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A Capricious Harbor for Minority Shareholders under UK & USA Legislation

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Abstract

An efficient corporate governance system ensures that an organization runs smoothly, protects shareholders, and ensures that directors conduct their duties in the best interests of the company. Because of their dominant position and voting power, majority shareholders can abuse their power by making major corporate decisions such as investments, director appointments, and misuse of the company's financial resources to suit their own interests. Minority shareholders are often pressured to sell their shares for less than market value. An effective legislative standard implies that all shareholders, regardless of their shareholding, are viewed equally and equitably. Minority shareholders are always told that, in the event of a grievance, they have the right to go to court and request an acceptable remedy, or that, if they wish to leave the company, they may sell their shares at fair market value. As a result, measures must be in existence for minority shareholders to secure their legal rights and discourage majorities from expropriating business resources; otherwise, they would continue to be powerless victims of administrative or directorial misconduct. Derivative litigation as the best remedy awarded to such shareholders is debated in this article under UK & USA legislative system.

Keywords: Minority shareholder, Litigation, Derivative Action, Majority Shareholder, Shares, Company, United Kingdom, United States of America

Introduction

"Companies stand to be governed according to the wishes of the majority, no matter how "unfair" the consequences may be to those with minority interests."

The concept of 'the company' made ripples in the field of business and commerce since the idea of separation of legal entity from its owners in its existence was developed for the very first time. The more important aspect of the company is that its liability is limited to itself rather than to its owners. A company is established by one (in the case of SMC) or more

than one member who pools up their capital and starts a business by incorporating a company that has its liability to the extent of contributed capital.

Shareholders who are the owners of the company not only administer the company but also receive all the profits in the course of business. The decisions of the shareholders whether bad or good will affect the Company's progress and eventually will affect themselves. The mechanism of deciding by shareholders is based on the majority votes therefore the shareholders having the majority in the company's capital structure will have a dominant role in making the decision. Majority shareholders' decisions, which may favor and disfavor the smaller investor who is resultantly left under the mercy of the majority shareholders and eventually might leave the fate of the company in a state of limbo. In such circumstances, the involvement of the Courts in the affairs of the company is always seen with wary eyes, as the company is a separate legal entity is a 'proper litigant' itself. Historically, the involvement of the Courts in rescuing the interest of the minority investors has been remained a distant dream due to the principle of 'proper litigant' as was decided in the case *Foss v Harbotle* that the company itself is the proper litigant to bring an action in the court of law against the miscreants and certainly the decision of the company shall only be the majority's decision.

A number of exceptions were developed to *Foss v Harbotle* in the shape of derivative and direct action. A derivative action is commenced by the minority shareholder to rectify any wrong done to its company which is otherwise prerogative of the Company itself, i.e. majority shareholder. If somehow the company failed to do so, the authority to prosecute transgressors is shifted to the company's investors. The power of litigation for shareholders over transgressors stems from the company's right of litigation that is why it's called a 'Derivative Action.' Derivative litigation (Sakina Khatoon v. S.S Nazir Ahsan, 2010) is significant in the view whenever a company is deceived; its shareholders lack to initiate a lawsuit over the transgressors because the predominant shareholders, who control the decision-making process, are the transgressors themselves. As a response, a derivative lawsuit by a minority owner who is unable to influence the dominant shareholder's decisions is needed, instead of that; the law will fall short of its goal of avoiding corporate injustice and wrongdoing.

The need for derivative actions is widely recognized as a remedial treatment to corporate injustices. As previously stated, derivative lawsuits are useful not just for recovering reimbursement for a company's damages, but they may also serve as a deterrence preventing subsequent managerial malpractice. Thomas (Kinney,1994) argues that derivative lawsuits might help entities save money by lowering expenses and eliminating management and executive wrongdoing. As a result, a productive derivative lawsuit holds erroneous Shareholders or Directors liable for damages to their reputation as well as additional financial losses. Derivative litigation acts as a deterrent not just towards future management malfeasance in the company on whom behalf shareholders-initiated proceedings, but also against subsequent managerial misdoings in other companies. As a result, both compensating aims and deterrent benefits of derivative actions work collectively to balance the interests of the majority and minority shareholders, lowering agency costs. Nonetheless, it is stated that the primary function of derivative cases is to serve as deterrence against future managerial misdoings rather than to recoup large financial advantages. The majority shareholder decision may bring lasting harm to the minority investor by several decisions such as Alternation of the Article (Kingsway Capital LLP v. Murree Brewery Co, 2017) of Association, variation of the class cost, Re-registration of the company, initiating winding-up proceedings (Additional

Registrar of Companies Karachi v. Karim Silk Mills Limited, 2009), mergers (Kohinoor Raiwind Mills Limited v. Kohinoor Gujjar Khan Mills, 2002) etc. The most apparent outcome of a derivation lawsuit is that it acts as a deterrent, which is crucial in preventing dominant managers from defrauding the company and minority. Derivative litigation is an effective and indispensable tool to prevent the breach of shareholders/directors' duties (Coffee, 1993). Because majority shareholder enforcement is required to uphold shareholders'/directors' obligations, derivative lawsuits, as one of the private-sector enforcement options, could perform an essential contribution in enforcing their legitimate interests.

Whether in Pakistan's Corporate Governance Structure, where the ownership and management of a company are diffused with each other to such an extent that the distinction of Board of Directors and Shareholders is hardly be distinguished, the doctrine of "proper litigant" requires to be changed? In such a situation, with weak institutional and proper litigant doctrine, a derivative action will be the only last sword for the minority shareholder to seek protection under the harsh decision of the majority shareholder. In the recent past, a sharp increase in registration of the new companies has been witnessed in Pakistan and under such an environment the issue of protection of minority investors will certainly rise in near future, therefore, the case for derivative action makes aground. Several countries with strongly concentrated control of shares have shown the notion that derivative action is only necessary for countries with diffused ownership incorrect, and derivative action is now regarded as a vital ingredient for corporate responsibility in such countries. One might argue that direct litigation is the best way to deal with wayward majority stockholders who influence each decision.

Shareholder derivative actions have long been recognized by US courts, allowing stockholders to sue on behalf of other shareholders. The majority of the law regulating shareholder derivative procedures was created by courts in the U.K through common law development (Prunty, Jr, 1957) . Several states in the United States have now established statutes enabling shareholder derivative actions, and the majority has followed both the MBCA's (MCBA, 1999) rules and substantive accountability requirements. Shareholders might launch a derivative lawsuit on behalf of a company for the damage to the company, which is now recognized by legislation in both federal and state courts. Whenever a shareholder has been harmed in his or her individual position, he or she may initiate direct shareholder litigation. The US is the hub capitalist, therefore; exploring the jurisdiction is an important step in my research since there are several legal and procedural lessons to be learned for a developing economy like Pakistan. This study will undertake" how derivative or direction are utilized by the minority shareholders in order protect their interest in corporations.

UK's company law being the oldest one has significant importance all around the globe. The laws governing companies in the UK have predecessors in centuries-old common law and the previous and the recent company law has significantly codified the principles of emanated from common law cases. Previously common law principles empowered minority shareholders to bring lawsuits for "unfair prejudice," on similar pattern suits for oppressions in the United States. However, the Companies Act of 2006 recognized for the first time that minority shareholders could bring derivative lawsuits under the codified enactment (Companies Act 2017) . The discussion, here in this proposal, is limited to the private firms that include diffused management controlled by the director who is simultaneously the shareholders. This research would investigate how the minority shareholders in the UK seek

fair treatment through the involvement of the Court of Law under the codified provision. In addition, it also tries to encapsulate the contribution of the minority investors in the growth of the UK's economy and will also draw parallels.

