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INTRODUCTION

On May 13, 2002 a US company, Tomran Inc. filed a derivative action suit in the City of Baltimore Circuit Court, Maryland on behalf of Allied Irish Banks, Ireland’s leading banking organisation, against the current and former directors of Allfirst Bank (a subsidiary of AIB based in Maryland) and against Allfirst Bank, Allfirst Financial and AIB as nominal defendants arising from losses of $700 million incurred by the bank as a result of the activities of a “rogue trader”. Tomran Inc. held 4,800 American depositary shares, quoted on the New York Stock Exchange (NYSE), in Allied Irish Banks, plc. The derivative action suit was heard in the first instance in the Circuit Court of the City of Baltimore, Maryland¹ and went on appeal in May 2004. The decision represents a précis of Irish and English law on derivative actions and illustrates how inadequate this action is as a minority protection device and how it compares unfavourably with the state law of a number of jurisdictions in the United States.²

This article thus highlights a number of specific issues. First, how the conflict of law issues as resolved in this case do not adequately address the rights of...
certain kinds of cross-jurisdictional investors, a matter of increasing importance in a globalised economy. This case concerns those investing in foreign companies listed on the NYSE through the medium of ADRs or ADSs. Secondly, that Irish and English rules on derivative actions present severe obstacles to the enforcement of minority shareholder rights. The article questions orthodox support for this status quo, evidenced most recently by the approach of the UK Company Law Review project conducted under the auspices of the DTI. Finally, the article considers the “corporate history” of Allied Irish Banks and seeks to question the relevance of corporate law to the resolution of the governance issues highlighted by this case and subsequent events in AIB. It is not intended to maintain that Allied Irish Banks is unusual in this context, quite the opposite. The intention is rather to take the “rogue trading” events, subsequent action on the part of the management, this litigation and subsequent events as representative of a typical scenario involving a large corporation dealing with an internal crisis. This case study illustrates the dissonance between company law and modern commercial and corporate practice. This relationship leaves a vacuum, which, it is argued, is currently filled by the adoption of private remedies or resolution, for example the requisition of an investigation by the management of Allied Irish Banks and its subsequent publication on the AIB website as an attempt to ameliorate shareholders’ fears regarding transparency. This raises a complex area of debate, which will be returned to in later work. Part I describes the events in AIB leading to the derivative action suit. Part II describes the jurisdiction and choice of law issues, together with the *locus standi* issues faced by the plaintiff. Part III illustrates the difficulties faced by the minority shareholder, in fact not even a shareholder but a beneficial holder, in relation to the substantive rules on derivative actions. Part IV considers the current reform proposals from the DTI. Part V considers the broader governance issues.


PART I: THE ROGUE TRADING SCANDAL

Allied Irish Banks plc is one of the two major banks in Ireland with banking interests in many different sectors. Its shares are quoted on the Irish stock exchange and on the NYSE. Having first begun to invest in overseas banking operations during the 1980s, by 1988 Allied Irish Banks had acquired just under 50% of the common stock of First Maryland and in 1989 First Maryland became a wholly owned subsidiary of AIB. It was renamed AllFirst in 1999. AllFirst Financial, which in turn owned AllFirst Bank is based in Baltimore, Maryland in the United States. Subsequent to the events described in this article, and in part as a resolution of the difficulties AIB experienced with its US venture, AllFirst was sold to M&T Bank. AIB now owns 22.5% of M&T. During most of the time AllFirst was owned by AIB it was managed exclusively at local level, with what has been described as a “hands off approach”, with the exception of the appointment of one high ranking officer to the Baltimore office from Dublin, AIB’s headquarters. In February 2002 it was finally discovered, although there had been indications of trouble before this time, that substantial losses to the tune of $691million were incurred during the period 1997 through 2002 by the unauthorised currency trading activities of an employee of AllFirst Bank, John Rusnak.

Media attention gave way at the time to an investigation, which was authorised by AIB management, designed to establish the sequence of events and to consider questions regarding management infrastructure, governance and oversight mechanisms in the group as a whole. The investigation eventually led to a report on this matter, which was made available to the public. The response of the Board of AIB seemed to be timely and rigorous and satisfied, or so it seemed from media reports at that time, that substantial losses to the company. However, some shareholders were not satisfied. In particular some US ADS holders (American Depository Shareholders), were not satisfied either

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6. In July 2004, the adjusted earnings per share for the first half of 2004 was reported by Allied Irish Banks plc as 64.4c, up 10% on the previous half year with the same value for the USA up 13%. See further www.aibgroup.com.

7. The factual account of events which took place at AllFirst and at AIB is derived from a report prepared for AIB in relation to these events: Promontory Financial Group and Wachtell Lipton Rosen and Katz: “Report to Board of Directors of Allied Irish Banks P.L.C., AllFirst Financial Inc., and AllFirst Bank Concerning Currency Trading Losses” March 2002. (hereinafter referred to as “the Ludwig Report”) See further www.aib.ie. Mr David Cronin was appointed to the senior management team as treasurer of AllFirst in 1989 and maintained close contacts with headquarters at AIB, Dublin throughout the entire period in question.

8. See further the Ludwig Report pp.20–25.

with the actions of the management of AllFirst or indeed with the actions of the Board of Allied Irish Banks in relation to the fraudulent activities of individual traders at AllFirst. Tomran Inc. holder of ADSs in AIB, first made demands on the chairman of AIB and of Allfirst Financial, Inc., and Allfirst Bank to take legal action to recover these losses and indicated that if such action was not initiated, Tomran Inc. intended to take a derivative action on behalf of Allfirst and/or AIB to recover losses caused to the company arising from this trading. Although the bona fides of management in relation to the actual trading is not in doubt, the question here is whether management can or ought to be accountable for losses caused to the corporation as a whole through the lack of strong governance structures. This case and its facts represent an extreme case of loss, caused by the very unusual activities of one individual, “a lone wolf”, and it must be emphasized that it is not intended to exaggerate the culpability of the management in any sense.


Jurisdiction and choice of law

The first issue the Circuit Court in Baltimore addressed was the question of jurisdiction. The first principle the court considered was the “internal affairs doctrine” enunciated most recently by the United States Supreme Court in Edgar v Mite Corp., et al. which provides that ordinarily the court (a US court) will not interfere in the internal affairs of a foreign corporation. The defendants in the Tomran case, particularly Allied Irish Banks, argued that this principle presented a complete bar to the present action. The court in Baltimore decided in favour of the plaintiffs in relation to this argument. It held that it was not constrained by this principle for a number of different reasons including that the acts complained of occurred in Maryland and that the evidence and witnesses and most of the defendants were situate in Maryland as distinct from the jurisdiction of incorporation, Ireland. The court also distinguished a decision.

