

2007

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Recommended Citation

Dr. Ige O. Bolodeoku, *Corporate Governance: The Law's Response to Agency Costs in Nigeria*, 32 Brook. J. Int'l L. (2007).
Available at: <https://brooklynworks.brooklaw.edu/bjil/vol32/iss2/4>

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CORPORATE GOVERNANCE: THE LAW'S RESPONSE TO AGENCY COSTS IN NIGERIA

*Dr. Ige Omotayo Bolodeoku**

I. INTRODUCTION

Corporate failures are hardly a new story.¹ Indeed, states and economies have failed in the past, and many more are failing. However, the magnitude of corporate failures and the extensiveness of their impact have made them part of the several issues hotly debated in contemporary corporate and political governance scholarship.² This also helps to explain why in the United States, a country with a federalized corporate law system, the federal government, following major corporate failures in 2001, introduced certain corporate governance safeguards that were once overlooked or considered unnecessary.³ What is interesting is that

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1. They led to the first corporate governance project chaired by Adrian Cadbury in 1992. See REPORT OF THE COMM. ON THE FIN. ASPECTS OF CORPORATE GOVERNANCE (Burgess Sci. Press 1992), available at <http://www.ecgi.org/codes/documents/cadbury.pdf> [hereinafter CADBURY REPORT]. In Nigeria, the Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act, (2004) Cap. F2, Laws of the Federation of Nigeria, 2004, is the institutional response to the failure of financial institutions in the early 1990s. In 2003, Nigeria's Corporate Affairs Commission and Securities and Exchange Commission launched the Code of Best Practices on Corporate Governance for publicly quoted corporations in Nigeria. In 2006, the Central Bank of Nigeria released a Code of Corporate Governance for Banks in Nigeria after the consolidation of Nigerian banks, to become effective from April 3, 2006.

2. See Jean Cartier-Bresson, *The Causes and Consequences of Corruption: Economic Analyses and Lessons Learnt*, in ORG. FOR ECON. CO-OPERATION AND DEV., NO LONGER BUSINESS AS USUAL: FIGHTING BRIBERY AND CORRUPTION 11, 12 (2000) (discussing agency problems in the political governance context, the author said: "Opportunities for corruption depend on the size of the rents in the control of public agents, the discretion they have in allocating them, and their lack of a sense of accountability to society.").

3. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002). Sarbanes-Oxley is essentially a response to the systemic problems in corporate governance, underscored by the collapse of Enron and other big corporations in the United States. Other institutional responses to corporate failures have come by way of reform of corporate governance rules. See N.Y. STOCK EXCH. CORPORATE ACCOUNTABILITY AND LISTINGS STANDARDS COMM., REPORT (2002) [hereinafter NYSE REPORT]. For Nigeria's approach, see SECURITIES AND EXCHANGE COMMISSION, CORPORATE GOVERNANCE CODE IN NIGERIA (2003).

failures, be they of corporations or states, are traceable, in part, to a common source, that is, activities of the respective agents representing the institutions.⁴

Every representative system must confront the problem of agency costs, whether as an internal matter or one that informs policy considerations by the appropriate regulatory bodies of governance structures.⁵ To be sure, agency costs are inevitable in a representative system, be it a business corporation,⁶ government, or any other form of association, whose activities are, in the nature of things, conducted by human beings.⁷ In other words, agency problems are associated with the delegation of power, management, and control, and thus highlight the transaction costs of specialization, which undoubtedly create value and enhance efficiency.⁸ On a more positive note, however, agency costs may be conceptualized as the transaction costs which a representative system must incur in ensuring efficiency in the system. In this regard, the system's success may be measured both in terms of the magnitude of the costs

4. To be sure, the agency relationship is pivotal to the existence and operations of business corporations. See Eric W. Orts, *Shirking and Sharking: A Legal Theory of the Firm*, 16 YALE L. & POL'Y REV. 265, 274 (1998) ("Legal agency relationships are one foundation of business organizations. Without legal agency, business firms of any complexity are impossible."). Note also that both law and reality supports the use of agency for the company's activities because of the company's peculiar nature as a legal entity. For example, sections 63 and 64 of the Companies and Allied Matters Act (CAMA) authorize a company to act through both institutional agents, such as the board of directors and the members in general meetings, and any agent or officer appointed by those two organs. Companies and Allied Matters Act (CAMA), (1990) Cap. C20, §§ 63, 64 (Nigeria). Even at the board level, the law permits a board of directors to delegate all its powers to an individual, called the managing director. See *id.* § 64(b).

5. For a discussion of agency concepts and costs, see Stephen A. Ross, *The Economic Theory of Agency: The Principal's Problem*, 63 AM. ECON. REV. 134 (1973).

6. It is important to note Orts' caution regarding the nexus between agency costs and the firm. See Orts, *supra* note 4, at 278 ("Although agency costs help to explain the economic dynamics of firms, they are not sufficient to explain the existence of firms and their boundaries.").

7. Orts argued that, "agency costs provide one important theoretical explanation for limitations on the size of firms." See Orts, *supra* note 4, at 275. In fact, the primacy of agency relationships to societal development may be better understood from the perspective of division of labor. For works describing the value of agency to development, see ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, (Kathryn Sutherland ed., Oxford Univ. Press 1993) (1776) [hereinafter SMITH, WEALTH OF NATIONS]; EMILE DURKHEIM, THE DIVISION OF LABOR IN SOCIETY, 11-30 (1997); Michael Jensen & William H. Meckling, *Specific and General Knowledge, and Organizational Structure*, in CONTRACT ECONOMICS 251 (Lars Werin & Hans Wijkander eds., 1992) [hereinafter Jensen & Meckling, *Specific and General Knowledge*].

8. See discussion *supra* note 7.

incurred relative to the benefits produced and by how well the costs are controlled or managed. On the whole, however, the inevitability of agency costs reinforces the need to design effective strategies for their management.⁹

In a corporate law context, the complexity of agency problems and costs is shaped, among other things, by both organizational size and ownership structure.¹⁰ A big organization with a large membership size (or diffused membership) will likely face graver agency problems requiring special contrivances for control than one that is small and has manageable and concentrated membership.¹¹ While agency costs usually emanate directly from the conduct of those entrusted with the management responsibility of a given system, their persistence may depend on, and sometimes be exacerbated by, certain exogenous factors such as culture,¹² perception, and the existence or lack of alternative control or intervention systems. Effective agency costs management will thus require that control systems are designed around the internal setting of the system; however the possibility that internal structures may weaken internal-oriented control mechanisms should serve as a reminder of the need to have alternative intervention systems.¹³

This Article will examine whether the response of the 1990 Companies and Allied Matters Act (CAMA or Act) and other allied legislation to

9. See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) [hereinafter Jensen & Meckling, *Theory of the Firm*].

10. See James S. Ang, Rebel A. Cole & James Wuh Lin, *Agency Costs and Ownership Structure*, 55 J. FIN. 81, 87 (2000) (finding that agency costs (1) are higher when an outsider rather than an insider manages the firm, and (2) are inversely related to the manager's ownership share).

11. One needs only to remember the analysis of Berle and Means about shareholders' size and its impact on management behavior and agency costs. See ADOLF A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1933).

12. See Mark J. Roe, *Can Culture Constrain the Economic Model of Corporate Law?*, 69 U. CHI. L. REV. 1251, 1262 (2002) ("The key point is not that one society or another is better off, but that culture would affect how the three-player contractarian corporate model played out."). Roe contrasted the reaction of the Swedish to the retirement compensation of Percy Barnevik. See David Woodruff & Almar Latour, *Barnevik Gets Harsh Verdict in Court of Public Opinion: Former ABB Chief Is Disgraced in Pension Plan*, WALL ST. J. EUR., Feb. 18, 2002, at A1. For a broader analysis of cultural impact on corporate law evolution, see Amir N. Licht, *The Mother of All Path Dependencies Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147 (2001).

13. In the context of this Article, the provisions of CAMA on investigation by the Corporate Affairs Commission are treated as the alternative control mechanism that can substitute for the failures of the internal control mechanisms. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, §§ 314–15.

agency problems are effective enough to guarantee good and accountable corporate governance in Nigeria. To be sure, this Article recognizes that other institutions beyond the law matter in measuring the effectiveness of the law itself. However, examination of these other institutions is not within the scope of this Article.¹⁴ The Article gives a pass mark to the CAMA, while noting areas that may need to be re-examined for reform.

Analysis in this Article begins in Part II with an explanation of the concept of agency costs, pointing out how agency costs may present different challenges in relation to public companies in two separate situations—public companies with disperse ownership structure and those that combine both dispersed and concentrated ownership. The latter type is of particular importance to Nigeria, as most companies in Nigeria are in this category. Part II further defines agency costs and examines their relationship with the concept of separation of ownership and control. Part III focuses on the theoretical and normative analysis of how agency costs may be effectively dealt with in both types of public companies already noted in this Article. Part IV examines the CAMA provisions in order to assess the Act's response to agency problems. This Part examines some of the provisions of CAMA in light of the normative or theoretical analysis guidelines discussed in Part III.

II. THE CONCEPT OF AGENCY COSTS EXPLAINED

A. *Foreground*

The organization of resources for productive purposes through the corporate form has become virtually complete, in the sense that it is dominant. A country will usually have a mix of private and public companies, with the former used mainly where organization of business through the partnership form would have been ideal; while the latter used not only where the requirement of capital is extensive, but also where it is in-

14. Note, for instance, that the judicial system is always pivotal not only to enforcement of rights in general, but also in ensuring the reduction of agency costs, in terms of prompt response to litigations in the enforcement of fiduciary duties. One may also note that the search for global capital, which forces domestic companies to either seek credit facilities abroad or list their securities in foreign stock exchanges, may require more disclosures on their part, thus enhancing the production of information and monitoring. See Rafael La Porta, Florencio Lopez de-Silanes & Andrei Shleifer, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Rafael La Porta, Florencio Lopez de-Silanes, Andrei Shleifer & Robert Vishny, *Investor Protection and Corporate Governance* (1999), available at <http://ssrn.com/abstract=183908> [hereinafter La Porta et al., *Investor Protection*] (“When investor rights such as voting rights of the shareholders and the reorganization and liquidation rights of creditors are extensive and well enforced by regulators or courts, investors are willing to finance firms.”).

tended to pool resources from a wide range of individuals sharing no other relationship than the mere coincidental desire to earn income from the resources they lack the capability or time to invest.¹⁵ Investment is not costless. It requires not only the capability and time to invest, but also the acumen to make resource allocation decisions which many people do not have.¹⁶

While the membership of a typical public company is large and diffused, and the individual stake of its members (investors) is small relative to the company's overall capitalization, it is not uncommon to have public companies, characterized by both concentrated and widespread share ownership. In their seminal book, Adolf Berle and Gardiner Means alerted the public to the consequences of the emerging modern corporation in which ownership of shares, due to its diffusion, is separated from control. "The corporate system appears," they observed, "only when this type of private or 'close' corporation has given way to an essentially different form, the quasi-public corporation: a corporation in which a large measure of separation of ownership and control has taken place through the multiplication of owners."¹⁷ Indeed, this separation can only be found in the United States and United Kingdom. In many other Anglo-American jurisdictions, share ownership of companies is largely concentrated. Often, in such companies, owners are also managers.

We, however, need not look further than Nigeria to get the sense of the other type of public company that combines concentration and diffusion of share ownership. Virtually all public companies in the financial and non-financial sectors have shareholders holding significant proportions of the issued shares,¹⁸ with some even holding a clear majority.¹⁹ Yet,

15. Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259 (1967) [hereinafter, Manne, *Our Two Corporation Systems*].

16. See Jensen & Meckling, *Specific and General Knowledge*, *supra* note 7, at 253.

17. BERLE & MEANS, *supra* note 11, at 4 (theorizing that the quasi-public corporations were dominating corporate America).

18. For a discussion of the ownership structure, see Boniface Ahuwan, *Corporate Governance in Nigeria*, 37 J. BUS. ETHICS 269, 271–73 (2002). One should note that Ahunwan's description of bank structures as widespread may mask the reality, because most banks, at least before the 2005 reform, had both combined concentrated and widespread ownership. Recent developments in the banking sector, which this Article addresses, have the potential to produce more diffuse share ownership of banks.

19. Recently, the Central Bank of Nigeria (CBN) implemented a policy that requires all banks to increase their paid up share capital to twenty-five billion naira by December 2005 at the latest. For further description of this policy, see CENTRAL BANK OF NIGERIA, GUIDELINES AND INCENTIVES ON CONSOLIDATION IN THE NIGERIAN BANKING INDUSTRY (Aug. 5, 2004), available at <http://www.cenbank.org/out/publications/bsd/2004/consolidationold.pdf>. This policy will definitely occasion widespread share ownership of

there is, to some extent, widespread public ownership of the remaining equity. Two separate and unrelated developments in the Nigerian corporate landscape are increasingly helping to shape the ownership structure of registered companies.²⁰ First, the privatization of state-owned enterprises (SOEs) in Nigeria, which favors the sale of SOEs to strategic or core investors,²¹ is bound to turn out a good number of public companies with concentrated share ownership, and also ensure widespread participation by the public in equity of the affected enterprises.²² While the government is to retain 40% of equity and cede 40% to strategic/core investors in the partially privatized industries,²³ the underlying policy is to cede the management of privatized enterprises to the strategic/core investors.²⁴ On the one hand, this arrangement produces investors who are not only substantial shareholders, but also retain managerial powers. On the other hand, the arrangement brings about widespread share-ownership in the public.

The second development is the decision by the Central Bank of Nigeria (CBN) to raise the shareholders' funds of Banks to twenty-five billion naira. By forcing existing banks to either merge or approach the capital market in order to raise the requisite funds, the policy will invariably change the ownership structure of existing banks in Nigeria. It is worth noting that out of the eighty-nine banks that existed before the CBN introduced this new policy, only twenty-nine banks survived the exercise.

banks in Nigeria, which may begin a path to the separation of ownership and control in line with the Berle and Means construct.

20. For analysis of some of the factors that historically shaped the ownership structure of Nigerian companies, see Ahunwan, *supra* note 18, at 270–71.

21. Defined as “formidable and experienced [corporations or consortia] with the capabilities for adding value to an enterprise and making it operate profitably in the face of international competition.” See *Guidelines on Privatization of Government Enterprises*, in NATIONAL COUNCIL ON PRIVATISATION, THE PRIVATISATION HANDBOOK 49, para. 13.2 (2001), available at <http://www.bpeng.org/docs/Privatization%20Handbook.doc>. In fact, management skill is one of the qualities that core or strategic investors must possess.

22. The privatization guidelines require strategic/core investors to acquire up to 40% of the equity capital of affected enterprises. See Public Enterprises (Privatization and Commercialization) Act (PEA) 1999, First Schedule, pt. 1, in NATIONAL COUNCIL ON PRIVATISATION, THE PRIVATISATION HANDBOOK 25 (2001). For more on the selection of strategic/core investors, see *Guidelines on Privatization*, *supra* note 21, at paras. 14.1–14.4.

Additionally, paragraph 12.3 of the *Guidelines on Privatization* provides that “no individual shall be allowed to acquire more than 1% equity in any enterprise whose shares are offered for sale” under the privatization program. The guidelines reinforce the philosophy of widespread ownership of the Public Enterprises (Privatization and Commercialization) Act (PEA) 1999. See PEA, paras. 5(2), 5(3).

23. See *id.*, First Schedule, pt. 1.

24. See *id.*, para. 4.

Additionally, the CBN indicated that domestic banks would be allowed to manage part of Nigeria's external reserves if only they could meet a threshold of equity capital. This statement induced some banks to approach the capital market for more equity funds.

These developments create two possibilities. First, the share ownership structure of banks that emerged from mergers is likely to be both concentrated and dispersed. Second, banks that had to depend on the capital market to raise the required equity capital and those still canvassing that market for more funds in order to qualify are likely to have more dispersed ownership. The degree of concentration of share ownership of banks in this category will depend on how much equity they need to raise from the capital market, the spread of share ownership, and how often the company returns to the market for further funds.

