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Abstract

This article considers the approaches to the remedies which are available to minority shareholders for conduct by the majority alleged to be oppressive, unfairly prejudicial or discriminatory. In doing so it focuses, inter alia, on the statutory provisions now contained in sections 232-3 of the Corporations Act 2001 Cth.

Keywords

minority shareholders, remedies, corporate law, alternative dispute resolution

MINORITY SHAREHOLDER REMEDIES – SHIFTING DISPUTE RESOLUTION PARADIGMS

By John H Farrar and Laurence J Boulle⁺*

Introduction

This article considers the approaches to the remedies which are available to minority shareholders for conduct by the majority alleged to be oppressive, unfairly prejudicial or discriminatory.¹ In doing so it focuses, inter alia, on the statutory provisions now contained in sections 232-3 of the Corporations Act 2001 Cth.

There are many forms of oppressive, prejudicial and discriminatory conduct and some account needs to be taken of these different manifestations when discussing appropriate remedies. They include: the exclusion of minority shareholders from management, the withholding of dividends, provision of excessive salaries to majority shareholder employees of the company and other forms of self-interested dealings, mergers, dissolutions and asset sales which are to the disadvantage of minority shareholders, improper use of assets, the diversion of profits to the majority shareholders, the failure to provide information, removal as directors, and general mismanagement of the business and basic lack of fair play.

Historically, the remedies for different forms of oppressive conduct against the minority have resulted in two main forms of practical outcome. The first has been winding up of the company. The second has been a buy-out of the minority's shares, the purchase being made either by majority shareholders or by the company itself. There have also been other less significant outcomes involving relief under the other provisions of section 232-3 of the Corporations Act 2001 or the general law. In addition there have been the outcomes which are a function of the absence of

* Professor of Law, Bond University and Professorial Fellow, University of Melbourne. The discussion in this article of the English Law Commission's Discussion Paper and Report on Shareholder Remedies is mainly based on *Farrar's Company Law* (1998, 4th ed), Butterworths, London by JH Farrar and B Hannigan. For a very useful and up to date analysis of the UK position see Brenda Hannigan, *Annotated Guide to the Companies Act* (2001) 915-928.

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¹ See the issue of the *Company Lawyer* devoted to this question and the reform proposals (1997) 18 *Company Lawyer* 8.

adequate or efficient remedies: high costs, diversion of management time and resources, loss of profitability, heightened personal antagonism and sometimes criminal conduct, loss of staff loyalty and customer base.

A central theme of this article is that minority shareholder remedies have been conceived within two dominant paradigms, one based on 'rights' and the other based on 'interests'.² The first derives from the original rule in *Foss v Harbottle*³ which was a 'rights based' paradigm and restrictive. The second is a more liberal 'interest based' paradigm reflected in the House of Lords decision in *Ebrahimi v Westbourne Galleries Ltd*⁴ and subsequent reforms to the statutory shareholder remedy and the derivative action.

The second paradigm is now undergoing a conservative revision by the courts in the United Kingdom which arguably reflects some misunderstanding of the judicial role under the legislation. There is a need for the development of a new third paradigm which, while retaining an interest based approach, would develop minority shareholder remedies within the context of changing approaches to civil procedure and the potential application of alternative dispute resolution processes. These changes are already reflected to some extent in Australia in the case management powers of the court under the new derivative action procedure in Part 2F.1A of the Corporations Act 2001 (Cth) and in England and Wales by the Civil Procedure Rules 1998 (SI 1998/3132).

This article will seek to develop the theoretical and structural basis of the third paradigm.

Sources of Minority - Majority Conflict

In contemporary dispute resolution terms it is appropriate to consider the sources of conflict between minority and majority shareholders in the modern company as a pre-requisite to a consideration of possible remedies.⁵ The source of the conflict provides one basis for dealing with the important 'diagnostic' question, namely which dispute resolution process is appropriate for which kind of dispute. It is suggested here that there are four major sources of conflict between the two groups:

Structural

In some situations conflict is caused by structural arrangements which provide certain advantages, or perceived advantages, to some persons over others, such as access to

² The distinction between 'rights based' and 'interest based' approaches to dispute resolution is dealt with below 5-6.

³ (1843) 2 Hare 461.

⁴ [1973] AC 360.

⁵ See for example Bernard Mayer, *The Dynamics of Conflict Resolution*, (2000) 8-16, Laurence Boulle, *Mediation: Principles Process Practice* (1996) 43-4.

information, control of resources or the institutional allocation of authority. In the context of company systems decision-making, through majority rule may be a structural cause of conflict in the legal framework in that it allows majority shareholders to prevail over the minority. This can of course be advantageous where there is a need for decisions to be made without the threat of deadlock but it can also lead to oppression and other forms of injustice for the minority. A second example of a structural cause of conflict is the overlap between ownership and management control, and a third is constituted by the restrictions on the ability to sell shares to third parties. The second and third examples are frequently found in proprietary companies.

Absence of Information and Factual Complexity

Absence of information and factual complexity are two sides of the same coin, which can both be sources of conflict. The absence of information can be a source of conflict where particular information is withheld by the majority shareholders and can cause suspicion and a loss of trust for the minority. Where the information is present it might be disorganised, complex and susceptible to different interpretations by protagonists and their advisers. In many company situations the dispute will have arisen in relation to past events and there will be different historical versions of what transpired. A common area of factual complexity relates to valuations, where there may be differences over both the relevant facts and the appropriate methodologies to be applied.

Personal Relations Breakdown

As in any closed social system a breakdown in the personal relations between directors, shareholders and employees can be a cause of conflict, or can at least exacerbate conflict caused by other factors. The breakdown can be caused by loss of trust, poor communication, stereotypes of gender or class, or high levels of emotion. Emotions can become the controllers of behaviour, particularly where there have been repetitive patterns of negative interaction over time. Personality clashes, cultural or gender tensions, autocratic or uncooperative behaviour, the death of a founding or key shareholder and the drive of superior talent all figure in analyses of conflict in this context.

Shortage of Resources

Conflict can be caused by a shortage, or at least the finite nature, of resources. In this zero-sum situation the more that is received by one individual or group, the less there will be available for others. In the company situation directorships, management and employee positions, dividends and tangibles are all resources of a finite nature and the more one receives, the less there will be for others. In a competitive world the limited nature of such resources may be a major source of conflict, often exacerbated by the other sources of conflict referred to above.

Diagnosing Conflict in the Corporate Environment

In reality the causes of conflict in the corporate setting are multi-variate and a problem triggered by, say miscommunication, can escalate because of structural or inter-personal reasons. Conflicts are also never static, and they can escalate over time, often well beyond the original presenting issue – de-escalation also occurs but not as frequently. There is a current view in dispute resolution theory and practice that some kind of ‘diagnostic’ assessment of the nature of conflict provides an initial basis for determining an appropriate form of intervention. Thus where the source of conflict is found in the absence of information, mechanisms are required to have information obtained, assessed, verified and evaluated. Where it is caused by relationship breakdown, it is best dealt with through appropriate communication between the respective parties. This perspective could be significant in dealing with the concerns of minority shareholders as against the majority.

Levels of Responding to Conflict

Modern dispute resolution theory also identifies different levels at which conflict can be dealt with.⁶ This again acknowledges the diversity in the nature of conflicts and the need for different matters to be dealt with at different levels.

Power Responses

Conflict can firstly be dealt with through a competitive contest, of varying degrees of civility or destructiveness. At this level the more powerful group or individual can determine outcomes according to their needs and wishes. Majority rule within company decision-making is an obvious form of response to conflict at this level - the majority view prevails and the minority is required to submit to it. In corporate life power is also exercised in the board room, the general meeting, the chief executive’s office, by managers and supervisors at the coal-face, and more informally in the ‘corridors of power’.

