	7.2	77	95	35	5.6	507	272	74

Table 10.4: Insolvency Services, ‘Length of Directors Disqualification Orders and Undertakings’ in ‘Insolvency Services Enforcement Outcomes – October to December 2015 – Tables (11<sup>th</sup> February 2016)

<<https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-experimental-statistics-october-to-december-2015>> accessed 4th April 2016.

From the data above, it is apparent that the director disqualification regime has been actively used as an enforcement mechanism in the UK. Table 10.3 shows that in 2015 alone, the total number of disqualification orders and undertakings was 1060. Many

would agree that this is by any standard a very good level of enforcement activity. The data in Table 10.3 also shows that in every year there has been a higher number of disqualification undertakings than disqualification orders. This shows that disqualification undertakings are actually being put to good use consequently saving valuable court time and resources.

In addition to this, Table 10.4 reveals that the average length of disqualification orders over the past seven years have been 7.3 years while the average length of disqualification undertakings have been 5.5 years. Therefore, on average, the duration of disqualification orders and undertakings have been reasonable lengthy. The length of the disqualification orders and undertakings is therefore severe enough to ensure effective deterrence.

A prime example of the UK's use of its disqualification regime is seen in the disqualification of some directors of Barings banking group.<sup>65</sup> The Barings banking group collapsed in February 1995 as a result of the unauthorised activities of Nick Leeson, a 'rogue trader', who had made trading losses of about £827 million. The main Barings companies in the UK also went into administration as a result of this. Following this, the secretary of state for trade and industry instituted director disqualification proceedings against ten directors of Barings companies, for their failure to supervise Leeson's activities. The case against three directors went to trial.

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<sup>65</sup> See *Baker V Secretary of State for Trade and Industry [2001] B.C.C 273*. Note that one of the directors unsuccessfully appealed the finding of unfitness and disqualification order. Other recent examples of director disqualification are the case of *Secretary of State for Business, Innovation and Skills v Adedapo [2015] CSOH 152* where a five-year disqualification order was granted under s6 of the CDDA 1986 in respect of the sole director of an insolvent company who had deliberately acted in a way that was detrimental to the company's creditors. See also *Secretary of State for Business, Innovation and Skills v Russell [2015] CSOH 128*, where a six-year disqualification order was granted under s6 of CDDA 1986. See also *FG Hawkes (western) Ltd Re [2015] EWHC 1585* where two company directors were disqualified under s6 of the CDDA 1986 for being unfit to manage a company.

At the trial, the judge found the directors to be unfit and ordered that they should be disqualified.

In addition to the UK's general disqualification regime, there have also been prohibitions or bans imposed by UK financial services regulators on directors operating in the financial services industry from taking up further roles in that industry.<sup>66</sup> A key example is seen in the ban of Peter Cummings, one of the executives of Halifax Bank of Scotland, from performing any 'significant influence' function in a financial services firm by the former Financial Services Authority in the wake of the bank's near collapse.<sup>67</sup> Similarly, more recently, the former chief executive officer of the Cooperative Bank, Barry Tootell, and a former managing director, Keith Alderson, were both banned as a result of the near collapse of that bank in 2013.<sup>68</sup>

In spite of these commendable enforcement activities, it is argued that the UK's general disqualification regime is not fully efficient. Almost all the attention of the UK disqualification regime is placed on directors of insolvent companies. Hence, most of the disqualification orders and undertakings issued are in respect of section 6 of the CDDA Act 1986 which relates to directors of insolvent companies. This is evident from the insolvency services own data reproduced in table 10.5.

### **Table 10.5**

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<sup>66</sup> These bans are made pursuant to s56 (2) of the Financial Services and Markets Act 2000 (FSMA) which provides that an order may be made prohibiting an individual from performing a specified function.

<sup>67</sup> FSA, 'Final notice', <<http://www.fsa.gov.uk/static/pubs/final/peter-cummings.pdf>> accessed 04/04/16. See also Jill Treanor, 'Ex-HBOS Banker Cummings Banned for Life and Fined £500,000' *The Guardian* (12<sup>th</sup> September 2012) <<http://www.theguardian.com/business/2012/sep/12/hbos-banker-peter-cummings-banned-fined-fsa>> accessed 04/04/16.

<sup>68</sup> See BBC, 'Former Co-Op Bank Executives Banned from Senior Financial Roles' *BBC* (15 January 2016) <<http://www.bbc.co.uk/news/business-35324438>> accessed 04/04/16.

### Director Disqualification Orders and Undertakings by Section

PERIOD	TOTAL	SECTION 2	SECTION 6	SECTION 8
2009	1,365	56	1,289	20
2010	1,509	48	1,451	10
2011	1,185	48	1,122	15
2012	1,011	50	957	4
2013	1,245	61	1,179	5
2014	1,300	73	1,227	0
2015	1,060	39	1,018	3

Table 10.5: Insolvency Services, ‘Director Disqualification Orders and Undertakings by Section’ in ‘Insolvency Services Enforcement Outcomes – October to December 2015 – Tables’ (11<sup>th</sup> February 2016)

<<https://www.gov.uk/government/statistics/insolvency-service-enforcement-outcomes-experimental-statistics-october-to-december-2015>> accessed 04/04/16.

The above data reveal that more than 80% of disqualification orders and undertakings under the UK disqualification regime are issued under section 6 of the CDDA. Therefore, most of the disqualification orders and undertakings in the UK are in respect of insolvent companies. This has led to concerns about the effectiveness of the UK disqualification regime as unfit directors are usually exposed only after the

company has fallen into difficulties.<sup>69</sup> This begs the question of what happens to directors of solvent companies who are unfit and should be the subject of enforcement action due to misconduct.

While it is important to disqualify directors of insolvent companies, there is need for some enforcement action to be taken against directors of solvent companies who have breached their duties or other corporate law requirements. This will ensure that the enforcement regime properly imposes a deterrent effect on company directors generally, including those whose companies are perhaps not at risk of insolvency. The current UK director disqualification regime is however unable to achieve this effective deterrence as it is focused almost exclusively on disqualifying directors of insolvent companies.

