O'NEILL V PHILLIPS:
A SOLUTION ALL SHAREHOLDERS CAN AGREE ON?

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“Equity has the power to eradicate the evils of a condemned scheme by prohibition of the use of admittedly valid parts of an invalid whole.”

Reed, Stanley, in U.S v Bausch & Lomb Co. 321 U.S 707, 724 (1994)

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INTRODUCTION

"Corporate power" is the ability to control a company's internal decision-making; this ability can be used inappropriately. The oppressed shareholder rule, as provided for in s 174 of The Companies Act 1993 ("the act), is company law's main response to inappropriate uses of corporate power.[1] This dissertation focuses on how the oppressed shareholder rule ought to distinguish between appropriate and inappropriate uses of corporate power.

Who holds corporate power in a given company "is a practical question of fact and law".[2] Corporate power may lie with a company's board of directors. In other cases it is derived from voting rights attaching to shares and the principle of majority rule, alternatively it may stem from the terms of shareholders' agreements. According to the 'nexus of contracts' theory of the firm these differing sources of corporate power are contractual relationships.[3] The distribution of corporate power within a company is consequently the product of a bargain, or bargains.

Our current oppressed shareholder rule uses fairness to distinguish between appropriate and inappropriate uses of corporate power. Courts have a free-floating discretion to decide what is fair in the context of a particular company. This dissertation argues that this approach is subject to a number of shortcomings caused by its ability to overturn bargains.

England's oppressed shareholder rule is also underpinned by fairness; however, it defines fairness in reference to agreements and equitable constraints. By adopting this definition it avoids overturning bargains. The current English approach, however, gives only a limited role to equitable constraints. This means it is unable to prevent the literal terms of agreements being used opportunistically.

This dissertation argues that we should adopt a modified version of the English rule, in which equitable constraints are given a larger role. This would allow the rule to prevent the opportunistic use of literal agreements, thus enforcing the parties' "real bargains". This would increase the approach's ability to reach fair results, making it equally as effective at doing this as the New Zealand approach, whilst avoiding the

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[1] Companies Act 1993, s 174.

[2] *Sturgess v Dunphy* [2014] NZCA 266 at [135].

[3] Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (1991) Harvard University Press 229.

shortcomings caused by overturning bargains. Such a rule would be both certain and flexible.

Part one looks at New Zealand's current oppressed shareholder rule (the "New Zealand rule"). Chapter one describes the mischief the New Zealand rule aims to prevent, as well as its history, and its current application. It shows that the New Zealand rule is underpinned by fairness and that courts take a discretionary approach when determining what is fair in the context of a particular company. Against this backdrop chapter two identifies the shortcomings of the New Zealand rule. These shortcomings are its lack of predictive certainty, its disrespect for parties' autonomy and the fact that it is conceptually inappropriate and overly paternalistic in the context within which it operates. These shortcomings stem from the New Zealand rule's ability to overturn parties' bargains.

Part two looks at the English oppressed shareholder rule (The English rule) and explains how it can be modified to make it more attractive. Chapter three describes the English rule. It shows that while it is also underpinned by fairness English courts use agreements and equitable constraints to determine what is fair. It shows how the English courts are interpreting equitable constraints narrowly, leaving the rule unable to prevent opportunistic uses of the literal terms of agreements.[4] It explains how adopting a wider view of equitable constraints prevents opportunistic use of literal agreements. Chapter four explains why the wider version of the English rule (the wider English rule) is more attractive than the current English rule.

Part three compares the New Zealand rule to the two variations of the English rule. It shows that the wider English rule is the most attractive option, and looks at how it could be implemented into New Zealand law. Chapter five explains why the New Zealand Court of Appeal's criticisms of the current English rule in *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd*[5] do not provide valid reasons for refusing to adopt the wider English rule. Chapter six applies the New Zealand rule, the English rule, and the wider English rule to the facts of *Sturgess v Dunphy*. It uses this context to show that the wider English rule is the best of these options. Chapter seven recommends including the wider English rule in the act. It describes how the wording of our current section could be changed to achieve this.

[4] The concept of opportunistic use of agreements will be explained and discussed later.

[5] *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328.

PART ONE

CHAPTER ONE: THE OPPRESSED SHAREHOLDER RULE IN NEW ZEALAND.

A INTRODUCTION TO THE OPPRESSED SHAREHOLDER RULE

The publicly listed corporation is generally thought of as the paradigm example of a corporation.[6] These corporations exhibit a separation between ownership and control.[7] Such corporations are relatively rare. In fact relatively few companies fit within this paradigm. This results in a tension, as company law rules should be applicable to all companies. The more numerous closely held companies do not have such a clear separation between ownership and control. In these sorts of companies a shareholder, or group of shareholders, will often have enough shares to influence the management of the company. This ability to influence management allows these shareholders to safeguard, if not promote, their own interests. The relatively small number of shareholders in these companies makes shareholders' agreements a real possibility; these can give shareholders the ability to dictate company decision-making in certain situations. The ability to dictate company decision making whether exercised by the majority of shareholders through their voting rights, or by a shareholder pursuant to a shareholders' agreement, can be referred to as corporate power. It is possible for corporate power to be used inappropriately.

The oppressed shareholder rule, as provided in s 174 of the act, is the law's main response to the potential for inappropriate use of corporate power.[8] It is the "general statutory mechanism that is available to shareholders to protect their interests against the risk of opportunistic behaviour" by other shareholders.[9] It is technically available to all shareholders but it is typically shareholders in closely held companies who seek a remedy under s 174. The case of *Latimer Holdings* is the only example of shareholders in a publicly listed company attempting to use section 174 in New Zealand. The shareholders in this case were unsuccessful. The lack of separation between ownership and control, which is typical in closely held companies, increases

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[6] A A Berle and G C Means *The Modern Corporation and Private Property* (Legal Classics Library, New York, New York Legal Classics Library, 1993) at 104.

[7] A A Berle and G C Means above n 6, at 104.

