Gamlestaden's appeal. The point is now before the Board for a final decision. It must be emphasised that, since this appeal arises out of a strike out of the Article 141 application, the facts pleaded in support of the application must be taken as true (save for any that can be shown by incontrovertible evidence to be untrue). The Bailiff and the Court of Appeal approached the case on that footing and so must their Lordships.

The point at issue (identified in para. 3 above) depends, first, upon the scope of the power of the court under Articles 141 and 143, properly construed, in dealing with the unfair prejudice application and, secondly, upon the particular circumstances that are relied on for bringing this application within that scope. …

[Having decided that Gamlestaden was a member, and was therefore entitled to request relief under Art 43, Lord Scott continued:] The first question to be addressed, therefore, is whether an order for payment of damages to the company whose affairs have allegedly been conducted in an unfairly prejudicial manner can be sought and made in an unfair prejudice application. …

There is nothing in the wide language of Article 143(1) to suggest a limitation that would exclude the seeking or making of such an order: the court 'may make such order as it thinks fit for giving relief in respect of the matters complained of.'…

That leaves the important issue regarding Baltic's insolvency. Here, too, it is appropriate to start by noting the breadth of the Article 143(1) discretion conferred on the court. The court 'may make such order as it thinks fit for giving relief in respect of the matters complained of …'…

Bar the relatively trivial sum that Gamlestaden must have paid in subscribing for its 1100 shares in Baltic, Gamlestaden's investment took the form of the provision of loans to Baltic to enable Baltic to fund SPK. Baltic was the corporate vehicle through which the joint venture enterprise of Gamlestaden and Mr Karlsten of investment in German commercial property was to be pursued. If mismanagement by the directors of that corporate vehicle has led to loss it seems to their Lordships somewhat artificial to insist that the qualifying loss, for Article 141 (or section 459) purposes, must be loss which has reduced the value of the investor's equity capital and that it is not sufficient to show that it has reduced the recoverability of the investor's loan capital. …

[Counsel's] submission comes to this, that it is a fatal and insurmountable bar in any and every application for Article 141 (or section 459) relief if the relief sought cannot be shown to be of some benefit to the applicant shareholder in his capacity as shareholder.

Mr Moss [counsel] supported his submission by reference, in particular, to the well established rule that a shareholder cannot petition for a winding-up order to be made in respect of a company that is insolvent. The reason is that the petitioning shareholder cannot obtain any benefit from the winding-up. The company's assets will be realised; dividends may be paid to creditors but nothing, if the company is insolvent, will go to the members. The rule that Mr Moss prays in aid is a long established one and one on which their Lordships cast no doubt. But there is a significant difference between a creditor's winding-up petition and an Article 141 (or section 459) application. The former is seeking an order to put the company into an insolvent liquidation that will affect the interests of all creditors as well as of all members. It will involve the administration of the liquidation either by the Viscount (or, in England, the Official Receiver) and his officials or by a professional liquidator who, in carrying out his duties, will be an officer of the court. The liquidation, although from a financial point of view carried out for the benefit of creditors, is a public act or process in which the public has an interest. It seems to their Lordships quite right that a member **(p. 694)** with no financial interest in the process or its outcome should be denied *locus standi* to initiate the process.

Where relief is sought via an unfair prejudice application, on the other hand, the position is quite different. There is no public involvement or interest in the proceedings, other than the natural interest that may attend any proceedings heard in open court. The purpose of Article 141, or of section 459, or of their counterpart in Hong Kong, is to provide a means of relief to persons unfairly prejudiced by the management of the company in which they hold shares. If the company is a joint venture company and the joint venturers have arranged that one, or more, or all of them, shall provide working capital to the company by means of loans,

it would, in their Lordships' opinion, be inconsistent with the purpose of these statutory provisions to limit the availability of the remedies they offer to cases where the value of the share or shares held by the applicant member would be enhanced by the grant of the relief sought. If the relief sought would, if granted, be of real, as opposed to merely nominal, value to an applicant joint venturer, such as Gamlestaden, in facilitating recovery of some part of its investment in the joint venture company, that should, in their Lordships' opinion, suffice to provide the requisite locus standi for the application to be made.

Mr Moss placed reliance on *Re J.E. Cade & Son Ltd* [1992] BCLC 213 where Warner J refused section 459 relief because the applicant was 'pursuing his interests as a freeholder of the farm and not his interests as a member of the company' (p 229). But there was no counterpart in that case with the feature in this case that the loans made by Gamlestaden were made pursuant to and for the purposes of the joint venture to be carried on by Gamlestaden and Mr Karlsten via Baltic.

