On Divorce: The atomic bomb, the sell-out or the pre-nuptial agreement?

'The speech of Lord Hoffmann in the case of *O'Neill v Phillips* [1999] 1 WLR 1092 says everything which needs to be said about section 459 of the Companies Act 1985 and (by implication) section 122 (1)(g) of the Insolvency Act 1986.' Discuss that proposition.

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Introduction

Formerly one of the most stagnant and moribund areas of company law, due in large part to the stringent requirements laid out in section 210 of the 1948 Act, has now, arguably, become one of the most active.[1] The advent of s459 was seen as a golden new dawn for the rights of the minority shareholder against a background in which majority rule is regarded as fundamental.[2] Given the recent Law Commission's Report on *Shareholder Remedies*,[3] which, *inter alia*, sought to improve the expediency and cost of s459 litigation through a more efficacious case management system, it seems rather appropriate that *O'Neill v Phillips*[4], the first case in the House of Lords to undertake directly an examination of the minutiae of the section, will now have the opportunity to offer a definitive account of this area of law. It will be seen that *O'Neill*, where it might not say everything expressly, certainly by implication, or at least by omission, is so far the most conclusive case on the subject of a s459 petition, especially if it is read in light of *Re Saul D Harrison & Sons Plc*.[5] It is difficult, even for a decision of the House of Lords, to offer a completely determinative account of the law, but if we are to interpret 'everything' as meaning anything that warrants either a clarification or a re-appraisal, then Lord Hoffmann's attempt is a commendable one. His Lordship gave the leading judgment in the case, scrutinising four of the most important aspects of the remedy's operation:

- The concept of unfairness and equitable considerations in a s459 petition;
- The nature of 'legitimate expectations' and the scope of its ambit;
- The availability of a right to 'exit at will' and the concept of a 'No-fault divorce'; and
- The most important remedy under s461: an offer to buy the petitioner's shares at a 'fair' value.

[1] B Clark: *Unfairly Prejudicial Conduct* SLT 1999 Issue 38
[2] See e.g. *Prudential Assurance v Newman Industries* [1982] Ch. 204, in which the Court of Appeal supported the rule in *Foss v harbottle* (1843) 2 Hare 461
[3] Law Commission no 246 CM 3769, The Stationary Office, 1997
[4] [1999] 2 BCLC 1
[5] [1995] 1 BCLC 14

In part 1 I will use these four heads as a guide to discuss the impact of the case on the compass and subsequent potency of a s459 remedy, and, in part 2, the position of a 'just and equitable' winding-up petition under s122(1)(g) will be examined in light of Lord Hoffmann's learned judgment.

PART 1

The concept of fairness

The concept of 'fairness' is the overarching principle around which s459 operates. The notion of fairness must facilitate two roles which are in constant tension. Firstly, it must be active in encouraging the liberalisation and enhanced scope of minority shareholder protection. Its predecessor, s210 of the Companies Act 1948, which talked in terms of oppression[6], was unduly restrictive and therefore redress could often only be had under the usually less than satisfactory remedy of what is now a s122(1)(g) winding-up. Secondly, as Lord Hoffmann mentioned in *O'Neill*[7], the ambit of its application cannot be broadened too widely; minority protection must never be seen to be encroaching too substantially on majority rule. Indeed, '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. memorably said in *In re J. E. Cade & Son Ltd.*[8]: "The court . . . has a very wide discretion, but it does not sit under a palm tree".'[9] Nevertheless, the courts, in something of a reversal from their previous non-interventionist position, with perhaps the teleological approach taken by the European Courts becoming increasingly more prevalent, still wield a considerable degree of discretion, and the wording and purposive interpretation of the section has conferred a wide power on the courts to do what appears 'just and equitable'. The starting point for the notion of unfairness, and thus a s459 petition, must therefore always be the case of *Ebrahimi v Westbourne Galleries*.[10]

In *re Saul D Harrison & Sons Plc.*[11], Lord Hoffmann agreed with the petitioner when he said the 'only test for unfairness was whether a reasonable bystander would think that the conduct in question was unfair.'[12] The court is therefore applying an objective standard of fairness, looking not at the nature of the unfairness, but the impact that that unfairness has had on the petitioner.[13] In establishing

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[6] Viscount Simonds adopted the dictionary definition of the word i.e treatment which was 'burdensome, harsh and wrong': *Scottish Co-operative Wholesale Society Ltd. v Meyer* [1959] AC 324
[7] *O'Neill v Phillips* [1999] 2 BCLC 1 at p.8g
[8] [1992] B.C.L.C. 213, at 227
[9] [1999] 2 BCLC 1 at p.7e
[10] [1973] AC 360
[11] [1995] 1 BCLC 14
[12] *Ibid.* at p.17f
[13] As was stated by Nourse J in *Re RA Noble & Sons (Clothing) Ltd.* [1983] BCLC 273, 290-291 when quoting the dictum of Slade J in *Re Bovey Hotel ventures Ltd.* (Unreported, 31 July 1981): 'The test of unfairness must, I think, be an objective, not a subjective, one. In other words 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'.