The power-based processes can be entirely appropriate ways of dealing with conflict where decisions have to be made, sometimes with urgency, and the business developed in particular directions. Thus where conflict is occasioned by a shortage of

⁶ See generally on this topic the ‘dispute systems design’ texts such as W Ury, J Brett and S Goldberg *Getting Disputes Resolved: Designing Systems to Cut the Cost of Conflict* (1988), J Brett, S Goldberg and W Ury *Managing Conflict: The Strategy of Dispute Systems Design* (1994), and C Costantino and C Merchant *Designing Conflict Management Systems – a Guide to Creating Productive and Healthy Organizations* (1966). For a comprehensive Australian perspective see B Wolski ‘13.7 Dispute Systems Design’ in Title 13 The Laws of Australia (1993-).

resources it might be entirely appropriate to respond at the power level. However, power-based processes can be partisan, oppressive and prejudicial to the minority. Less civilised forms of power contest can include duress, threats, blackmail, victimization or fraudulent conduct by one or other group. It is where there is an abuse of power, which overrides the rights and interests of the company minority, that more substantial processes are required. It may be possible, as will be suggested,⁷ to provide some standard response to the abuse of power through the presumption of prejudicial conduct in the legislation.

Legal and Rights Based Responses

The second level at which conflict can be handled is that of 'rights'. In this context the concept of rights usually refers to the rules, norms or principles contained in an authoritative legal source such as a contract, constitution or statute. The term can also be used more loosely to refer to other normative standards, such as codes of self regulation or less formal standards such as 'company policy', 'the traditions of the firm', or 'normal commercial practice'.

In all these cases a rights approach just entails ascertaining the facts of the situation, after which an objective standard can be applied to them in order to resolve the dispute. This can be done by a body, such as a court, tribunal or arbitrator which is independent of the parties and disinterested in the outcome. It can also be done by the board of directors or chief executive, in which case the process is not an independent and disinterested one. Where minority shareholders resort to litigation they are seeking a right-based solution to the dispute at hand and this may be done without consideration of other approaches. Sometimes the rights-based approach may be entirely appropriate, for example where there are structural problems which have given rise to systematic patterns of discrimination or disadvantage.

Interest-Based Responses

Much of the dispute resolution literature emphasises the importance of dealing with conflict, at least initially, at the level of interests.⁸ Here the term 'interests' refers to the motivating needs or concerns of the parties, both personal and commercial. Interests⁹

⁷ See below, 23-4.

⁸ See, for example, G Tillett *Resolving Conflicts – A Practical Approach* (1999) 63-74.

⁹ The concept of 'interests' is not without controversy and within the literature distinctions are drawn between subjective and objective interests and between instrumental and ultimate interests. See for example C Provis 'Interests vs Positions: A Critique of the Distinction' (1996) 14 *Negotiation Journal* 305. While the interests approach has its merits it is sometimes difficult to apply. Jeremy Bentham in *An Introduction to Principles of Morals and Legislation*, J Burns and HLA Hart (eds) (1970) said 'interest is a primitive term with no known genus'. See also Rudolf von Jhering, *Law as a Means to an End*, (1968) Chapter III. Von Jhering's approach was adopted by Dean Roscoe Pound in his

are generally more subjective and 'soft' in nature than legal rights. An approach at the level of interests also involves consideration of the future to a greater degree than rights approaches which tend to focus on past events. Thus while minority shareholders might settle for a legal buy out of their shares, their interests might revolve more around increased future participation in management and provision of necessary information. The modern ADR movement focuses largely on shifting disputing parties away from a conceptualization of the problem in terms of their competing rights and towards one which identifies their multiple interests, which might, besides being conflicting, also be overlapping and compatible in part. The dispute system design literature has a similar preoccupation with dealing first with the parties' underlying interests before resorting to a rights-based determination. In the corporate context the interest approach will tend to be appropriate where disputes have been caused by personal relations breakdown.

Prevention

Prevention, as the term implies, involves parties anticipating the future possibility of disputes in their business or personal affairs and making choices about ways of avoiding them or dealing with them when they eventuate. Prevention is claimed to be a high priority of good dispute resolution in terms of the efficiency and effectiveness it provides and it is the foundation of dispute systems design.¹⁰ In order to prevent disputes emerging in the first place emphasis can be placed on effective methods of communication, audits of dispute resolution methods, education and training and other preventative devices. Where a dispute does emerge the emphasis is on early and cost-effective intervention with the object of reducing the impact of the dispute and preventing its escalation; this suggests the need to attempt interest- and rights-based approaches before resorting to power.

In the corporate context it might be appropriate to deal through preventative mechanisms with disputes which might emerge for structural reasons or because of the absence of factual information. Contractual undertakings among shareholders, model articles and exit articles all have preventative dimensions. Experience suggests, however, that there are limits to the perceived advantages of full-scale dispute systems design in the modern corporation concerned with the short term bottom line and competitive advantage in changing economic circumstances.

many writings. See 'A Survey of Social Interest' (1943-4) 57 *Harvard Law Review* 1 and *Jurisprudence* (Vol III). As to the relationship between 'interest' and 'right' see R Pound, *Interpretations of Legal History*, (1923) 159.

¹⁰ On this topic generally see Brett Goldberg and W Ury *Managing Conflict: The Strategy of Dispute Systems Design*, Business Week Business Service, New York, 1994, Costantino and Merchant *Designing Conflict Management Systems* Jossey-Bass, San Francisco, 1996 and Bobette Wolski, 'The Model Dispute Resolution Procedure for Australian Workplace Agreements: A Dispute Systems Design Perspective' (1998) 10 *Bond Law Review* 7.

The analysis which follows refers to the models of dispute resolution which have been used in the past, and to possible models for the future.

Dispute Resolution Processes

In recent years there has been a proliferation of dispute resolution processes, each with its own theoretical assumptions and operational procedures, much of it under the rubric of alternative dispute resolution – ADR.¹¹ Here reference is made to those processes which involve the intervention of a third party, without reference to the degree of independence or neutrality of the third party individual or group. What follows is a basic typology which distinguishes among broad categories of dispute resolution process:¹²

Facilitative processes

Facilitative dispute resolution processes are those in which a third party to the dispute assists the disputants in their decision-making, without having the capacity to impose a binding decision on the parties. There is debate on the appropriate forms of assistance which can be rendered in the facilitative category of dispute resolution processes. In most approaches it would include assisting the parties in coming together, in preparing, in communicating appropriately, in negotiating productively, in considering options for settlement and in dealing with all relevant issues. There would be differing views over the extent to which the third party could express an opinion, provide advice (legal or other), or recommend a solution for the parties.¹³ Mediation and conciliation are the most common forms of facilitative dispute resolution, although in some contexts there may be unclear boundaries with the advisory category. They would be associated with the interest-based and preventative approaches to dispute resolution referred to in the previous section.

Advisory processes

Advisory dispute resolution processes also involve the intervention of a third party in the dispute, but here it is with the objective of ‘guiding’ the parties to an appropriate outcome. This intervenor also lacks the capacity to impose a binding decision on the

¹¹ See generally H Astor and C Chinkin, *Dispute Resolution in Australia* (1992), L Boulle, *Mediation Principles Process Practice* (1996), R Charlton, *Dispute Resolution Guidebook* (2000), T Sourdin, *Alternative Dispute Resolution* (2002). On ADR in the United Kingdom see H Brown and A Marriott *ADR Principles and Practice* (2nd ed, 1999) and L Boulle and M Nestic, *Mediation Principles Process Practice (UK edition)* (2001)

¹² See National Alternative Dispute Resolution Advisory Council, *Alternative Dispute Resolution Definitions*, Canberra (1997). These definitions have tended to be accepted over the years in the literature, in the promotion of ADR services and in documents specifying ethics and standards for ADR practitioners.

¹³ See B Wolski ‘Mediator Settlement Strategies: Winning Friends and Influencing People’ (2001) 12 *Australasian Dispute Resolution Journal* 248.

parties. The guidance can be provided in relation to the facts of the dispute, the law, matters of technical expertise or to likely court outcomes if the matter does not settle. It can be effected through the provision of information, the expression of an opinion, recommendation or advice, or by being critical or judgmental about the parties' bargaining positions or rights claims. There can be greater or lesser degrees of subtlety or forcefulness in the third party's exercise of these functions. However all the advisory processes, unlike the facilitative forms of dispute resolution, require some degree of experience or expertise in the substantive matters in dispute. Examples of the advisory processes are case appraisal, non-binding expert determination, early neutral evaluation and similar systems practised under different names in different jurisdictions.¹⁴ These processes are associated with a rights-based approach to dispute resolution, as referred to in the previous section, but they also accommodate interest-based elements.