In addition to this, the UK's public civil enforcement regime is restricted to directors' disqualification. It therefore makes no provision for imposition of other forms of sanctions on directors. It can therefore be argued that the UK's public civil enforcement regime is incomplete. As discussed in chapter 7,<sup>70</sup> it is essential for a regulator to possess a wide variety of sanctions in its enforcement arsenal. This will ensure that it is able to employ the right sanction for individual circumstances. The UK's public civil enforcement regime is however lacking in this respect, as it is unable to deal with other infractions which do not necessitate a sanction as severe as director disqualification. This problem is further coupled by the fact that its disqualification regime is unduly focused on insolvent companies. Therefore, while the UK disqualification regime has certain commendable features, and has been effective in certain respects, it nevertheless falls short in some other regard.

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<sup>69</sup> D Arsalidou, 'The Banking Crisis: Rethinking and Refining the Accountability of Bank Directors' (2010) 4 *Journal of Business Law* 284,294.

<sup>70</sup> See s7.3.1.1

In summary, some of the positive features of the UK disqualification regime which can be emulated by Nigeria are:

- **Certainty of Sanctions:** The number of successful disqualification orders and undertakings obtained each year demonstrates effective use of the disqualification regime.
- **Speedy Disposition of Cases (Celerity of Sanctions):** The Insolvency Service is the body responsible for administering the disqualification regime. Its efficiency is demonstrated not only by the number of disqualification order and undertakings obtained, but also by its speedy disposition of disqualification proceedings. According to the Insolvency Service Annual Reports and Accounts, it has instigated disqualification proceedings within 23 months in 98% of cases brought before it.<sup>71</sup> Disqualification proceedings are therefore quickly instituted by the Insolvency Service thereby ensuring that sanctions are swiftly applied.
- **Cost effectiveness:** The use of disqualification undertakings has significantly reduced the court's caseload with regards to disqualification proceedings. It has also eliminated the costs associated with court proceedings. Disqualification undertakings therefore offer a quicker and essentially cheaper means of disqualifying directors. The UK disqualification regime is also cost effective as each disqualified director has a net benefit of £100,000 pounds for the economy.<sup>72</sup>
- **Severity of sanctions obtained:** The lengthy nature of the disqualification orders and undertakings obtained is commendable. The average length of disqualification orders and undertakings secured against directors is 6 years. Similarly about 12% of

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<sup>71</sup> The Insolvency Service, 'Annual Reports and Accounts' 2014-2015  
<[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/460523/annual-report-14-15.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/460523/annual-report-14-15.pdf)>, 12 accessed 28<sup>th</sup> April 2016.

<sup>72</sup> The Insolvency Service, 'The Insolvency Service Annual Plan 2015-2016'  
<[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/448443/Insolvency\\_Service\\_Plan\\_2015-16.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/448443/Insolvency_Service_Plan_2015-16.pdf)>, 2 accessed 28/04/2016.

directors are disqualified for more than 10 years while about 49% are disqualified for five years or longer.<sup>73</sup>

- Regulatory accountability - The Insolvency Service is an agency of the Department for Business, Innovation and Skills. (BIS), it is therefore fully accountable to parliament through ministers. This ensures that the agency meets up with its performance targets with regards to director disqualification. Failure to do this would make it the subject of parliamentary inquiries.

On the other side, some weaknesses of the UK disqualification regime are:

- Its undue focus on directors of insolvent companies thereby preventing redress where a breach has been committed by directors of solvent companies.
- Its lack of explicit mechanisms for detecting directors who breach the disqualification order or undertaking imposed. This is important because there is always the risk that a disqualified director may potentially act as a shadow or *de facto* director while claiming to be a mere employee.<sup>74</sup>

In light of the shortcomings of the UK disqualification regime, the next section will analyse the Australian civil penalty regime as an example of a jurisdiction which offers a more robust public civil enforcement regime and has successfully used it in enforcing breach by directors.

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<sup>73</sup> The Insolvency Service, 'Annual Reports and Accounts' (n 71) 14.

<sup>74</sup> D Arsalidou, *Rethinking Corporate Governance in Financial Institutions* (Routledge 2016) 47.



### **10.4 Case Study 3: The Australian Civil Penalty Regime**

The Australian civil penalty regime which is contained in part 9.4B of the Corporations Act 2001 came into operation on the 1<sup>st</sup> February 1993 based on the recommendation of the Senate Standing Committee on Legal and Constitutional Affairs ('Cooney Committee'). The civil penalty regime for enforcement of director's duties was introduced in order to limit the place of criminal sanctions to only the most serious breaches.<sup>75</sup> Prior to the commencement of the civil penalty regime, directors' duties were enforceable by criminal sanctions.<sup>76</sup> However, difficulties with criminal proceedings such as the standard of proof and criminal rules of evidence prevented the criminal regime from being an effective enforcement system thereby necessitating the civil penalty regime.

The Australian civil penalty regime allows the Australian Securities and Investments Commission (ASIC) to commence court-based proceedings against directors who are suspected of breaching their statutory duties. The orders that can be sought by ASIC are:

- Declaration of contravention
- Pecuniary penalties (fines) up to \$200,000
- Compensation orders
- Disqualification orders.<sup>77</sup>

These orders serve varying purposes. The primary purpose of the pecuniary penalty order is to punish offenders and provide specific and general deterrent.<sup>78</sup> The

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<sup>75</sup> V Comino, 'Effective Regulation by the Australian Securities and Investments Commission: The Civil Penalty Problem' (2009) 33 Melbourne University Law Review 803,804  
<[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1686927](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1686927)> accessed 06/04/2016.

<sup>76</sup> *ibid* 805.

<sup>77</sup> See Corporations Act 2001, ss 1317J, 1317G, 1317H, & 206C.

disqualification order, on its own, is intended to protect the public against abuse of the corporate structure by unfit directors. It also has a punitive effect in addition to providing specific and general deterrence. The length of the disqualification order is at the court's discretion and there is no limit on the length of the disqualification order that may be imposed.<sup>79</sup> The compensation orders are generally intended to compensate the company for the loss suffered as a result of the director's breach.<sup>80</sup> To order payment of compensation, the court must be satisfied that there has been a breach of duty and that the corporation has suffered damage as a result of that breach.<sup>81</sup> The Australian civil penalty regime therefore attempts to ensure effective enforcement by providing deterrence, compensation and punishing offenders. It is also important to note that proceedings for a declaration of contravention or pecuniary penalty orders are treated as civil proceedings as such civil evidence rules and procedure are applied.<sup>82</sup>

In addition to the court based proceedings which ASIC can institute against directors who have breached their duties, ASIC also has the power to commence protective actions for breach. These are known as 'administrative actions'.<sup>83</sup> Hence, in addition to the power which ASIC has to seek disqualification orders from the court; ASIC also has the administrative power to disqualify a person from managing a corporation without recourse to the courts. In addition to this, ASIC may also publish public warning notices. Appeals from administrative actions taken by ASIC go to the Administrative Appeals Tribunal (AAT).