[8] Companies Act 1993, s 174.

[9] Chris Noonan and Susan Watson "Distilling their Frenzy: The Conceptual Basis of the Oppression Remedy in New Zealand Company Law" (2005) 11 NZBLQ 288 at 289.

the likelihood of someone having corporate power, which could potentially be used inappropriately. It is more likely that shareholders in these companies will develop the "reasonable expectations"[10] required to support a claim. It is also harder for shareholders to exit these companies, as their shares are not publically traded, this means that these shareholders can not cure any prejudice they may have experienced by exiting via the market.[11]

This rule is challenging for the courts to apply. Granting relief amounts to preventing the exercise of corporate power associated with burdensome decisions, which are often independently lawful. Courts have traditionally been reluctant to interfere in such decision-making.[12] Shares, and the voting rights which attach to them, are personal property.[13] Interfering with a company's decisions, made pursuant to the exercise of voting rights, represents a departure from the principle of majority rule, which is one of company law's main governance mechanisms.[14] Clearly in some situations shareholders should be able to use corporate power to promote their self-interest without interference from the courts. The rule therefore, requires the courts to distinguish between appropriate and inappropriate uses of corporate power. This dissertation focuses on how courts applying the rule ought to make this distinction.

B THE HISTORY OF NEW ZEALAND'S OPPRESSED SHAREHOLDER RULE

Prior to the Companies Act 1955 the response of New Zealand law to the problem of inappropriate use of corporate power was confined to the narrow "rights based" approach[15]articulated in *Foss v Harbottle*.[16] Under this approach minority shareholders could not sue for wrongs done to their company or complain of irregularities in the conduct of its internal affairs. [17] Regardless of the harm the alleged misconduct caused

[10] *Latimer Holdings Ltd v SEA Holdings NZ Ltd,* above n 5. The term "reasonable expectations" shall be discussed latter.

[11] *Latimer Holdings Ltd v SEA Holdings NZ Ltd,* above n 5, at [103].

[12] Paul L. Davies and Sarah Worthington *Principles of Modern Company Law* (9th ed, Sweet & Maxwell, London, 2012) at 721.

[13] Companies Act 1933, s 35.

[14] Muhammed Asim Iqbal "The effectiveness of shareholder dispute resolution in private companies under UK companies legislation: an evaluation" (November 2008). <http://irep.ntu.ac.uk/306/1/194154_Iqbal.pdf > at 1.

[15] John H Farrar and Laurence Boulle "*Minority Shareholder Remedies – Shifting Dispute Resolution Paradigms" (*12 January 2001) Bond Law Review <epublications.bond.edu.au/blr/vol13/iss2/3>.

[16] *Foss v Harbottle* (1843) 67 ER 189.

[17] *Foss v Harbottle* (1843) 67 ER 189.

to the interest of minority shareholders they would have no course of action if the majority could ratify the conduct.[18]

The oppressed shareholder rule was first recognised in New Zealand by s 209 of the Companies Act 1955; the section was essentially a reprint of s 210 of the English Companies Act 1948. It allowed shareholders to seek relief from the courts when the affairs of a company were being conducted "in a manner oppressive to some part of the members".[19] The English courts interpreted this section very narrowly, only granting relief when it could be proven that the conduct of those in control of a company was "burdensome, harsh and wrongful".[20] Given the similarities between this and the New Zealand section this became the test in New Zealand. This test presented a very difficult hurdle for applicants to overcome; there were only two successful applications under this section in New Zealand.[21]

The Macarthur Committee recommended broadening the scope of the section, in response to the previously narrow interpretation of the rule.[22] They primarily wanted a wider rule, as the law's only other response to unfairness amongst company insiders was to wind up a company on just and equitable grounds.[23] They considered liquidating an otherwise profitable company was too drastic a response to most inappropriate uses of corporate power.[24] The oppressed shareholder rule was attractive as it offered a selection of remedies that were less heavy handed, such as requiring one shareholder to acquire another's shares.[25] They considered it particularly important that the breadth of rule be increased so as to catch instances of exclusion from management or termination of employment. They considered these situations to be paradigm examples of inappropriate uses of corporate power that did not justify a just and equitable wind up.[26]

Parliament responded to the Macarthur Committee's concerns by amending the Companies Act 1955 in 1980. They changed the wording to allow relief when the affairs of a company had been conducted in a way that was "oppressive, unfairly

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[18] *Burland v Earle* [1902] AC 83, 93.
[19] Companies Act 1933, s 209.
[20] *Scottish Co-operative Wholesale Ltd v Meyer* [1954] AC 324 at 342.
[21] *Re Federated Fashions (NZ) Ltd* (1981) 1 NZCLC 95, 011 (HC); and *Re Anticorrosive Treatments Ltd* (1980) 1 BCR 238.
[22] *Final Report of the Special Committee to Review the Companies Act* (Wellington, 1973) at [371] [372].
[23] At [365]-[368].
[24] At [369].
[25] At [369].
[26] At [370].

discriminatory, or unfairly prejudicial"[27]. This wording has been carried through to section 174 of the act.[28]

Despite the changes made in response to the Macarthur Committee's concerns, this key phrase is still vague. The vagueness of the phrase "oppressive, unfairly discriminatory, or unfairly prejudicial" presents a challenge to those seeking to apply the rule, or predict its application. Essentially Parliament has invited the judiciary to formulate a test. The change in the wording following the Macarthur report, however, is a clear indication that the courts should adopt a more liberal approach.