Determinative processes

The determinative dispute resolution processes are those in which the third party has the authority to impose a decision on the parties and this decision is binding to a greater or lesser degree. The authority of the intervener can derive from statute, contract, a referring court or other authoritative source. The most common form of determinative ADR is arbitration,¹⁵ and other forms include binding expert determination. These processes are associated with the rights-based approach to dispute resolution, referred to earlier, although they too can accommodate interest-based elements.

Dispute resolution processes in the corporate environment

In relation to the themes of this article it can be seen that historically the law developed a rights based, determinative approach through the rule in *Foss v Harbottle*¹⁶ and its exceptions, which were restrictive of minority shareholder actions. Because of these restrictions parliaments in many jurisdictions introduced a statutory remedy, but this too proved to be too narrow and restrictive and did not effectively curb the power of the majority. Out of despair minority shareholders had to resort to the drastic remedy of seeking winding up on the just and equitable ground, another

¹⁴ In Australian jurisdictions advisory ADR is practiced mainly in Queensland where it is known as case appraisal. Courts may refer matters to case appraisal and in terms of the relevant legislation the case appraiser has the power to express an opinion on issues of both liability and quantum. The opinion is not binding but where a litigant rejects it and does worse at a subsequent hearing there can be an adverse costs order against them notwithstanding their success at trial. See Supreme Court of Queensland Act 1991 (Qld), s 100D and the Uniform Civil Procedure Rules (Qld), Ch 9 Part 4.

¹⁵ In Australia arbitration is regulated by the uniform Commercial Arbitration Acts enacted in all the States, see, for example, the Commercial Arbitration Act 1984 (NSW).

¹⁶ Above, note 2.

rights-based determinative approach. This was a terminal and destructive remedy in its nature but the presentation of a petition often motivated the majority to arrive at a settlement which accommodated some of the minority interests but still reflected the power of the majority. Later the statutory remedy was reformed, and more recently there has been the introduction of a statutory derivative action as well as remedies such as a statutory injunction and order for inspection of books and documents which reflect some of the contemporary approaches to responding to conflict and dispute resolution.

The corporate and commercial areas have been highly receptive to the introduction of ADR processes, since the very start of their modern existence.¹⁷ This was promoted initially by the attraction of the business community to processes which were less costly and more time efficient than the traditional litigation process and which could provide remedies more suited to commercial realities than to legal niceties. It was reinforced more recently by strong judicial acceptance and endorsement of ADR processes¹⁸ and by the increasing use of ADR within case management systems.¹⁹ While extravagant claims should not be made about mediation, there is evidence that it can improve relationships for the future,²⁰ a significant issue for corporate life.

The First Paradigm

The rule in *Foss v Harbottle*²¹ was based on the traditional reluctance of the courts to second guess business judgment. It stipulated that for any wrong done to a company the company was the proper plaintiff and normally the company would operate by majority rule. As Lord Davey said in *Burland v Earle* in 1902:²²

It is an elementary principle of the law relating to joint stock companies, that the court will not interfere with the internal management of companies acting within

¹⁷ See, for example, P Dwight, 'Commercial Dispute Resolution: Some Trends and Misconceptions' (1989) 1 *Bond Law Review* 1, M Fulton, *Commercial Alternative Dispute Resolution in Australia* (1992). In Australia ADR has also been used extensively in the development of industry-based dispute resolution schemes, such as in the banking and insurance industry – See T Sourdin, n 11 above, 120-2.

¹⁸ There are many illustrations of this. See, for example, the views of the Chief Justice of New South Wales that ADR is an integral feature of the court system, J Spigelman, 'Mediation and the Court' (2001) 39 *Law Society Journal* 62

¹⁹ Here case management refers to the introduction of managerial interventions in the litigation process conducted by judges or other court officials, operating both generally in civil procedure and specifically in relation to interlocutory proceedings and involving the use of ADR processes in the discretion of the court. On case management generally see T Sourdin 13.4 Case Management, 13 Dispute Resolution, *The Laws of Australia*, (1993-).

²⁰ S Caspi Sable 'Changing Assumptions about Mediation in Commercial Matters: Resolving Disputes and (Re)Building Relationships (2001) 12 *ADRJ* 180.

²¹ Above n 2.

²² [1902] AC 83, 93 (PC)

their powers, and in fact has no jurisdiction to do so. Again, it is clear law that in order to redress a wrong done to the company, or to recover moneys or damages alleged to be due to the company, the action should prima facie be brought by the company itself. These cardinal principles are laid down in the well-known cases of *Foss v Harbottle* and *Mozley v Alston*.

The references to ‘wrongs’ and ‘money or damages’ clearly reflect judicial predisposition towards rights-based dispute resolution effected through court determination, but only at the instigation of the majority shareholders. In this respect the power of the majority ruled. The rule was, however, subject to exceptions which also enabled minority shareholders to sue. These related to ultra vires or illegal conduct, circumstances where a special procedure had not been followed, where personal rights were infringed, where there was fraud on the minority or where the interests of justice required it.²³

The rule was first a recognition that the court wished to avoid a multiplicity of suits and thus ‘is not required on every Occasion to take over the Management of every Playhouse and Brewhouse in the Kingdom’,²⁴ which would open the floodgates. It was secondly a recognition that the company is a separate entity, distinct from its members. The rule operated with considerable rigour to inhibit shareholder action in spite of ingenuous suggestions by learned academics²⁵ and misconceived enthusiasm by the UK’s largest institutional investor in one leading case.²⁶

The rule established a rights based system which inhibited shareholders’ suits and did little to counter-balance the power of the majority. The scope of the exceptions was the subject of considerable uncertainty. Thus the ‘personal rights’ category was ill defined and the ambit of fraud on the minority and its relationship to ratification by the general meeting were also the subject of considerable controversy. Some of the difficulties in the use of rights-based approaches were due to the basic problem of distinguishing clearly rights of the company and personal rights of shareholders.²⁷

The shortcoming of the rule led to the introduction of the statutory remedy in section 210 of the UK Companies Act 1948. However, this was originally limited to oppression as a member and was not widely used. It was, however, adopted in Australia.²⁸

²³ See JH Farrar, *Corporate Governance in Australia and New Zealand* (2001), Chapter 18.

²⁴ *Carlen v Drury* (1812) 1V&B 154.

²⁵ See the summary in PL Davies (ed) *Gower’s Principles of Modern Company Law* (6th ed, 1997) 666.

²⁶ *Prudential Assurance Co v Newman Industries Ltd* [1982] Ch 204.

²⁷ See Gower, above n 25.

²⁸ See the Victorian Companies Act 1958, s 94. However the wording was changed in some respects in s 186(2) of the Companies Act 1961. See *Re Bright Pine Mills Pty Ltd* [1969] VR 1002, 1011.

The Second Paradigm

The Jurisprudence of *Ebrahimi v Westbourne Galleries Ltd*

The second paradigm dates back to 1972 and the House of Lords decision in the leading case of *Ebrahimi v Westbourne Galleries Ltd*.²⁹ This was a case of a partnership of two Persian carpet dealers in London, which was subsequently incorporated. Later the son of one of the directors was made a director and given shares. The father and son ganged up on the other director, Ebrahimi, who was removed from office. All the profits were distributed as directors' remuneration.

Mr Ebrahimi sued on the basis of the statutory minority shareholder remedy, which was then limited to oppression as a member, and [also sought] winding up on the just and equitable ground. He failed on the first but succeeded on the second. Lord Wilberforce delivering the leading speech reformulated the basis of the just and equitable winding up jurisdiction. He abandoned the earlier approach of strict categorisation and referred to some Australian cases which he cited with approval. He said:³⁰

My Lords, in my opinion these authorities represent a sound and rational development of the law which should be endorsed. The foundation of it all lies in the words 'just and equitable' and, if there is any respect in which some of the cases may be open to criticism, it is that the courts may sometimes have been too timorous in giving them full force. The words are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure. That structure is defined by the Companies Act and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The 'just and equitable' provision does not, as the respondents suggest, entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way.

It would be impossible, and wholly undesirable, to define the circumstances in which these considerations may arise. Certainly the fact that a company is a small one, or a private company, is not enough. There are very many of these where the association is a purely commercial one, of which it can safely be said that the basis of association is adequately and exhaustively laid down in the

²⁹ [1973] AC 360.

³⁰ Ibid, 379A-G.

articles. The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company - so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

It is these, and analogous, factors which may bring into play the just and equitable clause, and they do so directly, through the force of the words themselves.