There are several cases in which judicial approval is given to affording a wide scope to section 459. [His Lordship cited from several of them and continued:]

And in *O'Neill v Phillips* **[13.30]** at 1105 Lord Hoffmann said that

> 'As cases such as *R&H Electric Ltd v Haden Bill Electrical Ltd* [1995] 2 BCLC 280 show, the requirement that prejudice must be suffered as a member should not be too narrowly or technically construed.'

In their Lordships' opinion Articles 141 and 143 properly construed do not ipso facto rule out the grant of relief simply on the ground that the relief sought will not benefit the applicant in his capacity as member. In many cases such a feature might justifiably lead to the refusal of relief. … Their Lordships do not accept that the benefit must be a benefit to Gamlestaden in its capacity as a shareholder but they do accept that there must, where the only purpose of the application is to obtain payment of a sum of money to Baltic, be some real financial benefit to be derived therefrom by Gamlestaden.

In particular, in a case where an investor in a joint venture company has, in pursuance of the joint venture agreement, invested not only in subscribing for shares but also in advancing loan capital, the investor ought not, in their Lordships' opinion, be precluded from the grant of relief under Article 143(1) (or section 461(1)) on the ground that the relief would benefit the investor only as loan creditor and not as member.

In the present case the provision of loan capital to Baltic seems to have been mainly, if not wholly, made by Gamlestaden AB, rather than by Gamlestaden, although procured by Gamlestaden pursuant to its obligation to do so under its joint venture agreement with Mr Karlsten. But their Lordships, in agreement with the view expressed by Robert Walker J in relation to similar arrangements made by the applicant for section 459 relief in the *R&H Electric Ltd* case[50]… conclude that that feature should not bar Gamlestaden from relief under Article 141.

[And so] this appeal against the strike-out of Gamlestaden's Article 141 application ought to be allowed. …

(p. 695) ➢ Question

This case is likely to prove controversial. Is the legal analysis defensible? What practical consequences are likely to flow from this approach to the unfair prejudice provisions? Are these consequences either practically or commercially desirable?

Remedies

Section 996(1) gives the court the power to make 'such order as it thinks fit',[51] and s 996(2) provides examples of possible orders, including the commonly used compulsory share buy-back.

In particular, as indicated in s 996(2), the order may:

(i) regulate the conduct of the company's affairs in the future (*Re HR Harmer Ltd* in the Note following *Scottish Co-operative Wholesale Society Ltd v Meyer* **[13.24]**, p 685);
(ii) require the company to do or not to do some specified act (eg in *McGuinness, Petitioners* (1988) 4 BCC 161, the directors were ordered to comply promptly with a shareholders' requisition for the calling of a general meeting);
(iii) authorise civil proceedings to be brought in the name of the company (this is a possible way around the restrictions of *Foss v Harbottle* **[13.01]**; see, eg, *Bhullar v Bhullar* **[7.25]**;
(iv) prohibit the alteration of all or a specified part of the company's constitution without the leave of the court; or
(v) provide for the purchase of the shares of any members of the company by other members or by the company itself (see later).

Buy-out orders

In almost all successful cases brought under s 459, the court ordered one faction of shareholders to buy out the others. Section 994 is not proving any different. Usually, the majority is required to buy out the minority, although the reverse was ordered (on certain conditions) in *Re a Company, ex p Shooter* [1990] BCLC 384, where the controlling shareholder had shown himself unfit to continue to manage the business, and also in *Re Brenfield Squash Racquets Club Ltd* [1996] 2 BCLC 184.

Three questions arise. First, at what date should the valuation be made? Secondly, on what basis should the shares be valued and, in particular, should the holding be discounted to reflect the fact that it is a minority holding? Thirdly, should the conduct of the parties be taken into account in making the valuation?

As will be seen in 'Valuing shares in buy-out orders', pp 707ff, the courts have reserved to themselves a discretion as regards the first two questions, and have also held that the parties' conduct, and in particular their relative blameworthiness in the events leading to the breakdown in good relations between them, is a factor to be taken into account.

Although this may have some justification in logic, the consequences have been most unfortunate, for parties have felt obliged to make a s 459 hearing the occasion to review the whole of the company's history from its very beginnings and to reopen many old battles, thus greatly adding to the length and cost of the case and, at times, attracting unfavourable comment from the judges concerned.

Finally, the prevalence of the courts' exercise of its discretion to order a buy-out once unfair prejudice has been proved appears, by weight of precedent, to be becoming a*right* accruing to the petitioner once the unfair prejudice grounds are established: see *Grace v Biagioli* [2005] **(p. 696)** EWCA Civ 1222, [2006] BCC 85, CA. There the Court of Appeal held that the trial judge had erred when he declined to issue a buy-out order in circumstances where unfairly prejudicial conduct (in this case, non-payment of a dividend) had been established. The trial judge had considered the request, but refused to make a buy-out order, and instead ordered payment of a sum representing the dividend plus interest. The Court of Appeal affirmed the broad discretion in CA 1985 s 461 (CA 2006 s 996), but nevertheless ordered a buy-out, holding that these orders were the usual remedy under s 459 for addressing disputes within small companies, and for good reason, since it was normally only this order that could achieve the full purpose behind the court's power to intervene.

