

UNFAIR PREJUDICE: WHO HAS IT RIGHT, ECONOMICALLY SPEAKING?

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I. INTRODUCTION

The company law statutes of New Zealand, Australia and the United Kingdom (amongst other jurisdictions) all include very similar remedies for unfairly prejudicial conduct towards shareholders. These provisions were applied consistently between the early 1980s and 1999. The courts of all three jurisdictions recognised that a shareholder's legitimate expectations (which, if breached, could lead to a remedy) could arise from personal circumstances or generally accepted commercial standards rather than just from formalised arrangements. The 1999 House of Lords decision in *O'Neill v Phillips*¹ represents a significant change of approach by the UK courts in that it effectively limits 'unfairness' in terms of the remedy to breaches of legally enforceable agreements.

In 1990, Professor Brian Cheffins noted the lack of consideration of the theoretical basis for the unfair prejudice remedy. He proposed an economic analysis of the provision, under which courts would focus on the 'bargain' between corporate participants, whether express or implied.²

This article examines the background to the introduction of the unfair prejudice remedy, including an examination of the approach taken to the provision in North America, the source of the remedy in its present form. It then compares that approach with those taken in New Zealand, Australia and the UK, both before and after the *O'Neill* case, and assesses each approach in light of Cheffins's economic analysis.

II. THE UNFAIR PREJUDICE REMEDY: BACKGROUND AND PURPOSE

Remedies for unfairly prejudicial conduct towards shareholders appear in s 994 of the *Companies Act 2006* (UK),³ Part 2F.1 (ss 232-235) of the *Corporations Act 2001* (Cth) and s 174 of the *Companies Act 1993* (NZ). The remedy dates from 1948, when the original 'oppression remedy' was enacted in the UK.⁴ The provision was enacted both to provide a remedy in situations where no specific duty owed by (or to) the company had been breached, and a personal or derivative action was therefore not available, and in recognition of the fact that the only existing equitable remedy — winding up on just and equitable grounds — was often much too drastic a step, particularly if the company was prospering.⁵

Although the remedy had its origins in the UK, the broader wording now used in most jurisdictions — using phrases such as 'unfair prejudice' and/or 'unfair discrimination' in addition to or instead of 'oppression' — appears to be based on that first used in North American statutes. Bruce Welling notes that 'the complex wording of the Canadian statutes was designed to get around the failures of the English section' in its original form.⁶ The 1962 Jenkins Committee, when recommending the broadening of the remedy in the UK to

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1 [1999] 1 WLR 1092.

2 Brian Cheffins, 'An Economic Analysis of the Oppression Remedy: Working Towards a More Coherent Picture of Corporate Law' (1990) 40 *University of Toronto Law Journal* 775.

3 The remedy was previously located in s 459 of the *Companies Act 1985* (UK), repealed with effect from 1 October 2007.

4 *Companies Act 1948* (UK) s 210.

5 See Robert P Austin and Ian M Ramsay, *Ford's Principles of Corporations Law* (13th ed, 2007) [11.430].

6 Bruce Welling, *Corporate Law in Canada: The Governing Principles* (3rd ed, 2006) 534.

its current form, referred to unspecified United States antecedents.⁷ Given this pedigree, it is worthwhile noting how the provision has been applied in North America.

Section 241 of the *Canada Business Corporations Act*, which provides that relief may be granted for conduct that is ‘oppressive or unfairly prejudicial to, or that unfairly disregards the interests of any security holder, creditor, director or officer’ of a company, is typical. The court is empowered to make any order it thinks fit, ‘to rectify the matters complained of’. Broadly similar provisions appear in Canadian provincial legislation and throughout the United States.⁸

The three expressions used in s 241 — oppression, unfair prejudice and unfair disregard of a petitioner’s interests — have been generally treated by the Canadian courts as indicative of a single, broad standard of conduct which, if breached, will attract relief. In *Westfair Foods Ltd v Watt*, for example, it was held that the ‘repetition of overlapping ideas is only an expression of anxiety by Parliament that one or the other might be given a restrictive meaning’.⁹ John Lowry¹⁰ also emphasises the flexibility and open-endedness of the Canadian approach to the remedy. He notes the ‘often-cited recommendation’ in *Ferguson v Imax Systems Corporation*, that ‘the section should be interpreted broadly to carry out its purpose ... What is oppressive or unfairly prejudicial in one case may not necessarily be so in the slightly different setting of another’.¹¹

The Canadian provision does not specifically incorporate a ‘just and equitable’ standard for relief. However, the principles set out in *Ebrahimi v Westbourne Galleries*¹² have been applied by the Canadian courts to s 241. It was made clear in Lord Wilberforce’s judgment in *Ebrahimi* that the courts need not look exclusively at a company’s constitution when deciding the nature of the obligations undertaken by its participants. What is important is the giving of effect to the *full set* of terms and understandings on which it has been agreed the company will operate, be they expressed or implied. Thus, for example, where there is a reasonable expectation that all shareholders will participate in the company’s management, exclusion from management may be considered unfairly prejudicial, and a remedy will be available under s 241. This was the case in *Diligenti v RWMD Operations Kelowna Ltd* where the court concluded that, in such circumstances,

there are ‘rights, expectations and obligations inter se’, which are not submerged into the company structure, and these rights are enjoyed by a member as part of his status as a shareholder in the company ... Although [the applicant’s] fellow members may be entitled, as a matter of strict law, to remove him as a director, for them to do so in fact is unjust and inequitable, and is a breach of the equitable rights which he in fact possesses as a member.¹³

The circumstances under which the courts have not been willing to give effect to shareholder expectations are illustrated by cases like *Jackman v Jackets Enterprises Ltd*,¹⁴ where a shareholder was denied relief for her exclusion from the company’s management as she had been given her shares only as a gift and, therefore, had no real expectation of

7 Lord Jenkins (Chairman), *Report of the Company Law Committee*, Board of Trade (1962) [207]. This recommendation was only actioned in 1980.