This part of the judgment has three important implications. The first is that, instead of formulating a general approach based on good faith, the House of Lords attempted to formulate objective standards of fairness to be observed by the majority shareholders. Secondly, the decision reflected a greater willingness by the judiciary to intervene in the affairs of companies than was recognised under the first paradigm. Thirdly, the House of Lords showed a willingness to consider unfairness in a capacity other than that of shareholder.³¹ These three aspects determined the character of the second paradigm and reveal more openness to the array of competing interests present in any company situation.

The Influence of Ebrahimi

The decision in *Ebrahimi* was influential and was followed throughout the British Commonwealth.³² It also played its part in influencing law reform which led to reformulation of the statutory minority shareholder remedy, expanding the grounds for relief, and also to the enactment of statutory derivative action procedures. The extension of the statutory remedy to unfairly prejudicial conduct was recommended by the UK Jenkins Report³³ in 1962 although the phrase had been used in connection with variation of class rights since 1928. The first British Commonwealth jurisdictions to adopt the reform were Canada in the 1970s³⁴ followed by the United Kingdom³⁵ in 1980 and Australia³⁶ in 1981.

³¹ See the useful article by DD Prentice, 'Winding Up on the Just and Equitable Ground: The Partnership Analogy' (1973) 89 LQR 107.

³² See Gower, above n 12, 321 and Farrar, above n 23.

³³ Cmnd 1749 (1962).

³⁴ *Ontario Business Corporations Act 1970, Canada Business Corporations Act 1975.*

³⁵ *Companies Act 1980, s75.*

³⁶ *Companies Act 1981, s 320.*

Ebrahimi was first used in the interpretation of the new wording in Canada in *Diligenti v RWMD Operations Kelowna Ltd*³⁷ in 1976. The central idea of an equitable recognition of the understanding of the parties thereafter become the basis of intervention. This led to an interest based, rather than rights based, approach to minority shareholder redress. This was characterised in the drafting of the legislation by a more principled approach, using the categories of indeterminate reference of oppression, unfairly prejudicial and discriminatory conduct and conduct contrary to the interests of the members as a whole.

This difference of approach was noted by Richardson J in the New Zealand Court of Appeal in *Thomas v HW Thomas Ltd*³⁸ in 1984 where he said:³⁹

The foundation of the jurisdiction under the recast provision is a complaint by a member of oppression, unfair discrimination or unfair prejudice to him in the conduct of the affairs of the company or in acts of the company.

He continued later by referring to the particular wording of the New Zealand section at that time:⁴⁰

Putting the focus of the compendious expression 'oppressive, unfairly discriminatory, or unfairly prejudicial' on the justice and equity of the particular case harmonises the test under subs (1) with the just and equitable standard provided under subs (2). And as to that, the well-known statement of Lord Wilberforce in *Re Westbourne Galleries Ltd* [1973] AC 360 is equally apt under s 209.

Having cited Lord Wilberforce in *Ebrahimi* he said:⁴¹

In the same way it is the unfairly detrimental effect of the conduct of the company on the interests of the complaining member which brings into play the just and equitable subs (2) of s 209. That detriment may be to the financial interests of the member as a member or it may be conduct which is adverse to his interests in other capacities, as where, for example, he is excluded from management participation in the company. Where the member is adversely affected in that sense, the determination as to whether it is unjustly so within subs (1) calling for the granting of relief under subs (2) must turn on an overall assessment of the position in the company. Fairness cannot be assessed in a vacuum or simply from one member's point of view. It will often depend on weighing conflicting interests of different groups within the company. It is a matter of balancing all the interests involved in terms of the policies underlying the companies legislation in general and s 209 in particular: thus to have regard

³⁷ (1976) 1 BCLR 36.

³⁸ [1984] 1 NZLR 686.

³⁹ Ibid, 693.

⁴⁰ Ibid.

⁴¹ Ibid, 694-5.

to the principles governing the duties of a director in the conduct of the affairs of a company and the rights and duties of a majority shareholder in relation to the minority; but to recognise that s 209 is a remedial provision designed to allow the Court to intervene where there is a visible departure from the standards of fair dealing; and in the light of the history and structure of the particular company and the reasonable expectations of the member's interests arising from the acts or conduct of the company in that way is justifiable.

His honour seems to have arrived at some sense of bridled, rather than unbridled, fairness doctrine in relation to the legislation, with particular emphasis on balancing the various interests of relevant parties. *Thomas* was cited with approval by the High Court in *Wayde v NSW Rugby League Ltd*⁴² in 1985 and in many subsequent Australian cases.⁴³

This reveals a shift in emphasis to an interest based approach⁴⁴ to dealing with conflicts, but still within a determinative procedure. The attempt to distinguish between corporate and personal rights seems to have been abandoned in this jurisdiction. The grounds of relief and the remedies seem to confuse the two, no doubt reflecting the impossibility of drawing a sharp line between them.

Conservative Revisionism in the UK

Over a number of years Lord Hoffmann sitting at different levels has expressed scepticism about minority shareholder actions and commented critically about litigation practices.⁴⁵ In 1999 he had the opportunity of expressing his views at the highest level in the House of Lords in *O'Neill v Phillips*⁴⁶. This was an application under the English minority shareholder section. The case concerned a building company where the owners gave the plaintiff, an employee, a minority shareholding and directorship. Later he acted as a de facto managing director. There were discussions about an increased shareholding but these never came to anything. Later still the company experienced a down turn and the plaintiff left the company and brought an application under section 459 of the UK Companies Act 1985. The plaintiff

⁴² (1985) 180 CLR 459.

⁴³ See Farrar, above n 23.

⁴⁴ See also *Re JE Cade & Son Ltd* [1992] BCLC 213 noted by S Griffin, 'Defining the Scope of a Membership Interest' (1993) 14 *Company Lawyer* 64; *Re Sam Weller and Sons Ltd* [1990] Ch 682, 690.

⁴⁵ See the cases cited in *O'Neill v Phillips* [1999] 1 WLR 1092, 1093-4.

⁴⁶ [1999] 1 WLR 1092. Cited in *Fedorovitch v St Aubins Pty Ltd* (1999) 17 ACLC 1558, 1560 and *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd* (2001) 37 ACSR 672. Noted by J Payne and D Prentice (1999) 115 LQR 587; R Goddard (1999) CLJ 487 and AJ Boyle (2000) 21 *Company Lawyer* 253. See also the valuable article by G Shapira, 'The Hand that Giveth is the Hand That Taketh Away – *O'Neill v Phillips* and the Shareholder Legitimate Expectations' (2000) 11 *Australian Journal of Corporate Law* 260.

lost at first instance,⁴⁷ won in the Court of Appeal⁴⁸ and lost in the House of Lords.⁴⁹ The proceedings thus represented something of a forensic lottery.

Lord Hoffmann gave the leading speech in the House of Lords. He said:⁵⁰

In section 459 Parliament has chosen fairness as the criterion by which the court must decide whether it has jurisdiction to grant relief. It is clear from the legislative history (which I discussed in *In re Saul D Harrison & Sons Plc* [1995] 1 BCLC 14, 17-20) that it chose this concept to free the court from technical considerations of legal right and to confer a wide power to do what appeared just and equitable. But this does not mean that the court can do whatever the individual judge happens to think fair. The concept of fairness must be applied judicially and the content which it is given by the courts must be based upon rational principles. As Warner J said in *In re JE Cade & Son Ltd* [1992] BCLC 213, 227: 'The court ... has a very wide discretion, but it does not sit under a palm tree.'

Although fairness is a notion which can be applied to all kinds of activities, its content will depend upon the context in which it is being used.

In the case of section 459, the background has the following two features. First, a company is an association of persons for an economic purpose, usually entered into with legal advice and some degree of formality. The terms of the association are contained in the articles of association and sometimes in collateral agreements between the shareholders. Thus the manner in which the affairs of the company may be conducted is closely regulated by rules to which the shareholders have agreed. Secondly, company law has developed seamlessly from the law of partnership, which was treated by equity, like the Roman *societas*, as a contract of good faith. One of the traditional roles of equity, as a separate jurisdiction, was to restrain the exercise of strict legal rights in certain relationships in which it considered that this would be contrary to good faith. These principles have, with appropriate modification, been carried over into company law.

The first of these two features leads to the conclusion that a member of a company will not ordinarily be entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted. But the second leads to the conclusion that there will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith.