In the jurisdiction of the UK and US, the newly enacted company's law provides codified provisions for bringing a derivative action without any restriction. With the recent enactment of the Company Act, 2017, in Pakistan, the minority shareholders received a sigh of relief because the weightage of shares went down from 20% to 10% for those shareholders who can bring a derivative action against their own company before the SECP or the Court of Law. The moot question of whether reducing the strength of shares will bring everlasting protection to the minority holders is still debatable. The debate over the protection of the minority shareholder started from the day when the principle that the company is the proper litigant was decided in the case *Foss v. Harbotlle*. Subsequently, if the principle of proper litigant would apply in letter and spirit then the fate of minority shareholders will remain in the state of limbo forever. Although later many exceptions were made to the principle of the proper litigant, nevertheless the minority shareholder has always remained under the tyranny of majority shareholders.

Before the recent Company Act 2017, only those shareholders holding more than 20% (Companies Ordinance 1984) of total shares may initiate a derivative action against the company that left the minority shareholders having less than 20% of total shares at the mercy of majority shareholder. The company act also brought some revolutionary changes which increased the transparency into the veil such as the act made it obligatory for a company to disclose the entire director's compensation, to hold a compulsory general meeting annually, and to apply to the SECP to investigate into the affair's oppression and mismanagement of the company. With such recent changes in the company act, Pakistan secured 6.7 out of 10 for the indicator of the strength of minority investors' protection index and distance of frontier of Pakistan is 66.67%.

After the current changes, the minority shareholders are those having more than 10% of the equity share capital of the company and are empowered to initiate even the winding-up proceedings if the company's business affairs are hostile to the interest of minority of shareholders with numerous conditions attached. The issue of protecting the rights of the minority shareholders is those having a share less than 10% of total shares still exist because in the newly created scenario the minority shareholders are again at the mercy of majority shareholders and can easily be manipulated. Nevertheless, there are several other matters on which the minority shareholders need protection against the events such as the hostile election of directors, compulsory sale and purchase, distribution of dividends, etc.

The company act is completely silent on the issue of granting protection to those shareholders having less than 10% shares of the total. The rights of all shareholders are an essential element of the accountability structure of corporate governance. These rights determine the relationship between the shareholders and the management of the company, shareholder's *vis-a-vis* shareholders and other and other stakeholders including employees and creditors. The issues are how to devise an empirical formula for achieving a transparent check and balance in the power-sharing mechanism of the shareholders. This has always remained the discussion point among Corporate Law Practitioners.

Whereas derivative lawsuits could be an effective way to punish managers, there is a risk that shareholders' right to derivative lawsuits would be misused. The authority of stakeholders to bring derivative lawsuits, for instance, might be abused by unscrupulous

stakeholders to further their own goals. They can agitate controlling shareholders by filing fraudulent and scurrilous derivative proceedings in the courts, causing the company's operations to stall.

Derivative Action Under the Uk Companies Act 2006

The derivative action in the United Kingdom was governed by common law before the enactment of the statutory derivative claims underneath the Companies Act 2006 **[“CA 2006”]**. Minority shareholders' power to sue derivatively has been constrained under common law, which required investors to show fraud on the minority while transgressors were in control of companies. Nonetheless, before the enactment, Corporate Law Practitioners were aware of the difficulties minorities were having with common law derivative actions. Therefore, it was under consideration before the enactment that Derivative action should be made more accessible and inexpensive by creating a cost-effective method and increasing their transparency (Law Commission, 1997). Consequently, after deep contemplation, derivative action was placed under the statutory derivative claim underneath the Companies Act 2006 and eventually enacted by the British government. In this regard, the British Government constituted a Law Commission to propose and prepare a new legal framework for the regulation of the Companies’ affairs UK. The Law Commission undertook a comprehensive study of all the common law principles and proposed its recommendation to the Government which was conclusively incorporated in the new Act, i.e. Companies Act, 2006 after a thorough contemplation by the Law makers in British Parliament.

Statutory Reforms

Because of the Foss rule's complications and flaws, it was proposed to reform statutes for bringing everlasting remedies to Minority Shareholder, intending to replace the common law derivative action with a unique statutory derivative procedure that adopts a more advanced, adaptable, and accessible method to assess whether a company individual can bring a derivative claim. It was suggested before the enactment, “great clarity in the criteria for a derivative action was under consideration particularly important in an epoch of rising globalization of investments and rising worldwide interest in corporate governance.” It is therefore, it became necessary to rationalize and modernize the derivative method under the umbrella of a statute.

This is because as depicted in the common law history, the rule in Foss and its exceptions were "restrictive and outdated" in certain ways. Therefore, it was proposed that a legislative amendment because of four major flaws in the Foss rule. In the first place, "the Foss rule" "cannot be established in court rules, but only in case of law, much of which was determined many years ago." In fact, it was recognized before the enactment of CA, 2006 that to get a deeper grasp of the Foss rule, 'one must review several reported instances decided over 150 years, therefore the law in this regard is essentially inaccessible, except to attorneys who have specialized in this field of law. Second, underneath the Foss rule, it was necessary to show that the transgressors were in control of the company in condition for an individual shareholder to initiate a lawsuit on behalf of the company to collect penalties incurred by the company. A serious difficulty was identified, as the concept of "control" is unclear. Third, the ruling in Foss made it impossible to launch a derivative action based on a director's recklessness unless it could be shown that the malpractice benefited the majority shareholders or that the failure of other members of a company to pursue an action constituted a swindle on the minority. The last concern as appeared is that "the capacity of the member to initiate a derivative claim must be proved as a preliminary issue by evidence that demonstrates a prima

facie case on the merits." 'Without good case management, this might result in a mini-trial, that escalates the time and cost of the lawsuit,'

Due to the considerations outlined earlier, it is not unexpected that a novel statutory derivative mechanism has been proposed. It was suggested that the lawsuit ruling be delegated to anyone outside of the company, preferably the courts, to tackle common law issues. The Company Law Review Steering Group (CLRSG, 2000) generally supported these suggestions, which were subsequently included (albeit not entirely) into the Company Act 2006 when the new statutory derivative mechanism was launched.

The statutory derivative action and the role of 'commercial justice'

Due to the collapse of the common law derivative action underneath the Foss v. Harbottle doctrine and its exclusions to give justice to minority shareholders, the law on derivative actions in the United Kingdom has endured significant statutory modifications in recent years. As it was proposed by the Commission constituted for new enactment, the UK Parliament unveiled a novel statutory derivative mechanism under the CA 2006 Part 11, in response to the uncertainty around the exact meaning of "abuse on the minority" and "wrongdoer control (Companies Act 2006)."

In contrast to common law principles, the current statutory derivative method enables a member of a company to initiate a derivative action in a variety of situations. One of the main goals of establishing a new statutory derivative action was to strengthen legal safeguards against directors harming the company, while also strengthening relief for minority shareholders by permitting them to file suit on behalf of the aggrieved company (Arsalidou, 2009).

Although it was expected that the new statutory derivative procedure underneath the **CA 2006** will provide more contemporary, adaptable, and approachable criteria for determining whether a member of a company may bring a derivative claim, the evidence so far indicates that this is not the case (Keay and Loughrey, 2010). Admittedly, even though the new statutory derivative mechanism has been examined in several instances in various depths (Franbar Holdings Ltd v. Patel, 2008) there are still some questions about the interpretation and implementation of the new statutory derivative action.

Statutory derivative action – the framework:

One of the fundamental founding principles of the new statutory derivative action is Section 260 of the **Company Act 2006**, which stipulates that the derivative actions may be lodged on behalf of a company against errant directors for conducts or omissions that constitute abuses of the obligation owed to the company. Specifically, Section 260(1) of the CA 2006 describes derivative claims as actions initiated "by a member of a company – (a) in respect of a cause of action vested in the company, and (b) seeking remedy on behalf of the business (Boyle & Birds, 2014)." As per the aforementioned, a company member now has the locus standi to initiate derivative proceedings on behalf of the company, which was previously impossible for an individual shareholder to do under common law derivative actions.