8 See, eg, s 248 of the *Ontario Business Corporations Act*. See also Robert Thompson, ‘The Shareholder’s Cause of Action for Oppression’ (1993) 48 *The Business Lawyer* 699, note 70, for a list of the 37 American states whose corporate statutes include a remedy for ‘oppression’ or ‘unfair prejudice’.

9 (1991) 79 DLR (4th) 48, 52. See also the conclusion reached by Robert Dickerson, John Howard and Leon Getz, *Proposals for a New Business Corporations Law for Canada*, Report to the Department of Consumer and Corporate Affairs (1971) [484]: ‘In sum, we think that the courts should have very broad discretion, applying general standards of fairness, to decide these cases on their merits.’

10 John Lowry, ‘The Oppression Remedy — A Canadian Approach’ [1991] *Journal of Business Law* 196, 198.

11 (1983) 43 OR 128, 137.

12 [1973] AC 360, 379.

13 (1976) 1 BCLR 36, 51. See also *Canbev Sales and Marketing Inc. v Natco Trading Corp* (1998) 42 OR (3d) 574, where it was held that the remedy may be invoked where the reasonable expectations of the applicant, as construed by reference to the circumstances in which his or her rights in the company were acquired, are frustrated. This is described by Kevin McGuinness as ‘the prevailing Canadian view’ of the provision in *The Law and Practice of Canadian Business Corporations* (1999) 960.

14 (1977) 4 BCLR 358.

having any management role. In *820099 Ontario Ltd v Harold E. Ballard Ltd*,¹⁵ Farley J said that those expectations which the courts will consider are not ‘those that a shareholder has as his individual “wish list”. They must be expectations which could be said to have been (or ought to have been considered as) part of the compact of the shareholders’.

A significant feature of the unfair prejudice remedy in Canada is that a lack of good faith on the part of the defendant is not required for relief to be granted under s 241 and its equivalents — a point noted, for example, in *Sparling v Javelin International Ltd*:

It is not necessary that oppression and unfair treatment be caused by the deliberate act of the corporation or its directors, nor is it necessary for the unfairness to have its source in the management of the corporation at all. What is important is the *result, not the intent*. Thus, the applicant does not have to establish bad faith on the part of the corporation’s directors or management in order to convince the court to make an order.¹⁶

This approach has since been questioned in some cases,¹⁷ but the weight of authority has found that the intent of the ‘oppressor’ is irrelevant. In the leading case of *Brant Investments Ltd v Keeprite Inc*, the Ontario Court of Appeal held that

a requirement of lack of bona fides would unnecessarily complicate the application of the provision and add a judicial gloss that is inappropriate given the clarity of the words used ... The difficult question is whether or not [an applicant’s] rights have been prejudiced or their interests disregarded ‘unfairly’. In testing the facts in a given case against the word ‘unfairly’, evidence of bad faith as to motive could be relevant, but there may be other cases where particular acts effect an unfair result, but where there has been no bad faith whatsoever on the part of the actors.¹⁸

III. APPROACHES TO THE REMEDY IN NEW ZEALAND, AUSTRALIA AND THE UK PRE-O’NEILL

A. New Zealand

The approach taken by the New Zealand courts to s 174 of the *Companies Act 1993* can be traced to the judgment of Richardson J in *Thomas v H.W. Thomas Ltd*,¹⁹ a case brought under the equivalent provision in s 209 of the *Companies Act 1955* after its amendment in 1980.²⁰ Prior to this case, few actions had been brought under s 209 due to the restrictive approach adopted by the courts.²¹ Since then, however, Richardson J’s more liberal interpretation of the remedy, in line with the approach taken by the Canadian courts, has led to a much greater use of the provision. His Honour held that:

The three expressions [oppression, unfair discrimination and unfair prejudice] overlap, each in a sense helps to explain the other, and read together they reflect the underlying concern of the subsection that conduct of the company which is unjustly detrimental to any

¹⁵ (1991) 3 BLR (2d) 113. Similarly, in *Westfair Foods Ltd v Watt* (1991) 79 DLR (4th) 48, 58, the contrast between ‘reasonable expectations’ and ‘wishful thinking’ was noted.

¹⁶ [1986] RJQ 1073, 1077 (emphasis added). See also *Low and Anderson v Ascot Jockey Club Ltd* (1986) 1 BCLR (2d) 123 and *Lee v To* (1997) 153 Sask R 58.

¹⁷ See, eg, *Gillespie v Overs* (1987) 5 ACWS (3d) 430 and *Lloyd’s Bank Canada v Canada Life Insurance Co* (1987) 6 ACWS (3d) 427.

¹⁸ (1991) 3 OR (3d) 289, 305-306. See also *Sidaplex Plastic Suppliers Inc. v Elta Group Inc.* (1995) 131 DLR (4th) 399, 403-404: ‘While some degree of bad faith or lack of probity in the impugned conduct may be the norm in such cases, neither is essential to a finding of “oppression” in the sense of conduct that is unfairly prejudicial to or which unfairly disregards the interests of the complainant’. This point was specifically upheld on appeal to the Ontario Court of Appeal ((1998) 162 DLR (4th) 367, 373) and applied, for example, in *Downtown Eatery (1993) Ltd v Alouche* (2001) 200 DLR (4th) 289, 305-306; *Desjardins Ducharme Stein Monast v Empress Jewellery (Canada) Inc.* (Unreported, Quebec Superior Court, 11 March 2004), [38] and *Ford Motor Co. of Canada Ltd v Ontario (Municipal Employees Retirement Board)* (2004) 41 BLR (3d) 74, [225]-[227].