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<sup>78</sup> M Welsh, 'Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia' (2014) 42 Federal Law Review 217,237.

<sup>79</sup> Corporations Act 2001, s206c (1)

<sup>80</sup> Welsh, Realising the Public Potential of Corporate Law (n 78) 237

<sup>81</sup> See Corporations Act 2001, ss1317H, 1317HA (1).

<sup>82</sup> Corporations Act 2001, s1317L.

<sup>83</sup> ASIC, 'ASIC's Approach to Enforcement, Information Sheet 151'

<[http://download.asic.gov.au/media/1339118/INFO\\_151\\_ASIC\\_approach\\_to\\_enforcement\\_20130916.pdf](http://download.asic.gov.au/media/1339118/INFO_151_ASIC_approach_to_enforcement_20130916.pdf)> accessed 17<sup>th</sup> October 2016.

#### 10.4.1 Effectiveness of the Australian Civil Penalty Regime

An examination of ASIC's use of the civil penalty regime shows that it has achieved a good degree of success.<sup>84</sup> Success here is defined by the fact that this enforcement regime is frequently used by ASIC and it (ASIC) has obtained a declaration of contravention against at least one named defendant in its civil penalty applications in addition to obtaining other civil penalty orders.<sup>85</sup> While the civil penalty regime was not frequently used between 1993 and 1999, the story has now changed as since 2000 the regime has been used more effectively.<sup>86</sup>

Welsh's analysis of ASIC's civil penalty regime reveals that it has been an effective enforcement mechanism for breach of director's duties, insolvent trading, insider trading and continuous disclosure provisions.<sup>87</sup> In the early days of the civil penalty regime, most of the civil penalty applications were in respect of directors of proprietary (private) companies, however in recent years this trend has been reversed as more applications are now been made against directors of public companies.<sup>88</sup> Between February 1993 and June 2013, ASIC commenced civil penalty proceedings based on allegation of breach of directors statutory duties on 38 occasions. The result of 3 out of those 38 cases is unknown. With the remaining cases where the outcome is known, ASIC has achieved a very good degree of success as it obtained declaration of contraventions and civil penalty orders against at least one of the named defendants in a total of 29 cases.<sup>89</sup>

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<sup>84</sup> M Welsh, 'The Use of Civil Sanctions for Breaches of Corporate Law' (Submission to the Department of Treasury's Review of Sanctions in Corporate Law) Department of Business Law and Taxation: Corporate Law and Accountability Research Group Working Paper No 7 (2007) <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1029846](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1029846)>, 2 accessed 10<sup>th</sup> February 2016.

<sup>85</sup> *ibid* 17.

<sup>86</sup> *ibid* 2.

<sup>87</sup> *ibid*.

<sup>88</sup> M Welsh, 'Realising the Public Potential of Corporate Law (n 78) 234.

<sup>89</sup> *Ibid*.

**Table 10.6****Orders Sought by ASIC**

<b>Orders sought</b>	<b>No of Cases</b>
Declaration of contravention (no other orders)	1
Pecuniary penalty orders alone	1
Disqualification orders alone	7
Compensation orders alone	0
Pecuniary penalty and disqualification orders	16
Disqualification and compensation orders	2
Pecuniary penalty and compensation orders	2
Pecuniary penalty, disqualification and compensation orders	7
Unknown	2
Total number of cases seeking disqualification orders	32
Total number of cases seeking pecuniary penalty orders	26
Total number of cases seeking	11

<b>Orders sought</b>	<b>No of Cases</b>
compensation orders	

Table 10.6: Data directly obtained from M Welsh, ‘Realising the Public Potential of Corporate Law: Twenty Years of Civil Penalty Enforcement in Australia’ (2014) 42 Fed. L. Rev 217,237

In addition to the data above, additional information obtained directly from ASIC also reveal that the regulator makes regular use of its public civil enforcement regime.

**Table 10.7**

**ASIC Enforcement Outcomes in Respect of Action against Directors<sup>90</sup>**

	<b>Civil Actions*</b>	<b>Administrative Actions^</b>
<b>1<sup>st</sup> July 2011 – 31<sup>st</sup> December 2011</b>	10	-
<b>1<sup>st</sup> January 2012 – June 2012</b>	2	-
<b>1<sup>ST</sup> July 2012 -31<sup>st</sup> December 2012</b>	2	2
<b>1 January 2013 – 31<sup>st</sup> December 2014</b>	5	-

<sup>90</sup> Enforcement outcomes generally refer to formal actions taken to secure compliance about which ASIC has made a formal announcement. See ASIC, ASIC Enforcement Outcomes, < <http://asic.gov.au/about-asic/asic-investigations-and-enforcement/asic-enforcement-outcomes/>> accessed 7<sup>th</sup> October 2016.

	<b>Civil Actions*</b>	<b>Administrative Actions^</b>
<b>1<sup>st</sup> January 2015 – 30<sup>th</sup> June 2015</b>	2	5
<b>1<sup>st</sup> July 2015 – 31<sup>st</sup> December 2015</b>	4	4

\*Civil actions here refer solely to court ordered penalties. Therefore, the enforcement outcomes above do not include the less formal actions taken by ASIC to secure compliance where breach has occurred.

^Administrative actions refer to sanctions that are imposed by ASIC without recourse to the courts.<sup>91</sup>

Table 10.7: Data derived from ASIC, ‘ASIC Enforcement Outcomes’,

< <http://asic.gov.au/about-asic/asic-investigations-and-enforcement/asic-enforcement-outcomes/>> accessed 7<sup>th</sup> October 2016.

### **Table 10.8**

#### **Number of Directors Disqualified or Removed from Managing Corporations**

<b>Year</b>	<b>Number of Directors Disqualified</b>
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<sup>91</sup> ASIC, ‘ASIC’s Approach to Enforcement, Information Sheet 151’ <[http://download.asic.gov.au/media/1339118/INFO\\_151\\_ASIC\\_approach\\_to\\_enforcement\\_20130916.pdf](http://download.asic.gov.au/media/1339118/INFO_151_ASIC_approach_to_enforcement_20130916.pdf)>, 6 accessed 7<sup>th</sup> October 2016.