whether the conduct complained of was unfair or not, regard must always be had to the background[14] and context of the economic milieu in which the company inhabits, and more particularly, its constitution; fairness is not capable of a definition in a vacuum. Nor does the notion of unfairness discriminate between lawful and unlawful conduct. In a classic *Ebrahimi*[15] situation, the respondents acted perfectly lawfully and yet their conduct was held to be unfair on the 'just and equitable' ground; in *Jesner v Jarrad Properties Ltd.*[16] the directors acted in a manner which contravened various sections of the Companies Act 1985, yet their conduct was held not to be unfair. The standard of fairness is only concerned with how one's conduct impacts on another, and it is useful to examine the factors which the law actually takes into account in setting the standard.

It is firmly established that fairness should always be construed in the light of the commercial relationship and the prevailing economic climate. This will invariably need to be analysed on a case to case basis. The articles of association will almost certainly be the commercial and contractual nexus that governs the relationships of the shareholders *inter se* and with the company itself.[17] The articles determine the powers of the board and the company in general meeting and everyone who becomes a member of a company is taken to have agreed to them.[18] 'Since keeping promises and honouring agreements is probably the most important element of commercial fairness, the starting point in any case under s 459 will be to ask whether the conduct of which the shareholder complains was in accordance with the articles of association.'[19] It seems clear that the articles of association will, in all but the rarest of cases, even in very small, privately run companies, govern the entire relationship between the members; for any relaxation of this will undoubtedly disturb one of the most fundamental tenets in company law encapsulated by s14 of the Act. Those who freely enter into incorporation are thus bound by its terms; if one were able to freely renege on the provisions contained in the articles or memorandum, merely because some commercial hardship materialised which might be construed as 'unfair', then the corporate structure would be meaningless.

Substantively, a member of a company will only have grounds for pleading unfairness when one or more of the terms that the affairs of the company should be conducted by have been breached, or in some way used for an improper purpose. This must necessarily be qualified by *obiter* remarks made by Lord Hoffmann in *Re Saul D Harrison*[20], where he said that a s459 petition could not be used when merely technical or trivial infringements of the articles have occasioned. However, as we will see, sometimes it will be considered unfair for the company to rely on its strict legal rights, however lawfully impositioned. There are cases, such as when one has been excluded from management, in

[14] See *Jesner v Jarrad Properties Ltd.* 1994 SLT 83
[15] *Ebrahimi v Westbourne Galleries Ltd.* [1973] AC 360
[16] 1994 SLT 83
[17] *Hickman v Kent or Romney Marsh Sheepbreeders Assoc.* [1915] 1 Ch. 881
[18] Section 14 of the Companies Act 1985
[19] *Ibid.* No. 17 Per Ld. Hoffmann p18a. However, the directors could exercise their powers *intra vires* the company, i.e. in accordance with the articles of association, but for an improper purpose, which would be a breach of their duty of care to the company. See *Howard Smith v Ampol Petroleum Ltd.* [1974] AC 821
[20] [1995] 1 BCLC 14 at p.18i

which the letter of the articles does not fully reflect the understanding upon which the shareholders are associated. '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'.[21]

Lord Hoffmann, in his reasoning in *O'Neill*, makes it clear that injustice in the sense of a 'just and equitable' winding-up and unfairness in the sense of a s459 petition are so analogous as to be almost synonymous, *but only in terms of content*, and therefore the starting point in both situations is Lord Wilbeforce's speech in *Ebrahimi*[22], and the 'equitable considerations' it has given rise to.

Equitable Considerations

Despite the insurmountable obstacle in *O,Neill's* case rendering a s459 petition inapplicable[23], the question still remains, what is *now* needed to define the circumstances in which these questions of equity or fairness arise? Equitable considerations are said to hinge on the fact that, before incorporation, there existed a personal relationship between the parties that gave rise to a mutual confidence, and, in the majority of cases, a *prima facie* right to be engaged at all times in the running or management of the business. Certainly the fact that a company is a small one, or a private company, is not enough.[24] 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 articles. The superimposition of equitable considerations requires 'something more'[25], 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 (*Ebrahimi* being the seminal case on this issue);

(ii) an agreement, or understanding, that all, or some (for there may be "sleeping" members[26]), 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; and

[21] [1999] 2 BCLC 1at p.8a
[22] [1973] AC 360
[23] [1999] 2 BCLC 1 at p.12h
[24] Although it seems that public companies will rarely succeed in a s459 petition: See *Re Astec (BSR) Plc.* [1998] 2 BCLC 556 and *Re Leeds Utd. Holdings Plc.* [1996] 2 BCLC 545
[25] *Gibbs Palmer (Holdings) Ltd v Gibbs Palmer (Midland) Ltd* per Lord Caplan 1999 GWD 36-1730
[26] See Megarry J in *Re Fildes Bros. Ltd.* [1970] 1 WLR 592 at 596