It is worth noting that the corporate landscape in Nigeria is dominated by companies in which corporate managers are also significant shareholders. Here, residual claimants are also the decision agents, while minority shareholders, that is, individuals with small equity interests, have no decision-making power or authority, nor could they exert any tangible influence on decision makers. This minority group is often invisible in corporate governance due mainly to rational apathy.²⁵ As scholars Cubbin and Leech noted, "if the controlling group is management operating through ownership, then increasing dispersion will have the effect of making management's position more secure and the firm's behavior more 'managerial.'"²⁶

B. Agency Cost Defined

In an agency relationship,²⁷ three basic propositions are crucial to a proper understanding of the concept of agency costs. First, there is a general assumption that an agent, like all human beings, is a utility maximizer.²⁸ Second, it is not economically expedient for an agent to capture

25. See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* 55 (2d ed. 1971).

26. John Cubbin & Dennis Leech, *The Effect of Shareholding Dispersion on the Degree of Control in British Companies: Theory and Measurement*, 93 *ECON. J.* 351, 354 (1983). As the authors noted, management has more discretion to pursue its own objectives at the expense of shareholders than in cases where there is no controlling shareholders. *Id.*

27. This is defined "as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agents." See Jensen & Meckling, *Theory of the Firm*, *supra* note 9, at 308.

28. For another view criticizing the classical assumptions about agents from a behavioral perspectives, see Daniel Levinthal, *A Survey of Agency Models of Organisations*, 9

the total value added to his or her principal's business. Were an agent able to do so, it would be hard to imagine how the principals could make gains by engaging an agent. Third, agency from an economic perspective not only explicates specializations of tasks, but also helps to increase efficiency. These propositions accentuate the functionality of the agency concept just as they underscore the need to properly meter the agent's performance and ensure that appropriate reward systems are provided to motivate the agent to good performance.

Michael Jensen and William Meckling defined agency costs as the sum of the monitoring expenditures by the principal, the bonding expenditures by the agent, and the residual loss.²⁹ They further argued that, even if both the principal and agent incur monitoring and bonding costs (non-pecuniary as well as pecuniary), there would still be some divergence between the agent's decisions and those decisions which would maximize the welfare of the principal.³⁰ It is the dollar equivalent of such reduction in welfare experienced by the principal that Jensen and Meckling referred to as the "residual loss."³¹ Jensen and Clifford Smith characterized this definition "as the sum of the out-of-pocket costs of structuring, administering, and enforcing contracts (both formal and informal) plus the residual loss."³² As they explained, enforcement costs "include both monitoring and bonding costs, that is, resources expended by the principal and agent, respectively to ensure contract enforcement," whereas, residual loss "represents the opportunity loss remaining when contracts are optimally but imperfectly enforced."³³ Agency costs "include all the costs frequently referred to as contracting costs, transactions costs, moral-hazard costs, and information costs."³⁴

Despite its wide acceptance in the literature, the Jensen and Meckling definition requires some qualification. Bonding expenditures on the part of an agent do not exacerbate agency costs; rather, they attenuate them. Whether agents will incur bonding expenditures depends on the agents' appreciation of their importance (in terms of their unique or peculiar

J. ECON. BEHAV. & ORG. 153, 154 (1988) ("As with neoclassical theory more generally, agency theory can be criticized from a behavioral perspective for its narrow view of rationality and its assumptions regarding economic agents' cognitive abilities.").

29. See Jensen & Meckling, *Theory of the Firm*, *supra* note 9, at 308.

30. *Id.*

31. *Id.*

32. Michael C. Jensen & Clifford W. Smith, *Stockholder, Manager, and Creditor Interests Applications of Agency Theory*, in RECENT ADVANCES IN CORPORATE FINANCE 93 (Edward I. Altman & Marti G. Subrahmanyam, eds. 1985) (citing Jensen & Meckling, *Theory of the Firm*, *supra* note 9).

33. *Id.*

34. *Id.*

skills or expertise and their marketability) to the principals' businesses, the competitiveness of their positions, and the viability of a principal's agent replacement options. More importantly, however, the pecuniary value of bonding expenditures increases the principal's gain rather than derogates from it. Indubitably, bonding expenditures are costs to the agents; but, they are costs from which both the principal and the agent are expected to benefit.

Additionally, the above definitions are somewhat inadequate for omitting the cost effects of the various incentive programs that a principal may implement with a view to aligning the agent's interest with his own. While incentives may take several forms, they usually have monetary value. Strictly, the cost component of an incentive (or reward) system seems to fit uneasily into the monitoring taxonomy, although both monitoring and incentive systems are directed toward the same goal: reducing profusion and shirking by the target agent. However, if inappropriately designed, an incentive or a reward system may further exacerbate agency costs. Enron, WorldCom, and Nortel provide useful explications of this point.³⁵

C. The Dynamics Between Agency Costs and the Separation of Ownership and Control

To the extent that the reduction of agency costs depends, in part, on the ability of a principal to monitor the agent's activities, the separation of ownership and control will remain a factor in the overall design of control mechanisms needed to reduce agency costs. But as noted above, a modern analysis of the agency problem must take into account the various shades or degrees of separation of ownership and control, since dif-

35. See Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1242 (2002) [hereinafter Gordon, *What Enron Means for the Management*] (discussing stock-based director compensation as a double-edged sword: it "may enhance the board's vigor as a shareholder agent but also increase its ambivalence about uncovering embarrassing facts that will reduce the share price"); see also PERMANENT SUBCOMM. ON INVESTIGATIONS OF THE COMM. ON GOVERNMENTAL AFFAIRS, THE ROLE OF THE BOARD OF DIRECTORS IN ENRON'S COLLAPSE, S. REP. NO. 107-70 (2d. Sess. 2002) [hereinafter ENRON REPORT] (detailing how top executives at Enron Corporation abused stock options). Recent revelations on the "financial reporting mess" at Nortel Inc. show that the company's executives, with the acquiescence of the board of directors, adopted financial reporting methods that allowed them to report artificial profits on the basis of which they paid out bonuses that were contingent on the profits. At least twelve executives returned a total of Can\$10.4 million representing the value of the bonuses they collected under the fraudulent scheme. See Tyler Hamilton, *Review Rips Former CEO*, TORONTO STAR, Jan. 12, 2005, at C1.

ferent types of separation create peculiar delegation problems requiring special measures and attention.

The nexus between agency costs and the separation of ownership and control has received recognition for quite some time, beginning with Adam Smith. In *The Wealth of Nations*, Adam Smith highlighted the problem of agency costs by linking it with the separation of ownership and control. He stated that:

The directors of such companies . . . being the managers of other people's money that of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company³⁶

Berle and Means captured the inevitability of agency problem in their book, given what they saw as the emerging pattern of ownership structure of public companies in the United States. According to them:

The surrender of control over their wealth by investors has effectively broken the old property relationship and has raised the problem of defining these relationships anew. The direction of industry by persons other than those who have ventured their wealth has raised the question of the motive force behind such direction and the effective distribution of the returns from business enterprise.³⁷

It is in the foregoing context that Jensen and Meckling's observation becomes apposite.

Since the relationship between the stockholders and the managers of a corporation fits the definition of a pure agency relationship, it should come as no surprise to discover that the issues associated with the "separation of ownership and control" in the modern diffuse ownership corporation are intimately associated with the general problem of agency.³⁸

One only needs to add, for the purposes of this Article, that it is the degree of separation of ownership and control that will determine the acuteness of the associable agency problems and the measures that should be taken to solve the problems.

36. SMITH, *WEALTH OF NATIONS*, *supra* note 7, at bk. 5, ch. 1, art. I.

37. BERLE & MEANS, *supra* note 11, at 2.

38. Jensen & Meckling, *Theory of the Firm*, *supra* note 9, at 309.

III. CONTROL OF AGENCY COSTS IN PUBLIC COMPANIES

A. Nature of the Problem

A typical public company has a complex authority structure. The board is entrusted with the power of management or with the power to supervise management.³⁹ As is often the case, there is a delegation of management authority to the chief executive officer (or management director) with further delegation to other top, but lower-level managers, depending on the organization's size. In this regard, the shareholders, often far removed from operational details of a typical public company, are poorly positioned to police top management or the board of directors, because they lack material information that is key to monitoring.⁴⁰ However, we have another genre of public companies in which share ownership is both concentrated and diffused. Most publicly listed companies in Nigeria fall into this category. The two sections following will discuss the agency-costs implications of the two types of public companies and how they may, at least, in theory, be addressed.

B. Analysis in the Context of Public Companies with Dispersed Ownership

Where no single shareholder holds significant proportion of the company's shares to be able to influence decisions or remove directors from office, it is unlikely that the shareholder group will be able to monitor the company's management effectively. Monitoring is not costless, as it requires a great deal of information as well as the ability to analyze, process, and utilize the information as a monitoring tool.⁴¹ Above all, the cost of monitoring is a key factor that is likely to shape shareholders' monitoring behaviors. The shareholders often face collective action⁴² and free

39. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, §63(3) (Nigeria); Canada Business Corporations Act, R.S.C., ch. 44 § 102(1) (1985) (“[T]he directors shall manage, or supervise the management of, the business and affairs of a corporation.”); see also THE BUSINESS ROUNDTABLE, PRINCIPLES OF CORPORATE GOVERNANCE (May 2002), available at www.brtable.org/pdf/704.pdf.

40. See Orts, *supra* note 4, at 316.

41. On the value of information to monitoring, see Arnoud W.A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Proximity, Objectivity, and Adaptability in Corporate Governance*, 89 CORNELL L. REV. 356 (2004).

42. This term has been widely written about in political and social sciences and examined from different perspectives. See OLSON, *supra* note 25, at 53–54. According to Michael Taylor, “a collective action problem exists where rational individual action can lead to a strictly Pareto-inferior outcome, that is, an outcome which is strictly less preferred by every individual than at least one other outcome.” MICHAEL TAYLOR, THE POSSIBILITY OF COOPERATION 19 (1987).

rider problems where they are dispersed and each has a small proportion of the company's shares.⁴³ Because all the shareholders of a company will share in the benefit of monitoring, while the monitoring shareholder bears the financial burden of monitoring alone, the assumption is that shareholders of a widely held company will remain rationally apathetic to monitoring.⁴⁴

On the other hand, management is more organized as a unit to respond to allegations of misconduct or improprieties, knowing that shareholders are unlikely to have the necessary information to substantiate claims. Information becomes more expensive and difficult to gather where disclosure of material changes are not mandated; the only option being for the shareholders or creditors to privately bargain for the right to information on key transactions. Management controls the flow of information, and has access to the corporate treasury to prosecute proxy contests. Thus the limitation of the shareholders' monitoring capability, measured against the real possibility that corporate managers of widely held companies may shirk or become involved in unfair dealings and positional conflicts, raises the need to devise control mechanisms that will reduce agency costs.⁴⁵ Discussed below are some of the control devices commentators have identified for addressing agency costs in the context under consideration. The discussion will serve as a prelude to the assessment of the CAMA and other allied legislation in Nigeria.

1. Separation of Decision Management and Decision Control

Open corporations or publicly held companies are usually characterized by two distinct features, both of which help explain the nature of

43. For a recent analysis of the rational apathy theory, see Ige O. Bolodeoku, *Corporate Governance in the New Information and Communication Age: An Interrogation of the Rational Apathy Theory*, 7 J. CORP. L. STUD. 69, 72-76 (2007) [hereinafter Bolodeoku, *Rational Apathy Theory*] (discussing how the possibilities created by the Internet in information gathering, analysis and dissemination may motivate shareholders, especially retail shareholders, to be more active in corporate governance).

44. See Robert Charles Clark, *Vote Buying and Corporate Law*, 29 CASE W. RES. L. REV. 776, 779-83 (1979); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 402 (1983).

45. Note that other studies identify a tradeoff between dispersed ownership and managerial performance. See Mike Burkart, Denis Gromb & Fausto Panunzi, *Large Shareholder, Monitoring and the Value of the Firm*, 112 Q.J. ECON. 693, 694 (1997) (The authors argue that, "to the extent that managerial initiative . . . contributes to firm value, there is a trade-off between the gains from monitoring and those from managerial initiative." Dispersed ownership, they argue, induces managerial initiative, as it implies little interference with managerial discretion, while concentrated ownership reduces those initiatives and firm value, because it facilitates excessive limitation of managerial discretion or initiatives.).

agency costs and how they should be controlled. First, shares (or the residual claims) of a publicly held company are unrestricted and freely tradable, a fact that allows residual risks⁴⁶ to be spread across many residual claimants and enables risk bearers to diversify across companies offering such claims.⁴⁷ This feature ensures that none of the residual claimants bears enough risk to create a real need for participation in company management. Since the capital requirement of a typical public company is large, it is cost efficient to have a wide range of individuals bear the residual risk. Second, the size of such an organization and its activities are such that specific knowledge relevant for decisions is widely diffused among agents, so that efficiencies in decision making are accomplished by delegating the decision-management rights to agents with the specific knowledge valuable to those decisions.⁴⁸

The need for specialized risk bearing and management inherently presents agency problems that need to be controlled. As Eugene Fama and Michael Jensen observe, “control of agency problems in the decision process is important when the decision managers who initiate and implement important decisions are not the major residual claimants and therefore do not bear a major share of the wealth effects of their decisions.”⁴⁹ They propose that effective control procedures are necessary, because such decision managers are more likely to take actions that deviate from the interests of residual claimants. In this regard, and coupled with the necessity to delegate decision rights, Fama and Jensen suggested that an effective system of control requires that “decision management”⁵⁰ be separated from “decision control.”⁵¹ Without the separation, they ar-

46. Defined as “the risk of the difference between stochastic inflows of resources and promised payments to agents.” Eugene Fama & Michael Jensen, *Agency Problems and Residual Claims*, 26 J.L. & ECON. 327, 328 (1983) [hereinafter Fama & Jensen, *Agency Problems*].

47. See Paul Halpern, Michael Trebilcock & Stuart Turnbull, *An Economic Analysis of Limited Liability in Corporate Law*, 30 U. TORONTO L.J. 117, 142 (1980); Manne, *Our Two Corporation Systems*, *supra* note 15, at 262.

48. Jensen & Meckling, *Special and General Knowledge*, *supra* note 7, at 257.

49. See Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 304 (1983) [hereinafter Fama & Jensen, *Ownership and Control*].

50. Defined as the initiation and implementation of decisions. *Id.* at 308.

51. *Id.* at 308. This includes the ratification and monitoring of decisions. As Fama and Jensen noted, the devices for separating management and control include: (1) hierarchal structures in which decision initiatives of lower-level agents are passed on to agents above then in the hierarchy, first for ratification and then for monitoring; (2) boards of directors that ratify and monitor the organization’s most important decisions and hire, fire, and compensate top-level decision managers; and (3) incentive structures which encourage mutual monitoring among decision agents. Management and decision control are the components of the organization’s decision process or decision system. *Id.*

gued that residual claimants have little protections against opportunistic actions of decision agents, just as non-separation lowers the value of unrestricted residual claims (shares). However, “diffusion and separation of decision management and control have benefits because they allow knowledge to be used at the points in the decision process where it is most relevant and they help control the agency problems of diffuse residual claims.”⁵² While separating decision management and decision control will not eliminate agency costs, the value of such separation⁵³ lies in the fact that “the benefits of diffuse residual claims and the benefits of separation of decision functions from residual risk bearing are generally greater than the agency costs they generate.”⁵⁴

One clear implication of the foregoing view is that the control of management, and thus of agency costs, will be undertaken by a board of directors which must, at least, be independent of the managers, and whose main duty will be to monitor and ratify managerial decisions, in order to curb managerial shirking and opportunistic behaviors.⁵⁵ It will appear that this approach does not actually anticipate that the board will run the company’s business and affairs; rather it anticipates that the board will undertake the task of supervising the managers. However, the optimism of effective monitoring by the board of directors is, oftentimes, illusory, since the social and economic relationship between top-level managers and members of the board can, in fact, undermine the latter’s effectiveness as monitors.⁵⁶ In a recent work, Boot and Macey affirm, on a new

52. *Id.* at 309.