¹⁹ [1984] 1 NZLR 686.

²⁰ The amendment added ‘unfair prejudice’ and ‘unfair discrimination’ to the existing provision which provided for relief in cases of ‘oppression’.

²¹ See Andrew Borrowdale, ‘Shareholders’ Protection: The s 209 Remedy — A Survey’ [1988] *New Zealand Law Journal* 196; and Matthew Berkahn, ‘The Oppression Remedy and the “Group” Approach to Shareholder Remedies in New Zealand’ (1997) 10 *Corporate and Business Law Journal* 1, 5.

member of the company, whatever form it takes and whether it adversely affects all members alike or discriminates against some only, is a legitimate foundation for a complaint.²²

Richardson J also noted that, as the court has jurisdiction to grant relief when it is ‘just and equitable’ to do so, equitable considerations should be applied to the remedy as expressed in the *Ebrahimi* case.²³ He held that the court may intervene ‘where there is a visible departure from the standards of fair dealing ... in the light of the history and structure of the particular company and the reasonable expectations of the members’.²⁴

The initial intentions and legitimate expectations of shareholders — whether expressed formally or not — were used as a basis for assessing what was just and equitable in a number of subsequent New Zealand cases brought under s 209,²⁵ and continue to represent perhaps the overriding principles used in applying s 174 of the 1993 Act. In *Cornes v Kawerau Hotel (1994) Ltd*, for example, the company’s two directors each held 49.5 per cent of its shares, with one other shareholder holding 1 per cent. One of the directors (Mr Cornes) was removed from office and effectively excluded from management, contrary to an understanding between the parties that he would continue to be involved. Wild J relied on both *Thomas* and *Ebrahimi* in finding that, as the plaintiff was being ‘excluded from the benefits he was intended to receive from ... the company’, a remedy under s 174 was appropriate.²⁶ The judgment in *Cornes* makes no mention of any specific agreement, formal or otherwise, that Mr Cornes would continue in his management role. Yet the court held that this was the apparent intention of the parties and that, therefore, Mr Cornes had a reasonable expectation that it would continue.²⁷

Richardson J, in *Thomas*, also stated that it is not necessary to show a ‘lack of probity or want of good faith’ by those in control of the company for a remedy to be available. ‘Unfairness’ or ‘unreasonableness’, however, is required.²⁸ It is clear that the first of these two requirements applies to the oppressors’ *motives* and the second to the *effects* of the conduct on the applicant. This tallies with the Canadian authority noted above, and with Richardson J’s general view that the test for unfair prejudice should be objective rather than subjective.²⁹

B. Australia

Despite intermittent rewording and renumbering, the remedy for unfair prejudice in Part 2F.1 of the *Corporations Act 2001* remains substantially unchanged since 1983.³⁰

Shortly after the first cases under the amended unfair prejudice remedy in New Zealand and Australia were reported, Professor Robert Baxt commented that ‘my guess is that the *Thomas* line of interpretation will eventually prevail’.³¹ This has proven to be the case. The

22 [1984] 1 NZLR 686, 693.

23 See II THE UNFAIR PREJUDICE REMEDY: BACKGROUND AND PURPOSE above for the application of the principles expressed in *Ebrahimi* in Canada.

24 [1984] 1 NZLR 686, 694.

25 For example, *Vujnovich v Vujnovich* [1988] 2 NZLR 129 and *Lusk and Archive Security Ltd* (1991) 5 NZCLC 66,979.

26 (1999) 8 NZCLC 261,815, 261,825.

27 (1999) 8 NZCLC 261,815, 261,824-261, 825.

28 [1984] 1 NZLR 686, 693-696.

29 He notes, for example (at [1984] 1 NZLR 686, 692) the Australian case of *Re M. Dalley and Co. Pty. Ltd* (1968) 1 ACLR 489, 492, where Lush J said that oppression should be understood ‘in terms of its *impact* on the oppressed, not in terms of the *intention* of the oppressor’ (emphasis added).

30 As in New Zealand and the UK, the remedy was widened in 1983 so that ‘unfair prejudice’ and ‘unfair discrimination’, as well as ‘oppressive’ conduct, are now covered by Part 2F.1: see Ashley Black, Tom Bostock, Greg Golding and David Healey, *CLERP and the New Corporations Law* (1998) 166, and Keith Fletcher, ‘CLERP and Minority Shareholder Rights’ (2001) 13 *Australian Journal of Corporate Law* 290, 301. Black et al note that ‘whether conduct falls within [the scope of Part 2F.1] will be determined by reference to case law concerning s 260 [the relevant section until 1998] and its predecessors’. Fletcher states that ‘since [1983] the numbering of the provision has been altered a number of times as a result of corporate reform and legislative reorganisation but its substance has been virtually unaffected. The current Part 2F.1, ss 232-235, although amended in minor ways by the *CLERP Act 1999* (Cth) is little changed from its 1983 precursor’.