2014-2015	40
2012-2013	72
2011-2012	84

Table 10.8: Data derived from ASIC, ‘Outcomes in Detail, Annual Report 2014-2015’ < <http://download.asic.gov.au/media/3437963/asic-annual-report-2014-15-section-2.pdf>>, 61 accessed 6<sup>th</sup> October 2016.

Table 10.8 shows that ASIC has made effective use of its civil penalty regime in disqualifying a good number of directors. In view of this, Welsh argues that the prevailing evidence suggests that ASIC sees its role to be one of protecting the market by removing unfit directors and sending a ‘strong deterrent message’ to the market by targeting high profile defendants and pursuing punitive orders.<sup>92</sup> While the data in table 10.6 show that a compensation order was sought in 11 cases, it was never the only order sought.<sup>93</sup> This demonstrates the primacy given to deterrence and the need to punish offenders by ASIC.

Many of the Australian civil penalty applications have been made against high profile defendants which further supports the view that the regulators intend to pass a strong deterrent message to others. One of such cases is the James Hardie case.<sup>94</sup> In 2007, ASIC commenced civil penalty applications against the directors of James Hardie Industries Ltd (JHIL) a public listed company. JHIL in view of its exposure to compensate victims of asbestos disease due to its subsidiaries’ manufacture of asbestos had set up a foundation, the Medical Research and Compensation

<sup>92</sup> M Welsh, ‘Realising the Public Potential of Corporate Law (n 78) 239.

<sup>93</sup> *ibid* 238.

<sup>94</sup> See *ASIC v Macdonald (no 11) [2009] NSWSC 287, ASIC v Hellicar (2012) 247 CLR 345.*

Foundation Ltd (MRCF), to handle its asbestos claims. As required under the Australian continuous disclosure requirements, JHIL made an announcement to the Australian Securities Exchange (ASX) and also issued press releases about the arrangement. The announcement was to the effect that the foundation would have sufficient funds to meet all legitimate asbestos claims and would be fully funded. It however later became clear that the foundation was significantly underfunded to a sum up to an excess of \$1 billion. It was therefore alleged that the announcements made by the JHIL gave a false and misleading impression that the MRCF would have sufficient funds to meet all current and future asbestos claims. ASIC's civil penalty proceedings therefore alleged the defendants had breached their statutory duty of care.

The somewhat difficult litigation, which involved two appeals to the Australian High Court, led to an ultimate decision that the defendants had breached the Corporations Act 2001 by making misleading or deceptive statement in relation to the adequacy of the foundation's funding and had failed to comply with their continuous disclosure obligations. Consequently, JHIL's chief executive officer, Peter Macdonald, its chief financial officer Philip Morley, its company secretary and general counsel, Peter Shafron, and all the seven non-executive directors were found to have breached their statutory duty of care by failing to take reasonable care when they approved the said announcement. The court was of the view that they approved the announcement even though they knew that it contained misleading statements. The defendants were therefore disqualified from managing corporations for varying lengths of time and ordered to pay pecuniary penalties of different amounts.



Another high profile case under Australia's civil penalty regime was the case against directors of Centro properties group.<sup>95</sup> ASIC brought civil penalty applications under ss1317E, 1317G and 206C of the Corporations Act 2001 for declaration of contravention, pecuniary penalties and disqualification orders against the directors of Centro properties group. The allegations concerned approval of the consolidated financial statements at a board meeting attended by the defendant directors. It was alleged that the annual reports of Centro Properties Group (CNP) and Centro Retail Group (CRP) failed to disclose significant matters. In the case of CNP, the annual report failed to disclose \$1.5 billion of short-term liabilities by classifying them as non-current liabilities while in CRP, the annual reports failed to disclose about \$500 million of short-term liabilities.

The court found that the directors failed to comply with their statutory duty of care when they approved the 2007 financial reports of the CNP and CRP which contained significant omissions. They breached their duty by not taking the reasonable steps to ensure the accounts were accurate. They relied solely on management and external advisors rather than taking care to read and understand the financial accounts. Hence, they failed to exercise the required degree of care and diligence required. The court made declaration of contraventions against all the directors. One of the directors was ordered to pay a penalty of \$30,000 and the former CFO was also disqualified for two years.

Other examples of high profile defendants against whom civil penalty applications have been issued are directors of the HIH Group of Companies, the Australian Wheat Board Ltd, GIO Australia Holdings Ltd, and One. Tel Ltd. According to Keay and Welsh, in half of the applications issued since 2000, ASIC alleged not only a breach

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<sup>95</sup>See *ASIC v Healey* [2011] FCA 717.

of directors' duties but also breach of other provisions of the Corporations Act.<sup>96</sup> Examples of these include provisions dealing with financial benefits to related parties of public companies, insider trading provisions, continuous disclosure requirements, financial reporting requirements, and misleading conduct in relation to shares and financial product.<sup>97</sup>

It is also important to note that civil penalty applications in Australia have been issued against directors of solvent companies as well as insolvent companies. ASIC's civil penalty regime is therefore not restricted to insolvent companies. Examples of allegations issued against directors of solvent companies include failure to comply with required continuous disclosure requirement, failure to exercise necessary care and diligence in approving financial reports, deceptive conduct and misuse of information.<sup>98</sup> This is a vast improvement from the UK disqualification regime which is mostly focused on directors of insolvent companies.

It is evident that ASIC has achieved a good degree of success with its civil penalty regime. This has the potential of sending a strong deterrent message to other directors that the cost of noncompliance is high.<sup>99</sup> It also helps to reinforce the fact that a high standard of behaviour is expected of directors. While there is no accurate means of measuring the impact of the civil penalty regime on compliance, commentators agree that it is likely to have had an impact on compliance.<sup>100</sup> It is important to note that empirical data on individual's regulatory compliance is very scarce as noted by

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<sup>96</sup> A Keay and M Welsh, 'Enforcing Breaches of Directors Duties by a Public Body and Antipodean Experiences' (2015) 15 (2) *Journal of Corporate Law Studies* 255, 270.

<sup>97</sup> *Ibid* 270.

<sup>98</sup> *Ibid* 271.

<sup>99</sup> R Jones and M Welsh, 'Towards A Public Enforcement Model for Directors' Duty of Oversight' (2012) 45(2) *Vanderbilt Journal of Transnational Law* 343,387.

<sup>100</sup> *ibid* 388.