⁴⁷ [1997] 2 BCLC 739.

⁴⁸ [1997] 2 BCLC 739.

⁴⁹ [1999] 1 WLR 1092.

⁵⁰ *Ibid*, 1098D-1099A.

Lord Hoffmann then cited *Ebrahimi*.⁵¹ He thus emphasised the promissory basis on which the relief is usually granted and thought that the same principles underlie this remedy and the just and equitable winding up remedy. His Lordship saw both as originating in good faith, which is perhaps unfortunate since *Ebrahimi* had held that bad faith did not have to be established and it is a potentially problematic basis for the law. He said:

I do not suggest that exercising rights in breach of some promise or undertaking is the only form of conduct which will be regarded as unfair for the purposes of section 459. For example, there may be some event which puts an end to the basis upon which the parties entered into association with each other, making it unfair that one shareholder should insist upon the continuance of the association. The analogy of contractual frustration suggests itself. The unfairness may arise not from what the parties have positively agreed but from a majority using its legal powers to maintain the association in circumstances to which the minority can reasonably say it did not agree: *non haec in foedera veni*.⁵²

He then recanted his earlier views on legitimate expectations. He said:⁵³

In *In re Saul D Harrison & Sons Plc* [1995] 1 BCLC 14, 19, I used the term 'legitimate expectation,' borrowed from public law, as a label for the 'correlative right' to which a relationship between company members may give rise in a case when, on equitable principles, it would be regarded as unfair for a majority to exercise a power conferred upon them by the articles to the prejudice of another member. I gave as an example the standard case in which shareholders have entered into association upon the understanding that each of them who has ventured his capital will also participate in the management of the company. In such a case it will usually be considered unjust, inequitable or unfair for a majority to use their voting power to exclude a member from participation in the management without giving him the opportunity to remove his capital upon reasonable terms. The aggrieved member could be said to have had a 'legitimate expectation' that he would be able to participate in the management or withdraw from the company.

It was probably a mistake to use this term, as it usually is when one introduces a new label to describe a concept which is already sufficiently defined in other terms. In saying that it was 'correlative' to the equitable restraint, I meant that it could exist only when equitable principles of the kind I have been describing would make it unfair for a party to exercise rights under the articles. It is a consequence, not a cause, of the equitable restraint. The concept of a legitimate expectation should not be allowed to lead a life of its own, capable of giving rise to equitable restraints in circumstances to which the traditional equitable

⁵¹ [1973] AC 360.

⁵² [1999] 1 WLR, 1101H.

⁵³ [1999] 1 WLR, 1102B-F.

principles have no application. That is what seems to have happened in this case.

It is submitted that the concept of legitimate expectations was probably reductive and was potentially dangerous in the case of a public listed company where there is a greater need for certainty.⁵⁴

His Lordship did not favour a 'no fault divorce' concept even though the section sometimes resembles divorce proceedings.⁵⁵ There should not be a right of withdrawal. Here his Lordship makes no reference to the appraisal right in United States, Canadian and New Zealand law.⁵⁶

On the other hand where relief is sought he thought that there should be an offer made to buy out the applicant coupled with an offer as to costs if necessary. Unfairness does not usually consist merely in the fact of breakdown but in failure to make a suitable offer.⁵⁷

His Lordship's analysis thus seems to balance a scepticism about contemporary English minority shareholder litigation with a strong pragmatism. However, to the extent that the former leads him to a rights based revisionist approach to interpretation of what is essentially interest based legislation it seems unjustifiable. Basing the approach on good faith also seems problematic. Judicial policy concerns about certainty are no justification for cutting down the broad jurisdiction conferred by the legislation. The prolix pleadings are a result of litigants' concern about the courts' uncertain approach to a jurisdiction based on interest, principle and categories of indeterminate reference. What is called for is primarily better case management by the courts themselves, suited to the jurisdiction given to them.

*O'Neill v Phillips*⁵⁸ was discussed in the recent New South Wales Court of Appeal decision in *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd*⁵⁹ which involved the largest private bus group in Australia. A brother and sister ganged up against another brother after the death of their parents and it was held that their conduct amounted to oppression and unfairly prejudicial conduct under what was then section 260 of the Corporations Law, now section 232 of the Corporations Act 2001.

⁵⁴ See Jonathan Parker J in *Re Astec (BSR) PLC* [1998] 2 BCLC 556 at 589. See also *Re Blue Arrow PLC* [1987] BCLC 585; *Re Tottenham Hotspur PLC* [1994] 1 BCLC 655.

⁵⁵ [1999] 1 WLR, 1104B-1105B.

⁵⁶ See V Mitchell 'The US Approach the Acquisition of Minority Shares: Have we Anything to Learn?' (1995) 14 *Company and Securities Law Journal* 283.

⁵⁷ [1999] 1 WLR at 1107C-1108B.

⁵⁸ [1999] 1 WLR 1092.

⁵⁹ (2001) 19 ACLC 856.

The Court of Appeal did not seem impressed by Lord Hoffmann's concept of legitimate expectation, nor by his recantation of it. Spigelman CJ emphasised discretionary elements in the grounds of relief⁶⁰ but Priestley JA⁶¹ gave a long citation from Lord Hoffmann's speech. However, it is not clear whether the Court of Appeal agrees with this conservative revisionism. One detects a mild scepticism in the judgments.

The English Law Commission's Discussion Paper and Report

The terms of reference of the English Law Commission's recent work on shareholder remedies included a review of the unfairly prejudicial remedy.⁶² In that regard, the main concerns which emerged about section 459 related not so much to the scope of the provision but to the length and complexity of the proceedings. The Law Commission found, for example, that the hearing of the petition in *Re Elgindata Ltd*⁶³ lasted 43 days, costs totalled £320,000 and the shares, originally purchased for £40,000, were finally valued at only £24,600. As Scott V-C noted in *Re a Company (No. 004415 of 1996)*,⁶⁴ the tendency in section 459 cases is for the litigation to become a Chancery version of a bitterly contested divorce with grievances from the history of the marriage dredged up and hurled about in an attempt to blacken the opposing party.

In many ways these complaints about length and costs are complaints about civil litigation generally and are not problems peculiar to section 459 petitions. Bearing that in mind, the Law Commission, drawing on the recommendations of Lord Woolf on the Civil Justice System,⁶⁵ concentrated on procedural issues and, in particular, on the importance of active case management of section 459 petitions. Case management has been introduced into many common law systems over the past decade and generally has provided a more managerial role to judges and court officials in the conduct of litigation, with a view to making it more efficient and effective. Together with ADR processes it has resulted in common law litigation becoming considerably less 'adversarial' than it has traditionally been.

More substantively, the Law Commission recommended making provision for certain (rebuttable) presumptions in proceedings under section 459. There would be a rebuttable presumption that, in certain circumstances,

⁶⁰ Ibid, 859.

⁶¹ Ibid, 913 et seq.

⁶² See *Shareholder Remedies* (Law Com: No 246, Cm 3769).

⁶³ [1991] BCLC 959. See also the unreported case of *Re Freudiana Music Co Ltd* (1993).

⁶⁴ [1997] 1 BCLC 479,

⁶⁵ *Access to Justice. Final Report*, London (1996). See now the new case management powers under the Civil Procedure Rules (1998), SI 1998/3132 and *North Holdings Ltd v Southern Tropics Ltd* [1999] 2 BCLC 625; *Re Rotadata Ltd* [2000] 1 BCLC 122.

- i) where a shareholder has been excluded from participation in the management of the company, the conduct will be presumed to be unfairly prejudicial by reason of the exclusion; and
- ii) if the presumption is not rebutted and the court is satisfied that it ought to order a buy out of the petitioner's shares, it should do so on a pro rata basis (ie without any discount to reflect the fact that the petitioner's holding is a minority holding).⁶⁶

The presumptions would only apply to a private company limited by shares where all, or substantially all, of the members of the company are directors; and where, immediately before the exclusion from participation, the petitioner held shares in his sole name giving him not less than 10% of the right to vote at general meetings of the company on all or substantially all matters. The petitioner must have been removed as a director or been prevented from carrying out all or substantially all of his functions as a director.