10. Demand letter of March 6, 2002 and of April 5, 2002. Note that the serving of a demand letter is a procedural requirement under the law of the State of New York and of the State of Maryland. See further Dooley, n.2 above, 305–308, on Rule 23.1 of the Federal Rules of Procedure relating to the demand letter or notice.
of the Court of Appeals of the State of Maryland, *NAACP v Golding*,\(^\text{15}\) which reiterated the “internal affairs doctrine” on the grounds that there were no economic issues at stake in that case and on the grounds that the members of that non-profit voluntary organisation had failed to exhaust their internal remedies.

Having accepted jurisdiction over the affairs of AIB, the court went on to consider what law would apply. Critical to the resolution of this issue was the interpretation of the depository agreement, the agreement creating the ADSs as a means of holding a financial interest in AIB, on the NYSE. Although the document states that the relevant laws applicable will be those of the State of New York,\(^\text{16}\) the court seems to have been reluctant to accept the consequences of this statement for the defendants, which would have been to allow this action to proceed. The court was unable to accept the plaintiff’s argument that because the laws of the State of New York would apply the action could proceed “without regard to Irish law”. The court also expressed reluctance to go any further in ignoring the internal affairs doctrine than it already had by adopting a jurisdiction that was not the place of incorporation. The court stated that underlying the “internal affairs doctrine” was the principle that the law of the place of incorporation governs the rights and responsibilities of the parties with respect to its internal operations and that therefore Irish law applied to the issues at hand. The court’s reasoning in this area is flawed. First, and most importantly, by rejecting the argument based on the agreement that the laws of the State of New York applied, the court offended the principle that choice of law clauses enjoy “a presumption of validity” under US civil procedure rules, the only proviso being that “the courts usually require that the laws chosen have some connection with the parties or the transaction”,\(^\text{17}\) a condition that is clearly satisfied in this case. Similarly, the ADS agreement states quite clearly that the laws of New York should apply and although the court expressed a wish not to contravene the spirit of the “internal affairs doctrine” it explicitly did so in ignoring relevant provisions of a document drawn up by the corporation in question. Furthermore the only case which had been argued before it relating to the status of holders of ADRs was the case of *Batchelder v Kawamoteo, et al.*,\(^\text{18}\) where the United States Court of Appeals had denied standing to holders of ADRs in Honda because the agreement\(^\text{19}\) in question had indicated that

\(^\text{15}\) 342 Md. 663 (1996).

\(^\text{16}\) Para.7.6 of the ADR agreement states, “This deposit agreement and the receipts shall be interpreted and all rights hereunder and thereunder shall be governed by the laws of the State of New York.”


\(^\text{18}\) 147 F.3d.915 (CA 9 1998).

\(^\text{19}\) Note that the relevant clause in the ADR agreement in *Batchelder*, which led the
Japanese law was to apply and that Japanese law limited the right to bring shareholder actions to registered shareholders. Secondly, the court’s acceptance of jurisdiction on the one hand, explicitly rejecting the internal affairs doctrine for this purpose, and then choosing the law of the place of incorporation in an attempt to comply with the spirit of the “internal affairs doctrine” on the other, is illogical. In doing so the court took upon itself the interpretation and administration of Irish law ultimately influencing not only the internal affairs of AIB but also the internal affairs of many different corporations incorporated in this jurisdiction. The outcome is that the Circuit Court of the City of Baltimore has made the most recent pronouncement on an important aspect of Irish company law, not to mention the single most significant event in Irish corporate fraud in the history of the State.20

Locus standi

Once Irish law was deemed by the court to be the relevant law, the plaintiff then faced a number of difficult issues. The first and, as it turned out, by no means the least was the rule in s.123 of the Irish Companies Act 196321 equivalent to s.360 of the UK Companies Act 1985 which provides that “No notice of any trust, express, implied or constructive shall be entered on the register or receivable by the registrar.” In effect this means that in the normal course all rights and liabilities as between the company and its shareholders are exercisable by and against those registered as members. The difficulties faced by beneficial owners of shares in this context and in particular holders of modern financial instruments such as ADRs and ADSs have been addressed recently by the DTI (UK) Company Law Review project, and some recommendations were made to ameliorate these difficulties.22 The UK government has now considered these recommendations, and a White Paper has been produced outlining the map of future legislation.23 Nolan also provides

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20. Finally, even if the choice of law clause in the agreement was not supported by the court, the court had already acknowledged that most of the actions, evidence and witnesses arose and occurred around the affairs of a corporation operating in the state of Maryland and for this reason it could have opted to apply the laws of that state.

21. This act is still referred to as “the Principal Act” even though there have been substantial amendments to Irish company law in 1990 and most recently in 2003.


23. See Cm 5553 Sections 2.40 and Sections 2.41. www.dti.gov.uk/companiesbill/
very thoroughly researched material on the companies that have sought to redress the fact that holders of these instruments are effectively disenfranchised, but it would seem that most of these private agreements simply address rights to vote, to exercise proxy votes or to issue instructions to the depository. What does not seem to be addressed is the difficulty faced by this ADS holder, i.e. the rights to take action to remedy a particular wrong or grievance, in other words the right to litigate. In the absence of any statements in the ADS agreement the court was left to consider existing Irish law on the subject. Unfortunately there is no modern Irish or English decision on the question of whether a beneficial owner of shares is entitled to take a derivative action on behalf of the company. Nor are there any statutory statements to this effect. However, Pennington states that “A derivative action may be brought by a person who is entitled to shares or an interest in them but is not registered as the holder of them in the company’s register of members; such persons include an equitable mortgagee of shares or the renouncee of a letter of allotment of shares, but not a creditor of the company” The following cases are cited to support this proposition: Bagshaw v Eastern Union Rly Co. and Binney v Ince Hall Coal and Channel Co. The case law thus relied on by the plaintiff included statements from older English cases which seemed to recognise a right of action generally for the beneficial holder of shares despite the administrative rule of convenience set out in s.123 of the Irish Companies Act of 1963 or its English equivalent s.360. In the first mentioned case of Bagshaw v Eastern Union Rly Co. the plaintiff was the holder of a scrip certificate, but not a registered