S 174 (2) shows the remedies that can be given when s 174 (1) is satisfied. Technically these remedies can be given whenever a court considers it "just and equitable to do so".[29] In practice, however, they are given in response to a breach of s 174 (1). Sturgess supports this stating that "wrong and remedy are closely linked"[30] and that "the remedy responds to the detriment".[31] The most common remedy under the subsection is a buyout order.[32] S 174 (2) is as follows: [33]

> (2) If, on an application under this section, the court considers that it is **just and equitable to do** so, it may make such order as it thinks fit including, without limiting the generality of this subsection, an order -
>
> (a) Requiring the company or any other person to acquire the shareholder's shares; or
> (b) Requiring the company or any other person to pay compensation to a person; or
> (c) Regulating the future conduct of the company's affairs; or
> (d) Altering or adding to the company's constitution; or
> (e) Appointing a receiver of the company; or
> (f) Directing the rectification of the records of the company; or
> (g) Putting the company into liquidation; or
> (h) Setting aside action taken by the company or the board in breach of this Act or the constitution of the company.

[27] Companies Amendment Act 1980, s 10.
[28] Companies Act 1993, s 174 (1). See appendix for the full text of s 174.
[29] Companies Act 1993, s 174 (2).
[30] *Sturgess v Dunphy,* above n 2, at [148].
[31] At [148].
[32] Berkahn and Watson, above n 22, at 623.
[33] Companies Act 1993 s 174 (2). Emphasis added. See appendix for the full text of s 174.

C THE ROLE OF FAIRNESS IN THE OPERATION OF NEW ZEALAND'S OPPRESSED SHAREHOLDER RULE

The courts have responded to this invitation by creating a test underpinned by fairness. Courts applying the rule consider a use of corporate power is inappropriate if the harm it inflicts on other shareholders is unfair. This is shown by New Zealand's leading case *Thomas v H W Thomas Ltd*.[34] In this case Richardson J states that:[35]

> "I do not read the subsection [with the key phrase "oppressive, unfairly discriminatory, or unfairly prejudicial] as referring to three distinct alternatives which are to be considered separately in watertight compartments. The three expressions overlap, each in a sense helps to explain the other, and read together they reflect the underlying concern of the subsection that conduct of the company which is **unjustly detrimental** to any member of the company, whatever form it takes and whether it adversely affects all members alike or discriminates against some only, is a legitimate foundation for complaint.

Ultimately the single test is whether the conduct complained of amounts to "unjustly detrimental action."[36] Matthew Berkahn and Susan Watson describe this test as a question of fairness.[37] The literal meaning of "unjustly" supports this description. The Oxford Dictionary defines "unjustly" as " in a manner that is not in accordance with what is morally right and fair."[38]

Although the courts are ultimately trying to decide whether conduct is fair s 174 gives no guidance about how to do this. *Latimer* shows how New Zealand courts approach this decision.[39] The Court of Appeal in *Latimer* states that unfairness requires a "visible departure from the standards of fair dealing, viewed in the light of the history and structure of the particular company, and the **reasonable expectations** of [its] members".[40]

The phrase "reasonable expectations" is a reformation of the phrase "unjust detrimental" discussed in *Thomas*. A shareholder's expectation is a "reasonable expectation" if it would be "unjustly detrimental" for it not to be satisfied. In other

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[34] *Thomas v H W Thomas Ltd* [1984] 1 NZLR 686 (CA).

[35] At 693. Emphasis added.

[36] *Re Ashby and Co Ltd* (1988) 4 NZCLC 64, 131.

[37] Berkahn and Watson, above n 22, at 600.

[38] English Oxford Dictionary < https://en.oxforddictionaries.com>.

[39] *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd ,* above n 5. at [66].

[40] At [65]. Emphasis added.

words something is unfair if it is contrary to a shareholder's reasonable expectations. But this is to replace one vague phrase with another. The term "reasonable expectations" is essentially a label allowing the courts to exercise their discretion when deciding what is fair.

In response the courts have emphasized the need to take a contextual approach when exercising their discretion as to what is fair under s 174 (1). The court in *Latimer* stated that:[41]

> "That fairness is not to be assessed in a vacuum, or from the point of view of one member of a company, and that all the interests involved must be balanced against each other, including the policies underlying the act and those underlying s174."

Using this contextual approach the courts decide what expectations are reasonable, and therefore what conduct is fair, by looking at any factors internal and external to the company that they consider relevant.[42] Relevant factors internal to the company may include formal and informal agreements; relevant factors external to the company are things such as industry standards. [43]

The rule has a broad scope. The Court of Appeal in *Sturgess* acknowledged this describing the rule as "broad and flexible."[44] The rule does not hinge upon independent illegality it " characteristically operates so as to limit the exercise of legal powers; in other words, to stop or grant a remedy in respect of what would otherwise be lawful".[45] It does not require a lack of probity or good faith; the point is the effect on the complainant not the state of mind of the defendant.[46] The rule is not restricted to minority shareholders; it can be invoked by anyone against whom corporate power has been used. Who holds corporate power in a given situation is a practical question of fact and law not necessarily determined by shareholding.[47] Shareholders' agreements can give minority shareholders corporate power.[48]

The breadth of the rule, however, is limited by its need for evidence of unfairness. It is not so broad as to be a tool for the reallocation of resources away from

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[41] At [66].
[42] At [107].
[43] At [107].
[44] *Sturgess v Dunphy,* above n 2, at [137].
[45] *Jacobsen Venue Management New Zealand Ltd v Worldwide NZ LLC* [2008] NZCA 105 at [50].
[46] *Thomas v H W Thomas Ltd,* above n 37, at 693- 696.
[47] *Sturgess v Dunphy,* above n 2, at [135].
[48] *Sturgess v Dunphy,* above n 2, at [135].

dysfunctional companies. The courts have recognised this limit stating that the section does not provide an automatic right of exit when shareholders disagree about a company's policy and direction.[49]

Section 174 is assisted by section 175, which deems certain forms of conduct to be unfairly prejudicial for the purposes of section 174. The section, for example, deems certain forms of conduct in relation to major transactions and alterations of shareholders rights unfairly prejudicial.[50]

D SUMMARY OF NEW ZEALAND'S OPPRESSED SHAREHOLDER RULE

The oppressed shareholder rule is the act's response to the potential misuse of corporate power. After initially being interpreted narrowly Parliament amended the wording to prevent conduct that is "oppressive, unfairly discriminatory, or unfairly prejudicial." The courts interpreted this as prohibiting conduct that is "unjustly detrimental"; whether conduct is unjustly detrimental is a question of fairness. The statute provides no guidance as to what conduct is "fair". The courts have adopted a discretionary and contextual approach to this question. They view conduct as unfair if it breaches the reasonable expectations of a company's members, they determine what these reasonable expectations are with reference to any factors internal or external to a given company that they consider relevant. The remedy is "broad and flexible" most notably as it can prohibit conduct that is independently lawful, however it is not so broad as to be a tool for the reallocation of resources away from dysfunctional companies. The current oppressed shareholder section, section 174, is assisted by section 175, the deemed oppression section.