(iv) Lord Hoffmann adverted to this specifically in his judgment: unfairness may be present when the majority maintains the parties' association in circumstances where the minority 'can reasonably say it did not agree to[27]': *non haec in foedera veni*.[28]

Companies which reflect these features are often referred to as 'quasi-partnerships'. This term, however, although now firmly subsumed into judicial parlance, must always be used with caution[29]. Nevertheless, it remains a useful gauge to differentiate between companies where equitable considerations arise and those where they do not have to be drawn, both in cases where winding up on the just and equitable ground is claimed, and where relief from unfairly prejudicial conduct is sought. This liberal, more expansive approach, having regard to equitable considerations over and above strict legal rights is testament to the fact that a 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.'[30] This appraisal of the law has been giving statutory force in s459 when it is the 'interests of its members', and not just their legal rights, that may found a petition for unfair prejudice and thus embrace the 'equitable considerations' espoused by Lord Wilberforce above. It has been noted that to give a more precise definition of s459 may be unwise: 'Illustrations may be used, but general words should remain general and not be reduced to the sum of particular instances'.[31] Lord Hoffmann accepted this, stating that it is both impossible and undesirable to define exhaustively the circumstances in which equitable principles would preclude the exercise of legal rights; it was however the case that the manner in which 'equitable principles operate is tolerably well settled and … it would be wrong to abandon them in favour of some wholly indefinite notion of fairness'.[32] Indeed, because s459 petitions are often like a divorce, with lengthy and expensive litigation made even more exorbitant by spurious allegations and mudslinging hyperbole, the factors first espoused by Lord Wilberforce in *Ebrahimi* are essential because they will indicate when a petition is likely to succeed or not, and will therefore drive down the number of undeserving claims. Despite the Law Commission's concerns about adopting such an approach, it will be necessary for '…a balance … to be struck between the breadth of the discretion given to the court and the principle of legal certainty.'[33] Lord Hoffmann favoured this more restrictive approach, because in an area such as this, legal certainty is undoubtedly more desirous than ambiguous flexibility; parties must know of their relative success before embarking on such a lengthy and expensive journey. His Lordship was concerned too that the needle had perhaps shifted too far in favour of minority shareholders themselves, particularly in light of the Court of Appeal's judgment in *O'Neill*[34], where they held that

[27] *Virdi v Abbey Leisure Ltd.* [1990] BCLC 342
[28] [1999] 2 BCLC 1 at p.11d
[29] In *re Westbourne Galleries Ltd.* [1973] AC 360 at p.380: 'A company, however small, however domestic, is a company not a partnership or even a quasi-partnership …'
[30] *Ebrahimi v Westbourne Galleries Ltd.* [1972] 2 All ER 492 at 500
[31] *Supra.* At p.496
[32] [1999] 2 BCLC 1 at p.8h
[33] *Supra*
[34] *Re a Company* [1997] 2 BCLC 739

Mr. O'Neill had been constructively 'driven out' of P Ltd. on facts that would not have rendered it unfair for Mr. Phillips to withdraw from the negotiations.

Lord Hoffmann used *O'Neill* to establish the more restrictive approach to the principle of fairness, and, more pertinently, in light of the Court of Appeal's reasoning in the case, to re-examine the notion of 'legitimate expectation', which he held to be parasitic in nature and not capable of an independent or wholly separate existence, and thus needed to be tightened up and redefined more systemically, after his Lordship felt that his judgment in *Re Saul D Harrison*[35] was misapplied rather too frequently in subsequent cases.

Legitimate Expectation

The Court of Appeal in *O'Neill*, relying unduly heavily on Lord Hoffmann's 'legitimate expectation' yardstick first adumbrated in *Re a company*[36], found for Mr O'Neill, equating legitimate expectation as a precursor to unfairness, stating that if a legitimate expectation had been lost, then it invariably followed that it would be unfairly prejudicial to deny these expectations, and so a remedy under s461 should be given. In the present case, Mr. Phillips should offer to buy Mr. O'Neill's shares at a fair value.[37] Lord Hoffmann, presiding in the House of Lords, disagreed with the Court of Appeal, particularly their excessive reliance on 'legitimate expectation', which he said in his own judgment was perhaps 'a mistake' that he used this term.[38] He said that it should only exist as a corollary to the equitable principles discussed below, and 'should not be allowed to lead a life of its own'. It is implicit in his judgment that Hoffmann realised that his term had unduly broadened the ambit of successful redress under a s459 petition, and that the Court of Appeal 'may have been misled by the expression'[39] because they thought it was a cause, rather than a consequence, of the equitable restraint.[40] A 'legitimate expectation' properly so called in the Hoffmann sense, could never be stretched to the facts of *O'Neill*, when what was in dispute was not even an unconditional promise, but a conditional agreement that would only be made concrete if O'Neill had indeed reached the goals set for him. 'The real question is whether in fairness or equity Mr. O'Neill had a right to the shares. On this point, one runs up against what seems to me the insuperable obstacle of the judge's finding that Mr. Phillips never agreed to give them'.[41]