24. See Nolan, above n.3. Appendix. Indeed the Deposit Agreement under which Tomran Inc., held its ADRs also had these permissive provisions.
25. R. Pennington, Company Law (8th ed., Butterworths, London, 2001) 798. In a treatise on Minority Shareholders’ Remedies, Boros states at page 189 that in Australia, it has been held that a person who is merely an equitable owner of shares is not permitted to take a derivative action and she refers to two Australian cases to support this view, Mass v McIntosh (1928) 28 SR (NSW) 441 and Hooker Investments Property. Ltd. v Email Ltd. (1986) 10 ACLR 443. However, she goes on to state, “The position in England on this issue is less clear.” This is also true of the Irish position. She then refers to an earlier edition of Pennington’s Company Law, see above, which contains the statement outlined in the text. See E. Boros, Minority Shareholder Remedies (Clarendon Press, Oxford, 1995).
26. (1849) 7 Hare 114.
27. (1866) 35 L.J. Ch. 363.
28. The terms of the scrip certificate provided for the payment of a number of instalments of capital by the scrip holder and that once all instalments were paid the holder would be entitled to £500 of stock of the company. The scrip certificates were
shareholder, in relation to certain shares and sought to prevent the company and its directors from misapplying £100,000, which had been raised to construct one particular railway line, in expenditure on the construction of another. The company and the individual directors argued against the substance of the action, but also argued that the plaintiff had no standing to sue on behalf of both the owners of registered shares and on behalf of the owners of scrip certificates, as the interests of both “were conflicting with respect to the question in the cause”. Sir James Wigram V-C dismissed these objections and held in favour of the plaintiff both in relation to the substance of the claim and in relation to what he called objections “taken to the frame of the bill” which in his view required “much consideration”. He pointed out that it was not argued that the plaintiff as the owner of the scrip certificate did not have sufficient interest in the application of the capital of the company necessary for him to take the action, (the objection was more based on the potential conflict of interest), and he went on to state that this could not have been argued because of the fact “that there was an inchoate right in such parties to become general shareholders in the company”.

In conclusion, it would seem therefore, that even though the plaintiff at the time of the action was not a registered shareholder his “inchoate rights” as a shareholder and his consequent interest in the application of the capital of the company supported his right to take action in this case. In addition, on the basis of pure contract law principles the plaintiff also had a right as the assignee of the original subscriber to sue the company on the contract.

In the second case of Binney v Ince Hall Coal and Channel Co. the court specifically considered the effect of Article 142 of the Articles of the defendant company which stated the rule which is now codified in section 123 of the Irish 1963 Act and section 360 of its English equivalent. That Article provided that the company would not be “affected by notices of any trust relating to any share or shares in the company …”. In this case a shareholder charged his shares to the plaintiff as security by way of equitable mortgage, for a loan of 3000 guineas. The company had notice of this charge. The plaintiff, as equitable mortgagee of the shares, instituted proceedings to prevent the company from using 10,000 guineas worth of profits in a particular way, when the profits could have been used to pay dividends. The company argued that the plaintiff assignable with the assignee, as in this case, then becoming liable for the calls on the certificate and entitled, when all calls were paid, to be registered as a shareholder.

29. (1849) 7 Hare 114 at 116.
30. Ibid. at 130.
31. Ibid.
32. Ibid.
had no right to sue based on, *inter alia*, Article 142. Kindersley V-C held that this argument “could not be maintained.” He went on to state that the effect of the clause is:

“that … although they [the company] … have notice that A is a shareholder, and B is a *cestui que trust* [the beneficial owner], payment of dividend to the person standing on the books shall, notwithstanding the notice of the trust, be a good discharge. That is the whole effect of this clause. But is does not preclude a *cestui que trust* of A’s shares from coming and saying “Do not pay my trustee the monies as if they belonged to him, but pay them to me.” Nor does it preclude the plaintiff from coming to the company and saying, “You are injuring these shares in respect of a right which attached to them…”.”  

Otherwise, Kindersley V-C held that the company would be entitled to provide that “whatever injustice we choose to perpetrate there shall be no remedy against that injustice in any Court of equity.”

This case provides clear authority for the proposition that an individual with a beneficial interest in registered shares is entitled to seek an equitable remedy as against the company and supports the statement of Pennington that “A derivative action may be brought by a person who is the equitable owner of shares, such as an equitable mortgagee or the renouncee of a letter of allotment, but not by a creditor of a company.” There is no reason to suppose that these authorities should not be followed in Ireland and they are indeed supported by the statement of the former Chief Justice, Mr Justice Keane who states in his text on Irish company law that “The court indeed will intervene by injunction at the instance of the equitable owner to prevent a transaction being completed which would adversely affect its interest in the shares.” He does not elaborate. Finally, Forde reiterates the principle stated in the *Binney* case (although he does not refer to this case) when he states that “a beneficial owner can obtain orders against the trustee and indeed the company in order to protect his interest in the shares” noting that “[T]he effect of Article 7 is not that the company shall never be affected by a trust or that no trust shall be created on any share, but that the company is not to be affected by any notice of a trust.”

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33. (1866) 35 L.J. Ch. 363 at 368.
38. M. Forde, above n.36, 387 (emphasis added). Forde refers to the decision of Kelly L.J. in *McGrattan v McGrattan* [1985] N.I. 28 where it was held that a resolution
Based on these older cases the plaintiff’s argument was that because a derivative action is an equitable action and because if denied locus standi the holder of ADS (or indeed ADRs) would be left without a remedy, the court should accept that on the authority of these cases the beneficial holder of shares would be recognised by an Irish court. The defendant countered with two authorities, *Hooker Investments Pty. Ltd. v Email, Ltd.*\(^{39}\) and *Svanstrom v. Jonasson*\(^{40}\) which effectively decided that in those jurisdictions, New South Wales and the Cayman Islands respectively, the beneficial holder of shares would have no action. Having accepted its jurisdiction to interpret Irish law, the court stated that it found itself “in the unenviable position of having to interpret a critical point of Irish corporation law in the absence of any direct authority from the Irish courts.” The court went on to state that although “the plaintiff has constructed a well reasoned argument as to how and why an Irish court should extend whatever rights registered shareholders have to sue a company derivatively to beneficial owners of shares”, it was not the function of that court to “predict the direction in which Irish courts may head in the future when presented with an appropriate case of this nature.” In the absence of clear authority to support the plaintiff’s contention the court refused to extend locus standi to the plaintiffs.

The court’s view that the cases cited by the plaintiff and the cases cited by the defendant had equally convincing precedential weight in Irish law is questionable. Cases of the vintage of *Bagshaw, Binney* etc. are clearly more central to Irish law generally, not to mention the fact that *Foss v Harbottle*\(^{41}\) is of similar vintage and decided by the same judge as *Bagshaw* and this is supported by normal rules of precedent in Irish law.\(^{42}\) Furthermore, in the Northern Irish decision of *McGrattan v McGrattan*\(^{43}\) the Court of Appeal in Northern Ireland (Kelly L.J., Hutton J. concurring) cited and approved the decision in *Binney v Ince Hall Coal and Channel Co.* Kelly L.J. stated that “Article 7 [equivalent to section 123 of the 1963 Act] does not operate to prevent an equitable owner of shares obtaining an order from the court designed to protect his equitable interests, even if that order operates against the company as well as against the trustee of the shares.”\(^{44}\) If pre-1922 law is not clear on a matter, then an Irish court is free to consider decisions from other jurisdictions which was carried on the strength of votes cast by a trustee against the wishes of the beneficial owner was invalid.