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[49] *Yovich & Sons Ltd v Yovich* (2001) 9 NZCLC at [31].

[50] Companies Act 1993, s 175 (k) and s 175(l).

CHAPTER TWO: SHORTCOMINGS OF THE NEW ZEALAND RULE.

The lack of legislative guidance as to what conduct is "oppressive, unfairly discriminatory, or unfairly prejudicial", and the courts' consequential development of a discretionary test based on fairness gives courts the ability to overturn parties' bargains.

A OVERTURNING BARGAINS

It is common for shareholders in closely held companies to enter into shareholders' agreements to supplement their rights and obligations under their company's constitution and the general law.[51] These agreements facilitate the private ordering of shareholders' affairs. The rights and obligations that they create can give a shareholder, or a group of shareholders, corporate power in certain situations. Shareholders' agreements are contracts[52]; therefore the corporate power they provide is the product of a bargain.

The corporate power created by voting rights attaching to shares is also the product of a bargain. According to the 'nexus of contracts' theory of the firm, relationships in close corporations are defined by contract.[53] This theory claims, "The Corporation is not a thing but rather a web of implicit and explicit contracts establishing rights and obligations."[54] The choice of the company form, a company's constitution and any additional agreements between shareholders represent the terms of the underlying contract or bargain.[55]

For the purpose of this dissertation the 'nexus of contracts' theory will be used as a theoretical underpinning for discussion of the oppressed shareholder rule. This is appropriate, as these situations do not involve third parties, or a public element. The oppressed shareholder rule is concerned with the regulation of corporate power in interactions between company insiders.[56] Theories based on the company being a legal person distinct from its members are inappropriate when considering the oppressed shareholder rule, as the rule focuses on the behaviour and divergent

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[51] Lynne Taylor "The unfair prejudice remedy" in John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Thomas Reuters, Wellington, 2013) 83 at 83.
[52] Taylor, above n 51, at 83.
[53] Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (1991) Harvard University Press 229.
[54] Stephen M. Bainbridge *Corporation Law and Economics* (Foundation Press, 2002) at 8.
[55] Bainbridge, above n 54, at 8.
[56] Noonan and Watson, above n 9, at 289.

interests of the people behind the legal fiction.[57] Lord Wilberforce in *Ebrahimi v Westbourne Galleries Ltd* highlighted the divergent interests that exist behind a company (albeit in the context of an application for a just and equitable wind up). He stated that[58]:

> The words ['just and equitable'] are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure.

These interests that exist behind the company form, and the lack of third party interests, make the 'nexus of contract' theory an appropriate theoretical underpinning in this context. This, in turn, means that distributions of corporate power through voting rights can be seen as the products of bargains. As shareholders' agreements are literally contracts, both of these distributions of corporate power can be seen as the result of bargains.

As the rule has the ability to prevent otherwise lawful conduct[59], such as the use of corporate power created by a shareholders' agreement, or by voting rights, it has the ability to overturn bargains. The rule is underpinned by fairness, and courts have discretion to decide what they consider to be fair in the context of a given company. The courts, therefore, are deciding whether they consider that the uses of corporate power resulting from bargains are fair. This amounts to deciding whether the substances of shareholders' bargains are fair. When a court uses the rule to prevent a use of corporate power they are overturning a bargain.

The fact that the rule can overturn bargains is undesirable for three reasons. These are as follows:

1) It is conceptually inappropriate and overly paternalistic in the context within which these rules operate.
2) It limits parties' autonomy.
3) It reduces predictive certainty in the operation of the rule.

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[57] *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL).

[58] *Ebrahimi v Westbourne Galleries Ltd,* above n 60, at 379.

[59] *Jacobsen Venue Management New Zealand Ltd v Worldwide NZ LLC*, above n 48, at [50].

1 Conceptual Impropriety

Contract law does not act paternalistically to protect parties from bad bargains.[60] The general law only does this when bargains do not fit within the standard bargaining paradigm. Situations fall outside the standard bargaining paradigm when bargaining power is not roughly equal. These situations leave one side open to abuse and justify looking at the substance of a bargain, and intervening if necessary. In paradigm bargaining situations the law sees contracting parties as rational agents, as such they are assumed to be able to effectively perceive their own self-interest and promote it efficiently.[61] The law views these agreements as a suitable proxy for fair results, as these agreements are thought to embody the rational intentions of contracting parties. The law also expects such parties to protect their own interest.

The Fair Trading Act 1987 (FTA) provides a statutory example of the general law's treatment of contracts made in circumstances falling outside the general bargaining paradigm. The FTA operates in relation to standard form consumer contracts. These contracts are made in a situation outside the standard bargaining paradigm, due to the differences in bargaining power between consumers and businesses using standard form contracts. The FTA allows courts to inquire into the fairness of clauses in these standard form consumer contracts and to refuse to enforce them if they consider they are unfair.[62] The FTA is justified in looking at the substance of these bargains, and potentially intervening, as the differences in bargaining power that exist in these cases, create a risk of abuse.