53. Part of the value of separating decision management and decision control is the general administration of executive compensation by independent, outside members of the board of directors, whose role, essentially, is to monitor the performance of inside board members and determine their compensation. Such a scheme creates incentives for managers to monitor other managers, particularly when there is the possibility that hard-working managers may be promoted over the lazy ones. *See Jensen & Smith, supra* note 32 (“Lower level managers have an incentive to monitor managers above them because of the interdependence of their productivities, as well as the direct gains from successfully stepping over less competent managers.”).

54. Fama & Jensen, *Ownership and Control, supra* note 49, at 309.

55. Contemporary corporate governance codes or projects emphasize the need to have a corporate board that can effectively monitor management. To do this, the codes have not only suggested that a majority of the board members should be independent of management, but that the position of a managing director and that of the head of the board of directors should be occupied by two persons. *See CADBURY REPORT, supra* note 1, at 57; COMMITTEE ON CORPORATE GOVERNANCE, *THE COMBINED CODE: PRINCIPLES OF GOOD GOVERNANCE AND CODE OF BEST PRACTICE* (May 2000); CORPORATE GOVERNANCE CODE IN NIGERIA, *supra* note 3.

56. Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597, 658–59 (1982) [hereinafter Brudney, *Independent Director*].

theoretical basis, the doubts expressed by some commentators that the management and directors relationship is a factor likely to undermine the objectivity of proximate monitors such as the directors.⁵⁷

The orthodoxy is that a board of directors comprising mostly of independent/outside directors will be more daring to challenge management in appropriate circumstances, and yet promote a friendly working atmosphere among the executives and non-executive members of the board.⁵⁸ Indeed, it has been suggested that independent directorship is a better mechanism than regulation for the monitoring of management's integrity, efficiency, and social responsibility. While independent directorship has become a global phenomenon, Enron, WorldCom, and other major corporate failures continue to raise doubts in the minds of many and, in particular, its critics, on whether the board alone, even with a majority of independent/outside directors, can be relied upon to effectively monitor corporate managers.⁵⁹ In particular, despite the clamor for the independence of directors and the effort by many companies to promote it, corporate failures under the watch of independent directors are worse in intensity than when the consensus for independence began about thirty years ago.⁶⁰

57. See Boot & Macey, *supra* note 41, at 369 ("In addition to psychological barriers to objectivity, proximate boards lack objectivity from an economic perspective. Board supervision generally means that the board is jointly responsible with management for the state of the firm.").

58. THE BUSINESS ROUNDTABLE, *supra* note 39, at 11–13.

59. See Gordon, *What Enron Means for the Management*, *supra* note 35, at 1241–45 (discussing the fact that, notwithstanding the appearance of independence, a corporate board could still be compromised as was the case with the Enron board); see also Brudney, *Independent Director*, *supra* note 56, at 612–14. On how to address the failures in the internal monitoring process, see Michael C. Jensen & Joseph Fuller, *What's a Director to Do?* (Harvard NOM Research Paper No. 02-38, Oct. 2002), available at [www.http://ssrn.com/ABSTRACT=35772](http://ssrn.com/ABSTRACT=35772) [hereinafter Jensen & Fuller, *Director to Do?*] (criticizing these practices as responsible for the ineffectiveness of corporate boards as monitors and recommending what the board must do to fulfill their role as the top-level corporate control mechanism); John Pound, *The Promise of the Governed Corporation*, in HARVARD BUSINESS REVIEW ON CORPORATE GOVERNANCE 79 (2000).

60. For a view reinforcing this position, see Alton B. Harris & Andrea S. Kramer, *Corporate Governance: Pre-Enron, Post Enron*, in CORPORATE AFTERSHOCK: THE PUBLIC POLICY LESSONS FROM THE COLLAPSE OF ENRON AND OTHER MAJOR CORPORATIONS 49, 76–78 (Christopher L. Culp & William A. Niskanen eds., 2003).

2. The Use of a Combination of Mandatory and Suppletory Constitutive Rules

The law matters.⁶¹ Undoubtedly, there is a sort of correlation between investor protection and control of agency costs. As scholars have argued:

When investor protection is very good, the most the insiders can do is overpay themselves, put relatives in management, and undertake some wasteful projects. After a point, it may be better just to pay dividends. As the diversion technology becomes less efficient, the insiders appropriate less, and their private benefits of control diminish.⁶²

Melvin Eisenberg identified certain characteristics of publicly held companies,⁶³ which should help determine the proper approach to dealing with agency costs that arise in company management. First, it is Eisenberg's view that bargaining in a publicly held company among the shareholders, or between managers and the shareholders as a body, is virtually impossible.⁶⁴ Accordingly, he observed that most of the constitutive rules of such a company are determined not by contract,⁶⁵ but by law or private bureaucratic rulemaking, i.e., by managerial orders; by board or committee resolutions; by board-adopted by-laws (articles of association); or by the board's determination of governance terms in preferred stocks, stock rights, or debt instruments.⁶⁶

61. La Porta et al., *Investor Protection*, *supra* note 14.

62. *Id.*

63. First, Eisenberg defined the companies to mean those that "have a large number of shareholders, most of whom neither participate in the management of the company nor directly monitor corporate management." Second, he observed that in a publicly held company, the number of managerial and non-managerial agents is also large, and for reasons of efficiency the business of the company is controlled and conducted by those agents. See Melvin Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1471 (1989) [hereinafter Eisenberg, *Corporation Law*].

64. *Id.*

65. Eisenberg was in fact responding to the view expressed by the contractarians, such as Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1418 (1989) [hereinafter Easterbrook & Fischel, *Corporate Contract*] ("The corporation is a complex set of explicit and implicit contracts, and corporate law enables the participants to select the optimal arrangement for the many different sets of risks and opportunities that are available in a large economy. No one set of terms will be best for all; hence the 'enabling' structure of corporate law . . .").

66. *Id.* It should be noted that Eisenberg's analysis relates to the corporate law system in the United States. Obviously, some of the powers given by statute to a board of directors are expressly dealt with by the legislature under CAMA. A board of directors of a Nigerian company lacks the competence to alter the articles of association (by-laws) without recourse to the general meeting or to vary the voting rights of the shares it issues, as these matters are regulated under CAMA in a manner that leaves no discretion to the

While recognizing that the interests of the shareholders and managers of a public company converge in many respects, Eisenberg noted that, as in any principal-agent relationship, the two interests also diverge. Basically he argued that managers of a public company are prone to shirking, outright diversion of the company's assets to personal use through unfair self-dealing, and, more importantly, to positional conflicts.⁶⁷ To him, while top managers of public companies might control shirking and unfair self-dealing because their self-esteem was tied to hard work and accomplishment, they might be unable to avoid positional conflicts, which, he believed, were more persistent.⁶⁸ First, inefficient top managers are unlikely to believe themselves as inefficient.⁶⁹ Second, they may even be unable to recognize that positional conflicts exist in the first place. Finally, they may be even more tempted to maintain or enhance their positions than they would in situations marked by shirking or unfair self-dealing.⁷⁰

In view of the foregoing, Eisenberg observed that “[t]he divergencies of interest between corporate agents and shareholders, and the special problem of positional conflicts, explain why some constitutive rules that govern publicly held corporations should be enabling or suppletory while other should be mandatory.”⁷¹ He then made the following agency costs-reducing propositions in relation to public companies:

(1) the legal rules that govern internal organization of the company and the conduct of corporate actors below the level of top managers should by and large be enabling or suppletory. The reason being that top managers have both the self-interest and the power to install constitutive rules that will efficiently determine the roles, coordination, supervision, and monitoring of lower corporate agents and constrain those agents from giving expression to their own interests in preference to the interests of the shareholders.⁷²

(2) the core fiduciary and structural rules that govern material divergences of interest of top managers in publicly held corporation should be neither determined nor subject to material variation by the action of managers or managerial organs. This is because ‘agents whose interests

board. For instance, CAMA provides that shares of a registered corporation shall carry one vote. *See* Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 116.

67. For the definition of this term and instances of position conflict, see Eisenberg, *Corporation Law*, *supra* note 63, at 1471–72.

68. *Id.* at 1473.

69. *Id.*

70. *Id.*

71. *Id.* at 1473.

72. Eisenberg, *Corporation Law*, *supra* note 63.

may materially diverge from the interests of their principals should not have the power to unilaterally determine or materially vary the rules that govern those divergencies of interests;⁷³

(3) the rules in (2) above should also normally not be subject to determination or material variation even with shareholder approval, because of the possibility that shareholder approval may be nominal, tainted by conflict of interest, coerced or impoverished.⁷⁴

In offering a rule-based approach to solving some species of agency problems, Eisenberg proposed that, "in publicly held corporations, mandatory rules should govern those core fiduciary and structural areas in which the interests of shareholders and top managers may diverge."⁷⁵ For instance, he argued that, to deal with traditional conflicts of interest, mandatory rules should impose a duty of fair dealing, provide for disclosure of self-interested transactions, and establish an effective enforcement mechanism.⁷⁶ In the case of shirking, however, he argues that mandatory rules should impose a duty of care. In essence, fiduciary duties should be mandatory at the core, and no difference should exist in this regard between closely held corporations (private companies) and publicly held corporations.⁷⁷

Eisenberg classified core structural rules into three main categories.⁷⁸ One set of structural rules, he argues, should provide for the appointment and monitoring of senior executives by a governing organ (board of directors) that is elected by the shareholders for a limited term of office, a majority of which is composed of members who are independent of the senior executives.⁷⁹ A second set of structural rules should require periodic disclosure of detailed financial data and information concerning material business and legal developments and should provide for an institutional mechanism to ensure that the information is reliable.⁸⁰ A third set of rules should provide for approval of, and dissent from, transactions that tend to raise positional conflicts. Specifically, shareholder approval should be required for any control transaction or that which causes a change in the assets or business of the company; when a transaction involves either traditional or positional conflicts, or creates a significant potential for overreaching by control shareholders, dissenting sharehold-

73. *Id.* at 1473–74.

74. *Id.* at 1474.

75. *Id.* at 1480.

76. *Id.*

77. Eisenberg, *Corporation Law*, *supra* note 63.

78. *Id.*

79. *Id.*

80. *Id.*

ers should have the right to require the corporation to purchase their shares at fair value.⁸¹

3. Markets as Agency Costs Control Mechanism

Those opposed to the rule-based approach to controlling agency costs contend that regulations overlook the contractual nature of the corporation, which requires that parties discreetly contract around agency problems, since regulation may not always produce the most efficient outcomes.⁸² Scholars have noted that regulations of the type contained in a corporation code were essential, as they provided standard form contracts that shareholders would likely choose. Noting that writing contracts is costly, these contractarians pointed out that a corporation statute which contained some prescriptive rules might help reduce the transaction costs of negotiations. Besides, the difficulty of anticipating all possible contingencies in long-term relationships make ex ante or default rules very helpful to lessen bargaining costs. However, they emphasize the essence of contracting or private ordering in the resolution of future disputes that could not have been anticipated and, therefore, were not specifically addressed.

While advocating an enabling structure of corporate law that enhances innovation and provides flexibility for the parties, the contractarians also make the case⁸³ that the control of agency costs in business corporations should be left to the markets, which they argue, are most effective in aligning both the managerial and shareholders' interests.⁸⁴ However, a

81. *Id.*

82. See Easterbrook & Fischel, *The Corporate Contract*, *supra* note 65.

83. Part of the economic theories of the corporation see the latter as a "nexus of contract," a perspective that not only equates the interests of other groups within the corporate family with those of the shareholders, but also challenges the view that management should be accounted to the shareholders. See Eugene Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 289 (1980) [hereinafter Fama, *Agency Problems*] (making a case for setting aside the orthodoxy that a corporation has owners, and arguing that the two functions attributed to the entrepreneur, management and risk bearing, should be treated as separate factors within the set of contracts called the firm). For critiques of this approach, see William W. Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 409 (1989); Victor Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 COLUM. L. REV. 1403 (1985) [hereinafter Brudney, *Rhetoric of Contract*]; Melvin A. Eisenberg, *The Conception that the Corporation Is a Nexus of Contracts and the Dual Nature of the Firm*, 24 DEL. J. CORP. LAW 819 (1999) [hereinafter Eisenberg, *Dual Nature of the Firm*] (arguing that the "nexus of contracts" theory is unsatisfactory as a positive or descriptive analysis of the corporation).

84. Ralph Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

preference for the institution of the markets as ideal or better monitors means that shareholders will have no monitoring role to play.⁸⁵ The markets that have been identified as capable of checking managerial excesses are the market for capital, the products market, the market for corporate control, and the managerial market.⁸⁶

The takeover market is said to provide investors with an important source of protection when the internal control mechanisms of the corporation, which operate through the board of directors, break down.⁸⁷ According to Jensen and Ruback, the market for corporate control is the arena in which alternative management teams compete for the rights to manage corporate resources.⁸⁸ Henry Manne⁸⁹ argues that, besides the stock market, there is no objective standard of managerial efficiency, particularly because courts, as evidenced by the business judgment rule, are loath to second-guess business decisions or remove directors from office.⁹⁰ To Manne, therefore, “[o]nly the take-over scheme provides

85. See Fama & Jensen, *Ownership and Control*, *supra* note 49.

86. In some cases, the market for managers and corporate control are treated as one, because the two are intertwined. See Michael Jensen, *Takeovers: The Controversy and the Evidence*, in WILLIAM G. KARNES SYMPOSIUM ON MERGERS AND ACQUISITIONS 27, 28 (Charles M. Linke, ed., 1986) (“The market for corporate control is best viewed as a major component of the managerial labor market. It is the arena in which alternative management teams compete for the rights to manage corporate resources.”). Granted that replacement of the chief executive office may take place without a change in control, there is still the need to separate the two analytically. As Jensen and Smith observed, “competition in the labor market tends to ensure that the manager receives only a competitive level of compensation. Reputational effects cause the value of a manager’s human capital to depend on his performance inside the firm.” Jensen & Smith, *supra* note 32. Since the market is likely to be aware of the role a top-level manager plays in a control transaction that occasions a change in management, to the extent that top-level managers anticipate a relocation of their human capital, they have incentives to invest in decisions that reduce divergence from value-maximizing behavior. See Fama, *Agency Problems*, *supra* note 83, at 292–93.

87. Henry G. Manne, *Merger and the Market for Corporate Control*, 73 J. POL. ECON. 110, 113 (1965) [hereinafter Manne, *Market for Corporate Control*].

88. Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5 (1983).

89. Henry Manne is credited with insight on the role of the market for corporate control in governance.

90. Manne, *Market for Corporate Control*, *supra* note 87, at 113. For the monitoring effect of the market for corporate control, see Mary S. Schranz, *Takeovers Improve Firm Performance: Evidence from the Banking Industry*, 101 J. POL. ECON. 299 (1993) (finding that banks, in jurisdictions where there are active takeover activities, perform better than those in jurisdictions where takeovers are restricted by legislation). *But see* Julian Franks & Colin Mayer, *Hostile Takeovers and the Correction of Managerial Failure*, 40 J. FIN. ECON. 163 (1996) (The authors studied “the disciplining function of hostile takeovers” in the United Kingdom in 1985 and 1986 and found that there was “little evidence

some assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling shareholders.”⁹¹ The alignment of interests occurs, and with it a possible reduction of agency costs, because “[t]he very existence of potential competition for positions of incumbent managers conditions them to think in terms of keeping stock prices as high as possible relative to other companies in the same industry.”⁹²

The capital market, it has been argued, also constrains management’s excesses and forces corporate managers to allocate the company’s assets more efficiently. Free tradability (or transferability) of the shares of publicly held companies provides an organized market, whose role is to price shares and transfer them at low costs.⁹³ The stock market thus represents an external device for monitoring public companies. According to Fama and Jensen, “stock prices are visible signals that summarize the implication of internal decisions for current and future net cash flows.”⁹⁴ Underperforming managers, the argument goes, will find it more expensive to raise capital in the market, either by way of equity capital or debt capital.⁹⁵ Thus the competitive nature of capital and the repercussion that will attend a company’s inability to raise the needed capital are likely to force

of poor performance prior bids,” suggesting that the high board turnover did not derive from past managerial failures.).