A further important aspect of the novel statutory derivative action is section 260(3), which, unlike the common law principles, allows an individual of a company to initiate a derivative claim against a negligent director for a wider range of categories of violations. A derivative claim may only be initiated by a member of a company "in connection of a cause of action arises from an actual or prospective act or omission involving negligence, default,

breach of duty, or breach of trust by a director of a company," according to section 260(3). Since there is no longer a necessity for a member of a company to demonstrate "fraud on the minority" or "transgressor control," this appears to include a broader variety of violations than available under common law principles. Section 260(3) of the CA 2006 now enables a member of a company to file a derivative suit for any suspected violation of directors' responsibilities.

The addition of negligence among the categories of violations for which a derivative claim may be lodged is one of the most noteworthy changes to the law of derivative actions. The addition of negligence is essential as it's now acknowledged that any violation of a director's fiduciary duty and competence would give rise to a derivative claim by a company member, even though such action can be authorized by the general meeting.

It's also pertinent because there's no longer a need to differentiate among simple negligence, that was not accepted as "fraud" underneath the "fraud on the minority" exception and thus barred a derivative claim by a company member, and negligence benefiting wrongdoing directors (Daniels v. Daniels, 1978) , which was recognized as "fraud." A company member now can file a derivative action based on negligence, without having to prove that the errant director benefitted from his negligence, according to section 260(3). As Lord Hodgson of Astley Abbotts responded by pointing out, allowing derivative claims based on negligence demonstrates that the new statutory derivative action may go beyond current common law principles (Deb, 2006).

The Law Commission justified the amendment by stating that while shareholders "accept the possibility that people who run a company may make mistakes," but "do not accept the directors would fail to comply with their responsibility". As a result, allowing representatives of a company to brought derivative lawsuit based on recklessness might be seen as a significant achievement through derivative action legislation, as it enables minority investors to seek redress for wrongdoings done to the company without having to show that offenders benefited from their negligence. In contrast to the complexity of the common law derivative action, the concept of establishing the statutory derivative action was to render it simple for representatives of a company to institute a derivative action.

A further major change in the derivative action legislation is that section 260 subsection 3 now permits a company member to initiate a derivative action against the director or a third party, or even both. Only in cases where the loss to the company was caused by a breach of obligation on the part of the director should this cause of action be recognized. The Explanatory Notes to the Company Act 2006 give examples of such causes of action, which include: for known receiving of payment or known transfer of assets in breach of trust, or known aid in a breach of trust.

Lord Goldsmith also highlighted two instances that demonstrate the importance of enabling a company member to pursue a derivative claim against a third party. The first of his illustrations involve circumstances in which the company property has been transferred to a third party as a result of an infringement of the director's obligation, and the third party is obligated to return it. Other instances include situations in which the company's assets have been transmitted in violation of trust or when a third party has provided deliberate aid. In such cases, a derivative claim might be lodged not only against the director but also against the 3rd party.

Lord Goldsmith's second hypothetical scenario involves an economically successful company becoming the victim of a third-party tort. In such a scenario, a company's board may opt not to pursue legal action against the third party. ‘These directors, while otherwise dedicated to the company's well-being, do not desire for ill cause and ulterior purpose to implement the tort remedy on this occasion,' according to Lord Goldsmith. They would've been in breach of duty in such scenarios, but that infringement wouldn't even have given rise to the claim; in the words of the [CA 2006], the claim is not “arising from an actual or projected act or omission by a director” he added. As Lord Goldsmith stated that, it would not be unusual for a company member to pursue legal action against a 3rd party in these circumstances.

It might be claimed that the Government proposed this amendment to accomplish fairness because if individual shareholders were unable to initiate a derivative claim against other entities, wrongs would go unpunished. Both for the company as well as its minority investors, this would have been considered unfair and unjust. It is likewise irrelevant whether the cause of action originated before or after the individual requesting to file a derivative claim became a member of the company, according to Section 260(4) of the CA 2006.

During the period of contemplation of the Committee Stage, there were substantial reservations about whether such a clause would lead to an increase in frivolous or near-frivolous litigation in the UK. Lord Grabiner stated that allowing only former or prior investors to file a complaint is unfair because investors can purchase and sell shares in a company frequently. Lord Grabiner asserts that ‘When you acquire shares, you become a participant to a changeable contract and have access to all of the rights and privileges that come with it. The fact that you come later than others on the ground should not rid you of your contractual rights. Company law experience might suggest otherwise.

Milman seems to agree with this perspective, arguing that receiving shareholders profit from effective managerial activities and, quite understandably, suffer from previous mistakes that harm the company therefore, they have a valid right to commence derivative proceedings' (Milman, 2006) .

As a result, section 260(4) might be said to be a significant advance in derivative action legislation since it permits new shareholders to initiate a derivative claim on behalf of the company to rectify atrocities committed to it.

A further important change in legislation on derivative actions is now that, under section 260(5), "shadow directors" could now be held responsible in the same manner as de jure directors and be susceptible to a derivative claim by company members. While those who have been formally appointed as the de jure company's directors are unquestionably owed the general obligations specified in sections 171 to 177 of the Company Act 2006, now it is acknowledged that shadow directors are also owed such responsibilities to the extent that "the respective common law rules or equitable principles so adapt." The reason for enabling a minority shareholder to file a lawsuit against a shadow director appears to be to hold liable those who have significant control over the company's activities answerable for wrongdoings (Griffin,2011) . It might thus be stated that the purpose of including shadow directors in § 260(5) was to minimize corporate inequities as much as feasible. However, it is uncertain to what extend shadow directors bear fiduciary obligations to the company.

Is there any alternative mechanism to the derivative claim in the UK?

The function of the derivative claim in the English legal system should be revisited, according to the preceding part, because the derivative claim is a method of safeguard for the company as a separate personality from its investors, and the company must be shielded for the sake of all investors. But, such reasoning would be invalid if evidence existed that alternative systems of accountability could take the place of the derivative claim. The various accountability systems can supplement and replace one another, according to one basic perspective (Agrawal and Knoeber, 1996) According to this viewpoint, in the United Kingdom, there is no need to resort to shareholder private lawsuits, including the derivative claim, as a means of protecting against errant directors due to the availability of various corporate governance mechanisms and the costs of judicial intervention (Enriques,2009). This viewpoint has been advanced by citing the authority of shareholders under UK corporate law, which allows them to study annual reports and accounts as well as vote on management compensation packages at the Annual General Meeting **[“AGM”]**. Furthermore, they have the legal authority to fire directors without reason (Companies Act 2006).

Unfair prejudicial conduct and shareholder covenants are other popular means of minority shareholder protections in private companies. Nevertheless, as previously stated, the shareholder primacy principle underpins these so-called alternate alternatives to the derivative claim. These were created to safeguard shareholders' benefits when there is a contradiction among shareholders and directors, and only shareholders have the authority to utilize them toward misbehaving directors. Even when it comes to safeguarding shareholders, such procedures haven't always been the best option for minority shareholders. One obvious reason is that these pathways are typically under the control of majority investors, such as controlling investors, and the interests of majority investors may conflict with those of minority investors. The derivative claim, on the other hand, is a mechanism for safeguarding the company itself, and it is more likely to be utilized by minority shareholders and, in this case, individuals who have no other choice to preserve their reflected investment in the firm. Even though the availability of alternative accountability measures may offer a situation in which the derivative claim becomes less essential, the contention is that the derivative claim will still play a vital function alongside these measures to give full protection for the company as a whole. As a result, it should be a more inexpensive and transparent method underneath the law.