No-Fault Divorce

[35] [1995] 1 BCLC 14
[36] [1986] BCLC 376 at 379. Hoffmann J., as his Lordship was then, imported the concept of legitimate expectation from administrative law. See *Re Postgate and Denby(Agencies) Ltd.* [1987] BCLC 8 at p.14 for a definitive account of the concept.
[37] For what is a 'fair value' see later
[38] [1999] 2 BCLC 1 at p.11h
[39] [1999] 2 BCLC 1 at p.12h
[40] See *Co. Lawyer* Vol.20 no.7 p.221

Mr. O'Neill's counsel, Mr. Hollington, raised the interesting notion of a no-fault separation, especially in relation to a quasi-partnership; in other words, it did not matter whether Mr. Phillips had done anything unfair, the fact of the case was that the mutual confidence and trust between the parties had irretrievably broken down and therefore there ought to be a 'parting of the ways', and the unfairness lay in Mr. Phillips, who was not prepared to settle it in this amicable way. In essence, Mr. O'Neill should be allowed to recover his stake in the company automatically. It must be noted at this juncture that Lord Hoffmann, when speaking of a 'no-fault' divorce, meant it in the specific sense that a member or members (usually the minority) of the company, in the absence of any impropriety by the majority, will still be able to sell his shares in the company, and did not mean it in the more general sense of a winding-up. A s122(1)(g) petition may be granted in a no-fault scenario (provided fault in this sense connotes a degree of unfairness or *culpa*) if the mutual trust and confidence of the parties have broken down to such a degree that it would be 'just and equitable' to wind up the company. It would appear that Mr. Hollington was trying to merge together both s459 and s122(1)(g) by saying that it did not matter if Mr. Phillips had done anything unfair because the unfairness lay in not allowing Mr. O'Neill to recover his stake in the company. Surely this is just allowing s459 in by the back door by circumventing the crucial requirement of establishing unfairness *before* Mr. Phillips wished to be bought out? In this case, a s122(1)(g) petition would have been the more applicable action, when all that has transpired is the fact that the trust and confidence between the parties has broken down. Lord Hoffmann was highly dismissive of such a 'stark right of unilateral withdrawal'[42], and agreed with the Law Commission in that allowing recourse to such a notion would 'fundamentally contravene the sanctity of the contract binding the members and the company'.[43]

By implication, therefore, Lord Hoffmann preserves the status of s122(1)(g), and despite Gower and other commentators' contentions, the winding-up petition will remain an important remedy when all that can be established is that the mutual confidence between the parties has broken down to such an extent that it would be 'just and equitable' to wind up the company. However, its scope will be limited and only be adverted to as a 'remedy of last resort'.[44]

Share valuation machinery and the 'reasonable offer'

Where a petitioner is successful in showing that he has been treated in an unfairly prejudicial manner, the remedies available to the court are extensive.[45] The most important and widely used order under s461 is undoubtedly the ability of the courts to make the respondent purchase the shares of the

[41] [1999] 2 BCLC 1 at p.12h
[42] [1999] 2 BCLC 1 at p.14f
[43] Report No.246 (Law Society, 1997) at para. 3.66
[44] *Re A Company* [1997] 1 BCLC 479 at p.487
[45] Section 461 provides the court with an unlimited discretion in the granting of remedies for the relief of unfairly prejudicial conduct. Subsection 461(2) lists four (merely illustrative) orders. An order under s461(2)(d) providing for the purchase of the petitioner's shares by other members of the company or the company itself is by far the most common.

petitioner.[46] One significant lacuna in the statutory scheme is that no provision is expressly made for the principles of valuation to be applied where a court order is made pursuant to that section. We must thus turn to the courts to find the criteria that are used to arrive at a value for the petitioner's[47] shares.

In *O'Neill*, despite the finding that there had been no conduct that had been unfairly prejudicial, Lord Hoffmann thought it an area of 'such great practical importance'[48] that the mechanics of judicial share valuation should be analysed. The starting point in such matters is the case of *Re Bird Precision Bellows Ltd.*[49] which still remains an important and thorough case on the issue of share valuation. Nourse J., at first instance, gave the leading judgment and said that it was 'axiomatic that a price fixed by the court must be fair'.[50] The utility of this concept is understandably vague; each case must invariably be judged on what is fair in the light of its own facts, although some guidelines can be discerned from the various judgments made by the courts.[51]

Lord Hoffmann thought in *O'Neill* '… that parties ought to be encouraged, where at all possible, to avoid the expense of money and spirit inevitably involved in such litigation by making an offer to purchase at an early stage'. This is indeed a laudable idea, because for s459 to be wholly effective, costs have to be kept firmly under control[52], but in practice the complex mix of facts and law might prevent this from happening, even where machinery is in place that provides for an independent accountant to value the shares in light of any prejudice and on a *pro rata* basis.[53] Indeed, Lord Hoffmann starts his evaluation of the offer by stating that the purchase must be at a fair value, without a discount being taken for the fact that it is a minority shareholding.[54] A sale of shares will invariably be a petitioner's best remedy, short of a winding up, and it is therefore crucial to clearly establish what price should be sought for the shares transferred to the majority.[55] 'In my judgment the correct course would be to fix the price *pro rata* according to the value of the shares as a whole and without any discount, as being the only fair method of compensating an unwilling vendor of the equivalent of a