91. Manne, *Market for Corporate Control*, *supra* note 87, at 113.

92. Henry G. Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 1967 DUKE L. J. 231, 237 (1967). Note that some commentators have stressed the need to curb takeover activities because of its damaging effect to the company’s growth and to the economy. See Martin Lipton, *Takeover Bids in the Target’s Boardroom*, 30 BUS. LAW 101 (1979); Martin Lipton, *Takeover Bids in the Target’s Boardroom: A Response to Professors Easterbrook and Fischel*, 55 NYU L. REV. 1231, 1233 (1980) (arguing that tender offers should be left to the directors’ business judgment, as long as the economic benefits of takeovers are debatable); see also Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, 4 MIDLAND CORP. FIN. J. (1986) (arguing that despite their benefits, including increased efficiency within the corporation, takeovers have created additional pressures on top-level corporate executives which may result in increased anti-takeover restrictions).

93. Eugene F. Fama & Michael C. Jensen, *Organisational Forms and Investment Decisions*, 14 J. FIN. ECON. 101 (1985) (discussing how the characteristics of residual claims distinguish investment rules for various organizational forms).

94. See Fama & Jensen, *Ownership and Control*, *supra* note 49, at 313. While this assessment may be largely correct, cases exist in which the price of a company’s stock may be simulated to the public, so that the prices do not actually reflect the true implication of internal decisions. This sort of situation happened with Enron share prices before its collapse and with the share prices of Nortel before the bubble burst. See Harris & Kramer, *supra* note 60, at 64–70 (detailing corporations previously falsified financial reports which were later restated).

95. See Winter, *supra* note 84.

corporate managers to orient a corporation's decision process toward the interests of residual claimants.⁹⁶ However, one needs to note that unless the capital market is efficient,⁹⁷ it may be unable to effectively perform its monitoring role.

As noted earlier, the managerial market is linked with the market for corporate control, to the extent successful takeovers often result in the change of top management personnel. However, this market exists even outside the market for corporate control. Internally, middle level managers often aspire to displace their seniors or to gain promotion to the top, and those at the top are equally aware that they need to constantly perform well to retain their jobs. Such internal rivalry, Fama noted,⁹⁸ constituted a threat to all managers, and could ultimately induce them to cut down on shirking or other value-decreasing behaviors. Additionally, the need for mobility within the industry could force managers to invest in value-maximizing behaviors, especially as the managerial market may easily access their performance records.

4. Shareholder Voting as a Monitoring Option

Few commentators concede any role to the shareholders of public companies in corporate monitoring.⁹⁹ Largely, the internal monitoring discourse in corporate law focuses on and concedes to the board of directors the task of monitoring top-level management; whereby the board fails in this regard, the various markets are expected to narrow the divergence between managerial and shareholders' interests, by serving as alternative or even concurrent monitoring mechanisms.

96. *Id.*

97. For a detailed analysis of capital market efficiency, see Ronald J. Gilson and Reiner H. Kraakman, *The Mechanism of Market Efficiency*, 70 VA. L. REV. 549 (1984).

98. See Fama, *Agency Problems*, *supra* note 83, at 292-93, 295-98.

99. For a detailed analysis of the perception of shareholder voting over time, see Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting*, 79 IOWA L. REV. 485 (1994). For the criticism of the value of shareholder voting to governance, see Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 310 (1999) ("In both theory and practice . . . shareholders' voting rights—at least in publicly traded corporations—are so weak as to be virtually meaningless"); Easterbrook & Fischel, *Voting in Corporate Law*, *supra* note 44, at 402-3; Jeffrey N. Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CAL. L. REV. 1, 43 (1988) (noting that the reliability of voting as a decision mechanism has come under attack by collective action problems in dealing with management, as the latter controls the proxy machinery); see also Henry G. Manne, *The "Higher" Criticism of the Modern Corporation Law*, 62 COLUM. L. REV. 399, 410 (1962) [hereinafter Manne, *Higher Criticism*].

Notably, voting by the shareholders has been regulated differently, depending on the jurisdiction. The United States and the United Kingdom present contrasting approaches which also reflect differences in how policy makers in these two jurisdictions perceive the shareholders' place in the governance scheme relative to the extent to which they think management should account to the shareholders. For instance, proxy regulation in the United States appears to reflect, over time, the lawmakers', or the Securities and Exchange Commission's (SEC), perception of the power shareholders have in corporate monitoring.¹⁰⁰ However, since 1992,¹⁰¹ there has been increasing recognition by the SEC of the need to not only empower the shareholder in corporate governance, but also to encourage increased shareholder participation, by lessening several of the strictures which exacerbated the costs of shareholder participation. On the other hand, little regulation exists under the U.K. company legislation to limit shareholder participation and the shareholders' right to utilize the corporate proxy machinery, as is the case under the federal proxy rules in the United States.¹⁰²

The good news is that not all the countries in the Anglo-Saxon jurisdictions share the U.S. position, which, in theory¹⁰³ and practice, diminishes

100. The U.S. SEC rules on shareholder participation have developed on two fronts, namely, rules dealing with proxy solicitation and those dealing with the use by the shareholders of the corporate proxy machinery. For the historical development of the latter, see Leila N. Sadat-Keeling, Comment, *The 1983 Amendments to Shareholder Proposal Rule 14a-8: A Retreat from Corporate Democracy?*, 59 TUL. L. REV. 161, 166-94 (1984). Of course, the audience should note that the SEC further reviewed this rule, the aim being to simplify their interpretation and application. The latest effort at reform was the 2003 SEC proposal to obligate corporations to list shareholders nominees in the corporate proxy materials in certain circumstances. In relation to proxy solicitation, the 1992 SEC reform liberalized the concept of solicitation as to exempt certain communication by the shareholders which hitherto qualified them as solicitors and obligated the filing of proxy returns. See SEC Rules, 17 C.F.R. § 240.14a-1(1)(2)(iv), § 240.14a-2(b)(2), § 240.14a-3(f). It was widely believed that the old expansive definition of solicitation had a chilling effect on shareholder participation. For a comparative work that put the U.S. proxy rules in perspective, see Douglas G. Smith, *A Comparative Analysis of the Proxy Machinery in Germany, Japan and the United States: Implications for the Political Theory of American Corporate Finance*, 58 U. PITT. L. REV. 145, 190-203 (1996).

101. Regulation of Communications Among Shareholders, SEC Release No. 34-31326, 57 FED. REG. 48276 (1992). Note that the stated purpose of the amendments contained in the Release was to facilitate communications among shareholders and to reduce the costs of complying with SEC regulations for persons engaged in proxy solicitations.

102. See 17 C.F.R. §240.14a-8.

103. Abram Chayes, *The Modern Corporation and the Rule of Law*, in THE CORPORATION IN MODERN SOCIETY 25, 40-41 (Edward S. Mason ed., 1973) (arguing that shareholders are the least in need of protection, and that focusing on them in the corporate democracy debate is anomalous because, as a group, shareholders' interest can be

the shareholder constituency as a monitoring body. Shareholder voting is receiving increasing attention in modern corporate governance projects, with the OECD encouraging its members to ensure that the vote matters.¹⁰⁴ The increasing dominance of institutional investors in corporate finance has helped to renew the clamor for more of a monitoring role for the shareholders.¹⁰⁵ For shareholder monitoring to be effective, however, the voting policy in the governing corporation code should facilitate informed decision making by ensuring that management furnishes sufficient information to the shareholders on every crucial issue considered at general meetings. In the extreme, the operative voting system should promote “vote solicitation” rather than proxy solicitation, by disengaging participation from physical presence at meetings and reducing the cost to shareholders of personally participating in general meetings. Shareholders can be allowed to participate (that is vote on issues) by electronic means, namely telephone or via the Internet. Happily, most developed countries have already undertaken reforms of their corporate laws to accommodate the use of modern communication technologies in corporate law administration and in the context of corporate governance.¹⁰⁶

Moreover, where, as is presently the case in the United States and in Canada,¹⁰⁷ the use of the Internet has been integrated in the administra-

“readily reducible to monetary terms” and relocated, given the workings of the security markets); Bayless Manning, Book Review, 67 *YALE L.J.* 1477, 1486–90 (1958) (arguing against the idea of voting by the shareholders generally); see also Blair & Stout, *supra* note 99; Manne, *Higher Criticism*, *supra* note 99; Manne, *Our Two Corporation Systems*, *supra* note 15, at 261.

104. See OECD, OECD PRINCIPLES OF CORPORATE GOVERNANCE, pts. II & III (2004), available at http://www.valuebasedmanagement.net/articles_oecd_corporate_governance_principles_2004.html. Shareholder coalition formation is one issue emphasized in the OECD’s corporate governance principles. See also *id.* pt. II.G. (“Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.”).

105. See Bernard S. Black, *Shareholder Passivity Re-Examined*, 89 *MICH. L. REV.* 520, 580–84 (1990) (examining how shareholders may overcome the collective action problems given the emergence of institutional investors). But see Edward Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 *GEO. L.J.* 445, 452 (1991) (discussing the problems that might make institutional investors wary of monitoring, and highlighting the fact that as agents, they have incentive problems which might hinder their monitoring role).

106. They include the United States, DEL. CODE ANN. tit. 8, § 211, Canada, Canada Business Corporation Act, R.S.C., ch. C-44, § 132(4)-(5), and the United Kingdom, Companies Act 2006, c. 46, sched. 5, pts. 3 & 4.

107. For a discussion of the relevant laws in these and other jurisdictions, see Ige O. Bolodeoku, *Going Virtual: Using Some Common Law World Initiatives to Update the*

tion of both corporate and securities law to create information depository and retrieval systems (such as the EDGAR and the SEDAR) so as to allow for easy and affordable retrieval, analysis, and dissemination of corporate information, one should expect the shareholder constituency to be more active. As dissident shareholders may now use the Internet to communicate with non-proponent shareholders, coordinate monitoring activities, and transmit information, it is not unlikely that the apathy which once beset the shareholders of most public companies may wane over time, particularly with retail shareholders.¹⁰⁸ It is expected that policymakers, especially in Nigeria, will initiate the necessary reforms so that extant communication and information technologies can become integrated into corporate governance laws relating to enforcement of shareholders' rights as well as reforms encouraging shareholder coalitions.¹⁰⁹

5. Control of Information Asymmetry

Information asymmetry is a critical barrier between investors and issuers of common shares.¹¹⁰ Bernard Black puts the issue more pointedly when he observed as follows:

The value of a company's shares depends on the company's future prospects. The company's past performance is an important guide to future prospects. The company's insiders know about both past performance and future prospects. They need to deliver this information to investors so that investors can value the company's shares.¹¹¹

Being able to value shares gives investors the chance to make rational resource allocation decisions. Given that the limited liability concept externalizes risks by shifting them to corporate creditors,¹¹² information on material activities of public companies will assist the creditors to better

Nigerian Law on Corporate Democracy (unpublished manuscript, on file with *Brooklyn Journal of International Law*).

108. See Bolodeoku, *Rational Apathy Theory*, *supra* note 43 (discussing in detail how retail shareholders may overcome passivity by taking advantage of the possibilities of the Internet).

109. For the areas of reforms that Nigerian law may consider in new reform initiatives, see Bolodeoku, *Going Virtual*, *supra* note 107.

110. Bernard S. Black, *Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 786 (2001) [hereinafter Black, *Legal and Institutional Preconditions*].

111. *Id.*

112. See FRANK EASTERBOOK & DANIEL FISCHER, *THE ECONOMIC STRUCTURE OF THE CORPORATION* 49-50 (1991).

evaluate risks and to determine appropriate checks to enhance their post-bankruptcy conditions.

However, investors' concerns are not limited to those present at the entry point. Investors should be able to evaluate the companies in which they invest to determine whether it is rational to remain as investors or relocate their investments. These concerns necessitate a regime of information disclosure that obligates corporate managers to disclose the right and sufficient information with little opportunity for distortions. As Black pointed out, "[i]nsiders have an incentive to exaggerate the issuer's performance and prospects, and investors can't directly verify the information that the issuer provides. This problem is especially serious for small companies and companies that are selling shares to the public for the first time."¹¹³ It is not enough to permit corporate executives to restate profits. Sometimes, restatements come in too late, as most investors are already harmed by being prevented to bail out at the right time because they are fed with false information, as in the cases of Enron, WorldCom, and Nortel.

C. Control of Agency Costs in Public Companies with Concentrated Ownership

Dealing with agency costs or problems in public companies with concentrated ownership poses somewhat different challenges than those posed in a typical widely held public company, although the challenges are considerably similar in both. In most cases, the same group of persons undertakes the risk-bearing and management functions. Even when major shareholders do not undertake management functions, they have the power to elect the directors who will appoint top-level managers.

The fusion of risk-bearing and management functions in the same hands is efficient in many respects.¹¹⁴ First, if those who contribute large capital possess the technical skill required for business decisions, it will be efficient to combine residual risk-bearing and management func-

113. Black, *Legal and Institutional Preconditions*, *supra* note 110, at 786.

114. See George J. Benston, *The Self-Serving Management Hypothesis: Some Evidence*, 7 J. ACCT'G & ECON. 67 (1985); see also Yan Wang & Xiaonian Xu, *Ownership Structure, Corporate Governance, and Firms' Performance: The Case of Chinese Stock Companies* (The World Bank, Policy Research Working Paper Series No. 1794, 1997), available at <http://www.worldbank.org/html/dec/Publications/Workpapers/WPS1700series/wps1794/wps1794.pdf>. The authors found, *inter alia*, that there is positive correlation between ownership concentration and firm performance; see also Andrei Shleifer & Robert Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461 (1986).

tions.¹¹⁵ Allowing significant residual claimants to be decision agents may then substitute “for costly control devices to limit the discretion of decision agents,”¹¹⁶ because the fact that decision agents also bear the wealth effects of their decisions could help reduce the degree of divergence between the shareholders and management’s interests.¹¹⁷

Where concentrated ownership is combined with weak complementary systems, such as laws that do not protect minority rights, underdeveloped capital markets, and unreliable judicial systems, there may be a significant and irremediable expropriation from the minority group. Thus, while concentrated ownership is not problematic on its own, country-specific situations may aggravate the associated agency problems.¹¹⁸

A further characteristic of a public company with concentrated ownership is that, unlike private or closely held companies, outside residual claims may not be held by persons whose relationships with management allow control of agency problems without the separation of management

115. One can observe that the ownership structure of privatized enterprises which the law envisages after privatization may be efficient in light of this observation.

116. See Fama & Jensen, *Ownership and Control*, *supra* note 49, at 306; see also Jeremy S.S. Edwards & Alfons J. Weichenreider, *Ownership Concentration and Share Valuation*, 5 GERMAN ECON. REV. 143 (2004). First, this Article provides empirical support for the view that the extent of the conflict of interest between controlling and minority shareholders depends on the extent to which the controlling shareholder’s rights exceed her cash-flow rights. *Id.* at 151. Second, the authors found, while focusing on ownership structure in Germany, that while controlling shareholders, sometimes, gain private benefits at the expense of minority shareholders, “the net effects of equal increases in both the control and cash-flow rights of the largest shareholder does not harm, and, depending on the type of largest shareholder, may benefit minority shareholders.” *Id.* at 146. Pointing to the German corporate governance, the authors argued that it is difficult for a controlling shareholder in a German company to abuse its power, because of the admixture of the governance structure and minority rights over major corporate decisions. *Id.* at 147–49.

117. See Fama & Jensen, *Ownership and Control*, *supra* note 49, at 307–11; see also Ang et al., *supra* note 10 (confirming empirically the view of Jensen and Meckling in their 1976 seminal paper).

118. Stijn Claessens, Simeon Djankov, Joseph P.H. Fan & Larry H.P. Lang, *Expropriation of Minority Shareholders: Evidence from East Asia* (The World Bank, Policy Research Working Paper Series No. 2088, 1999), available at <http://www.worldbank.org/html/dec/Publications/Workpapers/wps2000series/wps2088/wps2088.pdf> (studying companies in East Asia, and finding that that the risk of expropriation is indeed the major principal-agent problem for large publicly traded corporations, depending on whether concentration is through family holding, state, or widely held institutions or the use of pyramidal holdings, and that expropriations ultimately depend on country-specific circumstances); Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 759 (1997) (“As ownership gets beyond a certain point, the large owners gain nearly full control and . . . prefer to use firms to generate private benefits of control that are not shared by minority shareholders.”).

and control decisions. Moreover, there is no guarantee that business associates whose goodwill and advice are important to the organization are also potential candidates for holding minority residual claims.¹¹⁹ Thus, agency problems are kept alive in public companies that combine concentrated ownership and a stream of outside residual claimants, since decision agents are likely to be appointed by the residual claimants with the largest portion of claims.