So-called alternatives to the derivative claim in Private Companies

As per the UK Government's latest Green Paper, the country has a considerable number of substantial private enterprises and Limited Liability Partnerships [“LLP”]. There are almost 2,500 private firms and 90 limited liability partnerships (LLPs) with far more than 1000 workers. As a result, private businesses constitute an important element of the UK market. These businesses, whether smaller or larger, are not subject to the same formal corporate governance and reporting requirements as publicly traded companies; nonetheless, the repercussions of dominant shareholders' actions can be just as devastating for minority shareholders and investors. The British Government aims to promote a set of corporate governance standards adequate for the ownership structures of big private firms under the latest corporate governance guidelines. However, according to this study, the suggested corporate governance rule will not enhance directors' responsibility in private firms.

Firstly the private companies are free to adopt these principles, and they will be free to adopt or continue to utilize their preferred techniques if they so want. Secondly, the prospective code of corporate governance will only work for private firms with a particular

size and number of workers. Finally, in certain private corporations, such as BHS, there is just no shareholder outside of the wrongdoers' team who may impose sanctions on directors through the proposed rule. To return to the thesis's topic, since the implementation of the statutory derivative claim, private company shareholders in the United Kingdom have launched the bulk of derivative lawsuits. The rationale that derivative action may be more important in private firms is because minority shareholders and employees are far more vulnerable to conflicts of interest by majority shareholders, which can destroy the company and jeopardize their particular interests. In the case of shareholders as petitioners, there is typically no distinction between control and ownership in private firms, and shareholders are also company directors.

Minority shareholders, on either hand, have no authority to safeguard their rights in the company when dominant shareholders undermine the company via fraudulent activities, incompetence, mismanagement, and misuse of corporate assets owing to the function of the majority rule concept. Minority shareholders in private firms do not have market access equivalent to that provided to shareholders in public companies to sell their shares and avoid future damage to their rights if majority shareholders misuse their position. Even if a purchaser could be found for their stock, the articles of association of private companies may include limitations on the transfer of shares. As a result, when the firm is damaged, the most realistic alternative for minority owners is to sell their shares to dominant shareholders at a lower price.

In a nutshell, in respect of safeguarding the company itself, the derivative claim is the most standard tool accessible in private corporations to safeguard the company and its shareholders from majority shareholder abuse. Other methods, such as the undue prejudice claim, are said to be insufficient to cover the role of the derivative claim in safeguarding the firm. I examine these systems to show that they are incapable of providing complete protection for the company in all scenarios.

The unfair prejudice claim and the blurred interaction with the derivative claim

The unfair prejudicial conduct complaint appears to play the most significant role among the various methods suggested by academics and practitioners as replacements to the derivative claim in the UK. The fundamental reason is that under section 260(2) of the Companies Act 2006, a derivative claim may be made both under the statutory derivative claims rules and in response to a judicial order through section 994 proceedings for member prevention against unfair prejudicial behavior. Section 996(c) of the CA 2006 is referred to throughout the Act. According to Sub section 996(c), a court may permit civil actions to be brought in the company's name. As a result, shareholders have the option of making a lawsuit on behalf of the company or opting for a personal remedy. A hypothetical director would be less inclined to agree with the continuation of the derivative claim if a claim for unjust prejudice had been filed in addition to the derivative claim and a buy-out offer had been made to the applicant, according to the deputy judge in Franbar Holdings (Holdings, 2008).

Furthermore, in *Kleanthous v. Paphitis*, the court refused authorization based on the fact that the shareholder had filed a claim under section 994 procedures. The possibilities of addressing corporate wrongdoings through the unfair prejudice conduct complaint have sparked a protracted discussion among academics and practitioners about whether this vehicle can replace the derivative claim. One theory is that the breadth of measures provided through an unfair prejudice lawsuit has made it a desirable remedy for United Kingdom shareholders. According to Reisberg, the unfair prejudice claim's breadth of treatments, as compared to the derivative claims, as well as the hazy interplay among unfair prejudice

behavior and the derivative claim, have created an unpleasant shadow, which has harmed derivative proceedings' effectiveness.

Apart from a derivative claim, stockholders should not need to file a leave application or go through a lengthy two-stage leave process to file an unjust prejudice complaint. Nevertheless, given the differences in the existence of these two methods (the unfairly prejudicial complaint is a self-remedy for shareholders, whereas the derivative claim is a pathway to remediate the company's injustice), why would the Companies Act enable a claim on behalf of the company to be filed in unfair prejudice proceedings? The apparent reason for this might be that the regulator views shareholders as the eventual beneficiary of both claims. As a result, they may pick between sections 260 and 996. (1). Nevertheless, since the derivative action is a claim on behest of the company, and the corporation does not pertain to shareholders, such a perspective is problematic. As a result, a shareholder's claim cannot be used to replace a claim that belongs to the corporation as a different legal entity from its shareholders.

Unfair Prejudice Conduct

A personal redress for shareholders is an unfair prejudice petition. The remedy was primarily intended to compensate shareholders when the company's dealings are being or have been carried out in a way that is wrongly injurious to the objectives of its participants generally, or a particular group of participants, or when any actual or proposed act or misstatement of the company is or would be unfairly prejudicial.

In most unfair prejudice claims, the complainant claims personal compensation underneath the Company Act 2006. Section 996, on the other hand, enables investors to seek remedy on behalf of the company in the context of an unjust prejudice claim. ‘If the court is satisfied that a complaint under this Part is well-grounded, it may issue such direction as it considers suitable for providing relief in the form of the issues complained of,' according to Section 996(1). Section 996(2) authorizes the claimants to initiate a civil action in the name and on behalf of the corporation by such person or persons and on such conditions as the court would order.

It was assumed that unfair prejudice could be used as an alternative remedy to the derivative claim because it was possible to pursue the company's wrongs under section 996 and because section 261(2)(b) asserts that a derivative claim can be brought either under derivative claim provisions or under section 996(c). The legislator's inability to specify the conditions under which corporate wrongdoing should be challenged in the context of a shareholder unfair prejudice claim further supports this contention. In addition to the ambiguity, section 263(f) asks the court to assess whether the action that is the subject of the derivative claim might be brought by the member in his or her right during authorization hearings for derivative litigation. Because of the legislative ambiguities in the connection among the derivative complaint and the unfair prejudice purports, distinct court interpretations to the solutions accessible under the unfair prejudice claim have resulted in shareholder misunderstanding.

The Unfair Prejudice claim is not an ultimate substitute to the Derivative Claim

This study contends that the unfair prejudice claim ought not to be viewed as a substitute for derivative action for the reasons stated below.

Firstly, while the *Jenkins Committee*, in its findings recommending the creation of the statutory unfair prejudice solution, anticipated that it would be used in cases involving

wrongs committed to the company, (Law Committee Report,1962) the legislature never meant for the unfair prejudice remedy to supplant the derivative claim. In reality, the unfair prejudice claim was created to offer the courts greater pliability and to serve as a substitute for the just and reasonable winding-up remedy to avoid the harsh repercussions of a winding-up decision (Shareholder Remedies, 1996). A derivative action is taken in certain circumstances to reduce costs and duration of unfair prejudice petitions, according to the Law Commission, and members may be incentivized to do so instead of bringing the more extensive proceedings under section 996 of the Companies Act 2006, which will shift some of the responsibility from unfair prejudice remedy. As a result, the Law Commission decided to keep two separate remedies in place. Because the usual order under section 996 is that the respondent purchases the petitioner's shares. The argument is that the unjust prejudice petition has largely been viewed as a remedy for departing the firm.