Surveys of section 459 proceedings consistently show this type of fact pattern and the outcome in the vast majority of cases is invariably that the court regards exclusion from participation in these circumstances as being unfairly prejudicial and the respondent must purchase the petitioner's shares at a pro rata price. If that is the case, then there is little point in having long and expensive litigation to reach an outcome which can be predicted at the outset. The Law Commission itself conducted a review of 233 unfairly prejudicial petitions lodged in the High Court in 1994 - 1996 and found that 96% of the cases related to private companies; 82% of which had five or fewer shareholders; 64% contained allegations of exclusion from management; and in 69% of cases the remedy sought was a purchase order.⁶⁷

Developing a New Paradigm

Shareholder disputes will not go away. The law should not close the door on minority shareholders. The question is really what is the best forum for dealing with such disputes, and what approaches should be adopted. Modern ADR processes might provide relevant options.

Historical Trends in Corporate Dispute Resolution

The modern history of ADR in the jurisdictions under discussion commenced in the 1980s. It developed partly as a product of new ideologies based in community organisation and partly in response to the perceived shortcomings of the litigation

⁶⁶ *Shareholder Remedies*, above n 62.

⁶⁷ See I M Ramsay, 'An Empirical Study of the Use of Oppression Remedy' (1999) 27 ABLR 23 for a useful survey of Australian cases. For an earlier survey see H Rajak, 'The Oppression of Minority Shareholders' (1972) 35 *Modern Law Review* 156.

system. In the latter context mediation and other facilitative processes with an interests focus were developed as alternatives to, or options within, legal proceedings. In areas such as building and construction disputes the newer ADR processes also tended to substitute for commercial arbitration which had tended to become procedurally rigid, technical, time-consuming and expensive.

In the company law arena the arbitration articles based on *Palmer's Company Precedents*⁶⁸ were common in the United Kingdom until the late 1930s. Their origins seem to be found in railway company articles since the applicable legislation encouraged the use of arbitration for disputes involving railway companies.⁶⁹ However the arbitration article in *Palmer* fell into disuse due to doubts as to whether the contract constituted by the article was a sufficient written agreement for submission to arbitration for the purposes of the Arbitration Act. The case of *Beattie v E & F Beattie Ltd*⁷⁰ held that the deemed contract constituted by the articles which covered disputes as shareholder did not extend to disputes in the capacity as director even though on the facts of the case the particular director was also a shareholder.

While arbitration faded away in this area in the United Kingdom it grew popular in the 1950 - 60s in the United States and was advocated by the late Professor F Hodge O'Neal who was author of the US treatise on the subject of Close Corporations.⁷¹ It also developed as a method of resolving disputes in securities litigation in the 1980s. Given this history it is appropriate to consider the arguments for and against arbitration in the modern corporate arena.

In comparison with court-based litigation arbitration is traditionally regarded as having the following potential advantages:

1. There is power to selector the arbitrator(s) and ensure necessary expertise;
2. The arbitration process is potentially more flexible than the court processes;
3. Arbitration can be quicker and less expensive than litigation;
4. The hearings can be held in private and confidential matters can be safeguarded;
5. Arbitration can produce a broader based solution to the dispute.

The main disadvantages of the arbitral process are:

1. It can still be formal, procedurally complex and not necessarily quicker and less expensive than litigation;

⁶⁸ See R Buchanan-Dunlop, *Palmer's Company Precedents* (17th ed, 1956) Part 1 General Forms, 686.

⁶⁹ See the English Railway Companies Acts of the Nineteenth Century. [1938] Ch 708.

⁷¹ F Hodge O'Neal and RB Thompson, *O'Neal's Close Corporations* (3rd ed, 1988) Vol 1, Chapter 9C.

2. It tends in practice to be rights-based with the potential for focusing on party interests not often realized;
3. As in litigation, the parties lose control of the dispute to the arbitrator who makes a binding determination;
4. The applicable legislation imposes some procedural requirements on the system and it is susceptible to judicial review on limited grounds.

It is appropriate that arbitration be assumed as a dispute resolution option in comparison to court-base adjudication. Thus far, however, there has been little evidence of arbitral processes being deployed to resolve disputes involving minority shareholders. At a time of increasing experimentation in and road-testing of dispute resolution models it is appropriate to consider some of the new processes., including the facilitative and advisory system referred to above.⁷²

The Recent UK Deliberations

As indicated above, the English Law Commission favoured greater case management of applications and statutory presumptions of unfair prejudicial conduct and a pro rata basis for share buyouts. It also considered introducing an arbitration and ADR article into Table A⁷³ but due to a lack of enthusiasm by the legal profession it dropped the proposal.⁷⁴

Another idea considered by the Commission was the voluntary introduction of an exit article.⁷⁵ This again has been dropped, this time because the company formation specialists indicated they would delete it in their standard form constitutions.⁷⁶

All of this represents a triumph for negative thinking but there is nothing to stop a company choosing to adopt such articles. In the Appendix to this article we set out draft articles for possible adoption.

The Final Report of the Company Law Review Steering Group of the UK Department of Trade and Industry, *Modern Company Law For a Competitive Economy* states:⁷⁷

We have made proposals whose aim has been to achieve clarity, accessibility and cost-effectiveness. They include the following measures:

⁷² See for example J Wade, 'Current Trends and Models in Dispute Resolution Part I' (1998) 9 *ADRJ* 59 and 'Part II' (1998) 9 *ADRJ* 125.

⁷³ Discussion Paper.

⁷⁴ Report above n 49.

⁷⁵ See A McGee, 'Exit Mechanisms in Private Companies' [1999] 3 *Company Financial and Insolvency Law Review* 52.

⁷⁶ See below n 62.

⁷⁷ Vol 1, 33-4.

- Our decision to maintain the effect of a recent court ruling whose consequence is to restrict the ability of members to take action for unfair prejudice under section 459 to cases where there has been a breach of the constitution, some other breach of duty, or some sort of agreement that makes it inequitable to confine the member to his strict rights under the constitution. We believe that limiting the unfair prejudice claim will discourage the practice of making all manner of allegations which might conceivably sustain a case of unfairness. This practice can lead to lengthy and expensive proceedings that can destroy small companies;
- The placing of the derivative action on a statutory basis, and making provision for the circumstances where a member may take action on behalf of the company where the directors fail to do so; and
- The clarification of the nature of the company's constitution (currently laid down by the outmoded and inadequate section 14), including increased certainty as to what rights are enjoyed and may be pursued by members personally under the constitution.'

The Report goes on to discuss dispute resolution specifically. It states:⁷⁸

Where disputes cannot be resolved through the internal procedures of a company, it is vital that the external mechanisms available should be efficient and cost-effective. Litigation is often both lengthy, diverting scarce management resources, and expensive, undermining the financial viability of the company and leaving the minority shareholder and/or the company with costs exceeding any award made by the court. Our consultation on this issue has shown that there is significant demand for action to reduce the burden of litigation in shareholder disputes. We are convinced that all forms of alternative dispute resolution (ADR) should be encouraged, and we believe that our reforms to the law on minority rights and on directors' duties will reduce the complexity of cases and, therefore, make disputes more amenable to ADR. Discussions with some of the main ADR providers have shown that facilities to provide ADR for shareholder disputes already exist or could, in the case of arbitration, easily be developed. In the light of these discussions, we recommend that the Government should take two steps. First, it should increase awareness of and accessibility to ADR through publicity and the establishment of referral mechanisms. Second, it should work with arbitration providers in order to establish an arbitration scheme designed specifically for shareholder disputes. We believe that, if these steps are taken, the expense and length of shareholder disputes will be significantly reduced, providing proper remedies for aggrieved minority shareholders while limiting the costs and disruption suffered by companies.

The Position in Australia

⁷⁸ Ibid, 38

In terms of case law, Australian courts have in the past followed *Thomas*⁷⁹ and *Wayde*.⁸⁰ There is no compulsion to follow the conservative revisionism of *O'Neill v Phillips*⁸¹ which did not refer to and was arguably per incuriam those decisions. The wording of section 140(1) of the Corporations Act 2001 overcomes the problem of *Beattie*⁸² and there is no indication that Australian company formation specialists will necessarily follow their UK counterparts. There is much to be said, therefore, for Australia persevering further down this track and considering the matter in the broader context of alternative dispute resolution in general as we have outlined above.