The fact that decision agents may not be hundred-percent owners creates an incentive for the managers to maximize the wealth effect of their decisions at the expense of outside shareholders.¹²⁰ One interesting point to note about this type of public company is that the existence of a shareholder or a few shareholders with high control rights does not inexorably mean that those few shareholders provide the greater portion of the capital,¹²¹ as control rights need not correlate with cash-flow rights, especially in countries that permit companies to issue shares with differing control rights. Another problem often associated with a public company with concentrated and dispersed ownership is the possibility that the insiders may abuse confidential information at the expense of the outside shareholders.¹²²

Jensen and Meckling observed that “[i]f a wholly owned firm is managed by the owner he will make operating decisions that maximize his utility.”¹²³ And further that:

if the owner-manager sells equity claims on the corporation which are identical to his own (i.e., which share proportionately in the profits of the firm and have limited liability), agency costs will be generated by the divergence between his and those of the outside shareholders, since he will then bear only a fraction of the costs of any non-pecuniary benefits he takes out in maximizing his utility.¹²⁴

119. Claessens et al., *supra* note 118.

120. Jensen & Meckling, *Theory of the Firm*, *supra* note 9, at 313 (“As the owner-manager’s fraction of the equity falls, his fractional claim on the outcome falls and this will tend to encourage him to appropriate larger amount of the corporate resources in the form of perquisites.”).

121. See La Porta et al., *Investor Protection*, *supra* note 14.

122. Addressing insider dealing is important, at least, to provide outside investors and the public at large with some confidence and assurance of the effectiveness of the system. See Black, *Legal and Institutional Preconditions*, *supra* note 110, at 804; Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459 (2001) (generally discussing the impact of law on the evolution of the separation of ownership and control in the United Kingdom).

123. See Jensen & Meckling, *Theory of the Firm*, *supra* note 9, at 312.

124. *Id.*

Jensen and Meckling further noted that as the equity of the owner-manager falls, his claims to the company free cash flows falls, the implication being that such a fall in the owner-manager share of the total profits is likely to “encourage him to appropriate large amounts of the corporate resources in the form of perquisites.”¹²⁵ As a result, minority shareholders must expend more resources in monitoring the behavior of the managers. They must be equally ready to initiate costly derivative actions to redress possible managerial abuse of office. But if the minority group lacks the capability to monitor, other types of intervention must be employed to protect their interest.

Furthermore, when a public company combines concentrated share ownership with diffused outside equity, the shareholder-managers will usually have the votes to alter the memorandum and articles of associations. They can elect and remove directors and, in some cases, may be able to effect fundamental transactions independently of the outside shareholders. Because outside shareholders will realize that they have relatively small equity compared to the shareholder-managers, they are unlikely to have the incentives to monitor the managers.¹²⁶

In the Nigerian context, one of the governance problems likely to emanate from the privatized companies with concentrated ownership in core investors and scattered public ownership is that non-core investors are most likely to be rationally apathetic to monitoring. It may also be said that, if the market is efficient, in that it is able to absorb the likely tendencies of owner-managers to generate agency costs as their claim to the company free cash flow decreases, than the amount outside shareholders will pay for their shares will reflect these possible costs. But this is merely relevant at the entry point; the threat and burden of agency costs are not removed and still have to be dealt with throughout the life of the company. Above all, significant share ownership stake in a company affects its viability as a takeover target and can diminish the control function that the market for corporate control is expected to perform.¹²⁷

125. *Id.* It is important to note that the realization by the owner-manger that he has no total claim on the resources of the company may also induce him to shirk, rather than merely enhance his perquisites.

126. See OLSON, *supra* note 25, at 50–52, 55.

127. See Rene M. Stulz, *Managerial Control of Voting Rights: Financing Policies and the Market for Corporate Control*, 20 J. FIN. ECON. 25 (1988) (showing that the fraction of share votes owned by managers is an insignificant determinant for an all-equity firm, as it affects the possibility of a tender offer and the size of premium. A higher equity stake by management, Stulz argues, would lower the probability that a hostile bid would occur.).

In this regard, internal control mechanisms, from the monitoring role of the board of directors¹²⁸ or shareholders' participation, may be a less effective mechanism in controlling agency costs. Information is crucial. Unless representation of the minority group on corporate boards of public companies in this category is mandated or a robust regime of information disclosure exists, major shareholders are likely to monopolize material information that the other group of shareholders may need for monitoring. Even when there is no such monopoly, it is doubtful whether outside shareholders will have the time and competence to process material information into a monitoring tool. It is pertinent to worry about how agency costs in companies that combine concentrated ownership of shares with diffused share ownership should be monitored and controlled, if the minority shareholders, most of whom may be unorganized, are not represented on corporate boards and have neither the time nor means to monitor the decisions agents.

Because of the value of information to monitoring of any sort, it is desirable to have cumulative voting through which minority shareholders can elect, at least, some directors on corporate boards. The presence of minority shareholder representatives on corporate boards could create information access and acquaint them with the activities of the shareholder-managers.¹²⁹ The combination of concentrated and diffused ownership also requires that other forms of protection exist, which outside shareholders can take advantage of. With a good regime of information disclosure and access to information on opportunistic behaviors of the managers, outside shareholders should be able to trigger administrative investigation of the affairs of the company, and, if need be, commence derivative actions against the owner-managers or the directors loyal to him or commence a proceeding charging the directors with violating fiduciary duties. Having examined the normative issues involved in controlling agency costs in both types of public companies, the Part following will discuss how the CAMA has responded.

IV. RESPONSE OF CAMA TO AGENCY PROBLEMS

In assessing to what extent CAMA conduces to effective control of agency costs, this Part will focus on the control mechanisms that: (1) limit agency costs through either private contracting or mandatory pre-

128. As Warren Buffett once pointed out, if the controlling shareholder is an owner-manager, the board has virtually no functions. Lawrence A. Cunningham, Compilation, *The Essays of Warren Buffett: Lessons for America*, 19 CARDOZO L. REV. 1, 40 (1997).

129. This practice is adopted under the Canada Business Corporations Act (CBCA). Canada Business Corporations Act, R.S.C., ch. 44 (1985). The SEC in Nigeria has also recommended it in its recent corporate governance project.

scriptions; (2) reduce behavioral opportunism on the part of managers; (3) align the interests of management with those of the shareholders; (4) reduce control positional conflicts; and (5) subject managerial behaviors to the shareholders' control.

A. Contracting Around Agency Costs and the Enabling Nature of CAMA

As noted earlier, a corporate law system that allows managers and residual claimants to contract around agency costs may, to a considerable extent, produce a more efficient result than that which dictates solutions by regulations.¹³⁰ As a mechanism to reduce agency costs, however, private ordering is most effective when the parties' bargaining power is equal or near equal and information cost is at its lowest.

The good news is that CAMA provides an enabling structure that members of the corporate family may utilize to reduce agency costs. However, it is impossible to bargain in every situation, cost may be prohibitive and contracting parties may have unequal bargaining power. Therefore, desirable corporate legislation should contain mandatory provisions, procedural guidelines, or managerial conduct regulation to empower managers to initiate some transactions, while retaining shareholder approval rights to mitigate the effect of conflicts of interest.

In relation to the board's management powers and the extent to which the board's discretion may be limited, sections 41 and 63 of CAMA provide the essential flexibility in the framework that provides the flexibility needed to craft customized solutions to agency problems. Section 63(2) of CAMA provides that, "[s]ubject to the provisions of this Decree, the respective powers of the members in general meeting and the board of directors shall be determined by the company's articles."¹³¹ This subsection is then followed by a default provision in subsection (3), which empowers the board of directors to manage the business of the company and exercise "all such powers of the company as are not by this Decree or the articles required to be exercised by the members in general meeting."¹³² Section 63(2) thus leaves it entirely for the company to design the intra-

130. This claim is the central focus of the contractarians. For the contractarian rendering of corporate law, see Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1997) (book review); Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266 (1999). For criticisms of the contract construct, see Brudney, *Rhetoric of Contract*, *supra* note 83; Eisenberg, *Dual Nature of the Firm*, *supra* note 83.

131. Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 63(2) (Nigeria).

132. *Id.* § 63(3).

corporate power structure and to provide the desirable limits or restrictions on the powers exercisable by corporate managers.

While it is hardly expected that the shareholders, particularly of public companies, will undertake any management obligations, what is not in doubt is that the power of management may be curtailed or subjected to the shareholders' scrutiny, even when it is conceded to the board of directors on efficiency grounds. However, until the shareholders act in that direction, the board of directors, when operating within powers conferred on it either by CAMA or the articles of association, are not bound to obey the directions and instructions of the members in general meetings, except the articles confer on the shareholders the power to override management in respect of specific matters or transactions.¹³³ Obviously, it will not be cost efficient for the shareholders to direct or instruct the board of directors in all cases involving the business of the company; however, the fact that directors may, sometimes, abuse their powers renders the existence of such control desirable.

For its full effect, section 63 should be read with section 41 of CAMA. While subsection (1) of the latter provision reinforces the contractual effect of the memorandum and articles of association between the company and its members and officers, and between the members and officers *inter se*, subsection (3) provides a legal platform for flexibility in the

133. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 63(4). The subsection provides as follows:

Unless the articles shall otherwise provide, the board of directors, when acting within the powers conferred upon them by this Act or the articles, *shall be bound* to obey the directions or instructions of the members in general meeting: Provided that the authors acted in good faith and with due diligence.

Id. (emphasis added). It is this author's view that the phrase "shall be bound," as it appears in the Act, is meaningless in light of the proviso at the end of the subsection, and that perhaps the draftsman inadvertently admitted the word "not," which would have made the phrase read "shall not be bound." It makes no sense whatsoever to compel a board acting with the power conferred on it by legislation and articles to obey the instruction of members acting in a general meeting, when the opening phrase already indicates that the rule intended by the subsection is to operate as a default rule. This author further argues that the legislature, indeed, intended to reenact the principle in the English case of *Automatic Self-Cleansing Filter Syndicated Co. v. Cunningham*, [1906] 2 Ch. 34 (C.A.), subject to the statutory "good faith and due diligence" clause. In essence, what the phrase "[u]nless the articles shall otherwise provide . . ." implies is that the shareholders could reserve to themselves the power to instruct or direct the board in respect of the business of the company. Where such reservation has been made, it is the opinion of this author that the power so reserved shall apply even to matters in respect of which the Act or the articles have empowered the directors to act. Consequently, this provision qualifies the application of the common law principle enunciated in *Automatic Self-Cleansing Filter Syndicated Co. v. Cunningham* [1906] 2 Ch. 34 (C.A.).

relationship between the company and any other party. The subsection provides that “[w]here the memorandum of articles empower any person to appoint or remove any director or other officer of the company, such power shall be enforceable by that person notwithstanding that he is not a member or officer of the company.”¹³⁴

Since the section refers to “any person,” it seems to provide a framework for those dealing with the company, whether in their capacity as shareholders, creditors, or officers to safeguard their interests by reserving the right to appoint directors that may protect their specific interest in the company. The directors appointed in the foregoing circumstance may be useful to bridge the information gap that may prevent the appointing party from effectively protecting his or her interest in the company.

The foregoing analysis brings into relevance management agreements contemplated under the privatization scheme in Nigeria. A management agreement may implicate corporate governance issues. Specifically, they may limit the discretion of the managers or the board of directors of the privatized companies. While there is nothing wrong with such agreements, it is important to note that, unless they are incorporated as part of the companies’ articles or memoranda, it may prove difficult to enforce the agreements. Moreover, if a term of a management agreement contradicts specific provisions of CAMA relating to the powers reserved for the general meeting, the term may become void and unenforceable.

The provisions of section 63 encourage pre-emptive monitoring of managerial actions, and they are best appreciated when compared with their counterpart in jurisdictions with statutory grant model. In these jurisdictions, such as the United States¹³⁵ and Canada,¹³⁶ the board of directors is expressly conferred with the power to manage (or to supervise the management of) the business and affairs of the corporation. Because directors enjoy a statutory grant, shareholders are correspondingly denied the right to interfere with the management powers of boards of directors.¹³⁷ Indeed, the federal proxy rules in the United States reinforce the

134. Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 41(3).

135. DEL. CODE ANN. tit. 8, § 141(a) (2006).

136. Canada Business Corporations Act, R.S.C. ch. C-44, § 102(1) (1985).

137. Brian R. Cheffins, *Michaud v. National Bank of Canada and Canadian Corporate Governance: Victory for Shareholder Right?*, 30 CAN. BUS. L.J. 20, 23 (1998). In the United States, one district court’s decision affirms that a board’s power to issue shares and decide its own rights does not preclude the shareholders’ right to use a corporation’s bylaws to constrain the board is crucial. *See* International Bhd. of Teamsters Gen. Fund v. Fleming Co., No. Civ. 96-165c-A, 1997 U.S. Dist. LEXIS 2979 (W.D. Okla. Jan. 14, 1997). Its importance lies in the fact that the relevant Oklahoma state provisions under consideration in *Fleming* are *in pari material* with those of the Delaware corporation code.

directors' managerial power by preventing the shareholders from utilizing the corporate proxy machinery in respect of matters that fall within the ordinary management powers of the board of directors.¹³⁸

The legislative policy that prevents shareholders from interfering with the management power of corporate boards in the United States and Canada manifests in a variety of ways that may exacerbate agency costs. In the context of hostile takeovers, the statutory grant model appears to be a major factor that shapes the judicial views on the directors' power in takeover bid transactions in these jurisdictions. By tying a board's power of intervention in takeover bid situations to the board's management power, the courts in these jurisdictions hold that directors can "just say no" to bids they perceive as harmful to corporate policy and effectiveness, an approach that effectively eviscerates the monitoring role that many believe the market for corporate control will perform in corporate governance.¹³⁹

B. The Deregulation of Limited Liability

The limited liability rule implies that corporate managers and shareholders do not bear the cost of their decisions,¹⁴⁰ and except when sued

138. The U.S. position contrasts sharply with the position in Nigeria, Canada, the United Kingdom, and other common law jurisdictions where shareholders are not disallowed from using the corporate proxy machinery in respect of matters falling within the ordinary powers of the board of directors. For Canada, see Canada Business Corporations Act, R.S.C., ch. C-44, § 137; for Nigeria, see Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 235; for United Kingdom, see Companies Act, 2006, c. 46, § 294.

139. The Supreme Court of the State of Delaware gives authority for the defensive tactics mounted by target boards against takeover bids, even if the shareholders would have preferred the bid. See *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1154 (Del. 1989). The court held that:

Delaware law confers the management of the corporate enterprise to the stockholders' duly elected board representatives. The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals. That duty may not be delegated to the stockholders. Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.

Id. (citations omitted)). For a critique of this position, see Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 988-94 (2002). For an analysis of the Nigerian takeover bid jurisprudence in light of the U.S. position, see Ige O. Bolodeoku, *The Market for Corporate Control: Assessment of the Role of the Target Board in Nigeria*, 18 TEMP. INT'L & COMP. L.J. 269 (2004).

140. This is the implication of the decision in *Salomon v. Salomon & Co.*, [1897] A.C. 22, 35 (H.L.) (appeal taken from Eng.) (U.K.); see also Manne, *Our Two Corporation*

for breaches of fiduciary duties or made to account in derivative actions, directors may escape being held accountable for misappropriation of corporate assets or shirking. Moreover, the concept of limited liability, while shielding residual claimants from the cost of investment, externalizes the associated risks by transferring them to creditors.¹⁴¹ In a way, therefore, limited liability has the potential to aggravate agency costs. The deregulation of limited liability by CAMA may, therefore, be seen as an insightful way to deal with agency problem, as those dealing with the company may force its directors to tie their fortunes to the success of the company and, by so doing, induce them to bond to good performance.¹⁴² The deregulation of limited liability by CAMA is even more commendable in view of the fact that some modern corporate legislation now requires companies to pay for directors' insurance¹⁴³ or excuse directors from liability for breach of fiduciary duties.¹⁴⁴

Section 288(1) of CAMA states that, if so provided by the memorandum, the liability may be unlimited for directors, managers, or managing

Systems, *supra* note 15, at 262 (“[L]imited liability . . . allows individuals to use small fractions of their savings for various purposes, without risking a disastrous loss if any corporation in which they have invested becomes insolvent.”).