Elffers et al.<sup>101</sup> It is difficult to create an empirical study which effectively measures the effect of deterrence. People who decide not to break a law, perhaps due to potential sanctions, do not normally publicise that decision, hence it is challenging to gather evidence of successful deterrence.<sup>102</sup>

In spite of this difficulty with obtaining clear empirical data on the level of deterrence occasioned by enforcement action, many would agree that the Australian civil penalty regime has been very effective. Indeed Welsh in her empirical study suggests that enforcement activities by ASIC was an important factor in encouraging companies compliance and may act as a deterrent for potential offenders.<sup>103</sup> Similarly, enforcement activities by the regulator encourage corporate officers to ensure that their policies and procedures are compliant.<sup>104</sup> The interviews conducted by Welsh also revealed that the James Hardie case had a considerable impact on compliance as some of the interviewees stated that it encouraged them to review their compliance policies.<sup>105</sup> There is therefore very good evidence to suggest that the Australian civil penalty regime has had an effective deterrent effect.

It must be clearly pointed out that this chapter does not intend to portray the Australian civil penalty regime as the perfect enforcement regime. The Australian civil penalty regime has its flaws and indeed has been subject to some criticisms. One key criticism of the Australian civil penalty regime is the manner in which the courts have been interpreting the civil penalty provisions by applying certain procedural

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<sup>101</sup> See H Elffers, P. Van Der Heijden and M. Hezemans, 'Explaining Regulatory Non Compliance: A Survey Study of Rule Transgression for two Dutch Instrumental Laws, Applying the Randomized Response Method' (2003) 19 *Journal of Quantitative Criminology* 409, 410.

<sup>102</sup> See M. K Ramirez, 'Just in Crime: Guiding Economic Crime Reform after the Sarbanes-Oxley Act of 2002' (2003) 34 *Loyola University Chicago Law Journal* 414-415.

<sup>103</sup> M Welsh, 'New Sanctions and Increased Enforcement Activity in Australian Corporate Law: Impact and Implications' (2012) 14 *Common Law World Review* 134-166.

<sup>104</sup> *ibid* 136.

<sup>105</sup> *ibid* 161.

protections which is similar to that which is granted to defendants in criminal trials.<sup>106</sup> In spite of some of these shortcomings of the civil penalty regime however, it nevertheless paints an overall positive picture of its effectiveness as an enforcement mechanism. This provides further empirical support for this thesis' arguments for a greater role for public civil enforcement in Nigeria. As noted earlier, difficulties with the effective use of criminal proceedings as an enforcement mechanism necessitated Australia's introduction of the civil penalty regime. Empirical data, examined above, suggest that this has enhanced the enforcement of corporate law in Australia. Nigeria can therefore draw lessons from this enforcement success by reforming, and providing an enhanced role for, its public civil enforcement regime.

In summary, the positive features of the Australian civil penalty regime which are responsible for its effectiveness are:

- Its wide variety and severity of penalties - The Australian public civil enforcement regime offers a wide variety of sanctions which range in their severity. This ensures that the regulator can use the appropriate sanction for each individual case.
- Proactive approach to enforcement – The Australian civil penalty regime offers a proactive approach to its enforcement activities as it focuses on both solvent and insolvent companies. It therefore does not wait until the company has gone insolvent before commencing enforcement action.
- Regulatory Accountability – ASIC, just like the UK Insolvency Services, is accountable to parliament. The parliamentary joint committee on corporations and

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<sup>106</sup> See generally V Comino, 'Effective Regulation by the Australian Securities and Investments Commission (n 75), see also V Comino, 'James Hardie and the Problems of the Australian Civil Penalties Regime' (2014) 37(1) University of New South Wales Law Journal 195-230.

financial services provides parliamentary oversight of ASIC. ASIC also appears before various parliamentary committees and inquiries as necessary.<sup>107</sup>

- Budgetary allocation –ASIC receives its funding from the parliament. It however prioritises enforcement and therefore allocates a significant part of its resources to its enforcement and surveillance activities. In 2014-2015, ASIC allocated 38% of its resources to enforcement and 20% to its surveillance activities.<sup>108</sup> This reiterates the fact that availability of adequate resources is a crucial part of securing effective enforcement.
- Timeliness of enforcement actions (celerity of sanctions) – ASIC recognises the effect that timely enforcement outcomes can have on deterring wrongdoing and promoting confidence in the financial market. It therefore aims to complete its enforcement actions promptly. Over a four-year period, between 2011 and 2015, the average time that ASIC has taken to complete its investigation in civil actions is 19 months. The average time taken to complete civil court actions is 40 months.<sup>109</sup> This reveals that the agency prioritises speedy disposal of cases thereby ensuring effectiveness of its public civil enforcement regime.

As mentioned earlier, the Australian civil penalty regime has its flaws. In spite of this, it has attained a good and commendable level of enforcement. One caveat, which must be pointed out here, is that this thesis does not advocate public civil enforcement action for *every* misconduct by directors. Regulators are generally faced with financial constraints and limited resources. It is therefore impossible to detect, investigate and enforce every breach that occurs. Hence, advocating an improved

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<sup>107</sup> See ASIC, 'Annual Report 2014-2015, about ASIC'

<<http://download.asic.gov.au/media/3438469/asic-annual-report-2014-15-section-1-30-10.pdf>> accessed 17<sup>th</sup> October 2016.

<sup>108</sup> ASIC, 'Annual report 2014-2015, key outcomes' <<http://download.asic.gov.au/media/3437951/asic-annual-report-2014-15-prelims.pdf>> accessed 17<sup>th</sup> October 2016.

<sup>109</sup> *ibid.*

public civil enforcement regime for Nigeria does not connote that all breaches should be enforced by the regulators. However, in order to ensure compliance, there is need for an enhanced role for public civil enforcement. A regulator should therefore be able to enforce a good number of violations, which will be sufficient to send a strong deterrent message to the market thereby securing *compliance* with the law. This is the ultimate goal of enforcement.