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[46] S461(2)(d) of the Companies Act 1985
[47] Note: it is not always the minority shares that will be bought: *In Re Jermyn Street Turkish Baths Ltd.* [1970] 1 WLR 1194
[48] [1999] 2 BCLC 1 at p.15d
[49] [1986] Ch. 658
[50] *Supra* at p.666
[51] *The Theory of the Firm: Minority Shareholder Oppression: Sections 459-461* DD Prentice OJLS 1988 vol. 8 No.1 (a) The price to be paid must not impound the consequences of the unfair prejudice. (b) A petitioner should not benefit from any contribution for the benefit of the company attributable exclusively to the efforts of the respondents, and vice versa. (c) a minority holding must not be discounted because it is a minority holding.
[52] *Re Unisoft Group Ltd (no.3)* [1994] 1 BCLC 609 at p 611e: 'Petitions under s459 have become notorious ... for their length, their unpredictability of management, and the enormous and appalling costs which are incurred upon [the parties involved in the litigation]'.
[53] *North Holdings Ltd. V Southern Tropics Ltd.* [1999] 2 BCLC 625
[54] However, this will not always be the case, particularly when the minority shareholding was not based on a prior personal relationship that has given rise to a quasi-partnership. Where the minority shareholding is purely for financial or commercial gain then a discounted offer, in the absence of nothing more, will usually be the basis for the valuation of the shares.
[55] Although sometimes the majority's shares will be transferred to the minority: *In re Jermyn Street Turkish Baths Ltd.* [1970] 1 WLR 1194

partnership share. Equally, if the order provided, as it did in *In re Jermyn Street Turkish Baths Ltd.*[56], for the purchase of the shares of the delinquent majority, it would not merely not be fair, but most unfair, that they should receive a price which involved an element of premium.'[57]

Does fairness under s459 only manifest itself when, after exclusion, an unfair price for the petitioner's shares is not given? Lord Hoffmann in *O'Neill* said himself that 'unfairness does not lie in the exclusion alone but in exclusion without a reasonable offer'. If the respondent to a petition has plainly made a reasonable offer, then the exclusion as such will not be unfairly prejudicial and he will be entitled to have the petition struck out. However, where litigation has commenced at a time when no reasonable offer has been made, as in *O'Neill v Phillips*, the offer will generally not be reasonable unless it includes an offer of costs as well.

In the past, a pre-emption clause or a 'put' article would preclude a section 459 petition if the valuation of the shares were 'of a fair price'.[58] Now however, if the respondent has made a fair offer to purchase the petitioner's shares on a *pro rata* basis, and the petitioner still seeks redress to the courts, even though the valuation given by the respondent was as much as he could have hoped for, then the petitioner should pay for the costs of the litigation.[59] Moreover, in another instance where the valuation need not always contain an offer to pay the petitioner's costs is where the majority has not been given a 'reasonable opportunity' to make an offer before he becomes obliged to pay costs. Where, therefore, a petition has been presented, and the majority shareholder has not had a reasonable time in which to make an offer, it need not follow that he must offer to pay costs.[60]

The Law Commission's proposal that there should be a statutory presumption that in cases such as these[61], the fair value of the shares should be determined on a *pro rata* basis.[62] This was endorsed in *O'Neill* by Lord Hoffmann as representing the current state of the law. This approach, firstly, that the shares should not be discounted because of the shareholder's minority status, but rather valued on a *pro rata* basis, and secondly, that the offer should be determined by an independent expert, has a lot to commend it. Not only will it circumvent the quagmire of facts that will have to be wallowed through, but it will also provide certainty and perhaps less resort to the courts when the majority has implemented share-value machinery which automatically takes account of these facts. Lord Hoffmann at once realises that both full arbitration or the 'half-way house ' of an expert will have their weaknesses, but proclaims that in all cases, the main objective should be 'economy and expedition', even if this might result in the 'possibility of a rough edge for one side or the other'. Lord Hoffmann's analysis of this area, however commercially efficacious it will be in practice, must surely