31 Robert Baxt, ‘The New Remedy in Oppression — A Reworded Provision or a New Remedy?’ (1985) 3 *Company and Securities Law Journal* 21, 29. Baxt discusses the *Thomas* case and *Re G. Jeffery (Men’s Store) Pty. Ltd* (1984) 2

approach taken to the remedy by the Australian courts has been very similar to that employed in New Zealand. John Farrar, for example, discusses the two jurisdictions' unfair prejudice sections together, and devotes much of his discussion to the *Thomas* case. He notes that Richardson J's reasoning was followed by the High Court of Australia in *Wayde v New South Wales Rugby League Ltd*,³² the most commonly cited Australian unfair prejudice case,³³ and has also been applied in a number of subsequent Australian cases.³⁴

For example, in *Re Norvabron Pty. Ltd*, Derrington J considered the principles applicable to a just and equitable winding up in *Ebrahimi*³⁵ (the same principles applied by Richardson J in *Thomas*), and concluded that 'precisely the same considerations apply to [the unfair prejudice provision], where the relationship of those persons inter se is the foundation of the remedy'.³⁶ Similarly, in *Re Dalkeith Investments Pty. Ltd*, McPherson J implied that in cases where the facts justified a just and equitable winding up, relief would also be available under the unfair prejudice provision. The basis for this finding was that the parties had 'entered into an arrangement, which was no doubt implied rather than expressed, the substance of which was that they constituted a partnership in corporate form'.³⁷

In more recent Australian cases too,³⁸ the liberal attitude taken by Richardson J, in *Thomas* and in later New Zealand cases, to unfairly prejudicial conduct continues to be applied. In *Raymond v Cook*, for example, the court relied on *Thomas*, *Wayde* and *Ebrahimi* in concluding that equitable considerations should, where appropriate, be superimposed upon the dealings between company shareholders and that, while conduct that will justify a winding up on just and equitable grounds will not necessarily always secure relief on an unfair prejudice application, 'there is a considerable area of overlap'.³⁹

Relief under the Australian unfair prejudice provisions does not require a want of good faith or probity. It is not a condition of relief under Part 2F.1 that the persons whose conduct is alleged to be unfairly prejudicial act with a dishonest motive, purpose or intention; it is the effect of their conduct that is material.⁴⁰

C. United Kingdom (Pre-O'Neill)

Section 994 of the *Companies Act 2006* (UK), like its predecessor, s 459 of the *Companies Act 1985*, allows a remedy for conduct which is 'unfairly prejudicial to the interests of [a company's] members generally, or to some part of its members'. In keeping with the

ACLC 421, the first Australian case after the provision's amendment. In *Jeffery*, the court held that earlier cases in which the term 'oppression' had been discussed and defined should be used to provide guiding principles to the courts hearing cases under the reworded provision. This interpretation is described by Baxt as 'disappointing', given the obvious legislative intention to broaden the application of the remedy. The *Jeffery* case is now considered to be of little value, given the preference shown in later judgments for Richardson J's more liberal approach: see, eg, *Morgan v 45 Flers Avenue Pty. Ltd* (1986) 10 ACLR 692, 704.

32 (1985) 180 CLR 459, 468-472.

33 Ian Ramsay notes that, in 88 judgments between 1961 and 1997, *Wayde* was applied or referred to 26 times (29.6 per cent of cases), 10 more times than the next most cited case, while *Thomas* was applied in a further six cases (6.8 per cent): 'An Empirical Study of the Use of the Oppression Remedy' (1999) 27 *Australian Business Law Review* 23, 29 and 37.

34 John Farrar, *Corporate Governance: Theories, Principles and Practice* (3rd ed, 2008) 208-210. Farrar lists a total of 17 Australian cases which have followed *Thomas* between 1985 and 2000, suggesting that some of the citations of *Wayde* noted by Ramsay also include at least indirect reference to Richardson J's comments in *Thomas*.

35 [1973] AC 360.

36 (1987) 5 ACLC 184, 214.

37 (1985) 3 ACLC 74, 79.

38 See also: *Parker v National Roads and Motorists Association* (1993) 11 ACSR 370, 380; *Coombs v Dynasty Pty. Ltd* (1994) 14 ACSR 60, 82; *Re D. G. Brim and Sons Pty. Ltd* (1995) 16 ACSR 559, 588; and *Re George Raymond Pty Ltd* (2000) 18 ACLC 85, 90.

39 (1998) 29 ACSR 252, 264.

40 Robert P Austin and Ian M Ramsay, above n 5 [11.450]. In *Re Quest Exploration Pty Ltd* (1992) 6 ACSR 659, 669, for example, Mackenzie J noted Richardson J's comments in *Thomas* and those of Lush J in *Re M. Dalley and Co. Pty Ltd* (1968) 1 ACLR 489, 492 to this effect, and concluded that 'want of probity is only one of the ways in which oppression can manifest itself ... [The provision] speaks of oppression in terms of its impact on the oppressed, not in terms of the impact of the oppressor'. See also *Fexuto Pty. Ltd v Bosnjak Holdings Pty. Ltd* (1998) 28 ACSR 688, 703 and *Popovic v Tanasijevic (No. 5)* (2000) 34 ACSR 1, 71.

approach applied elsewhere, it was, until 1999, consistently held in the UK that illegality or bad faith by those in control of a company is not necessary for a remedy to be granted:

It is not necessary for the petitioner to show that the persons who have had de facto control of the company have acted as they did in the conscious knowledge that this was unfair to the petitioner or that they were acting in bad faith; the test, I think, is whether a reasonable bystander observing the consequences of their conduct, would regard it as having unfairly prejudiced the petitioner's interests.⁴¹

This statement has been cited with approval in a large number of subsequent cases,⁴² indicating general agreement with the approach taken in New Zealand and Australia.