## **10.5 Conclusion**

This chapter has examined three major enforcement case studies in the UK and Australia. It has shown that the UK statutory derivative claims regime has been unable to secure effective enforcement of corporate law due to its inherent difficulties. This chapter also examined the UK disqualification regime and the Australian civil penalty regime. The examination of these two regimes have shown their effectiveness as an enforcement regime in corporate law

As mentioned in chapter 7, certainty of sanction is regarded as the most important factor that determines deterrence.<sup>110</sup> In order to have any chance at deterring potential misconducts, there must be a good likelihood that sanctions will actually be imposed when a breach is committed. This is the major defect of the UK derivative claims regime as the low incidence of claims means the certainty of sanctions is low thereby preventing the enforcement action from having a deterrent effect. Empirical data derived from the UK disqualification regime and the Australian civil penalty regime however provides *strong* evidence of the effectiveness of public civil enforcement regime. It therefore supports the argument made in part 2 of this thesis that the public civil enforcement regime offers the best option for achieving effective enforcement of corporate law in Nigeria in the short term. Consequently, Nigeria should focus its

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<sup>110</sup> See section 7.3.1.3.

immediate reform efforts on improving its public civil enforcement regime, and providing an enhanced role for this enforcement regime.

## CHAPTER 11: CONCLUSIONS

### 11.1 Brief Overview of Thesis

This thesis examined the enforcement of corporate law in Nigeria drawing lessons from the UK and Australia. In the course of this thesis, it was established that enforcement is essential for securing compliance. This is based on the premise that human beings are self-interested and rational creatures who consider the consequences of their actions and are influenced by these in their decisions.<sup>1</sup> Therefore, in order to ensure that people comply with the law or refrain from breaking the law, there is need for effective enforcement. This logic applies to human beings generally, which despite some views to the contrary, includes directors. It is therefore simply insufficient to develop rules and standards of conduct for directors without developing appropriate and effective enforcement regimes to deal with instances of breach. This argument was developed in this thesis and has influenced its analysis of the various enforcement regimes in Nigerian corporate law.

In carrying out its analysis, this thesis examined three major enforcement regimes in Nigeria. These are the criminal enforcement regime, the private civil enforcement regime and the public civil enforcement regime. The effectiveness of these enforcement regimes are critically examined using the criteria for determining effective enforcement which were developed in the course of this thesis. These criteria are deterrence, compensation and cost effectiveness.<sup>2</sup> Following this

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<sup>1</sup> R Paternoster, 'How much do we Really Know about Criminal Deterrence?' (2010) 100(3) Journal of Criminal Law and Criminology 765, 782.

<sup>2</sup> See Chapter 3.



examination, it was revealed that the Nigerian criminal enforcement regime falls significantly short as an effective enforcement regime in corporate law. This is due to the fact that it is faced with several challenges which prevents it from having effective deterrence or compensatory benefits. It is also not a cost effective option. The criminal enforcement regime therefore cannot deliver effective enforcement of corporate law in Nigeria.

The second enforcement regime examined was the private civil enforcement regime. In the analysis of this enforcement regime, we saw that the derivative actions regime suffers from certain inherent difficulties which hinders its effectiveness as an enforcement regime. Therefore, while the statutory provisions of Nigeria's derivative actions regime are definitely in need of significant reform, this alone cannot resolve the difficulty with this enforcement regime. The private civil enforcement regime therefore suffers from significant weaknesses which go beyond the proper content of the law. Consequently, it cannot offer significant increase in the overall enforcement of corporate law in Nigeria.

In light of this, the final enforcement regime, which was examined in this thesis, is the public civil enforcement regime. This enforcement regime was analysed against the criteria for effective enforcement. We saw that in comparison to the other enforcement regimes mentioned earlier, public civil enforcement better fulfils the criteria for effective enforcement. Public civil enforcement offers a stronger deterrent effect than both the criminal and private civil enforcement regime. In addition to this, it also better provides compensation for those who have suffered a loss as a result of directors' misconduct. Finally, it was argued that public civil enforcement offers significant advantages in terms of its cost effectiveness. This is particularly so in light of the fact that sanctions under this regime can be imposed without recourse to courts.

The public civil enforcement regime therefore offers clear advantages in terms of all the criteria for effective enforcement over both the criminal and private civil enforcement regime. Hence, it offers the best potential for enhancing the effectiveness of Nigeria's corporate law enforcement. Consequently, this thesis argued that the public civil enforcement regime offers the greatest potential for securing effective enforcement of corporate law in Nigeria. Therefore, in order for Nigeria to attain effective enforcement of corporate law, there is need for it to fully develop, and reform, its public civil enforcement regime in line with the recommendations put forward in this thesis.

## **11.2 Summary of Thesis**

In developing its argument, this thesis starts in Chapter 2 by examining the agency problem in corporate law. In that chapter, it was argued that the agency problem is the central problem of corporate law and corporate governance. It is therefore necessary to put in place legal strategies for reducing the agency problem. These legal strategies include both regulatory strategies and governance strategies. The legal strategies identified in this chapter form the basis for this thesis' subsequent categorisation of enforcement strategies in corporate law.

Chapter 3 critically examined the idea of enforcement in corporate law. It conceptualised enforcement and identified the goal and purpose of enforcement. It argued that the central purpose of enforcement in corporate law is deterrence and compensation. It crucially noted that while the idea of retribution may sometimes be applicable in corporate law, it does not occupy a prime place. Focus is therefore placed on deterrence and compensation.

In justifying the need for enforcement in corporate law, this chapter drew on the deterrence theory which is often used within the field of criminology. It argued that

enforcement is necessary in order to deter future offenders. It noted the empirical evidence in support of the deterrence theory. It therefore argued that in order to secure compliance and prevent directors from breach, enforcement is necessary. Enforcement ensures that the costs of non-compliance outweighs its benefits thereby making sure that compliance becomes a more attractive option than breach. It therefore argued that in order to deter directors from breach, enforcement is essential. In addition to this, this chapter developed and defended certain criteria which can be used to judge or determine an effective enforcement regime in corporate law. The first criterion is that the enforcement regime must fulfil an enforcement purpose viz deterrence and/or compensation. The second criterion, which should be used to judge an effective enforcement regime, is its cost effectiveness. Therefore, in determining the effectiveness of an enforcement regime, focus must be placed on its ability to meet an enforcement purpose and its cost effectiveness. The criteria for determining effective enforcement developed in this chapter has important implications for other chapters in this thesis as it is the standard used to determine the effectiveness of the different enforcement regimes in Nigerian corporate law. Finally, the chapter created a typology of the various enforcement regimes in corporate law noting importantly the ones which are focused on in this thesis.

Chapter 4 examined the Nigerian corporate landscape in order to give the reader an overview of the Nigerian corporate law regime. It commenced by exploring the history of commercial development in Nigeria before moving on to focus on the regulatory framework governing companies in Nigeria. In doing this, the provisions of the different laws governing directors in Nigeria were examined. The chapter also examined the regulatory agencies which govern and monitor companies. In this chapter, it was revealed that Nigeria has a reasonably sufficient network of laws,

codes and regulatory agencies intended to secure compliance by directors. The pertinent issue however is whether these laws are effectively enforced.