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41. (1843) 2 Hare 461.
42. This is a simple statement and leaves aside the principles applicable to Constitutional review which presents a different set of issues.
44. *Ibid.* at 34.
as having persuasive authority. Given the statement of Chief Justice Keane in his text it would seem unlikely that an Irish court would accept that a decision from the Cayman Islands would have sufficient weight to cast doubt on this line of authority. Finally, the principle which prevents a court from adopting laws in the choice of law context which may yield a favourable or less favourable outcome for the plaintiff is analogous to the argument made here that certain jurisdictions, the Cayman Islands being one of them, hold themselves out as areas where business can be conducted secretly with less disclosure obligations than other jurisdictions and that their company law jurisprudence should be considered in that context. Therefore it is hard to accept that a decision from such a jurisdiction would have similar weight to English decisions in an Irish court.

**The group structure: double and triple derivative suits**

In an amended filing on August 14 the plaintiff styled its action as a triple derivative action in an attempt to address issues raised by the group structure between AIB and the various subsidiaries in Maryland. The plaintiff Tomran Inc. was a holder of ADSs in Allied Irish Bank, and the main corporate cause of action seemed to be against the officers of the institution where the actual fraud occurred, namely in the currency trading section of AllFirst Bank, thus the cause of action was on the part of a second tier subsidiary against the directors of a second tier subsidiary. As the subsidiaries were wholly owned the decision to act rested with the parent, the only shareholder. The derivative action was therefore an attempt on the part of an external shareholder in the parent to force the parent to act. Thus the action was described as a triple derivative action involving piercing the veil of not one but two companies to establish the connection between the plaintiff and the ultimate defendants. These actions

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45. See further Silberman and Stein, above n.17.
46. The Cayman Islands is familiar to Irish lawyers as the locus of the centre of an offshore banking structure which led to substantial investigative efforts on the part of the Irish State in the 1990s in relation to tax avoidance by many senior political and business individuals in Ireland. See further The Report of the Inspectors appointed to the High Court to enquire into the affairs of Ansbacher (Cayman) Ltd., Office of the Director of Corporate Enforcement, Department of Enterprise and Employment, Dublin, Ireland. www.odce.ie. See also many articles in The Irish Times including for example Saturday, July 31, 1999 where it is stated that “The investigatory tribunal had made unsuccessful application to the courts in the Cayman Islands for information regarding Ansbacher (Cayman) Ltd. This bank was a subsidiary of a South African banking group, FirstRand which has since been sold. The two cases cited by the defendants are also somewhat problematic as authority. A complete analysis of why these cases are problematic will be returned to in a later case note.
have been recognised in the United States since at least the latter part of the nineteenth century, particularly where the plaintiff is a shareholder in a group structure based on wholly owned subsidiaries, which was the case here.

As the Kansas Supreme Court put it almost 125 years ago, while upholding plaintiffs’ right to pursue a double derivative claim, “If any other rule were adopted, the plaintiffs would be denied all relief, and the wrongs of which they complain would go unredressed. Even if the directors and officers of these corporations were willing to prosecute, it would be a mockery to permit a suit against themselves to be brought and prosecuted under their management to obtain the relief sought in this action.”

No authorities in England or in Ireland have addressed the legitimacy of this approach nor does it seem to have been the case that such an action has been accepted in Australia. Finally, although a moot point then because of the judgment of the court and now because of the sale of the AIB interest, the court in Baltimore did observe, having referred to the most recent Irish cases, in particular *Crindle Investments v Wymes* and *O’Neill v Ryan* that “nothing in the above quoted language or in the text of either of those decisions suggest to this Court that Ireland is about to permit double or triple derivative actions

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48. *Ryan*, above n.47. 1879 WL, 23. *Brown v Tenney* explains: “Without triple or double derivative suits [a] shareholder of record in the holding company would … be without remedy, even where, as here, the holding company is the wrongdoer. The additional layer in the corporate structure would prevent the righting of many wrongs and would insulate the wrongdoer from judicial intervention. The law, however, cannot be deceived by spurious and illusory devices, disguises, or circuitry of action” (author’s emphasis) 532 N.E. 2d 230, 233 (Ill. 1988).


51. [1993] I.L.R.M. 557. This case is not central to the law on derivative actions, such as it is. The plaintiff was aggrieved, *inter alia*, by alleged collusion between a number of the defendants contrary to Articles 85 and 86 of the EC Treaty on anti-competitive practices, clearly a cause of action for the corporation alone and not the individual shareholder. The distinction between wrongs of third parties and wrongs internal to the company mentioned earlier is apt.
by *even registered shareholders*. In contrast the state of New York and the state of Maryland recognise these actions, yet again underlining the much less restrictive approach to derivative actions in the United States.

In conclusion, the lack of standing of the beneficial owner was fatal to its claim. In view of the fact that ADRs and ADSs are becoming increasingly important vehicles for companies to facilitate investment through foreign ownership, a reconsideration of these rules is timely. In addition to the reforms currently canvassed in the UK and by the Irish Company Law Review Group, serious consideration ought to be given to the fact that failure to restate the law in this area may present significant procedural barriers to *litigation by beneficial owners* and cause considerable injustice to those enticed to invest through various equitable vehicles in a particular corporation. The reform proposals are considered below.

**PART III: THE DERIVATIVE ACTION AS A CORPORATE GOVERNANCE DEVICE**

*Foss v Harbottle* (1843) 2 Hare 461

Even if the plaintiff had managed to overcome this difficulty the problems in relation to a viable derivative action claim seem almost insurmountable. This part of the paper raises serious questions in a governance context as to whether the derivative action as currently understood provides the shareholder with any meaningful remedy at all. Even with the procedural clarifications presented in the recommendations from the Scottish and English Commission which were adopted by the Company Law Review Steering Group during the DTI company law review project it is doubtful that the shareholder would ever have a good chance of success, let alone go any distance in establishing a credible case.

The rule in *Foss v Harbottle* is quite simply a majority rule principle and nothing more. Interestingly, in the judgment of Sir James Wigram V–C in that case the court accepted the rule that in most cases the corporation will be the proper plaintiff but not without strongly worded statements that the rule was “much too broadly stated on the part of the Defendants.”

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52. See further Nolan, above n.3. The DTI Company Law Review Steering Group Report suggested reforms in this area which are considered in this article along with existing company practices. See further The Company Law Review Steering Group, “Modern Company Law for a Competitive Economy—Final Report”, Chap.7, para.7.4.


54. *Foss v Harbottle* (1843) 2 Hare 461, 491.
on to state that:

“If a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters, and asking in such character the protection of those rights to which in their corporate character they were entitled, I cannot but think that the principle so forcibly laid down by Lord Cottenham in *Wallworth v Holt* and other cases, would apply, and the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue.”

In Irish and English company law, four exceptions to the rule are normally described as follows:

(a) Where the majority purports to act illegally or *ultra vires*.
(b) Where decisions are made requiring more than a simple majority.
(c) Where actions are taken which “abridge or abolish” the individual rights of shareholders.
(d) Where a majority in control of the company commits a “fraud on the minority”.