In contrast the circumstances surrounding bargains allocating corporate power, by shareholder agreement, or majority rule, do not justify this substantive intervention. Unlike contracts governed by the FTA, shareholders' agreements are usually entered into in situations of rough equality of bargaining power. Furthermore, shareholders are not compelled to enter into shareholders agreements or buy shares at all. In addition to this shareholders often receive legal advice before signing shareholders' agreements or buying shares.[63] These bargains therefore fit within the standard bargaining paradigm. It is, therefore, inappropriate for the rule to evaluate the

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[60] John Burrows "Consideration" in John Burrows, Jeremy Finn , Stephen Todd *Law of Contract in New Zealand* (5th ed, LexisNexis, Wellington, 2016) 101 at 112.
[61] Richard H. Thaler & Cass R. Sunstein *Nudge: Improving Decisions About Health, Wealth, and Happiness* (Penguin Books, 2009) at 67.
[62] Fair Trading Act Section 46I 2(a) and Section 46I 2(b).
[63] *O'Neill v Phillips* [1999] 1 WLR 1092 at 1098.

substance of these bargains and overturn them if they do not accord with a judge's discretionary view of fairness. This substantive evaluation, and potential substantive intervention, is overly paternalistic. "Surely, it is not the role of the courts and section 174 to protect shareholders from bargains."[64]

2 Limiting Parties Autonomy

The oppressed shareholder rule limits parties' autonomy by undercutting their bargains. This is a limitation of their autonomy as it denies them the ability to privately order their own affairs. Promoting the autonomy of individuals' is a goal of the act. As such the limitations the rule places on shareholders' autonomy is a shortcoming of the rule. The act aims to promote autonomy, as it is largely an enabling statute. The long title states that the act "provide[s] basic and adaptable requirements for the incorporation, organisation, and operation of companies".[65] The Law Commission said that company law rules should be adaptable in order to allow people and organisations to satisfy their diverse goals.[66]

Contract law also aims to promote autonomy. It does this by allowing people to bind themselves to future obligations and consequently secure binding obligations from others. Contract law is often though to be partially justified by the promotion of autonomy.[67] Respect for shareholders' autonomy requires that their bargains be upheld. Hindsight may make some bargains seem bad, consequentially it may seem like freeing people from their bargains helps them, however we are also reducing their ability to bind themselves to future obligations. This reduces their autonomy and their ability to secure binding obligations from others.

3 Reducing Predictive Certainty

The rule's ability to undercut bargains reduces predictive certainty. This section will show how this reduces predictive certainty; it will also show why predictive certainty is important and consequentially why the resulting lack of predictive certainty is a shortcoming of the rule.

The rule's ability to undercut bargains reduces predictive certainty in two ways. Firstly, it is uncertain whether a court will choose to disrupt a given bargain.

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[64] Noonan and Watson, above n 9, at 301.

[65] Companies Act 1993, Long Title.

[66] Law Commission *Company Law Reform and Restatement* (NZLC R9, 1989) at 4.

[67] Stephen A Stephen *Contract Theory* (Oxford University Press, Oxford, 2004) at 23.

Secondly, if a court does decide to overturn a bargain it is uncertain which remedy, if any, it will award.

Rules have varying levels of predictive certainty. It is possible to perceive of predictive certainty as a continuum with individual rules falling at different points along it. The oppressed shareholder rule's ability to overturn bargains means it falls towards the less predictively certain end of the continuum. This is not satisfactory.

It is difficult to predict whether a court will choose to apply the rule to overturn a given bargain. We know that courts may overturn bargains and that they use a discretionary and contextual notion of fairness when deciding whether or not to do so. It is, however, very hard to predict whether in reality a court will actually decide to overturn a given bargain.

There is also uncertainty regarding what remedy, if any, a court will give if it holds that the rule has been breached. Section 174 (2) of the act allows a court to make any "such order as it thinks fit" provided they consider it "just and equitable to do so".[68] The subsection is as follows:[69]

> (2) If, on an application under this section, the court considers that it is just and equitable to do so, it may make such order as it thinks fit including, without limiting the generality of this subsection, an order -
>
> (a) Requiring the company or any other person to acquire the shareholder's shares; or
> (b) Requiring the company or any other person to pay compensation to a person; or
> (c) Regulating the future conduct of the company's affairs; or
> (d) Altering or adding to the company's constitution; or
> (e) Appointing a receiver of the company; or
> (f) Directing the rectification of the records of the company; or
> (g) Putting the company into liquidation; or
> (h) Setting aside action taken by the company or the board in breach of this act or the constitution of the company.

As can be seen above the subsection lists eight potential remedies, however it does so "without limiting the generality of the subsection".[70] A court can choose to award a different remedy in response to a breach of the rule; alternatively it could choose not

[68] Companies Act 1993 section 174 (2).
[69] Companies Act 1993 section 174 (2).
[70] Companies Act 1993 section 174 (2).

to award a remedy even when there has been a breach. The courts frequently give buy out orders[71], however the extent of the alternatives available to them, and the unfettered discretion they have when deciding which to use, means that the choice of remedy creates uncertainty.

The lack of predictive certainty in the rule is a shortcoming. Predictive certainty is valuable in this context for the following reasons.

i) Company rules ought to provide practical guidance for those using the company form. The more predictively certain a rule is the more practical guidance it provides.
ii) Predictive certainty is positively correlated with economic efficiency.
iii) A lack of predictive certainty increases the likelihood of wealthy minority shareholders extracting unmeritorious settlements from majority shareholders.

i) Practical guidance

The more predictively certain the rule is the more practical guidance it provides to those using the company form. If those who are affected by a rule are able to predict ex ante whether the courts are likely to hold a given course of conduct to be in breach of the rule, they will be able to use the rule to guide their conduct. The Law Commission was clearly of the view that company law rules ought to provide practical guidance to those using the company form. They said "a good system of company law should clearly identify the duties and powers within the corporate structure in an act designed for use by directors and shareholders and not just lawyers and accountants".[72] They also said that the 1955 Companies Act created a "need for more accessible and intelligible law".[73]

The Court of Appeal in *Latimer* also acknowledged the importance of predictive certainty. They stated, "it is appropriate that there be a principled approach to the section, against which the commercial world, and its advisors, can measure conduct."[74]

