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WHEN ONE HEAD IS BETTER THAN TWO – REVISITING THE MINIMUM NUMBER OF SHAREHOLDERS AND DIRECTORS OF A LIMITED LIABILITY COMPANY UNDER NIGERIAN LAW

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I. INTRODUCTION

It is generally acceptable that two heads are better than one. Perhaps this is what informed the provision of section 246(1) of the Companies and Allied Matters Act, Cap C20 LFN 2004 ("CAMA") which provides that every company shall have a minimum of two directors. In fact, any company whose number of directors falls below two is required to cease to carry on business after one month, until new directors are appointed. Similarly, only two or more persons may form a company in view of the provision of Section 18 of the CAMA[1]. Whilst there may be some logic in these requirements, experience and reality calls to question the necessity of having a minimum of two directors and two shareholders in a company. Thus, this article will discuss some practical challenges faced by companies in complying with these requirements, and advocates for the adoption of the practice in other jurisdictions such as the United Kingdom and India with regards to single membership and directorship of a company.

II. BACKGROUND

In Nigerian company law practice, before a company[2] is incorporated, a promoter- who is typically a prospective shareholder and director- must set out amongst other things, the details of the other director(s) and shareholder(s) of the proposed company[3]. In other words, to achieve compliance, the promoter must determine prior to incorporation, the persons that will run the company with him; either in the capacity of a director and/or shareholder.

However, highly ambitious entrepreneurs with brilliant business ideas, who would ordinarily operate as *lone wolf promoters*[4], are constrained by these statutory requirements. To achieve compliance, such promoters are compelled by law to have at least the prescribed minimum number of shareholders, which would typically comprise of their close friends, associates and/ or family. On many occasions, the shareholding structure of a proposed company with for instance 1,000,000 share capital is represented as 999,999 shares and a token of 1 share in favour of the promoter-shareholder and the additional shareholder respectively. From experience, the rationale for this shareholding structure is to fulfil the aforementioned minimum statutory requirements as against the genuine desire to have such additional shareholder as a member of the company.

A similar scenario plays out in the selection of directors of the prospective company. Bearing in mind the role a director plays in the affairs of a company, indeed, careful consideration should be given to the appointment of a director in a company. Unfortunately, the reverse is largely the case in practice with respect to small businesses and private companies. The CAMA is not helpful in this regard, as it does not expressly provide for the calibre or criteria to be considered in appointing a director. Conversely, it provides for the category of persons who are disqualified from being directors[5].

Consequently, the trend for lone wolf promoters, in the quest to fulfil the minimum requirement provided by the CAMA, is to name random family and/or friends or indeed, name other prospective shareholders also as directors. Whilst the strategy for appointing one's acquaintance as a director may be well intentioned and logical, it is worthy to note that the importance of the role extends beyond familial relationship, as it encompasses issues bordering on the capacity of the nominee to undertake the task effectively and contribute significantly to the welfare of the company. Indeed, in these circumstances, promoters put little or no thoughts to the task of determining the quality of the other directors of the company. A logical explanation for this is that the promoter might simply prefer to work alone; however his hands are forced by law to "run his business" with other people in order to comply with the minimum requirements of the law.

In reality, the lone wolf promoter actually runs his business alone, because he sees the company as his alter ego, and only requires the second director when it becomes necessary to demonstrate the company's compliance with the law.

III. THE DILEMMA

Unfortunately, as experience has shown, the scenarios above may have dire consequences. Appointing and indeed, working with people who are not sufficiently qualified or who do not share the same passion and goals for the company may put the company in a precarious position. There have been instances where lone wolf promoters become substantially dependent on the other director to move the company forward. Putting this in perspective, where there are two directors in a company for instance, the promoter -director may be unable to act without the other director. For example, the company cannot validly hold any board meeting, or pass **any** resolution without the collaboration of **both** directors. In fact, the Corporate Affairs Commission Regulations[6] even compounds this further as a company secretary who hitherto, would have been able to execute such resolutions in place of another director, cannot do so where a company has only two directors on record[7]. Although, all is well that ends well; experience has revealed that all is not always well.

1 Section 18 of the Companies and Allied Matters Act, LFN C20, 2004 (CAMA)
2Reference to a Company in this article is reference to a private company limited by shares
3A promoter is required to provide the details of the other shareholder(s) in the memorandum and articles of association, and director(s) in the other incorporation documents, before a company can be incorporated
4 Lone wolf promoters' in this article describes small business owners who prefer to do things on their own including running their business alone.
5 However, we note that the recent Financial Reporting Council (FRC) of Nigeria Exposure Draft of National Code Of Corporate Governance 2016 provides as follows:

Board Structure and Composition
The board shall be of a sufficient size relative to the scale and complexity of the company's operations and be composed in such a way as to ensure diversity of experience and gender without compromising competence, independence, integrity and availability of members to attend meetings.
6 CAC Regulations 2012
7 CAC Regulations (no 17) 2012

Whilst dependency amongst the directors is not a problem in itself, it becomes a challenge where one of the directors exploits a personal or business misunderstanding with the other director to the detriment of the company. A disgruntled director, for instance, may capitalize on corporate formalities to create a bottleneck and thereby stifle the activities of the company. He may for example, refuse to, or not promptly execute company documents; or refuse to attend meetings of the Board so that a quorum may not be achieved. Unfortunately, such disgruntled director cannot be readily removed in view of the strict requirements for directors' removal[8]; and because a resolution signed by the two directors will be required to register such removal at the Corporate Affairs Commission. Certainly, it is not expected that the disgruntled director will sign a resolution for his own removal. Also, no other director can be appointed because a resolution for such appointment must be signed by both directors thus creating a regrettable impasse.