A fifth exception referring to “the justice of the case” has also been canvassed in the Irish and English decisions beginning with statements of Jessel M.R. in *Russell v Wakefield Waterworks Co.* For more recent dicta to this effect see Harman L.J. in the English case of *Heyting v Dupont* and in Ireland in the case of *Moylan v Irish Whiting Manufacturers Ltd* where Hamilton J. referred specifically to the need to ensure the protection of constitutionally protected property rights. Against this fifth exception Keane states that:

“the exceptions to the rule are so clearly defined that in practice the Irish courts would be reluctant to extend them. In support of this approach, it may be pointed out that, provided the term ‘fraud’ is given its wider equitable meaning, the number of cases in which the invocation of the ‘justice of the case’ formula is necessary must be so few as not to justify the making of additional exceptions, with the undesirable consequence of uncertainty as to what the law is.”

55. 4 Myl. & Cr. 635.
56. (1843) 2 Hare 461, 492 (emphasis added).
57. (1875) L.R. 20 Eq. 474.
59. Unreported, High Court, April 14, 1980).
60. Keane, above n. 35, 317. See also L. Sealy, *Cases and Materials on Company Law*
In *Prudential Assurance Co. Ltd. v Newman Industries Ltd. (No.2)*, the \(^{61}\) exception of fraud on the minority was examined in great detail by Vinelott J. in his decision in the Court of Chancery in this case. On appeal\(^ {62}\) the Court of Appeal no longer had to consider this issue because, as Sealy states,\(^ {63}\) “the company itself (in whose favour the judgment of the lower court had been entered) had adopted the plaintiff’s case and the benefit of the victory.” The Court of Appeal was therefore not faced with many of the substantive issues surrounding *Foss v Harbottle*, but did make some observations, which are generally accepted as underlining the restrictive approach to derivative actions under English law. In particular the Court of Appeal rejected the idea that there is a broad exception to the rule under the “interests of justice” category.\(^ {64}\) In the passage cited from Wigram V–C this broader interpretation of the rule is however contemplated in the language he uses. Nevertheless, Keane’s view that fraud may be broad enough to cover the justice category is the starting point of the next section.

**The meaning of fraud**

In this case Tomran Inc. sought to bring itself under the fraud on the minority exception. The question is whether any of the management behaviour outlined in the Ludwig Report could be caught within the meaning generally given to fraud on the minority. The use of the term “fraud” is generally acknowledged not to be equivalent to fraudulent activities involving dishonesty and even less so criminality, but is understood as indicating situations where “a person entrusted with powers to be exercised on behalf of others used them for some other purpose.”\(^ {65}\) Cases in England and Ireland (which are relatively few in number) decided under this exception have usually involved expropriation by a controlling majority of the company’s property. However, a recent Irish case

\(^{61}\) [1981] 1 Ch. 257.

\(^{62}\) [1982] 1 Ch. 204.

\(^{63}\) Above n.60, 503.

\(^{64}\) [1982] 1 Ch. 204 at 221. See below for further discussion of this case in relation to the distinction between personal rights of a minority shareholder enforceable through a s.459 action under the English Companies Act 1985 or a section 205 action under the Irish Companies Act 1963.

did involve the court reviewing a decision by a controlling majority not to settle an action. Similarly, decisions not to sue could also be the proper subject matter of a derivative action. In *Crindle Investments v Wymes*\(^66\) the test set down by the Irish Supreme Court was whether the majority were seeking to “appropriate benefits to themselves to the detriment of the company as a whole” but it was held in that case that any decision of the majority not to settle the action (regarded as unjustified intransigence by the minority) would benefit the minority as well as the majority if proved to be a successful strategy. On the facts as presented in the Ludwig report, the governance question focuses on the decision by the Board as a whole not to sue some of its members. Accordingly the demand letter issued by Tomran Inc. indicates a view that a corporate action might lie for gross negligence and therefore a breach of the directors’ duties of skill and care owed to the company. An action might also lie alleging breach of the directors’ duties not to abuse their powers or to exercise their powers for proper purpose. If that is so, then for the minority shareholder the concern is why the Board has not taken such an action on behalf of the company against these errant directors. The English case of *Daniels v Daniels*\(^67\) is in point. In his judgment Templeman J. distinguishes between cases where directors have been negligent or even grossly negligent where it would seem that even in the latter case no derivative action would lie, and on the other hand cases where there is improper purpose or indeed gross negligence coupled with the possibility of benefit accruing to the directors personally. Possibly there may have been a benefit accruing to the Board of AIB and officers of AllFirst Financial in making a decision not to sue some of their number on behalf of the corporations, despite the formal demand letter sent to the Board by Tomran, so that disclosure of further culpability in the course of litigation would be avoided.\(^68\) This kind of benefit is adumbrated in the judgment in the Irish case of *Crindle*\(^69\) where the court was of the view that because a decision to litigate against a third party would be equally beneficial to all concerned if successful and equally detrimental to all if not, such a decision would not be within the exceptions to *Foss v Harbottle*. However, if the communality of interests is tainted where the potential...

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\(^{67}\) [1978] Ch. 406.

\(^{68}\) Above text accompanying n.10. Note that the formal demand letter is part of the procedural requirements for this type of action under the law of the relevant states in the United States.

\(^{69}\) Above n. 66.
defendants are not third parties but some of the Board, there is a conflict of interest and that may turn negligence into fraud.70 This problem may be addressed by subjecting the decision makers to closer scrutiny regarding their independence and this will be considered in the context of reform.

In the Ludwig report it was quite clearly stated that the review found nothing to indicate “that anyone at AIB or Allfirst, outside of the Allfirst treasury group, were involved in, or had any knowledge that, fraudulent or improper trading activity was occurring at Allfirst before the discovery of the fraud.”71 In other words, no evidence of per se fraud. Nevertheless the review did find that “Mr Rusnak’s (the trader’s) trading activities did not receive the careful scrutiny that they deserved; the Allfirst treasurer and his treasury funds manager—the principal persons responsible for Mr Rusnak’s supervision—failed for an extended period to monitor Mr Rusnak’s trading.”72 Secondly it is stated that at both AIB and Allfirst level all of those involved in risk assessment including senior management, risk managers and internal auditors at Allfirst, did not appreciate the risks involved in the hedge-fund style of foreign exchange trading conducted by Mr Rusnak and even in the absence of fraud his activities “warranted much closer risk-management review.” The report also states that the “heavy reliance” by senior management of Allfirst and AIB on the Allfirst treasurer was “misplaced”.73 Finally, the report goes on to make very specific recommendations on management issues. Some of these recommendations clearly indicate that the decision to permit proprietary trading was made without addressing the risks and costs involved (which are high) weighed against the potential gains (low) and that this trading was not adequately supervised or managed.74 As the Company Law Review Steering Group acknowledged in certain situations directors may have a “personal interest in condoning the wrong” or at least avoiding the risk of litigation and extensive discovery. That is not to exclude the legitimacy of deciding not to litigate because of further costs and damage to the company.