In the Australian context there has been none of the systematic reform which occurred in the United Kingdom but there has been a major growth in case management practices and in the development of ADR processes. These provide the infrastructure for more deliberative reforms. In the light of the English Law Commission and Department of Trade and Industry debates referred to above and current practices in ADR, we would recommend consideration of the following:⁸³

1. The adoption of presumptions as to unfair prejudice along the lines of the proposed section 459A of the UK Companies Act 1985 (set out in Appendix A).
2. The adoption of a presumption as to the purchase price of shares along the lines of the proposed section 461A of the UK Companies Act 1985 (set out in Appendix B).
3. Active case management of proceedings under Section 232 of the Corporations Act 2001 including,
 - a) Directions that preliminary issues be heard or some issues tried before others.
 - b) Power for the court to dismiss any claim or part of a claim with no realistic prospect of success at full trial.

⁷⁹ *Thomas v HW Thomas Ltd* [1984] 1 NZLR 686.

⁸⁰ *Wayde v NSW Rugby League Ltd* (1985) 180 CLR 459.

⁸¹ [1999] 1 WLR 1092.

⁸² *Beattie*, above n 70.

⁸³ These recommendations are based on the new derivative action procedures in Part 2F.1A of the Corporations Act 2001; the English Law Commission's proposals; the new English Civil Procedure Rules 1998, SI 1998/3132 and a consultation paper issued by the Department of Trade and Industry in 2000. See too Leslie Kosmin QC, 'Minority Shareholders' Remedies: Practitioner's Perspective' [1997] 1 *Company Financial and Insolvency Law Review* 211, 217-8 and Mr Justice Lightman's Foreword (1997) 18 *Company Lawyer* 225. See too the valuable overview by D Sugarman, 'Reconceptualising Company Law: Reflections on the Law Commission's Consultation Paper on Shareholder Remedies: Part 1' (1997) 18 *Company Lawyer* 226, 243-5; A McGee, 'Exit Mechanisms in Private Companies' [1999] 3 *Company Financial and Insolvency Law Review* 52.

- c) Power to adjourn proceedings to enable the parties to make use of mechanisms of ADR for disposing of the case or any part of it together with a duty to report back the outcome to the court.
 - d) Power to require a joint expert or appointment of an assessor.
 - e) Power to determine how facts are to be proved.
 - f) Power to exclude an issue from determination if it will not serve any worthwhile purpose.
 - g) Flexibility as to costs to reflect the manner in which the successful party has conducted the proceedings and the outcome of individual issues.
4. The introduction of replaceable rules in the Corporations Act 2001 for proprietary companies to encourage parties to sort out areas of potential conflict at the outset and in particular a replaceable rule allowing for the adoption of an exit procedure in terms of the draft Regulation 119 proposed for the UK Table A (set out in Appendix C). The latter would provide for adoption of a procedure by ordinary resolution, tailored to the company's situation.⁸⁴

These considerations are all based on current paradigms of best dispute resolution practice. The presumptions are designed to prevent and limit disputes involving minority shareholders, for example by attempting to avoid the 'duelling experts' phenomenon where valuations are being considered. The case management options are designed to bring more of a design effort into the dispute resolution process, for example by making referrals out of the litigation system to deal with discrete issues in dispute or by narrowing the issues needing adjudication. The replaceable rules are designed to encourage early intervention with an interest focus with the possible facilitation of the dispute resolution process by an independent outsider.

Conclusion

The law has failed minority shareholders. Litigation by them was actively discouraged under the first paradigm. Later it was facilitated under the second paradigm but increasingly it has run into the sands and UK courts have got cold feet about their capacity to handle the interests based jurisdiction given to them by Parliament. Australian and New Zealand courts have not necessarily been so pessimistic. However, one must distinguish between law which merely provides for adjudication of rights and law which provides a basis of principle on which to adopt an appropriate method to resolve a dispute as to interests. In Australia there is scope for a partnership between Parliament and the courts to create an appropriate system for the resolution of these disputes. Parliament can create a framework which includes scope for individual choice. Some of the UK ideas are worth adopting here. It is surprising that a conservative languor has descended on some of the United Kingdom

⁸⁴ Exit articles are not always fool proof. See *North Holdings Ltd v Southern Tropics Ltd* [1999] 2 BCLC 625 (issue of valuation raised serious points of law not appropriate to leave to a valuer).

reform proposals. Thus the proposals for statutory presumptions, the greater use of ADR and the proposal for exit articles seem to be in limbo at the moment.

As has been shown, the first paradigm was based on a rights approach. The second was based more on an interests approach which conservative revisionism is seeking to retranslate into a rights based approach. Any blueprint for a third paradigm involves making a decision as to which approach is to be adopted for minority shareholder disputes. There is much to be said for retention of the principles underlying the second paradigm which are now contained in the wording of section 232 of the Corporations Act 2001, rejection of the conservative revision by the House of Lords and design of an interest based dispute resolution system which involves active case management and provides a range of alternatives to conventional adjudication by the court. Based on general ADR policies, the new derivative action procedures and a consideration of the recent UK debates, we have put forward suggestions for statutory and procedural reforms aimed at reducing conflict and determining appropriate responses and processes for dealing with conflict when it arises.

In this regard it should be pointed out that the ADR movement has recently made significant developments on issues of justice, quality and standards in the new dispute resolution processes. In its early development there was criticism that it was concerned with 'quantitative-efficiency' criteria as opposed to 'qualitative-justice'⁸⁵ claims. Thus much of the early promotion of ADR revolved around quantitative factors of time and cost, and the additional benefits of privacy and absence of public scrutiny. While there are undoubtedly still grounds for voicing these concerns they can now be met by reference to significant evidence to the contrary. Thus at the conceptual level attempts have been made to relate ADR processes to traditional models of justice⁸⁶ and at the practice level there have been numerous codes and guidelines attempting to delineate and prescribe appropriate conduct and norms in this area.⁸⁷ These developments have been accompanied by increasing sophistication in the methodologies for evaluating dispute resolution systems.⁸⁸

Ultimately reforms in the area of minority shareholder remedies require a 'design effort' which takes account of modern dispute resolution theory and practice.

⁸⁵ See, for example, the early critique of C Menkel-Meadow 'Pursuing Settlement in an Adversary Culture – A Tale of Innovation Co-opted or "The Law of ADR"?' (1991) 19 *Florida State University LR* 6.

⁸⁶ See, for example, M Cappelletti 'Alternative Dispute Resolution Processes within the Framework of the World Wide Access-to-Justice Movement' (1993) 56 *Modern LR* 282.

⁸⁷ See Standards Australia, 'The Australian Standard: Guide to the Prevention, Handling and Resolution of Disputes' – AS 4608, Sydney 1999; Australian Competition and Consumer Council, ' Benchmarks for Dispute Avoidance and Resolution – A Guide', ACCC, Sydney 1997; National Alternative Dispute Resolution Advisory Council, 'A Framework for ADR Standards', Canberra 2001,

⁸⁸ See T Sourdin, note 11 above, 176-182.

Generally this would require the introduction of low-cost facilitative processes which provide for early intervention focused at the level of shareholder interests. Where settlement is not possible at this stage the focus might shift to more advisory processes which take account of shareholder rights but in a context in which negotiated settlements are encouraged. Finally there might have to be resort to authoritative determinative processes but these too can be designed to balance the respective parties' rights with their interests in forums appropriate for their determination.⁸⁹ Within this system consideration will also have to be given to balancing the choices of parties with some measures of encouragement and sanction.⁹⁰

In terms of the criteria for evaluating any such system it might be useful to bear in mind the views of the Australian Law Reform Commission. Although it was reporting on the federal civil litigation system its five objectives might be extended more broadly to the design of an appropriate resolution system.⁹¹ They are: the resolution, or at least limitation, of disputes, by processes that are considered fair by the parties, are accessible by them, are efficient in both the short and long terms, and have outcomes that are effective and acceptable. These are commendable objectives for the reform of minority shareholder remedies.

⁸⁹ ADR invites consideration of non-judicial forums, even for determinative processes. In Australia consideration was given to the constitution of a panel instead of the courts for dealing with takeover disputes under the Corporations Law – See Corporate Law Economic Reform Program, 'Takeovers, Corporate Control: A Better Environment for Productive Investments', Paper No 4 (Cth of Australia, Canberra, 1997) 40.

⁹⁰ The issue of good faith participation in different ADR processes, both contractual and mandatory, is emerging as a major factor in modern dispute resolution but is beyond the scope of the present article.