Secondly, for a company to be reimbursed under the unfair prejudice assertion, the shareholder must file a new lawsuit, in addition to the one previously filed for personal remedy, in the company's name. When choosing these two types of processes, the expenses and time commitment demanded by the complainant would be significantly greater than if the complainant used a derivative claim petition. Furthermore, the ‘demonstrative loss rule' serves to differentiate between business remedies and the shareholders' personalized remedy, preventing shareholders from recovering for both the firm's and their damage at the same moment. As a result, in an unfair prejudice claim, shareholders must determine either to prosecute directors for personal losses or company damages. There is also no assurance that shareholders will select the company redress over their individual redress underneath the unfair prejudice action if they had to make a choice.

Finally, directors owe their legal obligations to the company, not to the investors; as a result, violations of fiduciary responsibility by directors are often sued on behalf of the company as a distinct legal entity from its shareholders via a derivative action. The two remedies are fundamentally different in nature. The unfair prejudice claims are primarily a personal complaint that must be filed when the company's activities are being managed in a way that is excessively adverse to shareholders' rights. A derivative claim, on the other hand, is lawsuits carried on behalf of the company as a distinct legal entity from its shareholders, and will only be ushered under sections 260-264 of the Company Act in rare circumstances where the company has been damaged by malefactor opportunistic behavior, incompetence, or recklessness, and the board members unwilling to pursue the wrongdoers' fraud. Given all of the legal obstacles that the lawmaker has placed in the way of a derivative lawsuit to protect the company by precluding frivolous claims, it would be illogical to believe that the unfair prejudice claim was created for the investor to prevent the legal obstacles of a derivative lawsuit and reimburse the company for its loss. There is no judicial oversight or monitoring for unfair prejudice claims. Whereas the permission hearings procedure in derivative litigation has faults, indeed it plays an important function in preventing frivolous claims, and claims that are important to the company will be processed through it.

Considering each of these factors, it believes that the unfair prejudice complaint cannot be a viable substitute to the derivative claim. Even though the unfair prejudice action is intended to recompense the company's damage via the investors as the petitioner in particular cases, the government should identify such conditions. It ought to be clear how these conditions vary from the circumstances under section 261 and workers, such as the derivative claim applicant, may have an alike option.

The Derivative Action In The United States

After examining the efficacy of the UK's statutory derivative action as provided in the CA 2006 in safeguarding small investors, it's time to look across the Atlantic to see how well the US managed to deal with derivative actions, to see if there would be any lessons to be learned from the US expertise that might assist the UK re-examine their statutory derivative actions. In the light of this argument, the US approach is significant since derivative actions are far more prevalent in the US than in Britain. A further factor to analyze the US framework is that derivative actions in the US differ significantly from those in other countries (Li, 2007).

Even though the UK Foss v Harbottle ruling seems to have impacted many U.S judgments throughout the 19th century, the standards that apply to derivative actions in the United States are distinct from those in the United Kingdom. The first objective of this paper is to look at the history of derivative actions in the United States. Second, it will look at the ‘demand requirement' idea that is now being used by US corporations. It will also look into the business judgment principle as a barrier to bringing a derivative action by minority shareholders. Finally, there will be some closing remarks.

The Historical Development of Derivative Action in the United States

In the United States, derivative actions always conventionally played a crucial role in precluding unscrupulous directors from exploiting the company and its minority shareholders, and they continue to do so (Wilder, 1985). So it is no surprise, therefore, that in *Cohen v Beneficial Indus*. Loan Corp, Justice Jackson noted that US derivative proceedings constitute the "primary controller of company management." This is mainly because derivative lawsuits originated in equity courts, which were created to provide investors with a formidable tool to combat corporate wrongdoing. It might thus be asserted that the objective of derivative actions was to eradicate unfairness when it was feasible because, without the derivative actions tool, minority shareholders would have been unable to redress the company's wrongdoings.

The far more significant US court rulings on the subject of derivative proceedings initially appeared during the first mid of nineteenth century. They had to address the issue of minority shareholders' locus standi to initiate such proceedings on behalf of the corporation on their own because there were no applicable English precedents for the US court to adopt at the moment (as the well-known UK Foss ruling had not yet been determined) (Boyle, 1965). Even though *Taylor v Miami Exporting Co* was the first productive judgment of this sort of action, the court, in this case, did not extensively analyze and define the problem of derivative action.

It wasn't till judgment in *Robinson v Smith*, that drew considerable attention to the plight of a derivative action, that the opportunities to go further into this matter arise. Chancellor Walworth recognized in this judgment that, as a general principle, if board directors and officials misappropriate or misuse company resources, a derivative action should be launched in the name of the company to make them responsible for their conduct. Normally, such an action is initiated at the suggestion of the company's disinterested directors or the demand of the majority shareholders in a general meeting. Whereas the court agreed that a lawsuit to rectify a wrong done to the corporation should be brought on the company's behalf, it will never be allowed such a violation to go unpunished for the sake of form, and therefore decided that a derivative action must be admitted.

In *Dodge v Woolsey*, the Federal Supreme Court solidly recognized an individual shareholder's power to initiate a derivative action to rectify a corporate infringement. As this was considered as the foundation case for shareholders' ability to prosecute, it's really important to review the facts of the case concisely. Mr. Woolsey, a shareholder of the Branch Bank of Cleveland ('the Bank'), filed a lawsuit to restrain the Bank from paying, and the state of Ohio from receiving, an allegedly unlawful levy. In doing so, he listed the state's tax collector, George C. Dodge, as well as the Bank and its directors, as defendants in the complaint. The common law did not authorize a shareholder to launch a suit to hold corporate directors answerable for their acts at the moment the stockholder's complaint was filed. Mr. Woolsey's then the only option for initiating a complaint against the transgressors was to seek redress from equity, which, luckily for him, provided the remedy that was lacking under common law (Ferrara, Abikoff and Gansler, 2005). Nevertheless, the US Supreme Court (by a majority decision) recognized that individual shareholders do have fundamental rights in respect of the company's governance and management, stating that: 'It is no longer disputed that courts of equity in both England and the United States have jurisdiction over companies to pertain preventing remedies by injunction, to restrain those who regulate them from doing acts that would constitute a breach of charters, or to prevent any flagrant abuse of their assets or profits, at the request of one or more of their shareholders (Dodge v Woolsey, 1855).

Mr. Woolsey had no locus standi under common law to initiate a suit against the defendants, thus equity seemed to be the best choice, as equity allowed Mr. Woolsey to bring a lawsuit on behalf of the Bank for wrongdoings made to the Bank. In both Robinson and Dodge, the US courts appear to have taken a more liberal attitude to individual shareholders in initiating derivative claims than the UK common law principles. Undoubtedly, US courts "were willing to enable the minority shareholders to file a lawsuit where the board refused to act in flagrant breach of duty or, conversely, whenever it could be demonstrated that the company was underneath the influence of the transgressors" As Prunty contended 'Whilst also English lawyers and judges concentrated their early discussions on technical concerns of pleadings and process, their American counterparts demonstrated more interest with what, in the lexicon of the law, is referred to as substantial principles (Prunty,1957).

One of the primary reasons why the US courts have been more lenient on the problem of derivative actions than the UK common law rules is that, unlike in the UK, where company law rules are drawn from partnership laws, corporation law principles in the US evolved autonomously (Hornstein, 1967). As a consequence, UK company law concepts such as the "majority rule" and "internal management," which restrict courts from intervening with a corporation's internal matters, were not viewed as barriers by US courts in granting an individual shareholder the power to initiate a derivative action.

Nevertheless, this does not always suggest that the courts were willing to authorize unrestricted derivative proceedings. Before Mr. Woolsey filed the complaint in Dodge, for example, he submitted a plea to the Bank's board of directors to avoid the alleged wrongdoing that had been committed against the Bank. It is because, at the time, 'growing emphasis was placed on the need to exhaust any remedy within the company,' and as a result, a minority shareholder was obligated to produce a demand to the directors of the company, before instituting a derivative action, to redress the wrongs that had been triggered to the company.