141. See, e.g., *Walkovsky v. Carlton*, 223 N.E.2d 6 (N.Y. 1966). For criticisms of the *Salomon* decision, see O. Kahn-Freund, *Some Reflections on Company Law Reform*, 7 MOD. L. REV. 54 (1944); see also Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589 (1975) (arguing that limited liability transfers the risks of business failure from shareholders to creditors without compensation); Halpern et al., *supra* note 47, at 129 (“The existence of a limited liability regime provides the owners of the firm with the ability to obtain insurance, provided by the creditors, against loss on default without the necessity of the existence of a formal insurance market.”). *But see* Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 526 (1967) (contending that creditors are often compensated for the risks they bear through high interest rates, which they often charge because of the limitations imposed by the limited liability rule).

142. The downside of such liberalization is its potential to discourage people from accepting board positions. This argument undergirds the director liability reforms in the United States. See Craig W. Hammond, *Limiting Directors' Duty of Care Liability: An Analysis of Delaware's Charter Amendment Approach*, 20 U. MICH. J.L. REFORM 543 (1987) (discussing the background to section 102(b)(7) of the Delaware General Corporation Law).

143. See, e.g., Companies Act 1985, c. 6, § 310(3) (Eng.). For Canada, see Canada Business Corporations Act, R.S.C., ch. 44, § 124(6) (1985).

144. DEL. CODE ANN. tit. 8, § 102(b)(7) (2006). The practice is also prevalent in the United Kingdom since the applicable law now permits companies to pay for directors' insurance; see also Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385 (2006).

directors of a limited liability company.¹⁴⁵ Even where the memorandum does not contain an unlimited liability provision at registration, it is still possible to attain such a result, so long as there is a provision in the by-laws permitting the company to alter its memorandum by special resolution to render unlimited the liability of the company's directors, managers, or managing director.¹⁴⁶ In practical terms, this device is likely to be unpopular with most directors or managing directors. But where a company is highly leveraged, the company's creditors may require that the company's memorandum be altered to permit for unlimited liability of directors or managing directors.

While a company is at liberty to opt-in or opt-out of the deregulation of limited liability, it is suggested that companies in which inside ownership is significant and concentrated, and in which ownership and management are combined, may be required to make the liability of the owner-manager unlimited. Since the removal of limited liability will internalize the risks of investment and decision making, it is expected that the company's creditors, who are the likely beneficiaries, will find the deregulation of limited liability under CAMA particularly useful. To the extent that the managers bear the wealth effects of their decisions, other residual claimants will also benefit, as the managers may be forced to significantly reduce shirking or opportunistic behaviors. Deregulation of limited liability under CAMA is particularly suitable to the peculiar challenges of corporate governance in Nigeria. Most public companies have majority owners who are most likely to act as managers. Since the usual fear is that owner-managers may disregard the interests of minority shareholders, the latter may have their fears attenuated because the threat of expanded liability will probably align the interest of owner-managers with those of the minority shareholders.¹⁴⁷

145. Note that the deregulation of limited liability under CAMA is different from a typical case of unlimited liability under which shareholders are required to satisfy the excess of the corporation's debts from their personal wealth. The CAMA device is selective in that it is only the liability of top management or the directors that may be unlimited. Whether a company that opts into this regime will be able to attract quality personnel to serve as directors is another question. The same result may, however, be achieved where the chief executive officer and most members of the board of directors are major shareholders.

146. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 289(1).

147. The usual recourse or remedies open to minority shareholders, i.e., derivative action, oppression, or prejudicial remedy action, require a great deal of cost or information to prosecute. The monitoring that comes with the deregulation of limited liability is a significant improvement over the traditional remedies under sections 303 and 311 of CAMA.

C. Conflicts of Interest, Self-Dealing, and Positional Conflicts

Melvin Eisenberg is emphatic on the normative proposition in this regard for the modern company law: “agents whose interests may materially diverge from the interests of their principals should not have the power to unilaterally determine or materially vary the rules that govern those divergencies of interest.”¹⁴⁸ A related proposition is that such rules should also normally not be subject to determination or material variation even with shareholder approval. In essence, the governing rules should be mandatory at the core. How does CAMA respond?

1. Negotiation of Directors’ Liability

In the first decade of the twentieth century, the English courts enforced provisions in the articles of association of registered companies, which freed directors of liability for breaches of fiduciary duties.¹⁴⁹ However, the practice was soon outlawed under the English company law.¹⁵⁰ Contemporary corporate law in the United States, courtesy of the amendment to the Delaware corporation code, permits corporations to free directors from liability for a breach of fiduciary duty of care.¹⁵¹ In addition, state corporate laws in the United States, Canada, and in the United Kingdom empower companies to buy officers and directors’ liability insurance policies.¹⁵²

Provisions in corporate codes which exempt directors and officers from liability for breaches of fiduciary duties and those which empower the purchase of liability insurance policies arguably gain prominence as a compromise or trade-off for securing the services of qualified personnel to serve on corporate boards, many of whom had expressed concerns about the magnitude of liability relative to the gains they expected to make from serving as directors.¹⁵³ However, it can hardly be doubted that a no-liability regime may induce directors to shirk or engage in behaviors inimical to the interest of the company. If directors knew they would not bear the wealth effects of their conducts, fiduciary duties might not motivate them to invest the time necessary to run the com-

148. See Eisenberg, *Corporation Law*, *supra* note 63, at 1474.

149. See *In re Brazilian Rubber Plantation & Estates Ltd.* [1911] 1 Ch. 425, 440 (U.K.).

150. See Companies Act, 19 & 20 Geo. 5, c. 23, § 146 (1929) (Eng.).

151. DEL. CODE ANN. tit. 8, § 102 (b) (7) (2006). *Cf.* Companies Act 1985, c. 6, § 310 (Eng.).

152. See *supra* note 143.

153. See Cheffins & Black, *supra* note 144.

pany's business efficiently.¹⁵⁴ The position of a director is a crucial one, in view of the predictable impact that an inattention to serious business matters could have on the investors.

It is in this regard that the position under CAMA deserves some commendation. The Act provides that:

no provision, whether contained in the articles or resolutions of a company, or in any contract shall relieve any director from the duty to act in accordance with this section or relieve him from any liability incurred as a result of any breach of the duties conferred upon him under this section.¹⁵⁵

This position can be compared with those in other jurisdictions, e.g., the United States, where a company may excuse directors from liability in its bylaws or obligate the company to take out insurance policies regarding directors' liability.¹⁵⁶

2. Treatment of "Golden Parachute" by CAMA

Golden parachute is a term associated with American corporate law, and refers to a payment (or agreement to make a substantial payment) made to directors or the managing director of a target company as consideration for loss of office following a takeover of the company, whether by friendly or hostile bid or even in a merger transaction.¹⁵⁷ At its worst, a golden parachute is one defensive mechanism used to insulate management from the threat of a takeover, by making it costlier for a bidder to launch a bid or ensuring that a putative acquirer goes through the board rather than bypass it in a hostile bid transaction.

While not so recognized in Nigeria, this concept is not completely new to our laws. Given that most public companies have significant majority owners, most of whom are in management positions, most directors and

154. It is worthy of note that the contractarians have argued that it is efficient for the parties to be able to negotiate or contract around fiduciary duties, since such negotiation would reflect the parties' wishes. See Frank H. Easterbrook & Daniel E. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 734 (1982). For a criticism of this conception, see Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595 (1997) (arguing the reasons why the corporate law fiduciary duties, contrasted with commercial agent-principal fiduciary duties, should not be variable at the instance of the parties); Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 37 DUKE L.J. 879 (1988) (criticizing the *Jordan* court for analogizing fiduciary duty with "off-the-rack" rules).

155. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 278(8).

156. See Hammond, *supra* note 142, at 544-45.

157. BRIAN R. CHEFFINS, *COMPANY LAW: THEORY, STRUCTURE AND OPERATION* 662 (1997).

corporate managers in Nigeria may become prone to using such an exit device. In view of the concentrated ownership structure of Nigerian companies, a takeover of a company in Nigeria may not take place without the approval of the company's board. Thus, the increased likelihood of merger transactions as the means to effect changes in the control of companies in Nigeria may pave the way for the target management to secure its financial future with a robust exit price.

CAMA outlaws any payment by way of compensation for loss of office, or as consideration for or in connection with retirement from office, by a company to any director of a company, except when particulars of the proposed payment and other allied terms have been disclosed to and approved by members of the company.¹⁵⁸ Additionally, an exit payment cannot be made without meeting those same requirements.¹⁵⁹ A payment made to the director in contravention of the Act is regarded as illegal, and the director shall be deemed as trustee for the sum so received.¹⁶⁰ Moreover, CAMA imposes a duty on a director who expects to receive any such payment following a transfer of the company's shares to a person or body corporate to ensure that the particulars of the proposed payment are included in the notice of the offer sent to the shareholders.¹⁶¹ What is unclear, however, is whether the interested director is entitled to vote in respect of the proposal or payment when it is tabled at the meeting.

The 1999 Investment and Securities Act (ISA) is, however, likely to introduce a twist, in that section 111(6) of the ISA only requires that particulars of any proposed payment to directors in the context of a takeover bid be contained in the directors' circular sent to the shareholders. Such disclosure is not required for merger transactions, and ISA does require that the provisions of "all existing enactments," which include those of CAMA, "shall be read with such modification as to bring them into con-

158. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, §271. Note that in the United States and Canada, issues relating to directors' remuneration or compensation are not for the shareholders to determine in general meeting of members. Directors' compensation falls squarely in the category of the company's business which only the board of directors is empowered to handle. For Canada, see Canada Business Corporation Act, R.S.C., ch. C-44, § 102 (1985), and for Delaware, see DEL. CODE ANN. tit. 8 § 141(a) (2007). In the respective jurisdictions in which they apply, these provisions confer on corporate boards the power to manage or supervise the management of the businesses of incorporated companies.

159. Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 272(1).

160. *Id.* § 272(2).

161. *Id.* §§ 273(1), 274.

formity” with the provisions of ISA.¹⁶² In respect of takeover bid transactions, the more permissive ISA provisions may negate the purpose of sections 271 to 273 of CAMA, except the control which CAMA provisions are designed to serve is recognized and adopted in ISA.

D. Removal of Directors from Office

Agency costs are often exacerbated when directors cannot be removed from office in deserving circumstances. Removal of directors is tied to so many issues, all of which are dealt with under CAMA in ways that limit the directors from insulating themselves from removal from office. The issues range from the procedure for removal, the voting rights attached to shares, shareholders coalition, and the right to issue shares. For instance, under CAMA, directors are removable from office with or without cause, irrespective of the contract between the director and the company. The best option open to a director so removed from office is to claim compensation or damages in an action for breach of contract.¹⁶³

This position contrasts sharply with the state of Delaware, where directors cannot be removed without cause if the certificate of incorporation establishes staggered terms for directors.¹⁶⁴ Although a staggered board system, a practice that dominates American corporate law, is theoretically possible in Nigeria,¹⁶⁵ such practice is of little practical effect given the provision of section 262(1), which allows for the removal of directors “notwithstanding anything in its articles or in any agreement between it and him.”¹⁶⁶

Besides, the mode of appointment of directors also has some impact on how directors are removed and on agency costs. The American practice, whereby management nominates a slate of directors for the shareholders to vote on, does not help to ensure directors’ accountability to sharehold-

162. Investments and Securities Decree No. 45 (1999), § 261(1) (Nigeria). Note that the Investment and Securities Act, which was originally promulgated as a decree under the then Military Administration, like other decrees, is to be so called by virtue of section 315(1)(a) of the Constitution of the Federal Republic of Nigeria (1999).

163. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, §§ 262, 268(2); see also *Longe v. First Bank of Nigeria Plc* [2006] 3 NWLR (Pt. 967) 228 (Court of Appeal) (affirming the judgment of the lower court which held that the Bank had the right under the CAMA to remove the appellant, the bank’s managing director, from office).

164. See DEL. CODE ANN. tit. 8, § 141(k) (2007).

165. Section 259(1) of CAMA dealing with the rotation of directors is a default provision that allows a company to make different arrangement as to retirement of directors in the articles. Thus a company is at liberty to provide for a staggered board of arrangement, under which only a portion of the board members can retire after a three-year term.

166. Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 262(1).

ers. To challenge directors, shareholders of U.S. corporations are often forced to spearhead proxy contests, which are few and far between because the contests are usually very expensive.¹⁶⁷

In Nigeria, however, shareholders are at liberty to propose any person as a director, and there may also be an agreement in the article empowering named persons to appoint directors.¹⁶⁸ Shareholders may submit a proposal for a resolution to remove directors or on any matter, and equally submit written statements in respect of matters to be transacted at general meetings. Although it is required that reasonable payment be made for transmission,¹⁶⁹ the company is obligated to circulate a statement of resolution requisitioned by qualified shareholders.¹⁷⁰ While the information contents of the new proxy rules under the SEC regulations made pursuant to ISA may make shareholder participation in the proxy process more informed,¹⁷¹ it is yet to be tested what impact the rules will have on the shareholders, given that proxy solicitation is expansively defined without taking care of the problems similar definition has created for the shareholders in other jurisdictions,¹⁷² as a result of which there have been some clarifications in the affected jurisdiction in order to reduce the chilling effect of the definition.¹⁷³

E. Directors' Remuneration

Remuneration of top-level management and of the directors is a key determinant of agency costs.¹⁷⁴ If it is right, remuneration can align man-

167. See Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 894–95 (1991).

168. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 41(3).

169. See *id.* §235(4).

170. See *id.* §235(1).

171. See Securities and Exchange Commission, Rules and Regulations (Made Pursuant to the Investment Securities Act 1999), §§ 289–94 (Nigeria), available at <http://www.sec.gov.ng/pdf/SEC%20Rules.pdf>.

172. See Ige O. Bolodeoku, *A Critique of the Theories Underpinning Proxy Solicitation by the Board of Directors*, J. BUS. L. 377, 381 (2001).

173. See, e.g., Canada Business Corporations Regulations (Canada Business Corporations Act) SOR/2001-512 § 67 (qualifying section 147 of the Canada Business Corporations Act). For similar provision under the U.S. Proxy Rules, see SEC Rule, 17 C.F.R. § 14a-1(I)(2)(iv).

174. See Lucian A. Bebchuk & Jesse Fried, *Executive Compensation as an Agency Problem* (Centre for Economic Policy Research (CEPR) Discussion Papers No. DP3961, 2003), available at <http://www.cepr.org/pubs/dps/DP3961.asp> (The authors argue that the design of executive compensation is viewed not only as an instrument for addressing the agency problem between managers and shareholders but also as part of the agency problem itself. Boards of publicly traded companies with dispersed ownership, they argue, cannot be expected to bargain at arm's length with managers.).

agement interest with those of the shareholders. It is the theory that, when tied to the company's stocks, directors' compensation or remuneration engenders in management and directors a sense of identification with, or creates a stake in, the company.¹⁷⁵ Uncontrolled, however, remuneration can constitute a burden on the company's free cash flow, which can hurt the corporation, its creditors, and shareholders.¹⁷⁶

Outrageous compensation packages for corporate executives and their exponential increase relative to the value added have had their roles in the collapse of many recent celebrated corporate failures.¹⁷⁷ Considering American management remuneration, Kevin Murphy wrote that from 1992 through 2000, the median total compensation of CEOs in S&P 500 companies nearly tripled from US\$2.3million in 1992 to US\$6.5 million in 2000.¹⁷⁸ Option-driven escalation in CEO pay levels, Murphy observed, "is not limited to S&P 500 Industrials."¹⁷⁹ Evidence shows "that median pay in S&P 500 Financial Services companies increased 300 percent, from \$2.6 million to almost \$11 million from 1992 to 2000, while pay in smaller firms (defined as companies in the S&P MidCap 400 and SmallCap 600) more than doubled, from \$823,000 to \$1.8 million."¹⁸⁰ Some commentators attribute exorbitant executive compensation packages to the domineering influence of CEOs over compensation committees.¹⁸¹ Lucian Bebchuck et al. argued that, "much of what is observed in the world of executive compensation" can be explained by managerial opportunism and influence over captive boards of directors.¹⁸² Although

175. See Michael C. Jensen, *CEO Incentives—Its Not How Much You Pay, But How*, in CORPORATE GOVERNANCE AT THE CROSSROADS 192, 195 (Donald Chew, Jr. & Stuart Gillian, eds., 2005) ("The most powerful link between shareholder wealth and executive wealth is direct ownership of shares by the CEO.").