In *Re Scitec Group Ltd* [2011] 1 BCLC 277, after conceding that there had been unfair prejudice against the petitioner, the respondent argued that he should not be *ordered*to purchase the petitioner's shares, as he was willing to do so anyway. The judge rejected this submission and held that 'it will ordinarily be appropriate that an order for purchase should be made', and that it was appropriate to do so here, taking into account the history of the dispute between the parties.

Relevance of alternative remedies

In *Re Baltic Real Estate Ltd (No 2)* [1993] BCLC 503 and *Re Legal Costs Negotiators Ltd* [1999] 2 BCLC 171 the court refused relief to a petitioner who was complaining about a situation which he could remedy by using his own votes. In *Re a Company, ex p Schwarcz (No 2)* [1989] BCLC 427 Peter Gibson J said:

> The developing jurisprudence on s 459 petitions has established that the court, even on a striking-out application, will consider whether the relief sought by a petitioner is inappropriate and whether it is unreasonable to pursue a petition when, for example, it is clear that the petitioner must leave the company and a fair offer has been made for the petitioner's shares (see, for example, *Re a Company (No 003843 of 1986)*[52]) [or] when a petitioner seeking an order for the sale of his shares might have achieved that result by invoking the transfer machinery available in the articles but failed to do so (see *Re a Company (No 007623 of 1984)*[53] and *Re a Company (No 004377 of 1986)*[54]). If the court is of the view that the relief sought is wholly inappropriate and the petitioner is acting unreasonably in pursuing the petition, it may stay or strike out the petition as being an abuse of the process.

A parallel may perhaps be drawn between these remarks and the approach of the courts in giving rulings under IA 1986 s 125(2), where a petitioner has sought the winding up of a company and it is contended that he ought to have pursued some other remedy: see Note 2 following *Loch v John Blackwood Ltd* **[16.12]**, p 800.

An alternative remedy may be provided by the articles; then the general approach of the courts is to leave the parties to their constitutional rights, unless there are special circumstances. For example, where the majority shareholders had followed a procedure laid down by the company's articles to deal with a breakdown in relations, Hoffmann J in *Re a Company* [1987] 1 WLR 102, [1987] BCLC 94 held that this was not unfairly prejudicial conduct. The procedure in this case provided for the remaining shareholders to purchase the minority member's shares at a price fixed by the company's auditors. In similar circumstances, in *Re a Company (No 00836 of 1995)* [1996] 2 BCLC 192, the court took the view that what was on offer under the articles would give the minority shareholder all the relief which he could realistically expect to obtain under s 459. But in several other cases it has been thought not unreasonable for a minority shareholder to persist in his desire to have his shares bought out on terms fixed by the court rather than at a price determined by the company's auditors, since **(p. 697)** he might have reason to fear that the auditors would not be wholly independent and objective. (See, eg, the longish list of cases (all reported as *Re a Company*) cited in the last-mentioned case, and compare the Court of Appeal's ruling in *Virdi v Abbey Leisure Ltd*(Note 2 following *Loch v John Blackwood Ltd* **[16.12]**, p 800), a winding-up case.)

Examples of 'unfairly prejudicial' conduct

The cases provide guidance. But note that many of the rulings are not given on the basis of real evidence, but on presumed facts on an application to strike out the proceedings as disclosing no cause of action, or on a preliminary point of law. Then the decision is no more than a ruling that the conduct in question is (or is not), in theory,*capable* of being unfairly prejudicial within CA 1985 s 459 (or CA 2006 s 799). This can at best provide only a rough guide.