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[56] *Supra*
[57] [1986] Ch. 658 Oliver LJ, quoting Nourse J at p.667
[58] Per Lord Hoffmann in *Re a Company* (No. 006834 of 1988) *ex p Kremer* [1989] BCLC 365 at 367
[59] *Calderbank v Calderbank* [1976] Fam.93
[60] *Section 459 of the Companies Act 1985 - The House of Lords' View* Jenny Payne and DD Prentice (1999) 115 LQR 587
[61] I.e., is successful under s459
[62] The Law Commission (Shareholder Remedies (Law Com.No.246) Paras. 3.57 - 62

be qualified by the case of *North Holdings*[63], where resort to the court to value the shares at a 'reasonable and proper'[64] price was held to be needed, for it was thought that an accountant would not be competent to determine a fair price in light of the case's complicated issue of mixed fact and law.[65] Whether this approach taken by the Court of Appeal will be restricted to its particular facts, and only be used when an accountant could not possibly be asked to assess the valuation of a minority shareholding because of its complexity, or whether it will be applied more generally, is not known at present. In any event, it does seem to curtail the use of 'the fair offer', supported both by Lord Hoffmann and by the Law Commission[66], to alleviate any question of unfairness, and might once again signal a return to superfluous litigation when recourse to an accountant would be the more practical solution in all but the most unique of cases. Despite Aldous LJ's reasoning, in light of the facts of *North Holdings* itself, it would appear that an accountant would have been competent to evaluate a 'fair offer' since the profit made by Kasmare Ltd. From the use of Southern Tropics Ltd.'s assets would presumably have been only its saving of the additional costs of obtaining other funds or premises. *O'Neill* will thus have to be read with this qualification, however important it will prove to be in the future.[67]

What was not addressed in Hoffmann's analysis was the time at which the shares should be valued. Should it, for example, be at the date the unfairly prejudicial conduct occurs, the date of the petition, the date of the judgment, or at some other date? Again, the courts have to always consider the overarching principle of fairness, and so any general rule is eschewed in favour of the courts doing what they think is fair in light of the circumstances of each case. Lord Hoffmann, since he had already given his interpretation of fairness, perhaps thought it was therefore unnecessary to opine on such matters, although more than tacit recognition of this area would have provided much needed clarification to a rather labile area of law. To highlight the inconsistency of the cases, in *Re London School of Electronics Ltd.*[68], it was the 'date of the order or the actual valuation [that] would be more appropriate than the date of the presentation of the petition or the unfair prejudice'; in *Re Cumana Ltd.*[69] Vinelott J ordered shares to be valued as of the date of the petition as this was the 'date on which the petitioner elects to treat the unfair conduct of the majority as in effect destroying the basis on which he agreed to continue to be a shareholder'. However, it would appear that the overriding principle of fairness 'would by exceptions reduce it to no rule at all'.[70]

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[63] *North Holdings Ltd. V Southern Tropics Ltd.* [1999] 2 BCLC 625
[64] *Supra* at p.668
[65] *Supra* at p.635B. The facts of the case where that Mr. and Mrs Clarke had allegedly misused the assets of North Holdings to set up another company, Kasmare, which had made substantial profits, and this had unfairly prejudiced the other shareholder of North Holdings, who now demanded that, when they bought his shares, the value of them would reflect this. He felt that an accountant was unable to do this, and so resort to the law was the only practical consequence.
[66] See above
[67] See D Sellar *Paper on Company Law 2000* at p.9
[68] [1985] 3 WLR 474 at 484B
[69] [1986] BCLC 430
[70] *Re London School of Electronics Ltd.* [1986] Ch 211 at p.224

The Court of Appeal in *O'Neill* also expressed considerable doubt[71] about the availability of 'expectation' damages' being paid as part of the fair value for the shares. Lord Hoffmann's reasoning could be seen to implicitly concur on this point, and it seems unlikely in the future whether a fair valuation will include damages for a 'loss of a chance' of an entitlement to receive a certain sum of profits in the company.

PART 2

The Interrelation between s459 and s122(1)(g)

A s122(1)(g) petition, to wind up the company on just and equitable grounds is sometimes referred to as a 'sledgehammer' remedy; often the company that is to be wound up is still highly successful and prosperous, and the petition would be 'tantamount to killing the goose that might lay the golden egg'.[72] Indeed, it seems that the remedy has become increasingly dormant, and it would appear that Lord Hoffmann ascribes to it a very small area of effective operation, which might cast doubt on cases decided before *O'Neill.*[73] One must now query exactly where the s122(1)(g) petition lies after the liberalisation of s210 into s459 of the companies Act 1985. Indeed, as a result of this, s125(2) of the Insolvency Act 1986 states that the court need not grant a winding-up order if it is of the opinion that some alternative remedy is available to the petitioners and that they have acted unreasonably in not pursuing it. This will help dissuade an aggrieved member from maliciously destroying the company when a less abrasive remedy would be more prudent; often the petitioner will use a s122(1)(g) petition purely for tactical considerations, even if it only results in pyrrhic victory. What the court has to evaluate is the reasonableness of the one petition over the other; unless the petitioner can show that it would be more reasonable for him to pray for an order under s122 rather than s459, then in the event that he cannot, it would seem, after the practice directive[74], and s125(2), that the petitioner should be solely confined to the s461 remedies. It seems increasingly unlikely, in light of the statutory provisions and a growing body of case law which concludes that resort to s122(1)(g) should only be used when it is wholly impracticable to use any other remedy[75], that a winding-up order on the 'just and equitable'