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[71] Berkan and Watson, above n 22, at 623.
[72] Law Commission, above n 66, at 20.
[73] At 26.
[74] *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd,* above n 5 , at [64].

ii) Economic efficiency

The lack of predictive certainty in the rule is also a shortcoming, as predictive certainty is positively correlated with economic efficiency.[75] As the rule is not very predictively certain, those with corporate power may not make some decisions as they may not know if doing so will breach the rule. The lack of predictive certainty also makes disputes hard to settle, leaving companies paralysed during the interim, as parties do not know what a court is likely to decide. As per the long title of the act companies are vehicles for the aggregation of capital for productive purposes, and a means of achieving economic benefits.[76] The economy, therefore, benefits when companies are actively putting their resources towards productive purposes, rather then existing in a state of paralysis due to a lack of predictive certainty.

iii) Unmeritorious settlement

The New Zealand approach's lack of predictive certainty leads to adverse results in the settlement process. This lack of certainty gives minority shareholders the ability "to use the threat of costly litigation under section 174 to extract unmeritorious payments from companies."[77]

4 Lack of Legislative Comment On Predictive Certainty

The fact that neither the Macarthur Committee, nor the Law Commission's Report number 9, mentioned predictive certainty should not be taken to mean they did not consider it important. When the Select Committee issued their report the rule was being applied very restrictively and there had been only two successful cases under the section.[78] [79] In this context it likely never occurred to the Select Committee to express a need for predictive certainty, this is the case as the rule's ineffectiveness made it extremely predictively certain. The Committee focusing on increasing the scope of a very restrictive section, rather than commenting on predictive certainty, does not show they did not consider predictive certainty to be important. If the predictive certainty of the rule had been in doubt they may well have stressed its importance. Furthermore the Law Commission's Report made no substantive changes to the section.[80] Therefore, the fact that the report made no reference to predictive

[75] Portuese, Aurelien and Gough "The Principle of Legal Certainty as a Principle of Economic Efficiency" (July 8, 2013) European Journal of Legal Studies <dx.doi.org/10.2139>.
[76] Companies Act 1993, Long Title.
[77] Noonan and Watson, above n 9, at 295.
[78] *Re Anticorrosive Treatments Ltd* (1980) 1 BCR 238.
[79] *Re Federated Fashions (NZ) Ltd* (1981) 1 NZCLC 95, 011 (HC).
[80] Law Commission, above n 66.

certainty shows at most that the Commission did not think the rule was so uncertain as to warrant re drafting the section.

B TOWARDS AN OPPRESSED SHAREHOLDER RULE CONCEPTUALLY UNDERPINNED BY REAL BARGAINS

The conceptually improper operation of the rule, its failure to uphold parties' autonomy, and the lack of predictive certainty, all reflect shortcomings of the rule. These shortcomings could be avoided by refusing to overturn any literal bargain between shareholders that has been freely entered into. This would, however, be undesirable as corporate power can be used in ways that are both legal and oppressive. This will be shown in later chapters. The rule is meant to protect against abuses of corporate power.[81] The Law Commission has stated that "All Companies Acts are concerned with striking a balance between enabling the use of the corporate form and regulating to prevent its abuse."[82] The oppressed shareholder rule exhibits a similar tension. It must prevent abuses of corporate power without placing unnecessary restrictions on its use. The best way to manage this tension is by using the rule as a tool to uphold parties' "real bargains". The next chapter will look at the English approach to the oppressed shareholder remedy, which defines fairness in reference to agreements and equitable constraints arising between shareholders.[83] This approach will be considered as a possible platform for reform in New Zealand.

[81] Noonan and Watson, above n 9, at 289.
[82] Law Commission, above n 66, at 21.
[83] *O'Neill v Phillips*, above n 63.

PART TWO

CHAPTER THREE: ENGLAND'S OPPRESSED SHAREHOLDER RULE.

A ENGLAND'S OPPRESSED SHAREHOLDER RULE PRIOR TO O'NEILL V PHILLIPS

England's oppressed shareholder section is section 994 of the Companies Act 2006 (UK). This section is triggered by conduct, or a proposed act or omission, which is "unfairly prejudicial" to a company's members generally, or to some part of a company's membership.[84] If a court holds that section 994 is satisfied section 996 (1) allows the court to make "such order as it thinks fit for giving relief in respect of the matters complained of."[85]

The key phrase from s 994, "unfairly prejudicial", was the same under the Companies Act 1985 (UK).[86] This is significant as O'Neill was decided under this earlier act.

Prior to *O'Neill v Phillips* the approach of the English courts was effectively the same as that of the New Zealand courts.[87] "Unfair Prejudice" was caused by a breach of a shareholder's "legitimate expectations".[88] "Legitimate expectations" were not necessarily limited to the terms of formal agreements; they could arise in response to factors external and internal to a company.

B O'NEILL V PHILLIPS

O'Neill v Phillips radically changed the English approach.[89] Mr Phillips was the sole shareholder and director of a small company. Mr O'Neill was a manual worker at the company. Mr Phillips gave Mr O'Neill a 25% shareholding and expressed the hope that he would one day assume responsibility for managing the company, in which

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[84] Companies Act 1985 (UK), s 459(1).

[85] Companies Act 1985 (UK), s 461(1).

[86] Davies and Worthington, above n 12, at 724.

[87] John Farrar and Laurence Bolle "Minority Shareholder Remedies – Shifting Dispute Resolution Paradigms" (2001) 13 Bond LR 272 at 273 and 286-289.

[88] Prior to O'Neill the English courts used this phrase in the same way the New Zealand courts use the "reasonable expectations".