Examples of conduct that has been held to be (or held capable of being) unfairly prejudicial, include:

(i) exclusion from management (in a company formed as a quasi-partnership[55]): *Re RA Noble & Sons (Clothing) Ltd* [1983] BCLC 273 (Note 1 following *Loch v John Blackwood Ltd* **[16.12]**, p 754); *Re OC (Transport) Services Ltd* [1984] BCLC 251; *Re Phoenix Contracts (Leicester) Ltd* [2010] EWHC 2375 (Ch); *Re Abbington Hotel Ltd* [2012] 1 BCLC 410;
(ii) taking excessive remuneration: *Re Cumana Ltd* [1986] BCLC 430;
(iii) diversion of a corporate asset or business opportunity: *Re London School of Electronics Ltd* [1986] Ch 211;
(iv) not paying dividends: *Re a Company, ex p Glossop* [1988] 1 WLR 1068; *Re Sam Weller & Sons Ltd* [1990] Ch 682; *Sikorski v Sikorski* [2012] EWHC 1613 (Ch);
(v) making or proposing a rights issue which the minority cannot afford to take up: *Re Cumana Ltd* (see point (ii)); cf *Pennell Securities Ltd v Venida Investments Ltd*(25 July 1974, noted by Burridge (1981) 44 MLR 40);
(vi) stacking the board with directors having interests adverse to the company: *Whyte, Petitioner* (1984) 1

BCC 99,044;
(vii) failure on the part of the directors to advise the shareholders impartially on the merits of rival takeover bids (in one of which the directors were personally interested): *Re a Company* [1986] BCLC 382;
(viii) misuse of fiduciary powers: *Scottish Co-operative Wholesale Society Ltd v Meyer* **[13.24]**;
(ix) mismanagement, but only if 'serious': *Re Macro (Ipswich) Ltd* **[13.28]**; contrast *Re Elgindata Ltd* **[13.27]**;
(x) failing to allow minority shareholders independent representation on the board when all control is in the hands of the majority faction which has potentially conflicting interests: *Re Macro (Ipswich) Ltd* **[13.28]**;
(xi) seeking to sell the company's assets (a hotel) contrary to the original agreement, and knowingly creating and putting forward a false minute for that purpose: *Re Abbington Hotel Ltd* [2012] 1 BCLC 410;
(xii) dilution of a shareholder's interest: *Re Zetnet Ltd* [2011] EWHC 1518 (Ch);
(xiii) physical attack on the petitioner shareholder with a hammer: *Re Home & Office Fire Extinguishes Ltd* [2012] EWHC 917 (Ch).

(p. 698) Examples of conduct which has been held *not* to be (or not to be capable of being) unfairly prejudicial include:

(i) declining to implement a scheme to make it possible for petitioners, 'locked in' to a private company, to realise their shares: *Re a Company* [1983] Ch 178 (Note 2 following *Loch v John Blackwood Ltd* **[16.12]**, p 800);
(ii) mere breakdown of confidence between the parties: *Re RA Noble & Sons (Clothing) Ltd* ((Note 1 following *Loch v John Blackwood Ltd* **[16.12]**, p 799);
(iii) a situation which the petitioner could remedy by using his own votes: *Re Baltic Real Estate Ltd (No 2)* [1993] BCLC 503; *Re Legal Costs Negotiators Ltd* [1999] 2 BCLC 171;
(iv) the non-payment by a parent company of debts owing to a subsidiary when this course was considered to be in the interests of the group as a whole: *Nicholas v Soundcraft Electronics Ltd* [1993] BCLC 360; contrast *Scottish Co-operative Wholesale Society Ltd v Meyer* **[13.24]**;
(v) continuing to run a loss-making business when the minority shareholders stood to receive a substantial capital distribution if the company were wound up: *Re Saul D Harrison plc* **[13.29]**;
(vi) the dismissal of a member director of a quasi-partnership company as a result of his own misconduct, which jeopardised the company's ongoing survival:*Woolwich v Milne* [2003] EWHC 414 (Ch);
(vii) certain valuation offers, for example the valuation procedure at a discounted rate which underpinned the original offer made to Larvin in *Phoenix Office Supplies Ltd v Larvin* **[13.32]**;
(viii) the company's decision to achieve, by legitimate means, a result which avoids the need for a special resolution, even though this disempowers the minority from opposing the intended result: *CAS (Nominees) Ltd v Nottingham Forest plc* [2002] BCC 145;
(ix) failure to issue a transfer notice where it should have been given, as this falls within the *personal* obligation of a shareholder: *Re Coroin Ltd* [2012] EWHC 2343 (Ch).

Legitimate expectations and equitable considerations

As a general rule, managerial decisions are unlikely to amount to unfairly prejudicial conduct.

[13.27] Re Elgindata Ltd [1991] BCLC 959 (Chancery Division)

Rowland, the petitioner, had invested in a company controlled by Mr and Mrs Purslow, taking a minority shareholding. The company had been in existence for over four years. The remarks of Warner J quoted here relate to the question whether mismanagement is capable of constituting unfairly prejudicial conduct.