Chapter 5 critically analysed the Nigerian criminal enforcement regime. It examined the offences for which sanctions are imposed on directors in Nigeria. It however noted that in spite of these laws which impose criminal sanctions on directors, there have been only very few cases where directors have been successfully prosecuted for their offences. This is so in spite of the fact that directors in Nigeria have been indicted for various offences ranging from fraud to gross misconduct. In light of this obvious deficiency in the Nigerian criminal enforcement regime with regards to directors' breach, this chapter examined the issues and challenges besetting criminal enforcement in Nigeria. It showed that the Nigerian criminal enforcement regime is fraught with several challenges which include corruption and lack of judicial independence, infrastructural and institutional problems in the Nigerian judiciary, difficulty with detecting offences which are liable to criminal sanctions, ineffective prosecution and finally general procedural difficulties with the criminal enforcement mechanism itself.

In light of various problems with the Nigerian criminal enforcement regime, this chapter proceeded to measure the success or failure of the Nigerian criminal enforcement regime against the specific criteria for determining effective enforcement which was developed in chapter 3. It found that the Nigerian criminal enforcement regime falls short with respect to its deterrent effect, compensatory potential and cost effectiveness. It was argued, in that chapter, that the Nigerian criminal enforcement regime is unable to provide effective deterrence to directors. This is due to the fact that it faces immense difficulty in successfully detecting, prosecuting and convicting company directors for offences committed in the course

of duty. This difficulty is attributed to the several challenges faced by the criminal enforcement regime. It was also argued in that chapter that the situation is unlikely to change in the short term as many of the problems preventing the criminal enforcement regime from having a deterrent effect are deep seated. They are therefore unlikely to be resolved in the short term.

With regards to the regime's potential for delivering compensation, it was noted that the recently enacted Administration of Criminal Justice Act 2015 (ACJA) allows the court to award compensation orders to victims of an offence. It was however argued that payment of compensation to victims is dependent on successful prosecution of an offence. The difficulty with successfully prosecuting directors in Nigeria however has a knock on effect on payment of compensation to victims of the offence. The current criminal enforcement regime is therefore also unable to secure compensation for victims of directors' breach.

With regards to the third criteria, cost effectiveness, it was argued that the criminal enforcement regime is inherently expensive and therefore not a cost effective enforcement mechanism. Successful use of the criminal enforcement regime requires investment of significant resources in order to successfully detect and prosecute offences. This is coupled with the fact that Nigeria currently grapples with other debatably more serious crimes such as kidnapping, terrorism and oil bunkering. The criminal enforcement regime is therefore unlikely to receive the significant resources required for successful prosecution and conviction of directors. In light of this, the chapter argued that the Nigerian criminal enforcement regime is ineffective. It lacks a deterrent effect, is unable to secure compensation for victims and is costly to procure. It cannot therefore deliver effective enforcement of corporate law in Nigeria.

In light of the significant failings of the Nigerian criminal enforcement regime, Chapter 6 went on to examine the Nigerian private civil enforcement regime. It examined the four major private enforcement actions viz-corporate actions, action by administrators and liquidators, personal actions and derivative actions. Focus is then placed on derivative actions in light of the fact that many countries seem to place significant reliance on them as a private enforcement action. An analysis of the Nigerian statutory derivative actions regime revealed that the criteria for leave to bring derivative actions under the statutory regime is fraught with several difficulties and imposes an undue burden on potential applicants. It is also highly ambiguous leaving room for judicial arbitrariness and corruption. It therefore does not currently provide effective enforcement of corporate law.

The chapter then turned on questioning whether the difficulties with the Nigerian derivative actions regime are limited to the substantive provisions of the law. This would mean that the problem could easily be resolved by statutory reforms. This question is answered negatively. It is argued that the derivative actions regime has certain inherent difficulties which deter potential applicants from bringing derivative actions. These problems include lack of incentive to bring derivative actions, information asymmetries and the cost problem. These issues deter shareholders from bringing derivative actions and exist irrespective of the substantive provisions of the law governing derivative actions. The general reluctance of shareholders to bring private enforcement actions due to the difficulties faced therefore hinder the effectiveness of the private enforcement regime.

In light of these inherent problems, the chapter argued that the private enforcement regime is unable to secure either effective deterrence or compensation for victims. In addition to this, litigation is generally expensive thereby making private enforcement

actions a cost ineffective option. The chapter therefore argued that the private enforcement regime cannot, on its own, secure any significant increase in the overall enforcement of corporate law in Nigeria.

Chapter 7 examined the Nigerian public civil enforcement regime. It argued that the public civil enforcement regime offers the best option for enforcement of corporate law in Nigeria. In reaching this conclusion, the chapter critically analysed the theoretical benefits of public civil enforcement using the criteria for determining effective enforcement developed in chapter 3. In doing this, the deterrent effect, compensatory benefit and cost effectiveness of public civil enforcement was examined in comparison to the other enforcement regimes – criminal enforcement and private civil enforcement regimes. It was argued that the public civil enforcement regime offers a greater deterrent effect than both the criminal enforcement and private civil enforcement regimes. This is in light of the fact that it provides greater variety, severity, certainty and celerity of sanctions which are determinants of effective deterrence. It was also argued that the public civil enforcement regime offers greater compensatory potential than both the criminal enforcement and private civil enforcement regimes. With regards to the cost effectiveness of the public civil enforcement regime, it was argued that the regime is more cost effective as sanctions can be imposed without recourse to courts thereby effectively avoiding all the costs associated with the court process.

The chapter then examined the Nigerian experience of public civil enforcement noting that in practice, Nigeria fails to harness the immense benefits offered by this enforcement regime. In light of this state of affairs, the chapter went on to discuss possible reasons for this ineffective use of the public civil enforcement regime. The reasons identified include lack of enforcement powers by regulators, lack of

information by regulators, lack of adequate oversight, and corruption. In spite of these difficulties, this chapter went on to assert that a reformed public civil enforcement regime still offers the best option for enforcement of corporate law in Nigeria. This assertion is made based on the fact the public civil enforcement regime offers the greatest potential for securing effective enforcement of corporate law. This is further coupled by the fact that this enforcement regime can effectively sidestep many of the difficulties which plague the enforcement regimes in Nigeria. It was also argued in that chapter that the deep-seated problems with the Nigerian judicial system do not affect this enforcement regime as enforcement can be effectively secured by public regulators without recourse to the courts. The incentive problem, which affects the private civil enforcement regime, is also avoided here. Similarly, many of the other difficulties are significantly alleviated. The chapter therefore argued that the public civil enforcement regime offers the best potential for achieving significant improvement in the overall enforcement of corporate law in Nigeria.