[71] *Re A Company* [1997] 1 BCLC 479 at p.772 per Nourse J.
[72] *Gower's principles of modern company law* 6th Ed. P.750
[73] See *Re RA Noble & Sons (clothing) Ltd* [1983] BCLC 273 and *Jesner v Jarrad Properties Ltd.* 1994 SLT 83
[74] *Chancery 1/90*, [1990] 1 WLR 490
[75] *Re Full Cap International Trading Ltd.* [1995] BCC 382

ground will be granted. Does this mean, therefore, that the winding-up petition has 'finally come of age?'[76]

The case law in this area is becoming increasingly difficult to reconcile without recourse to rather tenuous distinctions. To be sure, *O'Neill* places due regard on the fact that at all times it should be more difficult to obtain a winding-up than any other remedy under s461, and thus must be said to cast significant doubt on a number of important cases which seemed to suggest the converse of that proposition.[77] Pre-*O'Neill*, it could be said that the case law conclusively proved that there was indeed a fundamental difference between the two remedies, although the relationship still remained somewhat problematic and the cases themselves often imprecise about their exact connection. What is clear, however, at least before *O'Neill*, is that the facts which go to the heart of the conduct of the parties might satisfy the test under section 122(1)(g) may not necessarily satisfy the test under section 459. In *Re RA Noble & Sons (clothing) Ltd.*[78] the claimant failed to satisfy the requirements of a s459 petition. This was because, *inter alia*, while the treatment of the petitioner was undoubtedly prejudicial, it was not unfair; unfairness must always connote a degree of *culpa* in the actings of the defendant party, and, in the above case, the petitioner's exclusion from participation in the company's affairs was to a large extent due to his own apathy and lack of interest. A winding up order was nevertheless made because the mutual confidence in the personal relationship between the parties had been destroyed and therefore the *Ebrahimi* test was satisfied. The confusion in some of the cases stems from the fact that although the very foundation of a successful s459 petition is constructed from the same building blocks that can found a winding-up order, because each use *Ebrahimi* as their starting point, and embrace the same equitable constraints therein, the identical nature of the remedies ceases completely at this stage. After that, s459, solely in the *conduct* that is required for a successful petition under it, is 'completely different'[79] from s122(1)(g). On this interpretation, the opinion of Lord Morison in *Jesner* is therefore correct on this point, and the decision will continue to have an important role to play in delimiting between the two remedies. However, it would appear from their judgments that both Lord Morision and Lord Justice Clerk Ross think that it would be easier to achieve redress under s122 than s459. In light of *O'Neill*, this must be open to considerable doubt.

The case of *Jesner* seems to operate on similar lines to *RA Noble and Sons,* whereby all that is needed under s122(1)(g) is that it would be 'just and equitable' to wind up the company, and while, coupled with the criteria needed to fulfil a quasi-partnership, unfair prejudice would be a most potent example of this, no allegation of unfairness whatsoever may be made to bring a successful case under this head.[80] Hoffmann himself said, 'the parallel [between s122(1)(g) and s459] is not in the conduct

[76] *Gower's principles of modern company law* 6th Ed. P.750
[77] In particular *Jesner v Jarrad Properties Ltd.* 1994 SLT 83 which is of binding precedent in the Scottish courts.
[78] [1983] BCLC 273
[79] *Jesner v Jarrad Properties Ltd.*1994 SLT 83 per Lord Morison at p.92I
[80] *Re RA Noble & Sons (clothing) Ltd.* supra

which the court will treat as justifying a particular remedy but in the principles upon which it decides that the conduct is unjust, inequitable or unfair'.[81]

Indeed, the distinction between conduct and principles goes to the very heart of the difference between s122(1)(g) and s459. In *Jesner v Jarrad Properties Ltd.*[82] it was held that the whole background of the relationship between the two companies must be considered when deciding if the conduct was unfair; a factor which Lord Hoffmann regarded as important in his judgment in *O'Neill.* In the *Jesner* case it was admitted that there was prejudice, but the prejudice was not unfair, because the petitioners knew what was happening, and knew of the informal nature of the two family companies (the directors had in the past not complied with the provisions in the Companies Act), although they were still acting in the best interests of both companies as a group whole. The Sheriff made an error by assuming that because the principles and the content of a winding up and a s459 petition were inextricably linked, he thought he could treat the issue of winding up as if such an application was the same as for an application under s459 of the Companies Act 1985[83], without looking at the crucial matter of the conduct between the parties.

S122(1)(g), as this case demonstrates, will only be used where the company fulfils the requirements of the three tests for a quasi-partnership[84], or something closely analogous to them, *in the absence of unfairness*. The mutual confidence in question, for whatever reason (In the *Jarrad*[85] case it was suspicion that those in control might still misappropriate the company's assets), must have broken down to a point where it would be 'just and equitable' to wind up the company. Lord Justice Clerk (Ross) in *Jesner* gives an example of such a breakdown: 'mutual confidence had been destroyed because it would be a curious form of mutual confidence which required to be supported by a permanent interdict'.[86]

The exact position for a winding-up petition, post *O'Neill,* still remains difficult to define. In light of Lord Hoffmann regarding a winding-up order as a 'death sentence' to the company, it would appear that s122(1)(g) will be employed only in rare cases, but I still maintain that it will have a role to play, however circumscribed its area of operation proves to be. Perhaps a winding-up petition would be more amenable to a 50-50 deadlock, when the company has been paralysed by the mutual falling out of each member in the absence of any unfairly prejudicial conduct by either party, and so, as a 'last resort' an order to wind up the company should be given. The courts, rather than adopting an objective test employed for s459, will rather look at the relationship in a particularly subjective light, and then if it is obvious that mutual confidence has been lost, for whatever reason, but that no unfairness can be substantiated, then a winding-up petition will be the only form of redress for the factious parties.