But there was no strong indication that the well-known UK Foss ruling impacted US courts at the time, it appears that in subsequent US cases (Brewer v. Proprietors, 1870), the Foss rule impacted their rulings on the problem of derivative proceedings. For instance, in *Brewer v Proprietors of Boston Theatre* the Massachusetts Supreme Court laid the foundation

for the US demand requirement' rule, which permitted an individual investor to make separate demands both to the board of directors and the majority shareholders in general meeting to initiate proceedings against the transgressors. Nevertheless, if deceptive behavior or ultra vires activities are revealed, such a claim will be dismissed.

The Supreme Court's judgment in Hawes v Oakland was even more inspired by the Foss rule because that appears to become the only judgment that has ever come closer to the Foss rule than any other US ruling (Griggs and Lowry 1994). This is because in Hawes, Justice Miller applied both procedural and substantive limits on individual shareholders' right to initiate derivative proceedings, which were very comparable to the restrictions imposed underneath the UK Foss doctrine. In actuality, Justice Miller proposed that the reasons for such proceedings be restricted to particular areas of malfeasance by directors, such as unlawful activities, financial fraud, or acts performed for their gain that would damage the corporation and its shareholders.

Moreover, Justice Miller laid plenty of regulatory limitations on individual shareholders who intended to pursue a derivative case. Firstly, the individual shareholder had to make demands on both the board of directors and the majority shareholders in the general meeting before taking this action. Secondly, the 'contemporaneous ownership condition' requires an individual's shareholders to be a 'shareholder at the moment of the transactions about which he claims, or that his interests have devolved on him afterward by force of law' to initiate a derivative suit. Finally, the individual shareholder had to show that "the litigation is not a collusive one to bestow on a US court jurisdiction in a matter in which it might otherwise have no cognizance."

As a corollary, it's necessary to probe deeper into some of the most important aspects of US derivative proceedings to determine whether there are any lessons to be learned from the US practice that could help the UK and Pakistan to rethink its statutory derivative approach. In the subsequent section, three key elements of US derivative actions will be reviewed and discussed for the sake of the research. The demand prerequisite, the business judgment principle, and the function of the special litigation committee are all examples of these.

The US current state of the law on Derivative Actions

The majority of US company law is based on state law, which means that each state's laws are different from one another. Although derivative action law varies from state to state in the US, there are certain common concepts, as evidenced by the fact that several states have adopted company laws focused on two prominent factors: The Delaware General Corporation Law and, The Model Business Corporation Act (Goehre, 2010). The demand requirement, the business judgment rule, and the function of the special litigation committee are three essential elements that every state has in similar. It has long been acknowledged that all these three factors make it tough for a minority shareholder to launch a derivative action, both substantively and procedurally (Scarlett, 2012). Analyzing these elements seems important to determine whether there are any lessons to be learned from the US experiences that might assist the UK and Pakistan rethink their derivative action approach.

The Demand requirement and its rationale

The Supreme Court held in the well-known case of *Hawes v Oakland* that, before filing derivative litigation, an applicant shareholder must first: 'Demonstrate to the satisfaction of the court that he has exhausted all available methods to achieve redress of grievances or action following his preferences inside the company. He should make a

genuine, not a phony, attempt to persuade the company's controlling body to take corrective action, and this should be made clear to the court'.

The notion of the "demand requirement" developed from this decision, which compels claiming shareholders who intend to rectify a crime committed to the company to first make a demand on the board of directors to initiate litigation against the transgressors to recover damages. The demand requirement exists to allow the company's board of directors the opportunity to evaluate and investigate the problems before an individual shareholder files a lawsuit in court. The affairs of the company "will be handled by or under the command of a board of directors," according to the underlying principle of US company law (Delaware Code, 2008) Because the board of directors is the company's "brain and nerve center,'' it is entirely within their jurisdiction to determine whether or not to file a lawsuit to restore damages (Hemraj, 2004).

Although it was formed differently than the Foss rule, it appears that the well-known British Foss regime was the primary source of influence for the demand requirement. The Foss rule recognizes that the appropriate complainant to file suit for atrocities committed to the company is the company on its own, not individual shareholders, and thus the board of directors, as officials of the company, has indeed been granted the authority to bring a claim against the offenders to restore for the damage caused to the company. As per the ‘demand requirement' doctrine, the U.s emphasizes the hypothesis that because fraud has been done to a company, the cause of action relates to the company, and thus the board members, acting as the company, will be granted the absolute authority to make lawsuits decisions.

On the one side, one could contend that the "demand requirement" method gives certain practical advantages. One of its advantages is that, because the company director has a better position than an individual shareholder in determining whether actions will be taken towards transgressors, the lawsuit decisions are put in the hands of the "professionals (Fischel, 1976)." Individual shareholders, in reality, "generally have limited awareness of the facts involved and lack access to the company's accounts and financial statements." Directors are more aware of the activities that have been alleged, and are thus in a better position to decide whether a complaint is legitimate.' Furthermore, the demand requirement guarantees that all intra-corporate conflict solutions have been explored before enabling the court to interfere, and that's important since it prevents individual shareholders from engaging in frivolous and wasteful action.

Enabling the board of directors to make all legal decisions is troublesome, especially in situations when the directors are accused of causing the company's wrongdoing. Nevertheless, research suggests that the offending directors are unlikely to suit themselves, and so the company's violation will go unaddressed. It might thus be claimed that such a method is "inequitable," because by allowing the board of directors to handle exclusively with the lawsuit ruling, no fairness would be served, as there will be no alternative avenues for minority shareholders to rectify the corporation's wrongdoing. Nevertheless, the demand requirement raises concerns that “involved board members could refuse shareholders' legitimate complaints, culminating in unfairness to the company and its investors (Goehre, 2010)."

Because the goal of the U.S demand requirement is to keep the courts out of the company's internal matters till all inside alternatives have been attempted, this method presents among the most significant questions: whether the demand requirement may be

waived, and if so, by what conditions. As a result, the method for the demand requirement and its exceptions will be discussed in the next section.

The procedure of the Demand Requirement and its exceptions

Whenever the board of directors receives a demand from a single shareholder to take legal action against the offenders, the board has three options: admit the shareholder's insistence and initiate legal action against the offenders on its own, solve this problem domestically, or refuse to accept the shareholder's insistence. Research shows that the board of directors seems to be more likely to dismiss the shareholder's petition (Fairfax, 2005). Even when they do, the shareholder could seek judicial oversight, but they should prove that the board denied their claim improperly. Several jurisdictions acknowledge that a single shareholder could choose not to make a claim to the board of directors, claiming that the claim should be dismissed (Aronson v Lewis 1984). It's indeed necessary for the shareholder to indicate that the board of directors erred in rejecting his claim or that the claim should be dismissed to determine that the "business judgment rule" doesn't applicable to the board's decision. The business judgment rule is protection that believes the company's directors performed in due diligence, devotion, and prudence, as required by respective fiduciary obligations. As a result, the individual shareholder should demonstrate that the number of the board of directors violated their fiduciary responsibilities to refute that the petition was wrongly denied by the directors.

If an individual shareholder seeks to excuse demand, he must establish that the majority of directors were financially involved in the transaction or were not acting independently when they made their decision. In other instances, the demand may be dismissed if it is established that the board of directors is hindered by a pecuniary potential conflict of interest, and the court may conclude that the board of directors is reluctant to prosecute itself in such circumstance. If the individual shareholder could even demonstrate there is a shred of sufficient evidence that, majority of the board of directors has a conflict of interest in the questioned transaction, a significant number of the board of directors lacks sovereignty, or the transaction in question is not a result of the lawful exercise of business judgment, demand may be excused in Delaware.