Fundamental reforms, which are necessary in order for Nigeria to harness the benefits of the public civil enforcement regime, were examined in Chapter 8. The proposed reforms include identification of an effective public enforcement agency, conferment of power to enforce breach of directors' duties to the Securities and Exchange Commission (SEC), clear whistleblowing laws and reporting channels, increase in regulatory oversight, complete overhaul of the Companies and Allied Matters Act (CAMA), regulatory accountability and adequate funding for public regulators. It was argued that these reforms are feasible in Nigeria as the country has some history of attaining successful reforms. The proposed reforms are therefore not an unrealistic ideal.



Part 3 of the thesis drew lessons from other jurisdictions. It commenced in chapter 9 by examining the legal transplants debate. The discussion on legal transplants was considered necessary in light of the fact that the subsequent chapter draws empirical evidence from the enforcement experiences of the UK and Australia. It aims to use these enforcement case studies as empirical support for the superiority of public civil enforcement. In light of the ‘comparative’ element of this study, this chapter addressed the legal transplants debate in order to demonstrate that the concerns raised by this debate do not affect this thesis’ attempts to draw empirical evidence from the UK and Australia. It commenced by examining the nature of legal transplants and the various types of legal transplants. It further examined the impossibility of legal transplants debate. It argued that legal transplants are indeed possible, consequently Nigeria can learn from the enforcement experience of other countries. It further examined whether legal transplants can be successful and the factors that influence this success. It argued that legal transplants could indeed be successful. It further argued that while this thesis does not advocate transplant of the UK or Australian enforcement regime, the attempt to learn from the enforcement experience of these countries does not raise any of the concerns surrounding unsuccessful transplants. Consequently, Nigeria can gather empirical evidence from the enforcement experience of the UK and Australia.

In order to reinforce the case for public civil enforcement, the case study of three enforcement regimes, the UK statutory derivative claims regime, the UK disqualification regime and the Australian civil penalty regime, were examined in chapter 10. An examination of the UK statutory derivative claims regime revealed that in spite of the significant reforms carried out in order to increase access to shareholders, the regime has been unable to achieve effective enforcement. This is

attributed to the fact that the problems with the derivative actions regime goes beyond its statutory provisions, it is therefore unable to secure effective enforcement. This further reinforces the argument put forward in chapter 6 that the difficulties with the private enforcement regime go beyond the content of the law rather they are inherent problems which are difficult to surmount.

The second case study examined is the UK disqualification regime. It was argued that the UK disqualification regime has been very successful in disqualifying several directors over the past years. The UK disqualification regime therefore provides an example of an effective public civil enforcement regime. Having said that however, this chapter noted that the effectiveness of the UK disqualification regime is somewhat limited by the fact that it is focused on directors of insolvent companies. There is therefore a need to examine yet another public civil enforcement regime which avoids this difficulty.

Consequently, the last case study examined is the Australian civil penalty regime. It is argued that this public civil enforcement regime has been successful in effectively enforcing breach of directors' duties in Australia. Its success is attributed to several factors which include the wide range of sanctions available, its proactive approach to enforcement and its accountability. This chapter therefore argued that the Australian civil penalty regime provides a prime example of an effective public civil enforcement regime. Nigeria should therefore learn from this success in reforming its own public civil enforcement regime in order to attain effective enforcement of corporate law in the country.

Overall, this thesis has shown, and argued, that the public civil enforcement regime offers the greatest potential for effective enforcement of corporate law in Nigeria. Therefore, in order for Nigeria to secure compliance by directors with its corporate

law requirements, there is a crucial need for it to develop, and reform, its public civil enforcement regime in line with the recommendations put forward in this thesis.

### **11.3 Areas for Further Research**

My research explored various regimes for enforcement of corporate law in Nigeria. In the course of writing this thesis, other areas of future research have been identified which could not be accommodated within the ambit of this thesis.

The first area of further research concerns the enforcement of corporate law using governance strategies. As mentioned in Chapter 1, this thesis has analysed enforcement of corporate law with regards to regulatory strategies.<sup>3</sup> It has however not examined the effect of governance strategies such as shareholders voting rights on directors' compliance. It has therefore not examined whether these governance strategies, if effectively used, can secure effective enforcement within the company. Future research into the effect of governance strategies on enforcement of corporate law would therefore be a worthwhile venture.

Secondly, this thesis has prioritised reforms to the public civil enforcement regime. This, as discussed in the course of this thesis,<sup>4</sup> is due to the significant advantages which it offers over both the criminal and private civil enforcement regimes in terms of delivering greater output in overall enforcement effectiveness for Nigeria's corporate law. However, as noted in chapter 8,<sup>5</sup> this does not connote that improvements should not be made to the criminal and private civil enforcement regimes. Future and more in depth research into potential reforms of these alternative enforcement regimes therefore remains important, even if the structural reforms to the public civil enforcement regime are pursued.

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<sup>3</sup> See section 1.5, Ch. 1.

<sup>4</sup> See Chapters 7 & 8.

<sup>5</sup> See section 8.1, Ch. 8.

Thirdly, Nigeria currently lacks comprehensive data on the incidences of enforcement action in corporate law. As mentioned in chapter 1, in the course of writing this thesis, significant difficulties were encountered in obtaining empirical data on enforcement actions in Nigeria. There are therefore significant gaps in literature in this regard. A comprehensive empirical study into the incidences of derivative actions in Nigeria would therefore be insightful and academically beneficial to the field of corporate law in Nigeria.

Lastly, there is scope for further research into the practical effects of the reforms proposed in this thesis. This thesis has suggested reforms to the public civil enforcement regime in Nigeria. These have been proposed in light of the theoretical benefits offered by the public civil enforcement regime. This however leaves room for further research into the workings and practical benefits of the reformed enforcement regime. A further empirical study, in a couple of years, investigating the practical effect of the recommended reforms in Nigeria would therefore make a significant contribution to the subject of enforcement.

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