WARNER J: [He referred to *Re Five Minute Car Wash Service Ltd* [1966] 1 WLR 745, a case under CA 1948 s 210 in which it had been held that mere mismanagement, however damaging, did not amount to 'oppression' for the purposes of that section, and continued:] I was referred, on this point also, to the judgment of Peter Gibson J in *Re Sam Weller & Sons Ltd*[56] at the end of which he said **(p. 699)** that he had no doubt that the court would ordinarily be very reluctant to accept that managerial decisions could amount to unfairly prejudicial conduct …

I do not doubt that in an appropriate case it is open to the court to find that serious mismanagement of a company's business constitutes conduct that is unfairly prejudicial to the interests of minority shareholders. But I share Peter Gibson J's view that the court will normally be very reluctant to accept that managerial decisions can amount to unfairly prejudicial conduct.

Two considerations seem to me to be relevant. First, there will be cases where there is disagreement between petitioners and respondents as to whether a particular managerial decision was, as a matter of commercial judgment, the right one to make, or as to whether a particular proposal relating to the conduct of the company's business is commercially sound … In my view, it is not for the court to resolve such disagreements on a petition under s 459. Not only is a judge ill-qualified to do so, but there can be no unfairness to the petitioners in those in control of the company's affairs taking a different view from theirs on such matters.

Secondly, as was persuasively argued by Mr Chivers, a shareholder acquires shares in a company knowing that their value will depend in some measure on the competence of the management. He takes the risk that that management may prove not to be of the highest quality. Short of a breach by a director of his duty of skill and care (and no such breach on the part of either Mr Purslow or Mrs Purslow was alleged) there is prima facie no unfairness to a shareholder in the quality of the management turning out to be poor. It occurred to me during the argument that one example of a case where the court might none the less find that there was unfair prejudice to minority shareholders would be one where the majority shareholders, for reasons of their own, persisted in retaining in charge of the management of the company's business a member of their family who was demonstrably incompetent. That of course would be a very different case from this. Mr Rowland deliberately invested in a company controlled and managed by Mr Purslow, whom he had known for five years or so. Indeed, he did so, despite Mr Purslow's reluctance to have him as a shareholder in his company. Mr Nourse submitted that Mr Rowland had a right to expect a reasonable standard of general management from Mr Purslow. In my view, he had no such right. He took the risk that Mr Purslow's management of the company might not be up to the standard that he, Mr Rowland, had hoped and expected …

However, exceptionally, significant and serious mismanagement may justify relief.

[13.28] Re Macro (Ipswich) Ltd [1994] 2 BCLC 354 (Chancery Division)

The applicants claimed that the two property-owning companies in which they were minority shareholders had suffered losses because a firm referred to as 'Thompsons' (the companies' property-managing agents) had committed various improprieties which Mr Thompson (an elderly, autocratic person who was the founder of Thompsons and the companies' sole director) had connived at or inadequately supervised. Arden J held that this was unfairly prejudicial conduct and ordered that the applicants' shares be bought out.

ARDEN J:… The question whether any action was or would be 'unfairly prejudicial' to the interests of the members has to be judged on an objective basis. Accordingly it has to be determined, on an objective basis, first whether the action of which complaint is made is prejudicial to members' interests and secondly whether it is unfairly so. Based on the findings of fact that I have made, I am satisfied that the companies suffered prejudice in consequence of failure to have a planned maintenance programme, the failure to supervise repairs, the failure to inspect properties regularly, the failure to let on protected shorthold tenancies, the taking of commissions from builders doing work for the companies by employees of Thompsons, the charging of excessive management charges and secretarial salary and the mismanagement of litigation. The absence of an effective system to prevent excessive amounts being retained on Thompsons' client account instead of paying it over to **(p. 700)** the companies is also in my judgment likely to cause loss to the companies in the future. All of these matters are within the responsibility of Thompsons as the companies' managing agent but they are attributable to the lack of effective supervision by Mr Thompson on behalf of the companies. It is this conduct of the companies' affairs by Mr Thompson which, in my judgment, is prejudicial in the respects I have mentioned. As the conduct is prejudicial in a financial sense to the companies, it must also be prejudicial to the interests of

the plaintiffs as holders of its shares …

[This] is not a case where what happened was merely that quality of management turned out to be poor (cf *Re Elgindata Ltd* **[13.27]**). This is a case where there were specific acts of mismanagement by Thompsons, which Mr Thompson failed to prevent or rectify. Moreover, several of the acts of mismanagement which the plaintiffs have identified were repeated over many years, as for example in relation to the failure to inspect repairs. In my judgment, viewed overall, those acts (and Mr Thompson's failures to prevent or rectify them) are sufficiently significant and serious to justify intervention by the court under s 461…

➢ Note

Although there is no finding in the judgment that Mr Thompson was guilty of anything other than mismanagement, it is pertinent to note that, like the negligence of the directors in *Daniels v Daniels*,[57] there was a self-serving aspect to this mismanagement, since it was Mr Thompson's own firm which stood to gain from (inter alia) the excessive management charges.