Until 1999, it was also commonly held in the UK that 'unfair prejudice' could encompass the breach of a shareholder's legitimate expectations, not necessarily limited to those matters set out in the company's constitution or in other express agreements.⁴³ For example, in *Quinlan v Essex Hinge Co. Ltd*⁴⁴ it was held that a minority shareholder and director was entitled to relief after being excluded from the management of a company, even though the strict terms of his service agreement allowed for his dismissal as a director upon six months' notice. In addition, the majority shareholder claimed that he considered the applicant to be his employee rather than his business partner, and that the applicant's directorship was merely a 'courtesy title'. The court, however, concluded that the applicant had established a legitimate expectation of continued participation in management, on the basis of 'an understanding' to that effect, and that he would participate in the conduct of the company's business over and above the specific areas defined in the service agreement.

In similar circumstances, it was noted in *Richards v Lundy* (decided before, though reported after, *O'Neill v Phillips*) that although it is

usually appropriate to treat the company's articles as representing the agreed contractual position between the shareholders, and therefore not to regard as unfair any action which the articles sanction, ... this is one of the cases, not all that infrequent, in which the personal relationships within a small company have given rise to legitimate expectations which, as a matter of equity, must be taken into account.⁴⁵

The court held that, despite the lack of any statement to this effect in the articles, and despite the applicant's minimal (10 per cent) shareholding, it was 'clearly understood' that he would participate in the company's management. His exclusion was, therefore, unfairly prejudicial.

IV. THE O'NEILL CASE

O'Neill v Phillips represents a shift away from the previous liberal approach to the unfair prejudice remedy in the UK. The case involved a similar situation to both the *Quinlan* and *Richards* cases noted above. The applicant, O'Neill, was given a 25 per cent shareholding in the company by Phillips, the then sole shareholder and director, who expressed the hope that O'Neill would assume responsibility for managing the company, in which case he would receive half of the company's profits. O'Neill duly did take over the running of the

⁴¹ *Re R.A. Noble and Sons (Clothing) Ltd* [1983] BCLC 273, 290, citing the words of Slade J in *Re Bovey Hotel Ventures Ltd* (Unreported, Chancery Division, 31 July 1981).

⁴² See eg, *Re London School of Electronics Ltd* [1986] 1, Ch 211; *Re Sam Weller and Sons Ltd* [1990] Ch 682; *Re Elgindata Ltd* [1991] BCLC 959; *Re J.E. Cade and Son Ltd* [1992] BCLC 213; *Re Little Olympian Each-way Ltd (No. 3)* [1995] 1 BCLC 636; *Re Regional Airports Ltd* [1999] 2 BCLC 30; and *Richards v Lundy* [2000] 1 BCLC 376.

⁴³ Giora Shapira describes the 'legitimate expectations' principle as 'the key concept' and 'centre-piece of the jurisdiction' under s 459 of the 1985 Act until its revision in *O'Neill v Phillips* [1999] 1 WLR 1092: 'The Hand that Giveth is the Hand that Taketh Away — *O'Neill v Phillips* and Shareholder "Legitimate Expectations"' (2000) 11 *Australian Journal of Corporate Law* 260, 261 and 270. See also David Bouchier, 'The Companies Act 1989 — Yet Another Attempt to Remedy Unfair Prejudice' [1991] *Journal of Business Law* 132, 137-142; Christopher Riley, 'Contracting Out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts' (1992) 55 *Modern Law Review* 782, 792-796; and Lynden Griggs and John Lowry, 'Minority Shareholder Remedies: A Comparative View' [1994] *Journal of Business Law* 463, 466-468.

⁴⁴ [1996] 2 BCLC 417.

⁴⁵ [2000] 1 BCLC 376, 393.

company and subsequently entered negotiations with Phillips to increase his shareholding to 50 per cent. Market conditions then changed, the company's fortunes declined and Phillips decided to resume personal control of the company. O'Neill was removed from his management position and the agreement that he would receive a 50 per cent shareholding in the company, and continue to receive 50 per cent of the profits, never eventuated. O'Neill sought an order that he be bought out by Phillips under s 459 of the 1985 Act.

It was, in the words of Shapira, 'a run-of-the-mill unfair prejudice case, which would not have commended much attention if it were not for the House of Lords' reversal'.⁴⁶ The Court of Appeal took what had hitherto been the conventional approach, finding that the absence of a conclusive agreement that O'Neill's shareholding would be increased did not prevent him from having a legitimate expectation that it would.⁴⁷ The House of Lords, however, adopted a narrower view. Lord Hoffmann accepted that the 'just and equitable' principle underlying the *Ebrahimi* decision⁴⁸ was equally applicable to s 459 but, contrary to the earlier cases, he saw the basis of this principle to be good faith on the part of those in control of the company:

Company law has developed seamlessly from the law of partnership, which was treated by equity ... 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 ... Thus unfairness may consist in a breach of the rules [on which it is agreed that the affairs of the company should be conducted] or in using the rules in a manner which equity would regard as contrary to good faith.⁴⁹

On the issue of 'legitimate expectations',⁵⁰ Lord Hoffmann concluded that 'the concept ... should not be allowed to lead a life of its own, capable of giving rise to equitable restraints in circumstances to which traditional equitable principles have no application', and that legitimate expectations should only be held to have been frustrated when the conduct in question 'would be contrary to what the parties, by words or conduct, have actually agreed'.⁵¹ In this case, as no binding, unconditional promise had been made regarding the matters in question, it was held that no unfair prejudice had occurred. O'Neill had a 'reasonable' expectation that these things would happen (in the sense that they appeared reasonably likely to him) but not a 'legitimate' expectation, as redefined by his Lordship.