[89] Giora Shapira 'The Hand that Giveth is the Hand that Taketh Away — O'Neill v Phillips and Shareholder "Legitimate Expectations"' (2000) 11 Australian Journal of Corporate Law at 260, 261 and 270.

case he would be allowed to draw 50% of the profits. Mr Phillips then retired as Chief Executive Officer leaving Mr O'Neill in charge of the running of the business. Negotiations were entered into concerning increasing Mr O Neill's shareholding to 50%, but a concluded agreement was never reached. Mr Phillips later lost faith in Mr O'Neill's ability as a manager; he consequently resumed management himself and said that Mr O'Neill's remuneration would be limited to his salary and the dividends on his 25% shareholding. Mr O'Neill claimed that Mr Phillips' conduct was oppressive.

The Court of Appeal found in favour of Mr O'Neill. They held that whilst there was no concluded agreement, he had a "legitimate expectation" to continue to draw 50% of the profits and to have his shareholding increased to 50%.[90] Lord Hoffman, delivering the judgement for the House of Lords, overruled this decision. He held that Mr O'Neill was entitled to 50% of the profits whilst he was the managing director, but as the controlling shareholder, Mr Phillips had the ability to resume his position of managing director. They held that upon doing so he could reduce Mr O'Neill's remuneration. He held that Mr Phillips had made no commitment that made it unfair for him to exercise this power. He also held that discussions concerning an increase in Mr O'Neill's shareholding had never gone beyond negotiation and Mr Phillips had not made a promise that compelled him to increase Mr O'Neill's shareholding.[91]

This case signalled a shift in English oppressed shareholders jurisprudence, moving their approach from a wide discretionary approach to a "contractual approach".[92] This change was largely motivated by a desire for increased certainty. This can be seen through Lord Hoffman's statement that " a balance has to be struck between the breadth of the discretion given to the court and the principle of legal certainty."[93] Lord Hoffman set out to achieve this increased certainty by abandoning the use of a "wholly indefinite notion of fairness".[94] Fairness remains the touchstone of the test, the difference is that under the O'Neill approach "the concept of fairness must be applied judicially and the content which it is given by the courts must be based on rational principles."[95] Lord Hoffman saw the use of contractual and equitable principles as a way to give courts a principled and certain process through which to reach fair results.

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[90] *O'Neill v Phillips*, above n 63.
[91] At 1103.
[92] Davies and Worthington, above n 12, at 727.
[93] *O'Neill v Phillips,* above n 63, at 1099.
[94] At 1099.
[95] At1098.

The O'Neill approach adopts the premise from *Re Saul D. Harrison & Sons Plc. Re Paul Harrison* that fairness in a commercial context is "keeping promises and honouring agreements".[96] It then builds on this premise defining oppressive conduct as conduct that is "contrary to what the parties by their words or conduct have actually agreed".[97] This means that a use of corporate power is unfair if it is contrary to the formal agreements between shareholders (such as those contained in a company's constitution or shareholders agreement) or is prevented by equitable constraints. The specific role of formal agreements and equitable constraints within the approach will be explained later in this chapter.

This approach is using agreement as a proxy for fairness. Fairness is an amorphous concept; it is therefore impossible for a rule to achieve results that everybody would consider fair in all situations. People may disagree with a rule that decides what is fair, or with the outcome reached when a judge is given discretion to decide what is fair. Contracting parties are generally assumed to be rational and able to effectively perceive and promote their self-interest.[98] Furthermore, people are not compelled to acquire shares in a company. Agreement is, therefore, arguably an effective proxy for fairness in this context as these agreements embody the rational and freely exercised intent of the parties to them.

The formal agreement component of the test is relatively simple. Formal agreements between shareholders are contained in a company's constitution and in any shareholder agreements that exist between shareholders. Using corporate power in a way that breaches a term of any of these formal agreements is oppressive conduct.[99]

C EQUITABLE CONSTRAINTS

Lord Hoffman quoted the following passage from *Re Astec (B.S.R.) Plc.* when describing equitable constraints:[100]

> "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

[96] *In re Saul D. Harrison & Sons Plc* [1995] 1 B.C.L.C. 14.
[97] *O'Neill v Phillips,* above n 63, at 1101.
[98] Jennifer Arlen "*The Future of Behavioral Economic Analysis of Law"* (1998) 51 VAND L REV 1765 at 1767.
[99] *O'Neill v Phillips,* above n 63, at 1098.
[100] *Re Astec (B.S.R.) Plc.* [1998] 2 BCLC 556 at 568.

> right and the party seeking to restrain such exercise, such as will affect the conscience of the former."

Lord Hoffman clarified the requirement that shareholders have "a personal relationship or personal dealing of some kind".[101] He said the test was "whether the exercise of the power in question would be contrary to what the parties, by words or conduct, have actually agreed."[102] Personal relationships and personal dealings are significant as they provide a context within which such an agreements can be reached, they have no significance independent of agreements. He saw informal agreements as the main form of equitable constraint. He said that:[103]

> "In a quasi-partnership company, they [equitable constraints] 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."

To distinguish such agreements from contracts he added "Nor is it necessary that such promises should be independently enforceable as a matter of contract."[104] He stated that such promises are "binding as a matter of justice and equity"[105] despite not being contractually enforceable. It is important to note the reference to agreement arising from conduct; past conduct is a useful evidential guide for establishing if an alleged agreement actually exists.

Such informal agreements are likely to be common, especially in New Zealand with our large number of small and medium sized businesses. Business partners who have worked together prior to incorporation may have a lot of trust in each other and may view putting their agreements into contractual form as an unnecessary expense.

Lord Hoffman also said that equitable constraints could arise from circumstances that put an end to the basis on which shareholders entered into their association. He claimed that events analogous to frustration would constitute an equitable constraint and stated that:[106]

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[101] At 1098.
[102] At 1098.
[103] At 1101.
[104] At 1101.
[105] At 1101.
[106] AT 1101.

> “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.”

The English courts still use the approach from *O’Neill*. This is shown by *Apex Global Management Ltd v FI Call Ltd*, an English case from 2015. *Apex Global Management Ltd* referred to O’Neill on a number of occasions and said that:[107]

> “the concept of unfairness is open-textured; but it is to be applied judicially and must comprise some breach of either the terms on which it was agreed the affairs of the company should be conducted or of equitable constraints which apply to the exercise of legal powers by reason of the nature of the relationship between the parties.”