Nonetheless, it's worth noting that most states adopt the Model Business Corporation Act, which establishes a generic demand requirement that renders the demand requirement mandatory for an individual shareholder in all cases and so cannot be excused (MCBA, 2002). Demand will be needed in those states that have implemented the MBCA, even if an individual shareholder has some concerns about whether the directors are truly interested or separate from the alleged wrongdoing. In comparison to Delaware's stance, the MBCA's theory looks to limit shareholder derivative litigation more often than Delaware's method, which enables demand to be excused in certain instances. However, this generates uncertainty when it comes to the exclusions to the demand criterion. As a result, an individual shareholder's ability to initiate a derivative action to rectify a company's wrongdoings is hampered.

A further roadblock to demand requirement exclusions is the so-called "business judgment principle," which determines whether or not the courts will allow an individual shareholder to invoke the demand requirement exclusions. In the next part, we'll look at the reasoning behind this rule as well as its implications for derivative actions legislation.

Business Judgment Rule

Director's protection is vital for a company to develop and flourish since it makes it difficult for them to make challenging managerial decisions without fear of prosecution. The ‘business judgment rule,' a judge-made notion that has been widely recognized and embraced as one of the core principles of US corporation law, can give this protection. The business judgment rule, as per Delaware Supreme Court in *Aronson v Lewis*, is "an assumption that the board members of an organization proceeded on an informed basis, in due diligence and the absolute belief that the actions being taken would be in the greatest interests of the organization." This could nevertheless have contended that the business judgment principal ‘plays a role as a shield to protect board members from responsibility for their actions if a business judgment principal criteria are met, such as if they have done their work on an informed basis, in due diligence, and the unshakable belief that they had been making decisions in the company's better interests, even though their actions "may have ended out terribly from a corporate viewpoint"

The business judgment rule, according to Animashaum, (Animashaun, 1989) stems from the fundamental concept established in section 141(a) of the Delaware General Corporation Law, which states that the director, not the shareholders, is accountable for managing the company's activities. The principle, according to Animashaum, performs the following way: ‘When taking managerial decisions, the directors... incur risks that might result in the loss of a shareholder's capital. Litigation against the directors who caused significant losses is unavoidable in the aftermath of such damages and business choices. As a result, directors must be safeguarded from personal harm while they carry out their duties in accordance with the set regulations. This is the aim of the business judgment rule, which protects directors from legal oversight of actions made in good conscience and with fair reasoning in the authorized and reasonable pursuing of company objectives.

In certain cases, the business judgment rule serves as a "safe harbor" for the board of directors, since it "prevents them from self-accountability for the case filed against them as a result of mistakes of judgment or business rulings that harmed the company (Arsalidou, 2003)." The principle aims to safeguard the company's directors, which rises the crucial question about what the business judgment rule's standards are that the company's directors should meet to be protected by the rule. For the regulation to safeguard the company's directors, four requirements must be met. It is necessary to examine such circumstances extensively for the objectives of the thesis.

The director shouldn't have any monetary stake in the transactions, according to the first requirement. When a director has a stake in the transaction's particular subject, the business judgment rule does not apply. For instance, if the transaction includes a corporation purchasing a director's personal property, the deal would not be shielded underneath the business judgment principle if the corporation's board allowed it. There have been, nevertheless, certain situations in which the transaction's involved director may be shielded from self-accountability. If the director could show that the dispute concerning the transaction was approved by a majority of the board of directors that have no interest in the transaction ('the uninterested directors') either by a vote of uninterested shareholders after disclosing information, then the principal will pertain and the board member will be protected from self-accountability. Furthermore, if the disinterested director can prove that the claimed transaction is beneficial to the company, he could prevent personal responsibility under the business judgment rule. In sequence for the ‘business judgment rule' to defend the board

members' action, the majority of the directors must act unilaterally, without the director who is engaged in the suspected transaction exercising dominating influence.

For the sake of the business judgment rule, the second requirement which should be fulfilled is that the director makes an informed decision. The prerequisite for making an informed decision "concentrates on a director's or official's preparation in making any investment decisions." To put it another way, the business judgment principle will not be used until it can be demonstrated that the company's directors were properly informed before making a decision based on "all significant facts reasonably accessible to them." As a result, it is essential that important material information is thoroughly obtained and examined by the company's director, as well as that the director takes time to think about his decisions. It was acknowledged that if the corporation's director is determined to have acted with "gross ignorance," the business judgment rule would not apply, and the directors would not be shielded from self-accountability (Smith v. Van Gorkom, 1985).

The rule's third criterion is that the director must have "rational relief" while executing his duties. In other terms, the directors considered the transactions would be in the best interests of the firm, and that belief was factually logical. Lastly, the rule's fourth requirement mandates the director to make a good business judgment decision. It has been established, for instance, that if a director of a corporation makes a decision that violates the law and the director is aware of it, the director would not be shielded underneath the business judgment principle.

The emerging role of the Special Litigation Committee

Concerning the business judgment rule discussed previously, the establishment of special litigating committees is yet another important barrier for individual shareholders seeking to launch a derivative lawsuit. The function of such a committee, which is often made up of directors who are impartial and uninterested in the claimed transactions, is to assess the individual shareholder's assertion to prosecute the offenders and determine if such a lawsuit is in the greatest interests of business. In the U. S., unlike in the United Kingdom, it is not unusual for a board of directors to establish special litigation committees to assess and appraise whether such a derivative action is in the best interests of the company (Adeyeye, 2017) . That is because these committee members have been regarded as a more capable and suitable entity to take litigious decisions than the boards of directors of the corporation in question.

Thus, if the special litigation committee believes that a derivative action ought not to be permitted as it is not for the benefit of the company; the judiciary is much more likely to adopt the special litigation committee's judgment.

The usage of special litigation committees, on the other hand, has been criticized. The most major concern with utilizing such panels is what is known as "structural bias." Because the participants of the special litigation committee are generally appointed by the board of directors, who seem to have a stake in the claimed transactions, the panel may see their duty as "those of a cushion to shield and defend managers from disgruntled and litigation investors." A derivative action elicits a reaction of group loyalty, so even a “maverick” director might feel forced to close ranks and protect his comrades from the onslaught of the strike suits” Coffee and Schwartz claimed. As a result, participants of the special litigation committee are more inclined to respond sympathetically toward their fellow directors when making a lawsuit judgment (Zapata Corp. v. Maldonado, 1981). Evidence suggests there is a risk of ‘systemic prejudice,' as designated special litigation committees in

a majority of incidents recommended that a lawsuit against the offending directors be dismissed.

Auerbach v Bennett is a well-known decision on this subject. An individual shareholder filed a derivative lawsuit against the errant directors of General Telephone & Electronics Company (‘GTE'), including the corporation's auditors, saying that the respondents must be held liable for transactions totaling upwards of $11 million in kickbacks. GTE's board of directors agreed to create a special litigation committee to investigate and assess whether a derivative claim must be lodged as a consequence of the individual investor's derivative action. Allowing a derivative claim against the directors and auditors; in the committee's perspective, will not be in the best interests of the company. The committee stated that the auditors had worked in good conscience and line with established audit procedures, thus there's no cause to pursue the issue further. The committee further argues that the director of a company did not violate their obligations because they did not benefit personally from the transactions, so the derivative claim ought to be dismissed.

In this case, the crucial question here is whether the business judgment rule could be used to shield the special litigation committee's verdict from judicial review. The special litigation committee was composed of three people who have joined the board of directors after the disputed transactions. A derivative suit was filed against four of the corporation's fifteen directors. The other directors were not aware of the suspected dealings, and the accused directors had not engaged in any illicit activities, according to the argument. As an outcome, the court determined that the special litigation committee's findings were not subject to judicial review and also that the business judgment principle was used to safeguard its conclusion. It is important to notice, nevertheless, that the court also has authority to investigate the committee's impartiality and also the legitimacy of the committee's investigation processes utilized to make its conclusion. Upon these facts of the case, the Appellate court stated that the committee's approach was correct, and as a corollary, it came to the result that the committee's finding was immune from further judicial review.