70. It is interesting that in Foss v Harbottle Wigram V–C specifically refers to injury caused “to the corporation by some of its members, for which no adequate remedy remained” ((1843) 2 Hare 461, 492) as distinct, I believe, from injury caused by third parties where the corporate response is likely to be more coherent. This distinction is apt in considering the Irish case of O’Neill v Ryan and Ors [1990] I.L.R.M. 140 and [1993] I.L.R.M. 557.
71. Above n.7, 3.
72. Above n.7, 2.
73. Above n.7, 2 and 3.
74. Above n.7, 45 and 46.
Ratification

In Daniels v Daniels Templeman J. addressed the defence that such actions are ratifiable and are therefore not within the exception to the rule in Foss v Harbottle. He states:

“In Pavlides v Jensen [1956] Ch. 565 it was alleged that the directors had been guilty of gross negligence. … Danckwerts J. struck out the statement of claim as disclosing no cause of action because no fraud was pleaded…. Mr Richards relies very strongly on this decision as showing that, whatever the exceptions to Foss v Harbottle may be, mere gross negligence is not actionable, and he says all that is pleaded in the present case is gross negligence at the most. But in Pavlides v Jensen no benefits accrued to the directors …”. 75

He concludes that shareholders must put up with “foolish or unwise directors”76 and even “an amiable set of lunatics” but

“a minority shareholder who has no other remedy may sue where directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company.”77

The Tomran case reflects the core problem considered by Sir Wigram in the middle of the 19th century, the question of what can be done when the Board does not bring its own members to account. The fraud on the minority exception is not based on negligence because this negligence, or even lunacy, is ratifiable. Rather, self-interest is the key to what is meant by fraud on the minority and it is always possible for a decision not to sue to be tainted by self-interest. Despite the report and despite the departure of a number of executives and the ongoing investigations by US authorities, AIB and its subsidiaries has not recovered any of the almost $700m losses it suffered.

Control by the wrongdoers

Even in the somewhat unlikely event that a court were to accept the decision not to sue as a ground for an exception to the Foss v Harbottle rule under the category of “fraud”, the plaintiff has to show that the wrongdoers are in control. The issue of control was considered in detail in Foss v Harbottle itself where

75. [1978] Ch. 406 at 413 (emphasis added).
76. Ibid. at 414, citing Lord Hatherley L.C. in Turquand v Marshall (1868–1869) L.R. 4 Ch. App. 376 at 386.
77. [1978] Ch. 406 at 414 (emphasis added).
the court states:

“How then can this Court act in a suit constituted as this is, if it is to be assumed, for the purposes of the argument, that the powers of the body of the proprietors are still in existence ….. the governing body of proprietors may defeat the decree [of the court] by lawfully resolving upon the confirmation of the very acts which are the subject of the suit. … In order then that this suit may be sustained it must be shewn either that there is no such power as I have supposed remaining in the proprietors, or at least, that all means have been resorted to and found ineffectual to set that body in motion. …” 78

Thus the question of whether the decision to litigate rests with the Board of Directors or with the shareholders in general meeting is pertinent. If it is the latter, Keane79 has expressed the view that in Irish law “it is accordingly important for the aggrieved shareholder to take all the steps open to him to convene an extraordinary general meeting before he issues proceedings.” Alternatively, “the court may as we have seen convene a meeting itself and would probably do so before embarking on a lengthy trial of the merits in a case when it had not been clearly established that the wrongdoers were in control.”80

However, this may not always be practical or appropriate. Sealy81 observes that this rule is “anachronistic” and ignores the fact that the Board of Directors may have exclusive competence to take the decision to sue. Vinelott J. in his decision at first instance in Prudential Assurance observed that even if such a procedural step were required, in a large company the directors alleged to be liable “might be able to determine the outcome of a resolution in a general meeting in their own favour by the use of proxy votes”82 and he also pointed out that most company Articles of Association vest the management of the business of the company in the Board and that such an article vesting the discretion to sue in the directors “cannot be overridden by a resolution of the general meeting.”83 On balance therefore in this case, there may be no steps open to the aggrieved shareholder prior to issuing the proceedings.

To address this issue many US jurisdictions outline a set of procedural steps that enable the plaintiff litigant to overcome these obstacles. In contrast under English and Irish law there are no clear procedural steps to be taken equivalent

78. (1843) 2 Hare 461 at 494.
80. Ibid.
81. Sealy, above n.60, 503.
82. [1981] 1 Ch. 257 at 324.
83. Ibid.
to the demand stage under the law of the states of Maryland and New York, and there is no clarity as to the establishment of a “special litigation committee” of the Board of Directors or any equivalent body as indicated by the law of those states. The reform proposals will be considered in the next part.

PART IV: PROPOSALS FOR REFORM

The standing of beneficial owners

In relation to standing, the DTI Company Law Review Steering Group considered the position of the beneficial owner of shares. The need for reform of this area is driven by the development of a multiplicity of ownership structures, many of them developed to facilitate investment in companies including, for example, ownership arising from the CREST system of share trading. The regulation of foreign securities trading in the US, which dictates the need to use ADR and ADS agreements in relation to foreign companies trading on the NYSE, is another. Having considered the Steering Group proposals in relation to s. 360 of the UK Companies Act of which s. 123 of the Irish Act is an equivalent, the UK Government White Paper makes the following broad ranging recommendation “the law should be amended so as to make clear that companies are able to recognise, if they wish, rights of holder of beneficial interests in shares at the request of the registered member”,84 but it rejected a further recommendation made by the DTI review group regarding the possibility of compelling some companies in some cases to recognise the beneficial shareowner. It is stated that the “practicality of extending a power of compulsion through statutory instrument to compel companies to recognise rights is being considered.”85 These views are also echoed in Nolan’s article86 and supported by his empirical research demonstrating that many quoted companies, their intermediaries and beneficial shareholders have already adopted a voluntary or privately agreed system. The fact is that such voluntary arrangements would not have assisted the plaintiff in this case and they would have been left similarly without a remedy as the ADS agreement in this case did not provide for such an eventuality and it is believed that the type of agreement used here is standard form. Nolan does state that the “beneficiary can always take court action to recognise his/her rights” 87 but no authority is given for this proposition.88

85. Ibid., para.2.41. These recommendations are now incorporated in Clause E of the draft Companies Bill.
86. Above, n.3.
87. Above, n.3, 79.
Given this current position any document such as an ADR or ADS agreement creates a set of rights that are not clearly identified. The decisions in Tomran and in the other cases which are considered in the judgment, in particular the modern cases which were followed, underline the unsatisfactory position of the beneficial shareholder in comparison with that of a registered shareholder. Where the purpose of an ADR agreement or ADS agreement is to facilitate investment by US residents in “foreign companies” it would seem to be unacceptable that the legislative framework which exists in these “foreign jurisdictions” does not match up to the expectations of the investors. The effect of current legal rules is to defeat the rights of beneficial holders of such securities. Given the reform proposals as they currently stand, with the emphasis placed on voluntary recognition, the barring of claims, such as those in the present case or indeed under section 459 of the English legislation providing a remedy for “unfair prejudice” or the similar section 205 of the Irish Companies Act 1963 on oppression hearings, will still be a reality. The Irish Company Law Review Group has not addressed this problem to date.