O'Neill v Phillips has since been followed in a number of cases, including *Re Guidezone Ltd*, where Parker J summarised the effect of the case as follows:

O'Neill v Phillips establishes that 'unfairness' for the purposes of s 459 is not to be judged by reference to subjective notions of fairness, but rather by testing whether, applying established equitable principles, the majority has acted, or is proposing to act, in a manner which equity would regard as contrary to good faith ... Applying traditional equitable principles, equity will not hold the majority to an agreement, promise or understanding which is not enforceable at law unless and until the minority has acted in reliance on it.⁵²

In Parker J's opinion, such reliance will most often occur in the case of agreements or understandings reached when a company was formed, by the minority's entering into the company in the first place. But the same cannot be said of subsequent agreements which are not, themselves, enforceable at law. There will be no lack of good faith (and therefore no 'unfairness') unless the majority allows a minority to act in reliance on such an agreement.

⁴⁶ Shapira, above n 43, 260, 261 and 266.

⁴⁷ [1997] 2 BCLC 739, 767.

⁴⁸ [1973] AC 360. See II THE UNFAIR PREJUDICE REMEDY: BACKGROUND AND PURPOSE above.

⁴⁹ [1999] 1 WLR 1092, 1099.

⁵⁰ A term Lord Hoffmann had himself used previously: see *Re Saul D. Harrison and Sons plc* [1995] 1 BCLC 14, 19.

⁵¹ [1999] 1 WLR 1092, 1101-1102.

⁵² [2000] 2 BCLC 321, 355. See also *Anderson v Hogg* [2002] SLT 354, where Lord Prosser (dissenting, but not on this point) said at [9] that 'having regard to what was said in *O'Neill* and *Re Guidezone Ltd*, it seems to me that [a] finding of good faith provides a proper basis for holding that unfairness was not established'.

V. REACTION TO *O'NEILL* IN NEW ZEALAND AND AUSTRALIA

The most recent New Zealand cases to discuss the unfair prejudice remedy in detail confirm that the New Zealand courts are standing by their previous more liberal approach despite what the House of Lords said in *O'Neill*.

A. *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328⁵³

This is perhaps the most significant recent New Zealand case. The plaintiffs were shareholders in a listed company, and brought a case under s 174 of the *Companies Act 1993* alleging that the company had been managed unfairly prejudicially. In particular, they claimed that their legitimate expectation of a return on their investment had not been met due to flawed management policies. The Court of Appeal (upholding the decision of the High Court) held that, although s 174 does apply to listed companies, in this case the plaintiffs were not entitled to a remedy. In the case of a large publicly listed company, minority shareholders have no legitimate expectation of being involved in (or of influencing) management. In such companies, the constitution will generally set out the parties' rights and obligations exhaustively, which will not necessarily be the case in small closely held companies.

In coming to this decision, Hammond J, delivering the court's judgment, noted⁵⁴ that the High Court had questioned whether the *Thomas* principles should continue to apply, in light of the suggestions by the English courts that 'the law in this area has moved on' since the *Thomas* and *Ebrahimi* cases.⁵⁵ After considering both the decision in *O'Neill* and the alternative approach employed in *Thomas* and subsequent cases in some detail, Hammond J came out firmly on the side of the latter. He noted the lack of any concern by the New Zealand courts as to the approach adopted in *Thomas*⁵⁶ and, after considering recent analysis of unfair prejudice cases in the UK,⁵⁷ identified the main problem in that country to be the length and complexity of proceedings and the costs thereof, rather than any fault in the courts' approach per se. He also noted the English Law Commission's recommendation that the way forward was through better case management, and not through changing the law.⁵⁸ His conclusion was that the House of Lords was correct in its statement that the remedy should not provide a 'right to exit at will' for disgruntled company shareholders — a right of 'no fault divorce' as Lord Hoffmann put it⁵⁹ — but that the *O'Neill* approach should nonetheless be rejected on three grounds:⁶⁰

1. The economic danger that senior executives and directors might avoid smaller companies for fear of being 'locked in'.
2. The doctrinal danger that the *O'Neill* approach effectively narrows what is 'fair' down to what is defined by pre-existing formal arrangements. Hammond J thought that, although the House of Lords' approach conforms with the economists' theory of the firm (as a 'nexus of agreements'),⁶¹ the approach in *Thomas* is more appropriate: 'This is because something may be lawful and "expected", but still be unduly prejudicial'.

53 The Court of Appeal's decision was upheld by the Supreme Court: (2004) 17 PRNZ 552. The approach taken in the *Latimer* case was most recently accepted as the 'proper approach' to s 174 in *Dunning v Chabro Holdings Ltd* (2007) 10 NZCLC 264,213, 264,225.

54 [2005] 2 NZLR 328, 340-341.

55 (2004) 9 NZCLC 263,358, 263,365.

56 [2005] 2 NZLR 328, 341.

57 See, eg, The Law Commission (UK), *Shareholder Remedies*, Law Com No. 246 (1997) pt 9.

58 [2005] 2 NZLR 328, 342. See The Law Commission (UK), above n 57, pt 17.

59 See *O'Neill v Phillips* [1999] 1 WLR 1092, 1107-1108.

60 [2005] 2 NZLR 328, 344-345.

61 As discussed below, VI ECONOMIC ANALYSIS OF THE UNFAIR PREJUDICE REMEDY, this is not quite correct. 'Agreements', in the economic sense, are not confined to express, fully articulated bargains.