176. See ENRON REPORT, *supra* note 35.

177. The Enron case still presents a classic example of how ambitious and outrageous compensation packages could hurt the company. *Id.*

178. See Kevin M. Murphy, *Explaining Executive Compensation: Managerial Power Versus the Perceived Cost of Stock Options*, 69 U. CHI. L. REV. 847, 847 (2002) (the increase in CEO pay in S&P 500 Industrialists during the 1990s primarily reflects a dramatic growth in stock options, which swelled from 27% to 51% of total compensation, representing a five-fold increase in dollar terms).

179. *Id.*

180. *Id.*

181. For a theoretical analysis of executive compensation in the United States, see Randall S. Thomas, *Explaining the International CEO Pay Gap: Board Capture or Market Driven?*, 57 VAND. L. REV. 1171 (2004) (providing other alternative theories to the exponential rise in executive compensation compared to other countries, and critiquing the board capture theory of executive compensation).

182. Lucian Bebchuck, Jesse Fried, & David Walker, *Managerial Power and Executive Compensation*, 69 U. CHI. L. REV. 751, 785 (2002) (basing their argument on the fact

CEO compensation packages in the United States are higher than their international counterparts,¹⁸³ there seems to be a global upward swing in CEO pay that is hardly justifiable in terms of performance.¹⁸⁴

Today, directors' compensation constitutes a major issue in any corporate governance reform, principally because the costs they add are sometimes too burdensome for the company and too high to benefit the corporation, its shareholders, and other stakeholders.¹⁸⁵ As it is consistent with modern corporate practice to categorize executive compensation as belonging to the realm of the company's business, only the board of directors (through its compensation committee) gets to decide issues relating to compensation. However, experiences have shown that advertised independent boards or committees are not as independent, given the complicated business ties most directors have with the corporations on whose boards they serve. The fact that the chief executive has a hand in the nomination of directors, independent or interested, is also a factor in gauging the level of resistance to expect from directors on the issue of compensation.¹⁸⁶

Under CAMA, remuneration of directors is not fixed by the board of directors, but by the company in a general meeting, and is payable only out of the company fund.¹⁸⁷ Besides, it is unlawful for the company to pay directors' remuneration free of income tax, or calculated by reference to or varying with the amount of his income tax, except by a contract to that effect, which must exist at the time of the Act and be contained in the articles.¹⁸⁸ It is also unlawful for a company to make a loan to any of the directors of its holding company, or enter into any guaran-

that the exercise price is indexed to general market movements, but is reset following market declines in stock prices). *But cf.* Murphy, *supra* note 178.

183. *See* Thomas, *supra* note 181, at 1173.

184. *See* ENRON REPORT, *supra* note 35.

185. Following the Enron Collapse, the New York Stock Exchange revised its listing standards to include that shareholders approve stock-based executive compensation, and the U.S. SEC approved it. *See* Order Approving NYSE and NASDAQ Proposed Rule Changes Relating to Equity Compensation Plans, Exchange Act Release No. 48,108, 68 Fed. Reg. 39,995 (July 3, 2003).

186. Bebhuck, Fried, & Walker, *supra* note 182; Brudney, *Independent Director*, *supra* note 56, at 612–14. Note that Murphy criticizes the view that explains high CEO compensation in terms of the CEOs desire to extract rent. *See* Murphy, *supra* note 178, at 850 (distinguishing between CEOs ability to extract rent and bargain for higher pay); Jensen & Fuller, *Director to Do?*, *supra* note 59, at 4–6.

187. *See* Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 267. The opportunity given to the shareholders to consider directors' remuneration is important, especially at a time when the likelihood that directors may drain the corporation through sumptuous remuneration package is on the rise.

188. *See id.* § 269.

tee or provide any security in connection with a loan made to directors by any other person.¹⁸⁹

While CAMA expressly requires that the company approve directors' remuneration, it provides that the board of directors shall fix the remuneration of the managing director. Without clear guidance on the factors to be considered in fixing remuneration, it is obvious that the possibility of abuse of this power by a subservient board, as seen in other jurisdictions,¹⁹⁰ cannot be ruled out, notwithstanding that compensation committees are a common feature of most board structures and in corporate governance projects.

It is suggested that shareholder involvement in fixing executive compensation is desirable, particularly when it involves stock options,¹⁹¹ as well as the publication of executive compensation figures in the company's proxy statements. In Nigeria, such publication will not only provide shareholders with information on executive compensation, but also precipitate possible review, critique, and intervention by the shareholders of the company where the compensation is considered to be outrageous. It should be remembered that, unlike in the United States or Canada where shareholders are not legally entitled to intervene, shareholders of companies registered in Nigeria can, by law, make recommendations to the board regarding any action to be taken by the board, notwithstanding that the board is empowered to manage the business of the company.¹⁹²

Under CAMA, shareholders participate in determining directors' remuneration or compensation in one significant respect. In relation to the employment contract of a director intended to be employed for more than five years where termination by the company is limited by agreement, the company is required to table the agreement with its terms before the general meeting for a special resolution approving the agreement.¹⁹³

F. Dealing with Conflicts of Interest

CAMA has some mandatory provisions to deal with directors' conflicts of interest, outlawing certain conduct or mandating disclosure, while leaving others for the shareholders to decide. CAMA also deals with di-

189. *See id.* § 270.

190. *See supra* note 35 and accompanying text.

191. This is the approach taken under the new listing standards of the New York Stock Exchange. *See generally* Order Approving NYSE and NASDAQ Proposed Rule Changes Relating to Equity Compensation Plans, Exchange Act Release No. 48,108, 68 Fed. Reg. 39,995 (July 3, 2003).

192. *See* Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 63(5).

193. *See id.* § 291.

rect self-dealing by directors.¹⁹⁴ For instance, promoters are regarded as fiduciaries, and are accountable for any secret profit made or for misuse of corporate information.¹⁹⁵ The company may rescind any contract, unless after the promoter's full disclosure of all material facts, the contract is ratified by the company's independent directors and all the members of the company, or by the shareholders in a general meeting at which the promoter and other interested shareholders are disqualified from voting.¹⁹⁶

While the law does not forbid directors from dealing with their companies, it requires that interested directors, whether directly or indirectly, in a contract or proposed contract with the company should declare the nature of their interests at a meeting of the directors where the contract is first discussed.¹⁹⁷ Furthermore, the Act specifically disqualifies, subject to certain exceptions,¹⁹⁸ a company from entering into any arrangement under which a director of the company or its holding company or a person connected¹⁹⁹ with such a director acquires or is to acquire one or

194. For the importance of controlling self-dealing, see Black, *Legal and Institutional Preconditions*, *supra* note 110, at 804–15.

195. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 62(2).

196. See *id.* § 62(3). The fact that CAMA relaxes the limitation period in the enforcement of the company's right against promoters is equally important in the reduction of agency costs.

197. See *id.* § 277. It is important to note the effect of a failure to comply with this provision. First, section 277(3) provides that a general notice that the director is a member of a specified company interested in the contract or that the director is interested without more is sufficient. *Id.* § 277(3). Moreover, failure to comply only attracts a small amount in penalty, except that subsection (5) preserves any rule of law restricting directors of a company from having any interest in contracts with company. *Id.* § 277(5). It is here suggested that specific disclosure of the particular interest of a director is necessary, considering that such disclosure is made to his or her colleagues, some of whom may change their minds or decide differently if they know the real nature of the transaction in which the disclosing director is involved.

On a practical note, Bernard Black has argued that only independent outside members of the board should consider the merit of a transaction in which a director is interested. See Bernard Black, *The Core Fiduciary Duties of Outside Directors*, 2001 ASIA BUS. L. REV. 3 [hereinafter Black, *Core Fiduciary Duties*] (“The procedural strategy for approval by disinterested directors can work only if a company has a reasonable number of independent directors. It can work *well* only if these directors are *in fact* independent of the executives. Otherwise, the procedures can become camouflage for a transaction that in fact benefits the insiders at the company's expense.”).

198. For other exceptions see Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 286. Other subsections of this provision also defines the liability of the directors for a contravention of the provisions of section 284 of the Act.

199. Section 286(8) defines several circumstances under which a person “is connected with” a director. *Id.* § 286(8). The expansive definition is essential to avoid sham transac-

more non-cash assets of a specified threshold,²⁰⁰ or the company is to acquire similar assets from the persons aforementioned.²⁰¹ Before a company can enter into an arrangement in this context, it is a precondition that the arrangement is first approved by a resolution of the company in general meeting, and if the director or connected person is a director of its holding company, by a resolution in the general meeting of the holding company.²⁰² It is significant to note that CAMA codifies the common law rule on the competence of directors to take advantage of corporate opportunities,²⁰³ and tapers their impact by a requirement of ex ante disclosure to the company in general meeting.²⁰⁴

It is also crucial to the discussion of agency costs to note that directors are treated as trustees of the company's moneys and properties, and are to exercise their powers honestly in the interest of the company and all shareholders, rather than in their own or sectional interests.²⁰⁵ In this regard, the Act forbids a director from making secret profits by accepting from any person a bribe, gift, or commission or a share in the profit made by that person from a transaction involving his or her company as a quid pro quo for facilitating the transaction between the company and the person.²⁰⁶ However, if the gift is unsolicited or given as a sign of post-transaction gratitude, the director may keep the gift, provided that the fact of the gift is reported to the board of directors and a note is made in the minutes book of the directors.²⁰⁷ The problem with this allowance is that the prevailing corruption culture in Nigeria may induce ex ante negotiations of rewards for facilitating a transaction. Consequently, prohibition of such practice under CAMA may prove very ineffective to arrest the practice. By permitting post-transaction rewards or gifts, parties may circumvent the law if the beneficiary of the transaction simply presents the reward afterwards in order to give it a cloak of legality.

tions, which allow directors to avoid the obligation imposed by the Act by using their relatives.

200. The value of the asset at the time of the arrangement is not to be less than two thousand naira, but subject to that, exceeds one hundred thousand naira or twenty percent of the company's asset value. *See id.* § 284(2).

201. *See id.* § 284(1).

202. *Id.*

203. *See Bray v. Ford* (1886) A.C. 44 (Eng.); *Regal (Hastings) Ltd. v. Gulliver* (1967) 2 A.C. 1347 (Eng.); *Canadian Aero Serv. v. O'Malley* (1973), 40 D.L.R.3d. 371 (Can.).

204. *See Companies and Allied Matters Act (CAMA)*, (1990) Cap. C20, §280(6).

205. *See id.* § 283(1).

206. *See id.* § 287(1).

207. *See id.* § 287(3).

G. Shirking, Agency Costs, and the Directors' Duties of Care and Skill

Agency costs are not generated only when agents divert the property or assets of their principals. Refusal to pay attention to duty or to invest the necessary time required by the business, commonly referred to as shirking, can generate agency costs. As investigations into the role of directors in the collapse of Enron showed, shirking played a vital role in the collapse process.²⁰⁸ The Enron directors were found to have given far less attention to their responsibilities and were highly dependent on management, a situation which prevented them from being acquainted with the details of operations and from asking critical questions of management.²⁰⁹ Happily, CAMA specifically gives some attention to shirking.

The Act recognizes that lax duties of care and skill will undoubtedly exacerbate agency costs, as they may induce directors to shirk. The Nigerian law reformers found the common law principles on the directors' duties of care unsatisfactory and recommended a more functional set of duties that underscore the seriousness of the role of directors in corporate governance.²¹⁰ Regardless of how directors are appointed to serve on a company's board, it is this writer's view that section 282(4) of CAMA appears to enjoin directors to recognize the enormity of their role and be ready to give to it the time and commitment the duty requires. The section also expects directors to candidly decline the offer to serve if, given the particular situation, they cannot give enough attention to the company's business.²¹¹

The CAMA provision, which calls on directors to exercise "that care and skill which a reasonably prudent director would exercise in comparable circumstances,"²¹² is an invitation to the court to apply an objective standard to the conduct of directors in light of the peculiar circumstances of each case.²¹³ In this respect, it is expected that courts will be assisted

208. See ENRON REPORT, *supra* note 35 ("The Board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders.").

209. *Id.* at 59.

210. The provisions of the CAMA on the duty of care and skill of directors effectively undermine the *rationes decidendi* in cases such as *In re Equitable Fire Insurance Co. Ltd.*, (1925) Ch. 407, and *In re Denham's & Co.*, (1884) 25 Ch.D. 752 (Eng.).

211. See *supra* note 198.

212. *Id.* In fact, Nigeria seems to be ahead of the United Kingdom in this respect, except that, through judicial activism, the U.K. courts can achieve the same objective as that in section 284 of CAMA. See *Norman v. Theodore Goddard*, [1992] B.C.C. 14 (Ch.D.) (Eng.); see also Cheffins & Black, *supra* note 144.

213. Nigerian courts may be guided by the recent decision of the Supreme Court of Canada in *People Department Stores Inc. (Trustees of) v. Wise*, [2004] 3 S.C.R. 461 which emphasizes the objective component of the assessment of whether a director

in determining what a reasonably prudent director will do by the admonitions contained in various corporate governance projects, just as the various opportunities offered by companies to train directors in the modern art of governance may become part of the court's assessment of what to expect from a director.²¹⁴ Specifically, it is no longer a defense to a claim of breach of the duty of care when a director was absent from meetings, because "the absence from the board's deliberations, unless justified, shall not relieve a director from his or her responsibility for the actions of the board."²¹⁵

More importantly, CAMA imposes the same standard of care on both executive and non-executive directors.²¹⁶ The emphasis on equality in responsibility and dedication expected from both the executive and non-executive directors also addresses the propriety of outside directors conceding to management on most crucial or critical issues of governance. At the minimum, it signifies that outside directors should see themselves more as business managers than mere advisers.²¹⁷ By implication, section 282(4) of CAMA requires non-executive (outside) directors to be more proactive in the discharge of their duties. As the Court of Appeal of New South Wales (Australia) rightly observed in *Daniels v. Anderson*,²¹⁸ the "concept of a sleeping or passive director has not survived and is inconsistent with the requirements of current company legislation such as, at the relevant time, [sections] 229 and 269 of the Companies (New South Wales) Code."²¹⁹ Arguably, a court of law may be justified in re-

breached the fiduciary duty of care under Canada Business Corporations Act, R.S. 1985, c. C-44, s. 122(1)(b)).

214. See *Bishopsgate Investment Management Ltd v. Maxwell*, [1993] B.C.C. 120, 139 (Eng.) ("[T]he law may be evolving in response to changes in public attitudes to corporate governance."). The global nature of the concerns in corporate governance, which is gradually leading to some form of convergence of practices, should also be crucial to how the courts should perceive the position of directors in the modern company. See Black, *Core Fiduciary Duties*, *supra* note 197.

215. See *Companies and Allied Matters Act (CAMA)*, (1990) Cap. C20, § 283(3).

216. See *id.* § 282(4).

217. See Myles L. Mace, *Directors: Myth and Reality*, in *THEORIES OF CORPORATE GOVERNANCE: THE PHILOSOPHICAL FOUNDATIONS OF CORPORATE GOVERNANCE* 96, 99 (Thomas Clarke ed., 2004) ("the lack of active discussion of major issues at typical board meetings and the absence of discerning questions by board members result in most board meetings resembling the performance of traditional and well-established, almost religious rituals."). For an account of the traditional relationship between directors and management, see also Robert Monks, *The Director's New Clothes (Or, the Myth of Corporate Accountability)*, in *CORPORATE GOVERNANCE AT THE CROSSROADS* 151 (Donald Chew, Jr. & Stuart Gillian eds., 2005).