➢ Question

In *Re Macro (Ipswich) Ltd* **[13.28]**, Arden J also said:

Given the presence of minority interests, the absence of an independent director would in my judgment be prejudicial to the position of the plaintiffs as shareholders in the companies. If support were needed for such proposition, it can be found in the recent report of the Committee on the Financial Aspects of Corporate Governance (the Cadbury Committee) published in December 1992. This report, which has been accepted by, inter alia, the Stock Exchange, emphasises that no one individual within a company should have unfettered powers of decision and that, where the chairman is also chief executive, there should be a strong and independent element on the board. While that report is directed to listed companies, the desirability of having a truly independent board is applicable to all cases where there are minority shareholders. In my judgment neither Mr Thompson nor Mr Farley [Mr Thompson's proposed nominee] would be able to act independently of Mr Thompson's position as majority shareholder and sole proprietor of Thompsons. That situation would in my judgment not only be prejudicial to the interests of the minority shareholders, but unfairly so.

Does the modern law on private companies adopt this approach, or even suggest that it is best practice?

'Legitimate expectations'.

[13.29] Re Saul D Harrison & Sons plc [1995] 1 BCLC 14 (Court of Appeal)

The petitioner held 'C' class shares in a company that made industrial cleaning cloths. The business had been founded by her great-grandfather in 1891. The 'C' class shares carried rights to dividends and to capital distributions in a liquidation, but no entitlement to vote. **(p. 701)** The company had substantial assets but had recently been run at a loss. The petitioner complained that the directors (her cousins) had unreasonably continued to run the business (and to pay themselves salaries, although the court ruled that these were not excessive), instead of closing the business down and distributing the assets to the shareholders. Vinelott J and the Court of Appeal held that the petitioner had no 'legitimate expectations' over and above an expectation that the board would manage the company in accordance with their fiduciary obligations and the terms of the articles of association and

the Companies Act, and that no breach of these obligations had been shown.

HOFFMANN LJ: Mr Purle, who appeared for the petitioner, said that the only test of unfairness was whether a reasonable bystander would think that the conduct in question was unfair. This is correct, so far as it goes, and has some support in the cases. Its merit is to emphasise that the court is applying an objective standard of fairness. But I do not think that it is the most illuminating way of putting the matter. For one thing, the standard of fairness must necessarily be laid down by the court. In explaining how the court sets about deciding what is fair in the context of company management, I do not think that it helps a great deal to add the reasonable company watcher to the already substantial cast of imaginary characters which the law uses to personify its standards of justice in different situations. An appeal to the views of an imaginary third party makes the concept seem more vague than it really is. It is more useful to examine the factors which the law actually takes into account in setting the standard.

In deciding what is fair or unfair for the purposes of s 459, it is important to have in mind that fairness is being used in the context of a commercial relationship.[58] The articles of association are just what their name implies: the contractual terms which govern the relationships of the shareholders with the company and each other. They 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. 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 …

Although one begins with the articles and the powers of the board, a finding that conduct was not in accordance with the articles does not necessarily mean that it was unfair, still less that the court will exercise its discretion to grant relief …

Not only may conduct be technically unlawful without being unfair: it can also be unfair without being unlawful. In a commercial context, this may at first seem surprising. How can it be unfair to act in accordance with what the parties have agreed? As a general rule, it is not. But there are cases in which the letter of the articles does not fully reflect the understandings upon which the shareholders are associated.

[His Lordship referred to *Ebrahimi v Westbourne Galleries Ltd* **[16.13]**, and continued:] Thus the personal relationship between a shareholder and those who control the company may entitle him to say that it would in certain circumstances be unfair for them to exercise a power conferred by the articles upon the board or the company in general meeting. I have in the past ventured to borrow from public law the term 'legitimate expectation' to describe the correlative 'right' in the shareholder to which such a relationship may give rise. It often arises out of a fundamental understanding between the shareholders which formed the basis of their association but was not put into contractual form, such as an assumption that each of the parties who has ventured his capital will also participate in the management of the company and receive the return on his investment in the form of salary rather than dividend …

(p. 702) Although the petition speaks of the petitioner having various 'legitimate expectations', no grounds are alleged for saying that her rights are not 'adequately and exhaustively' laid down by the articles. And in substance the alleged 'legitimate expectations' amount to no more than an expectation that the board would manage the company in accordance with their fiduciary obligations and the terms of the articles and the Companies Act …

Unfair prejudice and limiting the independent impact of legitimate expectations.