As a corollary, it might be contended that the business judgment principle, as well as the utilization of special litigation committees in litigation issues, are barriers to an individual shareholder bringing a derivative claim to rectify the company's wrongdoings (Adeyeye, 1980) . Numerous scholars believe that the business judgment rule requires closer examination because it is necessary to prevent the undesirable practice of judicial abdication and exemption from self-responsibility for boards of directors (Johnson, 1980) . This is because the derivative action must continue to be an appropriate tool that permits individual shareholders to initiate a lawsuit to address the company's crimes.

Zapata Corp v Maldonado, is an important decision on this subject, in which it has been accepted that the business judgment rule may not have the ultimate word on whether or not to permit a derivative action. This case was deemed to be important since it has been claimed that the *Zapata* judgment protects the derivative claim as a valuable tool for individual shareholders to correct wrongs committed by dishonest directors to the company. In this case, the individual shareholder filed a derivative claim over ten of the company's directors, claiming that they had broken their legal obligations. The board of directors agreed to create a special litigation committee, which included two new board members, to examine the subject further as a result of the derivative action. The committee suggests that derivative action against the errant directors will be prohibited. After that, the company filed a motion seeking a rejection or summary decision. The Chancery Court dismissed the summary judgment, stating that the business judgment rule does not permit for the rejection of

individual shareholder derivative proceedings, and each shareholder will have the option to sue these claims in particular situations. Following the Chancery Court's ruling, the company filed an interlocutory appeal with the Delaware Supreme Court, who rejected the Chancery Court's decision to refuse final judgment.

Nevertheless, the Supreme Court found that mere legislative investigations into the special litigation committee's autonomy, fairness, and rational inquiry were deficient safeguards toward potential fraud regarding the position of the business judgment regime in dismissing individual shareholders' derivative claims. This is subsequently decided that in all cases when pleas to reject a derivative action are brought, a two-step test must be adopted.

The first part is an investigation of the special litigation committee's autonomy and trustworthiness, including the logical reasons for the assisting special litigation committee's findings. If these conditions are not met, the corporation's request to reject a derivative action must be denied by the court. If these conditions are met, the court will go on to step two, which allows the court to make its autonomous business judgment about whether or not to reject the derivative claim. In comparison to the Auberman judgment, it might be claimed that Zapata was much more liberal in safeguarding shareholders from wrongdoers' exploitation and that "commercial justice" was accomplished.

Conclusion

There are many solutions and protections available to minority shareholders as members of a corporate body to effectively protect holders of minority interests from discriminatory shareholders whose conduct may be inconsistent with the Articles of Association. Some such remedies include, but are not limited to, unreasonable prejudice petitions, just and equitable winding up, and the derivative claim doctrine. Most of these remedies were deeply embedded in common law, but after reformation and codification under the Companies Act 2006 in UK, a substantial shift occurred.

Minority shareholders have the right to seek damages when certain or all of the members in a company are infringed by the actions happening in the company. Public or Limited Liability Companies grants three remedies to transgressed minority shareholder. A statutory derivative complaint (sections 260 to 264 CA 2006), a lawsuit against unfair prejudice actions (s 994 CA), or a suit for equitable and fair winding up of the corporation (s 122(1)(g) Insolvency Act 1986) are the options. The last two are personal remedies but the statutory derivative action is a corporate redress. This study would aim to have a quick analytical comparison of these actions.

Common law has been over-shadowed with Foss v Harbottle Doctrine & then exceptions related to it to award remedies to shareholders. The action has been questioned for being unnecessarily complicated and obsolete, as well as a series of procedurally insignificant complications. To resolve these issues, the Law Commission ultimately introduced a legislative derivative action in sections 260-264 of the CA 2006 that substituted common law derivative actions with a more modern method.

The major improvement is that any violation of the directors' duties, a proposed act, or omission can be used as a basis for filing a lawsuit. It would no longer be sufficient to prove that the suspected wrongdoers own the business or have benefited from the alleged wrongdoing. Furthermore, going to the majority to seek permission for using the name of the company in a lawsuit is no more eligible. While the codified derivative assertion makes it

easier to start an action, the action's process can stifle future applications and, as a result, make it more difficult to resolve corporation wrongdoing.

The right of a shareholder to file a derivative suit is always a secondary remedy, as the primary remedy is petition for unfair prejudicial treatment. It is not important to prove a pattern of behavior or even conduct that was unfairly prejudicial at the time the petition was filed. Since the clause denotes that the "company's affairs are being or have been handled" in an objectively prejudicial way, a plaintiff may demand claims relating to actions that occurred before he became a registered shareholder in the company.

A shareholder under s 122(1) of IA 1986 can wind up business on just and equal grounds. But the main condition is that the petitioner must prove that winding-up will result in a significant gain. The directors' power of authorization granted by s 175 can significantly reduce fraud on minority-based derivative claims. Besides that, judicial jurisdiction over derivative claims is focused on a complicated, strict, and deterrent criterion examination, which creates hurdles for plaintiffs to verify their allegations with adequate proof during the test stage, given their disadvantageous role in obtaining details about the company's internal affairs. However, due to the aforementioned flaws, the odds were in favor of seeking personal redress. For instance, the advantage obtained from a derivative argument has an indirect impact on interest of the shareholder, forcing him to leave this remedy and go for redress under unfair prejudicial action as it does not entail a preliminary examination for permission. Since it includes a versatile mechanism and a wide variety of grounds for a petition and available reliefs, S 994 is proving to be the most beneficial law in coming handy in protecting minority shareholder's interests. Presently Minority shareholder has a variety of statutory rights to assert his claim on. A combination of redresses can work for him.

The right to sue in a derivative procedure must be expanded to cases involving dubious payments made by corporations. Such corrupted transactions could be used to further the businesses' objectives; nevertheless, shareholders have the power to question such payments based on squandering of company assets and violation of the directors' fiduciary responsibility to the shareholders. Regarding derivative litigation, this aspect of the cause of action is accepted in the United States. In Auerbach v Bennet, for instance, a shareholder used a derivative action to challenge improper reimbursements and bribes received by the business. The cause of action including acts of bribes and illicit transactions was allowed to be prosecuted by the court. In the British, foreign corruption was acknowledged in the case of Konamaneni and others v. Rolls Royce Industrial Power (India) Ltd and others in a derivative action. Bribery and unlawful transactions are now also enforceable underneath the statutory derivative action framework given by Company Act 2006.

In the United States, the board of directors is responsible for assessing derivative actions. Courts in the United Kingdom use a paternalistic approach to evaluate derivative proceedings. The British Company Act has a two-stage process for filing derivative actions. Before proceeding to the usual proceeding, the courts must firstly demonstrate a prima facie case. Well before the case is taken up for a normal trial, the courts are responsible for conducting preliminary investigations and ensuring that there are adequate grounds to prosecute the claim. Prosecuting shareholders must submit a petition with the courts to get derivative proceedings approved.

Unless the courts intend to pursue a liberal stance, the corporation will be exposed to frivolous and insignificant lawsuits, while if it takes a strict stance, the minority will be returned to the pre-2006 CA scenario, where the laws were very rigid. Nonetheless, the most

essential aim is to protect minority shareholders from majority shareholder harassment while still addressing the interests of the majority. In the present world, it's no more the interests of a majority that are important, companies tend to listen to the claims of the minority, and all the unfair prejudices are shown the light of day through deterrence effect and court's keen order. This purpose has been trying its best to be accomplished with the help of codified remedies and modifications in the laws. Derivative actions in the US differ significantly from those in other countries. As Boyle pointed out, "the law of commercial entities is one domain where English and American law diverges to a very striking level (Boyle, 1965)."

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