218. *Daniels v. Anderson*, (1995) 118 F.L.R. 248 (Austl.).

219. *Id.* at 310.

quiring that non-executive directors establish the basis of their judgment, by showing the efforts made outside the assistance given by the inside members of the board to gather more information, particularly if the facts of the case show that more information is required before any good decision can be taken.²²⁰ While non-executive directors may simply rely on the presentations of inside members of the board, the court, arguably, may hold that, given the nature of what is being deliberated upon, a proper discharge of the directors' duties will require non-executive directors to seek independent information from other key employees of the company. This sort of provision is quite commendable, as they attune with the modern dictates of good governance. Besides, they could, if properly given a purposive interpretation by the court, be effective in addressing some of the agency cost concerns.²²¹

It is important to note that a breach of the directors' duties may be asserted and enforced in the course of the winding up of a company. Section 506(1) of CAMA allows a liquidator, receiver, and creditor, among others, to prove against any person that the latter participated in carrying on the business of the company recklessly or with intent to defraud its creditors. The court is empowered to hold such a person personally liable "without any limitation of liability for all or any of the debts or other liabilities of the company."²²² In particular, this provision is a warning to outside directors, and it reinforces the need for them to be more involved

220. Nigerian courts can learn a lot from Australian decisions on the scope of directors' duty of care and skill. Interestingly, the recent judgments in Australian courts which espouse the modern principles of directors' duties of care, skill, and diligence were inspired by the judgment of Judge Pollock of the Supreme Court of New Jersey in *Francis v United Jersey Bank*, 432 A.2d 814 (N.J. 1981). In *Francis*, Judge Pollock stated that a director: (a) should become familiar with the fundamentals of the business in which the corporation is engaged; (b) is under a continuing obligation to keep informed about the activities of the corporation; (c) is required to monitor corporate affairs and policies; (d) is required to maintain familiarity with the financial status of the corporation, by regular reviews of financial statements; and (e) may need to inquire further into matters revealed by a review of financial statements. *Id.* at 821–23. For an example of an Australian decision, see *Daniels v. Anderson*, (1995) 118 F.L.R. 248, 309 (Clarke JA & Sheller JA); see also *Australian Sec. & Investments Comm'n v. Loiterton*, (2004) NSWSC 172.

221. One can only appreciate the value of the Nigerian provisions for liability for breaches of duty of care, and particularly section 279(7) of CAMA in light of the fact that section 102(b)(7) of the Delaware Code was enacted as a direct response to the decision of the Delaware Supreme Court in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), which held directors liability for breach of duty of care. See also Mark A. Sargent, *Two Cheers for the Maryland Director and Officer Liability Statute*, 18 U. BALT. L. REV. 278 (1989) (discussing the genesis of the amendment made to the Delaware Code in the area of director liability).

222. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 506(1).

in governance, rather than turn a blind eye to the running of the affairs of the company as business managers. Moreover, the provision permits those empowered under it to seek remedy against directors where doing so would have been very difficult while the company is a going concern.

H. Minority Empowerment

1. Derivative Action

Derivative action is one minority empowerment device adopted under Nigerian law, apparently to reduce agency costs.²²³ To be sure, the remedy against prejudicial or oppressive actions, which the legislature empowers the shareholders to seek, is another form of minority empowerment, albeit, one which protects the personal interests of the complaining shareholders rather than that of the company. The focus in this section is on the derivative action remedy.

A derivative action instituted by minority shareholders does not benefit only the shareholders that bear the cost of the litigation. It is an action intended to benefit the company as a whole by remedying a wrong committed against the company either by management or when management is reluctant to act on behalf of the company. Given this fact, the greater the difficulty in instituting a derivative action, the less likely minority shareholders will have recourse to remedy a wrong against the company. While minority shareholders will indirectly benefit from a successfully prosecuted derivative action, there is no doubt that conceptually the action may help reduce agency costs.

Several elements of the CAMA provisions dealing with derivative action deserve some mention. First, a range of applicants may submit to the court for leave to commence the action.²²⁴ Second, the fact that an alleged breach of a right or duty owed to the company has been or may be approved by the shareholders of the company is not sufficient for a stay or dismissal by the court of an action already commenced.²²⁵ While the court may take such facts into consideration, the Act empowers the court

223. *Id.* §§ 300–30.

224. Under section 309 of CAMA, “applicant” means:

(a) a registered shareholder or a beneficial owner and a former registered owner 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 (d) any other person who in the discretion of the court, is a proper person to make an application under section 303 of the Act.

Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 309.

225. *See also id.* § 305.

to exercise its discretion and look into the justice or equity of the matter and decide what is right in the circumstances.²²⁶ Because the focus of a derivative action is the protection of the company's right, it is important that majority shareholders are not allowed to determine what sort of right the company may enforce, and by so doing, compromise the company's interest, particularly when to do so may benefit them indirectly. Third, the Act gives courts the discretion to order that an applicant be reimbursed for the cost of the action.²²⁷ Because no guidance is provided, it is for the court to look into the merit of the applicant's effort in deciding whether or not to order reimbursement.

The provisions dealing with derivative action under the Act, however, suffer from some fundamental defects, which may undermine sincere efforts to reduce agency costs.²²⁸ In particular, the conditions for bringing a derivative action implicitly attenuate the value associated with the action as a device for reducing agency costs. No action can be brought unless the applicant can show to the satisfaction of the court that the wrongdoers are the directors who are in control and that the directors will not take necessary action.²²⁹

Limiting the wrongdoers to the directors who are in control of the company reduces the scope of the action. In most cases, even when directors are not the wrongdoers, they may collaborate with the wrongdoers and refuse to bring an action. Thus, derivative action under CAMA may not cover cases of wrongs done to the company by persons other than the directors in control of the company. Even in the situation covered by the Act, minority shareholders are bound to confront information asymmetry. Derivative action designed to correct wrongs done to the company by directors in control is information intensive. Except where minority shareholders have representation on the board of directors, they

226. *See id.* § 304(2).

227. *See id.* § 304(2)(d). Moreover, the Act provides that an applicant seeking to enforce a company's right through a derivative action shall not be required to give security for costs in any application made or action brought or intervened in under section 303 of the Act. *See id.* § 307. The court may equally order the company to pay an applicant interim costs before the final disposition of the case. This is apparently to reduce the financial impact on an applicant of a prolonged litigation. *See id.* § 308.

228. *See* Brian R. Cheffins, *Reforming the Derivative Action: The Canadian Experience and British Prospects*, 1 CO. FIN. & INSOLV. L. 227 (1997).

229. The CAMA position can be contrasted with that under section 239(2) of the Canada Business Corporations Act, where no such condition as contained in section 303(a) of CAMA exists. The Nigerian approach is, it is submitted, overly restrictive. Note that except in relation to section 303(2)(a) of CAMA, the provisions of CBCA and CAMA on derivative action are *in pari material*.

may not have access to enough information with which to convince the court that a wrong has been committed. Yet, the Act does not make allowance for discovery, which would have facilitated the disclosure of information that may be crucial to the action. The good news, however, is that present or past directors or the Commission, who have better access to information about boards' operations and activities are equally empowered to seek the court's permission to commence derivative actions. Moreover, it is hoped that putative petitioners may take advantage of the rules of court on discovery to overcome information asymmetry.

2. Administrative Investigation

Investigation of company affairs by an administrative agency, in this case, the Corporate Affairs Commission (CAC),²³⁰ is one potent weapon that may significantly lessen managerial profusion and address part of the agency problems. The power given to the CAC to appoint competent persons to investigate a company may work well to stymie the acuteness of information asymmetry.²³¹ The knowledge by corporate managers that investigation may be conducted on the direction of the CAC into how they have run the affairs and managed the business of the company may also constitute a check on their conduct. In light of the fact of ownership structure of most Nigerian companies, the investigation device will go a long way in helping to address not just the concerns of minority shareholders, but also help change how corporate managers see their responsibilities.

Under CAMA, the CAC may, on the application of shareholders holding one-quarter of the class of shares issued, appoint inspectors to investigate the affairs of a company and report on them as the CAC may direct.²³² In this case, the applicants will be required to provide such evidence to the CAC to prove that they have good reasons for requiring investigation.²³³ Obviously, the requirement of evidence to support a request to investigate is designed to give some discretion to the CAC in the matter and to discourage frivolous applications. Moreover, a court may direct that the affairs of a company be investigated, in which case the CAC has no discretion and must conduct an investigation.²³⁴ The CAC

230. The Commission is the body responsible for the administration of the CAMA and its functions are more particularly set out in section 7 of the Act. *See* C.O. Okonkwo, *The Corporate Affairs Committee*, in *ESSAYS ON COMPANY LAW* 14 (E.O. Akanki, ed., 1992).

231. *See* Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 314.

232. *See id.* §§ 314(1), (2)(a).

233. *See id.* § 314(3).

234. *See id.* § 315(1). Note that sections 304 and 312 of the CAMA empowers a court to make such orders as it may think fit in the proceedings instituted under section 303 or

may also appoint inspectors to investigate the affairs of a company under the circumstances listed in section 315(2) of CAMA. The power of inspectors appointed under sections 314 and 315 of the Act to examine books, records, and accounts maintained by directors of the company under investigation, or to examine officers (past or present) or agents of the company²³⁵ is a considerable weapon, which, if properly deployed, may prove very useful.

I. Information Disclosure and Accountability

Under the Investment and Securities Act, public companies seeking to raise capital from the securities market are obligated to make very extensive disclosure of the companies' activities and prospects.²³⁶ Indeed, the long list of items on which information is required in the prospectus is bound to significantly reduce information asymmetry and help investors evaluate the company. Because management or the board of directors faces both criminal and civil liabilities should they falsify or misrepresent material information or fail to disclose it in the prospectus, it is arguable that the monitoring effect of disclosure will produce its desired effect on management. Moreover, the new proxy regime, which requires management to disclose information on specific transactions, is equally supportive of the overall effort to make corporate managers more accountable. However, the fact that ISA is yet to properly grapple with the importance of continuous disclosure of information of material changes as they occur may undermine the effectiveness of external control mechanisms, particularly the market for corporate control.

J. Strengthening the Board Structure Through Mandatory Audit Committee

Ordinarily, CAMA empowers a corporate board to perform its duties through committees.²³⁷ The audit committee is one such committee commonly established by public companies worldwide. Indeed, the role and composition of the audit committee has come under intense scrutiny following the collapse of Enron and other big corporations in the United States.²³⁸ Interestingly, CAMA mandates every public company to estab-

311 of the Act. The court may well conclude that investigation is necessary in the particular circumstance of the case before it.

235. *See id.* § 317.

236. *See* Investment and Securities Decree No. 45 (1999), § 50; Rule 225 of the Nigerian *SEC Rules and Regulations* (pursuant to ISA, 1999).

237. *See* Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 64(a).

238. *See* Sarbanes-Oxley Act, Pub. L. No. 107-204, tit. I, II, III, 116 Stat. 746 (2002) (focusing on several aspects of auditing, auditors' responsibility, audit committee and the

lish an audit committee, and stipulates as to the committee's membership,²³⁹ an approach this writer believes may prove beneficial in the overall drive to reduce agency costs. Specifically, section 359(4) of CAMA requires that the audit committee "shall consist of an equal number of directors and representatives of the shareholders of the company (subject to a maximum of six)" Indeed, one may be permitted to say that an audit committee is a committee of the company, rather than that of the board. Unlike section 64(a) of CAMA, which permits a board of directors to exercise its powers through committees consisting of such members of the board as the latter consider necessary, section 359(4) mandates a public company, rather than the board, to establish an audit committee.

That shareholders have direct representation on audit committees suggests that directors do not dominate audit committees in Nigeria. Not being members of the board, the shareholder representatives on an audit committee are expected, theoretically, to provide the necessary balance in the way the committee is expected to perform its functions. The Nigerian approach contrasts sharply with that in the United States and most common law countries where the concern is mainly with the independence of director-members of audit committees; it is somewhat anomalous in those countries for non-directors to serve on audit committees, because an audit committee is seen as a committee of the board, rather than that of the company.

It is, however, noteworthy that the Nigerian approach with regards to membership of the audit committee may pose some problems in practical terms. While contemporary corporate governance reforms of audit committees focus on the quality and independence of members, CAMA does not address who the shareholders may appoint as members of an audit committee. But it is becoming increasingly crucial for the members of an audit committee to be knowledgeable in financial matters, so they can make meaningful contributions in the course of the committee's deliberations. Moreover, one can only hope that the shareholder representatives on audit committees will not compromise their independence, especially as they may see the opportunity given to them to serve as a rare privilege to join the directors in sharing the spoil of office, rather than an opportunity to add value to the corporation on whose committee they serve.

board's relationship with external auditors). For Nigeria, see Code of Corporate Governance for Banks in Nigeria Post Consolidation (2006), §§ 3.12, 4.15, 4.16, 5.3.12, 7.1.4; NYSE REPORT, *supra* note 3.

239. See Companies and Allied Matters Act (CAMA), (1990) Cap. C20, § 359(3)–(4).

K. The Code of Corporate Governance Practices for Banks Post Consolidation

In Nigeria, the separation of ownership and control may be realized much faster in the financial (especially banking) sector than in other sectors. The Code of Corporate Governance Practices issued by the CBN deserves mention here, especially because, unlike most corporate governance codes, the CBN code is mandatory.²⁴⁰ Some of its provisions are definitely designed to reduce agency costs. The fact that banks must comply with it and include the Code's compliance status report in the audited financial statements²⁴¹ underscores the banks' responsibility to actively take steps that policymakers believe could prove useful in dealing with agency costs.

It is evident from the preamble to the Code that one of the CBN's main objectives is to provide an additional framework for effective governance that could minimize agency costs. The CBN noted, among other things, that "poor corporate governance was identified as one of the major factors in virtually all known instances of a financial institution's distress in the country."²⁴² Other specific corporate governance concerns which the Code identifies as requiring attention include fraudulent and self-serving practices among members of the board, management, and staff; overbearing influence of the chairman or managing director/chief executive officer, especially in family-controlled banks; weak internal controls; abuses in lending, including lending in excess of single obligor limit; and incompetent directorship.²⁴³

With the foregoing backdrop, one is able to relate better to some of the recommendations in the Code, which the CBN made mandatory for banks. The Code now requires a separation of the office of the chief executive officer and that of chairman of the board of directors. It further provides that no two members of the same extended family should occupy the position of chairman and that of the chief executive officer or executive director of a bank.²⁴⁴ It requires that a committee of non-executive directors should determine the remuneration of executive directors, and that the non-executive directors' remuneration should be limited to sitting allowances, directors' fees, and reimbursable travel and

240. Code of Corporate Governance for Banks in Nigeria Post Consolidation (2006), § 1.7.

241. *Id.* § 6.1.15.

242. *See id.* § 1.3.

243. *Id.* §§ 2.3, 2.4, 2.5, 2.10, 2.11.

244. *Id.* §§ 5.2.1, 5.2.3.

hotel expenses.²⁴⁵ More importantly, the Code requires banks to establish “whistle-blowing” procedure that encourages (including assurance of confidentiality) all stakeholders to report any unethical activity or breach of the corporate governance code using, among others, a special email or hotline to both the bank and the CBN.²⁴⁶

V. CONCLUSION

It must be noted that the use of agency costs as a tool of analysis within the corporate law and governance systems is still a novel subject in Nigeria; in part because efforts by scholars to explore the various interconnections between law, economic, and other aspects of social sciences to provide theoretical frameworks assessing the effectiveness of the law as an institution as well as the understanding of motivations of those entrusted to implement the law, is yet to predominate our scholarship. This Article is a modest effort to articulate: (a) the inevitability of agency costs and their persistence within the Nigerian corporate law and governance systems; and (b) various theoretical approaches that should inform the initiatives to deal with them.

Having noted that Nigerian companies combine both concentrated and dispersed ownership structures, whether by choice or policy design, the Article addresses the peculiarity of the agency problems associable with those structures. On balance, CAMA’s response to agency problems and costs has been impressive. As this Article has discussed, however, there is significant room for improvement in Nigerian corporate governance.

245. Code of Corporate Governance for Banks in Nigeria Post Consolidation (2006), § 5.3.9.

246. *Id.* § 6.1.12.