[13.30] O'Neill v Phillips [1999] 1 WLR 1092 (House of Lords)

In 1985 Phillips, who had owned all the shares in the company, gave a 25% share to O'Neill, its foreman and principal employee, and appointed him as a director. He told O'Neill that he hoped O'Neill would be able to take over the whole day-to-day management of the business, and on that basis he would be allowed to draw 50% of the profits. This in due course occurred and, indeed, Phillips retired from the board, leaving O'Neill as sole director.

The company prospered for the next five years, during which time there were discussions about increasing O'Neill's shareholding to 50%. But then the construction industry went into recession and the company's fortunes declined. Phillips took back control of the business and reduced O'Neill's status to that of a branch manager, and also withdrew his share of the profits. O'Neill took steps to leave the company, and also issued a s 459 petition. Lord Hoffmann, with the support of all the other members of the House, held that there was no basis for a court to hold that Phillips had acted unfairly.

LORD HOFFMANN:…

'Unfairly prejudicial'

In [CA 1985] s 459 Parliament has chosen fairness as the criterion by which the court must decide whether it has jurisdiction to grant relief. It is clear from the legislative history (which I discussed in *Re Saul D Harrison & Sons plc* **[13.29]**) that it chose this concept to free the court from technical considerations of legal right and to confer a wide power to do what appeared just and equitable. But this does not mean that the court can do whatever the individual judge happens to think fair. The concept of fairness must be applied judicially and the content which it is given by the courts must be based upon rational principles. As Warner J said in *Re JE Cade & Sons Ltd* [1992] BCLC 213 at 227: 'The court … has a very wide discretion, but it does not sit under a palm tree.'

Although fairness is a notion which can be applied to all kinds of activities, its content will depend upon the context in which it is being used. Conduct which is perfectly fair between competing businessmen may not be fair between members of a family. In some sports it may require, at best, observance of the rules, in others ('it's not cricket') it may be unfair in some circumstances to take advantage of them. All is said to be fair in love and war. So the context and background are very important.

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

The first of these two features leads to the conclusion that a member of a company will not ordinarily be entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted. But the second leads to **(p. 703)** the conclusion that there will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith.

This approach to the concept of unfairness in s 459 runs parallel to that which your Lordships' House, in *Ebrahimi v Westbourne Galleries Ltd* **[16.13]**, adopted in giving content to the concept of 'just and equitable' as a ground for winding up.

[His Lordship cited extracts from that case, and continued:] I would apply the same reasoning to the concept of unfairness in s 459. The Law Commission, in its report on Shareholder Remedies (Law Com No 246) (1997) para 4.11, p 43 expresses some concern that defining the content of the unfairness concept in the way I have suggested might unduly limit its scope and that 'conduct which would appear to be deserving of a remedy may be left unremedied'. In my view, a balance has to be struck between the breadth of the discretion given to the court and the principle of legal certainty. Petitions under s 459 are often lengthy and expensive. It is highly desirable that lawyers should be able to advise their clients whether or not a petition

is likely to succeed. Lord Wilberforce, after the passage which I have quoted, said that it would be impossible 'and wholly undesirable' to define the circumstances in which the application of equitable principles might make it unjust, or inequitable (or unfair) for a party to insist on legal rights or to exercise them in particular way. This of course is right. But that does not mean that there are no principles by which those circumstances may be identified. The way in which such equitable principles operate is tolerably well settled and in my view it would be wrong to abandon them in favour of some wholly indefinite notion of fairness …

I agree with Jonathan Parker J when he said in *Re Astec (BSR) plc* [1998] 2 BCLC 556 at 588:

> … in order to give rise to an equitable constraint based on 'legitimate expectation' what is required is a personal relationship or personal dealings of some kind between the party seeking to exercise the legal right and the party seeking to restrain such exercise, such as will affect the conscience of the former.

This is putting the matter in very traditional language, reflecting in the word 'conscience' the ecclesiastical origins of the long-departed Court of Chancery … I have no difficulty with this formulation. But I think that one useful cross-check in a case like this is to ask whether the exercise of the power in question would be contrary to what the parties, by words or conduct, have actually agreed. Would it conflict with the promises which they appear to have exchanged?… In a quasi-partnership company, they will usually be found in the understandings between the members at the time they entered into association. But there may be later promises, by words or conduct, which it would be unfair to allow a member to ignore. Nor is it necessary that such promises should be independently enforceable as a matter of contract. A promise may be binding as a matter of justice and equity although for one reason or another (for example, because in favour of a third party) it would be enforceable in law …

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

Legitimate expectations

In *Re Saul D Harrison & Sons plc* I used the term 'legitimate expectation', borrowed from public law, as a label for the 'correlative right' to which a relationship between company members may give rise in a case when, on equitable principles, it would be regarded as unfair for a majority to exercise a power conferred upon them by the articles to the prejudice of another member. I gave as **(p. 704)** an example the standard case in which shareholders have entered into association upon the understanding that each of them who has ventured his capital will also participate in the management of the company. In such a case it will usually be considered unjust, inequitable or unfair for a majority to use their voting power to exclude a member from participation in the management without giving him the opportunity to remove his capital upon reasonable terms. The aggrieved member could be said to have had a 'legitimate expectation' that he would be able to participate in the management or withdraw from the company.