⁹¹ See ALRC Issues Paper 20, Rethinking the Civil Litigation System, Sydney 1977.

Appendix A

Unfair prejudice

After section 459 (member may petition court for an order) insert -

- 459A – (1) This section applies if -
- (a) a member of a private company limited by shares petitions under section 459(1) for an order under this Part,
 - (b) it is shown that the member has been removed as a director or has been prevented from carrying out all (or substantially all) his functions as a director,
 - (c) immediately before the removal or prevention mentioned in paragraph (b) the member held at least 10 per cent of the voting rights in the company, and
 - (d) immediately before the removal or prevention mentioned in paragraph (b) all (or substantially all) the members of the company fulfilled the director condition set out in subsection (3).
- (2) Unless the contrary is shown, it must be presumed that because of the removal or prevention mentioned in subsection (1)(b) the company's affairs have been conducted in a manner which is unfairly prejudicial to the interests of the petitioner.
- (3) A member fulfils the director condition at the time concerned if he is then a director of the company.
- (4) Nothing in this section affects the operation of section 459 apart from this section.
- 459B (1) The reference in section 459A(1)(c) to the voting rights in the company is to the rights conferred on shareholders in respect of their shares to vote at general meetings of the company on all (or substantially all) matters.
- (2) For the purposes of section 459A(1)(c) rights of the member must be taken into account only if they are rights as sole holder of shares.
- (3) For the purposes of section 259A(1)(c) rights which are exercisable only in certain circumstances must be taken into account only –
- (a) when the circumstances have arisen, and for so long as they continue to obtain, or
 - (b) when the circumstances are within the control of the person who has the rights.
- (4) For the purposes of section 459A(1)(c) rights which are normally exercisable but are temporarily incapable of exercise must continue to be taken into account.
- (5) The following rules apply for the purposes of section 459A(1)(d) if at the time concerned a share is held by persons jointly -

- (a) if at least one of the holders is a director of the company, the director whose name appears first in the company's register of members must be taken to be the only member by virtue of the share;
- (b) in any other case, the holder whose name appears first in the company's register of members must be taken to be the only member by virtue of the share.'

4. After section 461 (provisions as to petitions and orders) insert -

- 461A (1) This section applies if –
- (a) by virtue of section 459A the presumption there mentioned applies and the contrary is not shown, and
 - (b) the court decides to make an order under this Part providing for the purchase of the petitioner's shares.
- (2) It must be presumed that the order should provide for -
- (a) the purchase to be for a price which represents for each share of a particular class a rateable proportion of the market value of all the company's shares of that class;
 - (b) that market value to be found by assuming a sale by a willing seller to a willing buyer of all the company's issued share capital.
- (3) The presumption mentioned in subsection (2) is displaced if the court orders it to be displaced.'

Draft Regulation 119: Exit Right

- (1) The company in general meeting may at any time pass an ordinary resolution under this regulation, and in this regulation -
- (a) 'specified' and 'named' respectively mean specified and named in the resolution;
 - (b) references to an independent person are to be construed in accordance with paragraph (13).
- (2) The resolution may provide that if a specified event (or one of a number of specified events) affects a named shareholder he has an exit right which -
- (a) is exercisable by notice given to the company and named shareholders within a specified period, and
 - (b) consists of the right to require those shareholders to buy the affected shareholder's shares for a fair price.

- (3) A specified event may be, for example -
- (a) the removal of a shareholder who is a director from his position as a director, otherwise than where he is in serious breach of his duties as a director;
 - (b) the death of a shareholder.
- (4) The affected shareholder's shares are shares in the company which fulfill these conditions-
- (a) they must be held by him when the notice is given;
 - (b) they must have been held by him when the resolution was passed or have been allotted directly or indirectly in right of shares so held.
- (5) If a specified event is the death of the affected shareholder the person entitled to shares by reason of the death may exercise the exit right to which the affected shareholder was entitled.
- (6) The resolution is invalid unless it contains provision as to the meaning of a fair price, and in particular it may provide for any of the following -
- (a) a price which represents a fair value as decided by an independent person (acting as an expert value and not as arbitrator or arbiter);
 - (b) a price representing a rateable value (found as mentioned in paragraph (7));
 - (c) in the case of shares which carry a right to participate in surplus assets on a winding up, a price representing their net asset value as decided by an independent person;
 - (d) in the case of shares which do not carry a right to participate in surplus assets on a winding up, a price equal to the capital paid up on them;
- and the resolution may contain different provision for different events.
- (7) A rateable value of shares of a particular class (the shares in question) is one decided by an independent person (acting as an expert valuer and not as an arbitrator or arbiter) by taking the market value of all the shares of that class in issue and multiplying it by the fraction -
- (a) whose numerator represents the capital paid up on the shares in question, and
 - (b) whose denominator represents the capital paid up on all the shares of that class in issue;

and the market value of all the shares of a particular class in issue is a value found by assuming a sale by a willing seller to a willing buyer of all the company's issued share capital.

- (8) The resolution may provide that the net asset value of shares is to take account of or to disregard intangible assets (depending on the terms of the resolution).
- (9) Unless the resolution otherwise provides, any value must be found by reference to the state of affairs obtaining at the beginning of the day when the notice exercising the exit right is given.
- (10) The following rules apply if a value has to be decided by an independent person for the purposes of the resolution -
 - (a) as soon as is reasonably practicable after it receives the notice the company must instruct the independent person to decide the value;
 - (b) as soon as the reasonably practicable after it receives the decision the company must give notice of it to the named shareholders;
 - (c) half the costs of the independent person must be borne by the affected shareholder or, if he is dead, the person entitled to his shares by reason of his death;
 - (d) half the costs of the independent person must be borne by the shareholders who are required to buy;
 - (e) the shareholder who are required to buy must bear that half in proportion to the number of shares they are required to buy.
- (11) Subject to any provision in the resolution and to any agreement by all the parties concerned -
 - (a) the shareholders who are required to buy must buy the shares in proportion to the number of shares registered in their names in the company's register of members at the beginning of the day of which the resolution was passed (treating joint holders as a single holder);
 - (b) all parties must do their best to secure that the purchase is completed before the expiry of the relevant period (defined in paragraph (12));
 - (c) at completion a buyer must pay a proper proportion of the price (in cash and in full) against delivery to him of a duly executed form of transfer.
- (12) The relevant period is a period of three months starting with -
 - (a) the day when the company gives notice to the shareholders of the decision of the independent person (if paragraph (10) applies), or

- (b) the day when the notice exercising the exit right was given (in any other case).
- (13) References in this regulation to an independent person are to an independent person who appears to have the requisite knowledge and experience and who is appointed in such manner as is specified.
- (14) A resolution is invalid unless every named shareholder gives a notice to the company (before the resolution is passed) stating that he consents to it.
- (15) A resolution ceases to be effective if a named shareholder dies or an event occurs after which he holds none of the following shares -
 - (a) shares held by him when the resolution was passed;
 - (b) shares allotted directly or indirectly in right of such shares.
- (16) Paragraph (15) has effect subject to the following rules -
 - (a) if a notice exercising the exit right has already been given paragraph (15) does not apply as regards that notice;
 - (b) if the death of the named shareholder is a specified event paragraph (15) does not apply as regards that event;
 - (c) paragraph (15) does not apply if the resolution disapplies it.
- (17) A resolution ceases to be effective if there is agreement to that effect by all relevant persons; and a relevant person is any person who is -
 - (a) a named shareholder, or
 - (b) a person entitled to a named shareholder's shares by reason of his death.
- (18) Regulations 111, 112 and 114 and 116 apply to a notice exercising the exit right as if it were a notice given by the company.
- (19) If a notice exercising the exit right is given it cannot be withdrawn without the consent of all relevant persons (within the meaning given by paragraph (17)).
- (20) If while a resolution is effective a named shareholder transfers shares, and after the registration of the transfer he would hold none of the shares mentioned in paragraph 15(a) and (b), the directors of the company must refuse to register the transfer unless all relevant persons (within the meaning given by paragraph (17)) notify the company in writing that they consent to the transfer, and consent unreasonably withheld must be taken to be so notified.

- (21) If a resolution is passed under this regulation -
- (a) a variation of this regulation or of the resolution is to be treated as a variation of the rights attached to the shares held by the named shareholders, and
 - (b) those rights may be varied only with the consent of all relevant persons (within the meaning given by paragraph (17)).