It becomes a double jeopardy when the two directors are also the only shareholders of the company. In this case, the other shareholder may refuse to attend general meetings in order that quorum may not be achieved. He may also decide not to exercise his right to vote or pass a resolution. In summary, absolutely nothing can be done to move a company in this position forward, unless extreme measures are taken including making an application in court[9]. Bearing in mind the formalities and procedures involved as well as the undue delays that may be encountered in bringing an application to the courts, the fact still remains that the activities of the company will be severely hampered or halted until the stalemate is resolved.

It is pertinent to note that the setbacks encountered when there are only two directors in a company can also recur where there are more than two directors; as all that is required is for all the subsisting directors, short of one to be aggrieved and collaborative in their effort to stifle the activities of the Company.

Nevertheless, the point to note in all of this is that the parties coming together to form a company must have a meeting of the minds and a clear sense of direction and responsibility as to where the company is headed. Indeed, a lone wolf promoter should not be put at the mercy or subject to the whim and caprices of another director or shareholder who clearly does not share the same vision for the company as the promoter.

IV. THE WAY FORWARD

The question then is whether it remains expedient that a promoter, in view of the current position of the law, should be compelled to have an additional shareholder and director before he can form and run a company in Nigeria?

The answer in this regard should be in the negative. Some have argued that such promoters can choose to register business names under part B of CAMA which will provide them the freedom and opportunity to work alone as sole proprietors. However, the protection provided to the shareholders of a limited liability company as expounded in the classic case of Salomon v. Salomon[10] is not available to proprietors under a business name.

Furthermore, whilst the argument to operate vide a business name may sound rational, certain countries have moved beyond this phase; as one person can now by himself form a company; thereby enjoying the benefits of a limited liability company whilst working alone.

Indeed, it is time to move in the direction of advanced countries like the United Kingdom where the prescribed minimum number of directors and shareholders that a private company can have is one. In other words, a single person can incorporate a company having himself alone as the director and shareholder rather than face the pressures of having to, more often than not, name a random shareholder in the memorandum and articles of association, and director in the other incorporation documents, to fulfil the minimum statutory requirements.

Furthermore, in India, a "One Person Company" has been introduced by the Companies Act, 2013[11]. A One Person Company is a hybrid structure, which combines most of the benefits of a sole proprietorship and limited liability company. Such company has only one person as a member who acts in the capacity of a director as well as a shareholder. Whilst the obsolete Companies Act in India provided for a minimum of two directors and shareholders in the formation of a private company, the country has moved beyond that position. Under the new Act, an individual can conveniently set up a One Person Company.

A one person company in India enjoys extremely relaxed compliance requirements as corporate formalities are reduced. Thus, issues of maintaining a quorum, avoidable deadlocks among directors, the need for convening and holding annual general meetings

8 See Section 262 of CAMA
9 See section 232 (4) & (5) of CAMA
10 [1897] AC 22
11(No 18. of 2013)

of the company are all dispensed with. The welcome result is that decisions concerning the management and progress of the company can be taken instantly without the constraints and delays of consultation.

V. CONCLUSION

The role of small and medium scale enterprises (SMEs) towards growing and deepening the Nigerian economy cannot be over emphasized. Accordingly, there is a need to create an enabling environment for these enterprises to thrive.

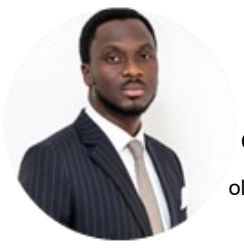
Indeed, a one person company in our opinion could turn out to be very beneficial in this regard. Firstly, small business owners will enjoy relaxed statutory requirements and corporate decision making will be accelerated.

Secondly, a one person company is very cost effective and suitable for SMEs that are keen on keeping costs at the barest minimum. Most importantly, it affords small business owners the opportunity to personally direct and manage their businesses alone from the start till they come across or till they become open to bringing in like minds who share the same passion and zeal to drive the company to the promised land.

Several other countries apart from the United Kingdom and India have enhanced the business environment within their jurisdictions by giving promoters the benefit of setting up companies having a single shareholder and director. They have achieved this by introducing new legislation on the corporate structure of limited liability companies; and there is no better time than now for Nigeria to do likewise.

However, in view of the current position of the law and the evolving responsibilities and influences of directors and indeed shareholders in a company, it is advisable for promoters to seek sound legal advice on the composition of the directors and shareholders as well as the constitutional documents of their companies to forestall the possibility of their companies being held to ransom by disgruntled directors and/or shareholders.

For any comments and additional information on the issues discussed, please contact any of the under-listed persons:



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