It was probably a mistake to use this term, as it usually is when one introduces a new label to describe a concept which is already sufficiently defined in other terms. In saying that it was 'correlative' to the equitable restraint, I meant that it could exist only when equitable principles of the kind I have been describing would make it unfair for a party to exercise rights under the articles. It is a consequence, not a cause, of the equitable restraint. The concept of a legitimate expectation should not be allowed to lead a life of its own, capable of giving rise to equitable restraints in circumstances to which the traditional equitable principles have no application. That is what seems to have happened in this case.

Was Mr Phillips unfair?

The Court of Appeal found that by 1991 the company had the characteristics identified by Lord Wilberforce in *Ebrahimi v Westbourne Galleries Ltd* as commonly giving rise to equitable restraints upon the exercise of powers under the articles. They were (1) an association formed or continued on the basis of a personal relationship involving mutual confidence, (2) an understanding that all, or some, of the shareholders shall participate in the conduct of the business and (3) restrictions on the transfer of shares, so that a member cannot take out his stake and go elsewhere. I agree. It follows that it would have been unfair of Mr Phillips to use his voting powers under the articles to remove Mr O'Neill from participation in the conduct of the business without giving him the opportunity to sell his interest in the company at a fair price. Although it does not matter, I should say that I do not think that this was the position when Mr O'Neill first acquired his shares in 1985. He received them as a gift and an incentive and I do not think that in making that gift Mr Phillips could be taken to have surrendered his right to dismiss Mr O'Neill from the management without making him an offer for the shares. Mr O'Neill was simply an employee who happened to have been given some shares. But over the following years the relationship changed. Mr O'Neill invested his own profits in the company by leaving some on loan account and agreeing to part being capitalised as shares. He worked to build up the company's business. He guaranteed its bank account and mortgaged his house in support …

The difficulty for Mr O'Neill is that Mr Phillips did not remove him from participation in the management of the business. After the meeting on 4 November 1991 he remained a director and continued to earn his salary as manager of the business in Germany. The Court of Appeal held that he had been constructively removed by the behaviour of Mr Phillips in the matter of equality of profits and shareholdings. So the question then becomes whether Mr Phillips acted unfairly in respect of these matters.

To take the shareholdings first, the Court of Appeal said that Mr O'Neill had a legitimate expectation of being allotted more shares when the targets were met. No doubt he did have such an expectation before 4 November and no doubt it was legitimate, or reasonable, in the sense that it reasonably appeared likely to happen. Mr Phillips had agreed in principle, subject to the execution of a suitable document. But this is where I think that the Court of Appeal may have been misled by the expression 'legitimate expectation'. 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. He made no promise on the point. From which it seems to me to follow that there is no basis, consistent with established principles of equity, for a court to hold that Mr Phillips was behaving unfairly in withdrawing from the negotiation. This would not be restraining the exercise of legal rights. It would be imposing upon Mr Phillips an obligation to which he never agreed. Where, as here, parties enter into negotiations with a view to **(p. 705)** a transfer of shares on professional advice and subject to a condition that they are not to be bound until a formal document has been executed, I do not think it is possible to say that an obligation has arisen in fairness or equity at an earlier stage.

The same reasoning applies to the sharing of profits. The judge found as a fact that Mr Phillips made no unconditional promise about the sharing of profits. He had said informally that he would share the profits equally while Mr O'Neill managed the company and he himself did not have to be involved in day-to-day business. He deliberately retained control of the company and with it, as the judge said, the right to redraw Mr O'Neill's responsibilities. This he did without objection in August 1991. The consequence was that he came back to running the business and Mr O'Neill was no longer managing director. He had made no promise to share the profits equally in such circumstances and it was therefore not inequitable or unfair for him to refuse to carry on doing so …

No-fault divorce?

Mr Hollington, who appeared for Mr O'Neill, said that it did not matter whether Mr Phillips had done anything unfair. The fact was that trust and confidence between the parties had broken down. In those circumstances it was obvious that there ought to be a parting of the ways and the unfairness lay in Mr Phillips, who accepted this to be the case, not being willing to allow Mr O'Neill to recover his stake in the company. Even if Mr Phillips was not at fault in causing the breakdown, it would be unfair to leave Mr O'Neill locked into the