Reform of the derivative action

In its final report the UK Company Law Review Steering Group addressed the circumstances in which a shareholder would be entitled to redress against the company. The report endorsed the previous proposals from the Law Commission which included restricting the right of action to breach of directors’ duties only, but this would include breaches of duties of skill and care. The report went on to address two other questions. First it raised a question about the extent to which decisions not to sue by the board or, alternatively, ratification of the directors’ actions present or ought to present a bar to the action. Secondly, it considered the question as to whether issues concerning the admissibility or otherwise of a derivative action should be embodied in legislative form. In relation to these questions the report went on to state that there was a strong case for “simplifying the law on ratification”, a statement that most would find hard to disagree with. It also recommended that questions surrounding the validity of decisions to ratify a wrong on the company by the directors, whether this involved fraud or not, and the validity of decisions by members of the board not to pursue such a wrong should depend on whether the necessary majority had been reached without the need to rely on the votes of the wrongdoers or on those who were substantially under their influence or

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88. A reference is made in this part of the text to Part 73 of the Civil Procedure Rules which seem to be concerned with the granting of stop orders and so forth.
89. Above n.53, para.5.82.
90. Above n.53, para.5.84.
who had a personal interest in condoning the wrong (author’s emphasis). In relation to the second category of issues, the report recommended that where a wrong was not lawfully ratified nor a decision not to sue lawfully taken the best test of whether a derivative action should proceed was whether the minority’s views on the question were the best available evidence of what was in the best interests of the company. If a majority of independent shareholders favoured not pursuing the wrong or ratifying it, that should prevent such an action. The decision to proceed would conceivably rest with the court on a discretionary basis at the case management stage.

The DTI proposals were put forward to clarify a remedy which has always been available to shareholders since the middle of the 19th century. Even with these proposals areas of uncertainty can be predicted. Whilst it seems acceptable to limit the action to decisions of the directors, questions arise, as they always have, regarding the role of the independent majority. On the facts of this case and many others of its kind, how is it possible for the independent majority to be formed? If there is no ratification or indeed no decision to sue or not to sue as in this case, what will the position of the shareholder be? Will the court have a role at the case management stage in convening the meeting to ratify or to consider a suit? Will the court give directions as to who may vote at either meeting? These questions are not raised in a petulant way, but are merely some of the questions that occur even now for a minority shareholder trying to take an action. Keane did say that the shareholder ought, given the current state of the law on derivative actions, take any steps open to it to achieve clarification between the minority view and what was perceived to be the view of the majority, but also acknowledged that in a large modern company this could be almost impossible. One can only conclude that if the proposals were accepted, the court’s case management role could be quite extensive.

PART V: THE CORPORATE GOVERNANCE ISSUES

Minority shareholder protection as a requirement of good governance

The first question in this final part relates to the majority rule principle. It is argued that the effect of the rule in Foss v Harbottle has been overstated, particularly in the last 50 years or so, by corporate law scholars in the British Isles and in other parts of the commonwealth. Coincidentally this has occurred as corporate and managerial power has increasingly become a cause for concern for all scholars interested in corporate governance issues. In contrast in the United States, despite a similar principle of majority rule, the derivative action provides a healthy cause of action for a minority shareholder. (Although not intending to compare the purpose and effectiveness of the “unfair prejudice” remedy or “oppression” in Ireland in this article, it is clear to this author, if
not to others\textsuperscript{92}, that the unfair prejudice remedy will not operate to render management accountable to the company as a whole, as was required in this case. As stated by the Court of Appeal in \textit{Prudential Assurance v Newman Industries (No. 2)} and as reiterated by Sealy there is a distinction between a shareholder who wishes to remedy some diminution of the value of his shareholding or erosion of his or her rights (the English s. 459 or Irish s. 205 remedy) and a shareholder who seeks to remedy a wrong done to the company through a derivative action brought on behalf of the company. Thus Sealy states:\textsuperscript{93}

\begin{quote}
“a shareholder cannot bring a personal claim against a wrongdoer, even in a claim based on fraud or deceit, when the loss which he claims that he has suffered is the diminution in the value of his investment in the company as a consequence of the effect of the fraud on the company. The company alone can sue for such a wrong.”
\end{quote}

The only way therefore for this corporate action to be taken where the controllers refuse to act is through a derivative action. Unfortunately this action is now so restrictive under Irish and English law that it is not a real alternative.

Those who argue that the Anglo-American corporate governance structure is more suitable than continental systems in facilitating investment and capital liquidity because of better minority shareholder protection devices\textsuperscript{94} ignore this and other salient differences on the two sides of the Atlantic. A close and precise reading of the original judgments in \textit{Foss v Harbottle}, without the reinterpretation of principle presented by subsequent judgments, seems to present a clear understanding that these rules are strongly procedural in character.

\textsuperscript{91} See section 459 of the UK Companies Act 1985 and section 205 of the Irish Companies Act 1963. Discussion of the relative merits of this action for minority shareholders is beyond the scope of this article, but the author is firmly of the view that not all issues can be addressed by this remedy as distinct from other causes of action, such as the derivative action.

\textsuperscript{92} For example in Courtney, \textit{The Law of Private Companies} (2nd ed., Butterworths, Dublin, 2002) the statement that the section 205 remedy, equivalent to section 459 in the English legislation drives a “coach and four” through the majority rule principle seems to be overstated to this author. Furthermore the distinction between a corporate action which can be pursued by a minority through a derivative action and a personal section 205 action is central to the decision of the Irish Supreme Court in its decision in \textit{O’Neill v Ryan and Ors} referred to above n.71.

\textsuperscript{93} Sealy, above n.60, 502.

and may be departed from when necessary to allow a meritorious claim to proceed. The purpose of *Foss v Harbottle* has always been understood as providing internal clarity in relation to governance issues. A secondary concern has been to prevent loss to the company through vexatious litigation concerning management decisions. Finally continuous disruption of the conduct of the internal affairs of a company has been a motivating factor in judicial support of the majority rule principle. However, cases such as the present one illustrate the limitations of our current understanding of the *Foss v Harbottle* principle. Effectively as it stands no remedy was available to the company to recover the losses caused by John Rusnak’s trading. This action would have had a far better chance of success under US state law. Similarly, the standing issue directly contradicts one of the goals of modern company law: to facilitate investment through capital markets. The dangers inherent in investing through ADRs and ADSs are only now becoming apparent.