3. The problem of excessive, time-consuming and costly litigation, which seems to have been behind the *O'Neill* decision to a large extent, has not in fact been solved by the restrictive approach adopted by Lord Hoffmann.⁶²

B. Re Environmental Products (New Zealand) Ltd (2005) 9 NZCLC 263,779

This case concerned a breakdown in the relationship between participants in a possum hide tanning and processing business. The disagreement led to the plaintiffs ceasing to work for the company on a day-to-day basis.

Heath J noted, and purported to adopt, Lord Hoffmann's words in *O'Neill*, including that the affairs of a company are governed by formal agreements made between shareholders, which may only be overridden if the conduct in question is contrary to good faith.⁶³ However, he also found that unfair prejudice had occurred, despite finding 'no intention on the part of [the defendants] to prejudice [the plaintiffs]' and 'expressly refrain[ing] from making findings on allegations of dishonesty' — that is, of conduct that was contrary to good faith.⁶⁴ Instead, his Honour's decision was based on the lack of trust and confidence that had developed between the parties, making it 'impracticable for [them] to work together in the future'.⁶⁵ This is much closer to the approach taken in the *Thomas* and *Latimer* cases (despite neither case being directly referred to) than it is to that applied in *O'Neill*.

C. Johnson v Sneyd [2005] NZHC 348

The situation in this case was, in some ways, similar to that in the *Environmental Products* case. The basis of the plaintiff's complaint was that there had been a complete breakdown in trust between the parties (the directors and shareholders of a small printing company) and that a continuing business relationship was therefore untenable. Among the specific allegations were forgery by the defendant of the plaintiff's signature on company documents, unauthorised transfers of company funds and other self-interested conduct. Goddard J found that these allegations were made out and that they amounted to 'serious allegations of bad faith'.⁶⁶ However, she was also careful to note (relying on *Latimer* and *Thomas*) that bad faith or lack of probity is not required for a remedy under s 174, and that the parties' reasonable expectations, not restricted to purely internal or formal expectations, are distinctly relevant in assessing whether conduct is unfairly prejudicial.⁶⁷

D. Australian Cases

The first Australian case to consider the approach to unfair prejudice put forward in *O'Neill* in detail was *Fexuto Pty. Ltd v Bosnjak Holdings Pty. Ltd*,⁶⁸ a case involving a corporate 'partnership' between family members. The appellant claimed that he had been 'alienated from decision-making' contrary to the principle of equality and consensus management upon which the company had been founded. The New South Wales Court of Appeal agreed, with Spigelman J noting that

the appellant was not able to point to any document, nor give any evidence of any conversation, by which the 'understanding' for which it contended was created. There was no evidence of any communication constituting any such understanding, or on the basis of which any express understanding could be inferred. The case, in this respect, was entirely a

62 Hammond J noted the survey of post-*O'Neill* unfair prejudice case law in David Milman, 'Unfair Prejudice: The Litigation Goes On, and On ...' (2004) 13 *Sweet and Maxwell's Company Law Newsletter* 1.

63 (2005) 9 NZCLC 263,779, [49].

64 *Ibid* [62] and [64].

65 *Ibid* [53].

66 [2005] NZHC 348 (Unreported, High Court Wellington, Goddard J, CIV-2004-435-84, 7 December 2005), [4] and [46].

67 *Ibid* [8]-[10].

68 (2001) 37 ACSR 672.

circumstantial one. The right to participate was to be established by a process of inference. Such an inference may be drawn in an appropriate case.⁶⁹

Priestley JA held that

the conduct of all concerned parties ... in my opinion showed a set of mutually accepted understandings giving rise to a situation [where] ... it would be arguable that it would properly be unjust, inequitable or unfair for a majority in [the defendant company] to use their voting power to exclude [the appellant] from participation in the management without giving him the opportunity to remove his capital upon reasonable terms.⁷⁰

The major part played by the appellant in building the business, and its family nature, were considered significant factors contributing to the appellant's case that he had a legitimate expectation of not being excluded from management.

Although the court in *Fexuto* (and Priestley JA in particular)⁷¹ discussed the *O'Neill* case at length, apparently with approval, the approach taken by the court is actually more in keeping with that employed in *Thomas* and *Latimer*. Farrar and Laurence Boule make the point that although no unequivocal disagreement is expressed with Lord Hoffmann's statements in *O'Neill*, neither is it 'clear whether the Court of Appeal agrees with this conservative revisionism. One detects a mild scepticism in the judgments'.⁷²

Some of the comments of the court in *Fexuto* are certainly inconsistent with Lord Hoffmann's judgment in *O'Neill*. For example, as well as accepting the possibility of an 'understanding' between shareholders which, though established only by a process of inference, could still give rise to a legitimate expectation of continued participation in management, Spigelman J also specifically rejected the assertion that the unfair prejudice remedy applied only to situations 'which equity would regard as contrary to good faith':⁷³

In *Ebrahimi* ... as in other authorities, reference is made to situation in which equity as a formal body of doctrine would intervene to prevent the exercise of the legal right. The statutory remedy, whether expressed in terms of winding up on the 'just equitable ground' or in terms of 'oppression' or 'unfair prejudice' or 'unfair discrimination', *does not apply only to situations in which equity would intervene*. No doubt the principles reflected in the formal doctrines of equity will assist the court in reaching the judgment for which the statutory provisions, respectively, provide. Nevertheless, the terminology employed by the Parliament was not of a technical character and was intended to confer a wide jurisdiction on the courts.⁷⁴

Other recent Australian cases also indicate a continued adherence to the pre-*O'Neill* approach to the unfair prejudice remedy. For example, in *Benjamin Corp. Pty. Ltd v Smith Martis Cork and Rajan Pty. Ltd*,⁷⁵ Carr J accepted that the plaintiffs had a reasonable expectation of continued involvement in the company's management. This finding was based in part on a verbal agreement between the parties that they would acquire and conduct the business together, and in part on 'common assumptions' that the court held were shared by the parties. These assumptions arose from the parties' previous personal and business relationships, rather than from any agreement as such.