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[81] [1995] 1 BCLC 14 at p.16e
[82] 1994 SLT 83
[83] *supra* p.90G
[84] Supra. p.90K-L and above
[85] 1994 SLT 83
[86] *Supra* p.91F

Importantly, and perhaps highlighting the continued need for a s122 remedy, the case of *Re Full Cap*[87] points to the fact that even if the conduct in question constitutes unfairness, a s461 remedy might not be given because in some circumstances (where the company is either insolvent or on the verge of insolvency) it would be more practicable to wind up the company.[88]

Conclusion

Lord Hoffmann, although he does quote from *Re Astec (BSR) Plc.,*[89] leaves absent the question of public companies in his judgment. Perhaps, however, by their very omission, he makes it implicit that, once he has set out his model of when s459 will be applicable, it will become increasingly obvious that public companies will rarely, if ever, fit into that framework. Equitable constraints on the exercise of majority power are only likely to be found in private quasi-partnership companies where it is easier to show that the company is underpinned by a set of close, informal personal relationships.[90]

Lord Hoffmann also fails to consider the outcome of a s459 petition where it is the majority seeking to found on the minority's unfairly prejudicial conduct, for example, by failing to sell his shares in the company after he was dismissed from its management.[91] The majority will usually have the power internally to redress the problem without recourse to the courts. It will also be increasingly difficult to establish unfairness when it is the majority who are complaining of it.

Is *O'Neill v Phillips*, therefore, a definitive account of s459? It is difficult, even for a House of Lords decision, to offer a completely definitive account of the present law, and therefore the judgment of Lord Hoffmann is admirable both for its brevity and clarity. It is perhaps most clear when read in conjunction with *Re Saul D Harrison*[92], since the judgment in that case is a necessary buttress to the decision delivered in the House of Lords, and restrains to some degree the liberal interpretation it

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[87] [1995] BCC 382

[88] *Supra* at p.694-695. See also the case on appeal as *Antoniades v Wong* [1997] 2 BCLC 419, where Mummery LJ states, at p.426a: 'First, the appeal is against a refusal of the judge to grant a discretionary remedy. Section 461 confers on the Companies Court what was described by Hoffmann J in *Re a company* (no 005287 of 1985) [1986] BCLC 68 at 70, as the 'widest possible discretion'. This means that, even if the facts are those which the petitioner alleges constitute an unfair prejudice, the petitioner must still convince the court that it is fit to make an order granting the relief which he seeks'.

[89] [1998] 2 BCLC 556

[90] *Supra* at p.558: '... if the market in a company's shares was to have any credibility, members of the public dealing in that market must be entitled to proceed on the footing that the constitution of the company was as it appeared in the company's public documents and was unaffected by any extraneous equitable considerations and constraints...Accordingly, the legitimate expectation allegations were without substance for the purpose of s459.'

[91] The case of *Re Legal Costs Negotiators Ltd, Morris v Hately* The Times Law Reports March 10th 1999, addressed this issue. The case offers little scope for the majority to bring a successful s459 petition as the majority will generally have sufficient power to deal with those matters internally. Since the three directors each held 25 per cent of the shares they could alter the articles of association by special resolution and include in them a right to compel the respondent to sell his 25 per cent back to them provided it was 'for the benefit of the company as a whole'. *Allen v Gold Reefs of West Africa Ltd.* [1900] 1 Ch 656

[92] [1995] 1 BCLC 14

was given in later cases, particularly regarding the term 'legitimate expectation'.[93] I think that Lord Hoffmann was desirous to once again lay down his formulation, pointing out the exact ambit and scope of each criterion, and applying the breaks to certain areas that, after his reasoning in *Saul D*[94], became too enlarged. In the House of Lords he had the chance to set his judgment in stone.

Does it, by implication, say all that needs to be said about s122(1)(g)? If we accept that Lord Hoffmann's analysis of a no-fault divorce was constrained only to the facts of a buy-out, and not to a 'parting of the ways' in the sense of a winding-up, then it would seem that a s122 petition will still have an important role to fill, although it will be rather more limited in its practical application than first envisaged. If his concern, however, were centred on the latter, more general exposition, then it would appear that a s122 petition has been curtailed to the point of redundancy.

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[93] See the Court of Appeal decision of *O'Neill*: *Re a Company* [1997] 2 BCLC 739
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