### The cost of governance

The costs of taking a derivative action claim are always considered to be an additional barrier in the British Isles. It has been observed that in the US,95 the plaintiff bar is the driver of the derivative action because unlike the plaintiff there are immediate gains to be taken by the plaintiff’s attorney if the case is either successful or settled. In the British Isles, the same incentive for the attorney to act should apply as the lawyer will be paid regardless of the lack of immediate gain to the plaintiff but the same level of activity is not present. Under the default costs rule in the United States, there is no disincentive for the plaintiff or her attorney in that if the action is lost there is no danger of the plaintiff having to pay the company’s costs and the costs of the other defendants. Even where the costs rule, normally applicable in the British Isles, that loser pays all is in normal circumstances a disincentive to litigation, in this particular context, the disincentive is not as great as it is in other actions. Generally in a derivative action case, the claimant may seek indemnity for costs from the company as in *Wallersteiner v Moir (No.2)*,96 although the granting of such indemnity is dependant on the making out of a prima facie case, or as stated by Walton J. in *Smith v Croft* the establishment to the court’s satisfaction that an independent Board of Directors would in the circumstances have authorized such an action on behalf of the company. Far from acting as a disincentive, it could be argued


96. [1975] 1 Q.B. 373.
that this provides some additional assurance for the British or Irish plaintiff’s lawyer.

On the other hand it is true that for the plaintiff the economic incentive to take and pursue an action is a lot less than that presented to the management of the company to defend such an action, particularly in cases such as these. Given these real financial difficulties, it is extraordinary how, procedurally and substantively, the law has developed to provide additional disincentives to prospective plaintiffs. The argument of course can be viewed from two perspectives. Against the plaintiff shareholder it can be argued that the availability of the derivative action encourages frivolous and vexatious litigation and therefore this action needs to be rigorously controlled.97 Alternatively, the derivative action could be used as a legitimate corporate governance tool to redress the concerns which all corporate governance scholars have with issues centred on management accountability and lack of shareholder voice. This article argues that the derivative action as originally conceived presents a real opportunity for active corporate governance. Therefore, any recommendations, such as those emanating in the UK, which provide procedural clarity and substantive opportunities ought to be welcomed.

**Legal rules and private remedies or “non-legally enforceable norm”**

This final part considers issues raised by the subsequent actions of the Board of AIB and its subsidiaries and the subsequent trading history. Allied Irish Banks continues to be a highly profitable company generating considerable income from its domestic banking operations, where as was stated at the beginning of this article it is a major player in what could be described as an oligopolistic market. It is also successful in other areas. In July 2004 the report on the half-year to June 2004 noted an increase in earnings per share of 10% to Euro 64.4 cents and an increase of 13 % in the profitability of, *inter alia*, its US operations.98 Because of its profitability in governance terms it continues to comply with the primary imperative from its shareholders. This is the case despite the trading losses suffered at the hands of John Rusnak and also despite considerable trading losses incurred by its other foreign operations, primarily in Poland.99 Perhaps in response to these difficulties, or otherwise, the last two

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97. See Dooley, above n.2.
99. See interim report from the company posted on July 29, 2003 which gives profit and loss statements for the half year to June 30, 2003. This report showed that whilst Allied Irish Bank figures improved from 2002 to 2003 in its domestic banking operations from 294 million to 310 million in 2003 and in its operations in Great Britain and Northern Ireland, from 117 million to 125 million it suffered losses in
years since this rogue trading scandal have witnessed a number of changes in AIB. AllFirst was sold, as has been described in the Introduction. There have been management changes at headquarters in Dublin, in particular a new Chairman has been appointed who is a member of the Irish bar and a former Attorney General. Others have resigned. Finally AIB has embarked on a significant buyback of its shares, including those traded on the NYSE. At this point it has purchased almost 900,000 shares at the price of 12.40 Euro per share.\textsuperscript{100}

Throughout the history of this trading scandal it is clear that the Board of AIB has been very proactive in seeking to allay investor fears in relation to the losses caused, underscored by the appointment of the investigating team, which led to the publication of the Ludwig report. The goal presumably is to achieve some sort of resolution of the issues which this scandal raised, and for the most part this strategy seems to have been effective. Most shareholders seem to be content with the resolution if one is to judge by investor confidence as reflected in share price and by various business and media reports. The shareholders have laid down their metaphorical swords and why should they not?

On the other hand not all stakeholders may be satisfied. During the summer of 2004 new problems have continued to be aired by the media causing further trouble for the management of AIB. These include reported deficits in its pension funds, questions regarding management involvement in some tax avoidance schemes, issues regarding overcharging of customers in relation to foreign trading and irregularities in its student banking activities.\textsuperscript{101}

However, the proactive stance of the Board of AIB and the fact that the central governance concerns have been satisfied raise interesting theoretical questions regarding the function of norms as distinct from legal rules, particularly in this corporate governance context. This has been a matter of considerable academic debate in the United States where a debate on the relationship between economic theory and social norms led initially to an investigation of how social norms affect behaviour in addition to economic motivations.\textsuperscript{102} This debate

\textsuperscript{100} As of November 2003.

\textsuperscript{101} “Serious questions raised about AIB’s corporate culture” \textit{The Irish Times}, June 23, 2004. In addition some serious matters were raised about the relationship between some senior management at AIB and a British Virgin Island company, Faldor whose “origins and activities” indicated possible tax evasion. “Unacceptable deal allocations a ‘thing of the past’–Buckley”, \textit{The Irish Times}, June 23, 2004.

has been extended to the relationship between law and norms of behaviour, usually classified as non-legally enforceable norms. One of the points made by those who consider NLERs to be effective in monitoring managerial performance is that adherence to norms of behaviour seems to work particularly well when the nature of the community is closed and where reputational interests are extremely valuable. This is clearly a useful analysis in this case in view of the membership of the board of AIB, the importance of reputation to its members and the close knit character of the Irish business and financial community.

CONCLUSION

For those of us interested in the larger issues raised by cases such as this many questions remain as to the adequacy of remedies as expressed in legal rules as compared with the resolution of these difficulties through the operation of non-legally enforceable norms. In particular, the derivative action as a minority shareholder governance mechanism seems to be almost a dead letter. Whether it can be revived through judicial interpretation and legislative reform is an important governance question. On the other hand, academics in the United States have done considerable research on why corporate law is designed to facilitate the operation of “non-legally enforceable norms” to achieve good governance outcomes. If, as seems to be the case here, the non-legally enforceable norms work as accountability mechanisms, what role is there for legal rules of any sort or indeed what role is there for the rules of company law as they currently stand? In light of the inadequacy of legal rules to achieve the shareholders’ governance requirements in this case, the question simply is whether good corporate governance is a public good and whether, like justice, it must be seen to be done? These questions will be returned to in a later article. At present, the first conclusion is that company law does not seem to be the most significant governance mechanism available to shareholders or other stakeholders and management.

106. As it happened, because of the international nature of this case, the company law of a number of jurisdictions influenced the outcome of the case including Irish company law, (which closely resembles that of existing company law provisions in the UK, leaving aside for the moment recommendations from the DTI Company Law Review), the law of the State of Maryland and other US jurisdictions and several other common law jurisdictions.