69 Ibid 679.

70 (2001) 37 ACSR 672, 749. See also *McEwen v Combined Coast Cranes Pty. Ltd* (2002) 44 ACSR 244, 251-252.

71 See (2001) 37 ACSR 672, 742-745.

72 John Farrar and Laurence Boule, 'Minority Shareholder Remedies — Shifting Dispute Resolution Paradigms' (2001) 13 *Bond Law Review* 272, 289. The same could perhaps be said of the judgment in *Re Environmental Products (New Zealand) Ltd*, above n 63.

73 See *O'Neill v Phillips* [1999] 1 WLR 1092, 1099 and *Re Guidezone Ltd* [2000] 2 BCLC 321, 355, noted above.

74 (2001) 37 ACSR 672, 679 (emphasis added).

75 [2003] FCA 1471 (Unreported, Federal Court of Australia, 11 December 2003) [50] and [81]-[82].

VI. ECONOMIC ANALYSIS OF THE UNFAIR PREJUDICE REMEDY

The pre- and post-*O'Neill* approaches to the unfair prejudice remedy agree that its purpose is to enforce the 'bargain' between the parties.⁷⁶ The difference between the two approaches lies in the content of this bargain: does it consist only of express, fully articulated terms, or will something less than that suffice? An economic analysis provides a coherent theoretical framework to answer this question.⁷⁷

In economic terms, a company is considered a 'legal fiction serving as a nexus for a set of contracts that are different from and presumably more efficient than those which would arise in the market'.⁷⁸ In other words, it is a 'pre-packaged legal form which is made conveniently and cheaply available' and which 'has been adjusted over time to reflect the needs of its users; current users thus benefit at low cost from the accumulated experience of previous users'.⁷⁹ It minimises the costs of doing business because its pre-packaged features supply, as standard terms, things that the parties would otherwise have to expressly adopt. The reasons that such terms are not generally fully articulated include the costs (in terms of time and resources) of setting out an express bargain, and the difficulty in clarifying the content of such an agreement, given imperfections in information and communication.⁸⁰ As well as this 'generalised hypothetical bargain', based on universally accepted commercial practice, there also exists the possibility of a 'particularised bargain', consisting of rights and expectations that are not subject to express contractual provision. The terms of such a bargain should, in economic terms, not be treated any differently to expressly agreed terms, provided they are 'founded on a fundamental understanding, or shared expectation'.⁸¹

Based on this framework, Cheffins concludes that

economic theory suggests that in applying the [unfair prejudice] remedy, the courts should focus on the content of the agreement between the participants, both in relation to express clauses *and what the agreement would have been if negotiations had been costless ...* Where the participants had not actually agreed on the matter in question, the next step would be to consider the matter in terms of a hypothetical bargain ... In certain situations *the nature of the corporation and the circumstances under which the applicant became involved in the business* might provide some assistance.⁸²

VII. CONCLUSION: WHO HAS IT RIGHT?

O'Neill v Phillips leaves no room for the alternative approach to unfair prejudice, which recognises that legitimate expectations could be based on personal circumstances or on generally accepted commercial standards, rather than just on formalised arrangements.⁸³ The scope for relief for unfair prejudice is thus now much more limited in the UK than it has been in the past, or than it continues to be in either New Zealand or Australia.

The revision of the remedy in *O'Neill* seems at odds with its apparent purpose — the enforcement of the 'hypothetical bargain' — a purpose evident from consideration of the

76 See, eg, Lord Hoffmann's reference to 'what the parties ... have actually agreed' in *O'Neill v Phillips* [1999] 1 WLR 1092, 1101-1102; and the 'set of mutually accepted understandings' referred to by Priestley JA in *Fexuto Pty. Ltd v Bosnjak Holdings Pty. Ltd* (2001) 37 ACSR 672, 749.

77 See Brian Cheffins, above n 2; Dan Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the Companies Act 1985' (1988) 8 *Oxford Journal of Legal Studies* 55; and Robert Goddard, 'Enforcing the Hypothetical Bargain: Sections 459-461 of the Companies Act 1985' (1999) 20 *The Company Lawyer* 66.

78 Brian Cheffins, above n 2, 784.

79 Dan Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461 of the Companies Act 1985' (1988) 8 *Oxford Journal of Legal Studies* 55, 59.

80 Brian Cheffins, above n 2, 785.

81 Robert Goddard, 'Enforcing the Hypothetical Bargain: Sections 459-461 of the Companies Act 1985' (1999) 20 *The Company Lawyer* 66, 74-76; Elizabeth Boros, *Minority Shareholder Remedies* (1995) 137.

82 Brian Cheffins, above n 2, 792-793 (emphasis added). See also Dan Prentice, above n 79, 75.

83 Giora Shapira, above n 43, 268-269; Bryan Clark, 'Unfairly Prejudicial Conduct: A Pathway Through the Maze' (2001) 22 *The Company Lawyer* 170, 173.

Ebrahimi case, and the consistent adoption of its principles by the courts of all jurisdictions with similar provisions.

This conclusion is supported by an economic analysis of the remedy. This suggests that Lord Hoffmann was wrong to limit the ‘bargain’ that is enforceable under the remedy to legally enforceable terms. Provided they have been agreed to by all parties (whether expressly or impliedly), expectations based on any form of agreement, however poorly articulated, should be considered ‘legitimate’ under the unfair prejudice provision.