Frank Digrado v. Antonio D'Angelo, Abbington Hotel Ltd provides an example of the operation of equitable constraints.[108] In this case the company concerned, Abbington Hotel Limited (the company), had two directors Mr D’Angelo (Mr DA) and Mr Digrado (Mr DG). The company had 100 issued shares; these were split into two blocks with each director owning one of these blocks.[109] There were no relevant formal agreements.[110] The judge held the shareholders had an informal arrangement that both of them would be entitled to equal participation in the business of the company.[111] The directors were both involved in the running of the business until they fell out[112]. Mr DG responded to this by removing Mr DA’s access “to the banking arrangements for the company, its computer records and, with the changing of the locks, its office paper work”.[113] The judge held that this amounted to excluding Mr DA from the management of the company. As this breached an informal agreement, which is a form of equitable constraint, it was held to be unfairly prejudicial conduct.[114]

This result shows the English approach is able to respond to situations of exclusion from management. If the informal agreement had been different the English approach could also have given a remedy for termination of employment. This is significant as

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[107] *Apex Management Ltd v FI Call Ltd* [2015] EWHC 3269 (Ch) at 44.
[108] *Frank Digrado v. Antonio D'Angelo, Abbington Hotel Ltd* [2011] EWHC 635 (Ch).
[109] At 1.
[110] At 30.
[111] At 93.
[112] At 98.
[113] At 118.
[114] At 118.

the Macarthur Committee considered it particularly important for the rule to cover these situations.[115]

This result also shows the breadth of equitable constraints and the English approach. Equitable constraints allow the English approach to reach the same results as the New Zealand approach in most cases[116], without resorting to a discretionary notion of fairness and overturning bargains. This means that in most cases the English approach can prevent the same abuses of corporate power as the New Zealand approach. As the English approach does not overturn bargains, however, it can reach these results in a way that is more predictively certain, more respectful of parties' autonomy, and more conceptually appropriate. It is more conceptually appropriate as it does not look at the substantive merits of parties' bargains in paradigm bargaining situations.

D THE RELATIONSHIP BETWEEN FORMAL AGREEMENT AND EQUITABLE CONSTRAINTS

The English approach, however, limits the breadth of equitable constraints by only giving limited effect to them when they contradict literal terms of a formal agreement. As will be shown below the English courts treat equitable constraints as alleged terms of the parties' bargain. This characterisation requires equitable constraints to satisfy the implied terms test in order to be legally enforceable when they contradict the literal terms of formal agreements.

In *Marks and Spencer plc. v BNP Paribas Securities Services Trust Company (Jersey) Ltd*[117] the UK Supreme Court held that the test for implied terms is the one established in *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (BP Refinery). The BP Refinery test is as follows:[118]

> "For a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract."

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[115] Law Commission, above n 66, at [368].

[116] Noonan and Watson, above n 9, at 292.

[117] *Marks and Spencer plc. v BNP Paribas Securities Services Trust Company (Jersey) Ltd* [2015] UKSC 72.

[118] *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 52 ALJR 20 at 26.

Re Company (No. 004377 of 1986) shows that the prior to *O'Neill* the English courts were treating what would now be referred to as equitable constraints as terms a party was seeking to imply into a formal agreement. In this case the shareholders' agreement stated that a shareholder who ceased to be an employee, or director, of the company had to transfer his shares to the other shareholders within 14 days.[119] The shareholder's agreement stated that if a price could not be agreed the company's auditors would value the shares. [120] A director of the company had been dismissed but refused to sell the shares at the price set by the auditors. He claimed to have been wrongfully dismissed and argued "there must be an implied term that an employee director who had been wrongfully dismissed was not obliged to give a transfer notice when he ceased to be a director."[121]The judge, however, refused to do so. He stated that to do so would not be to superimpose equitable considerations on his rights under the articles but to relieve him from the bargain he made."[122] He justified this decision by stating that "the proposed implied term cannot pass the test of necessity to give business efficacy to the article. [As] It can work perfectly well as it stands."[123]

It can be seen that the judge is using the terms equitable considerations and implied terms interchangeably. He also applied the business efficacy test, which itself is a requirement under the BP Refinery test for implied terms. He is, therefore, treating equitable considerations like terms a party is seeking to imply into a formal agreement.

This is a very restrictive approach. It makes it nearly impossible for the use of a literal term in a formal agreement to be restricted by equitable considerations. Formal agreements will nearly always be workable without being subject to equitable considerations in the form of an implied term. The "implied term" will therefore not be necessary to give the contract business efficacy; this will prevent it satisfying the implied terms test.

Nugent v Benfield Greig Group Plc shows that despite the explicit acknowledgment of equitable constraints in O'Neill*,* the English courts are still taking this restrictive approach. This case involved a dispute over the valuation of a deceased shareholder's shares. The company's shareholders had entered into a shareholders' agreement requiring the executor of a deceased shareholder's estate to sell any shares they held

[119]*Re a Company (No.004377 of 1986)* [1987] 1 WLR. 102 at 105.
[120]*Re a Company (No.004377 of 1986)*, above n 119, at 105.
[121] *Re a Company (No.004377 of 1986)*, above n 119, at 107.
[122] *Re a Company (No.004377 of 1986)*, above n 119, at 107.
[123] *Re a Company (No.004377 of 1986)*, above n 119, at 107. Emphasis added.

to the other shareholders. The shares were to be sold at a price set by a prescribed valuer. The executor of the deceased shareholder's estate claimed that he had an informal agreement with the other shareholders that he would be allowed to make representations to the valuer (despite this not being included in the shareholders' agreement). The executor claimed that this created an equitable constraint on the corporate power granted by the shareholder agreement. The judge applied the test from *BP Refinery*, implicitly characterising the alleged equitable constraint as a term the executor was seeking to imply into the shareholder's agreement. The judge held that such a term could not be implied, as it was not necessary to give the agreement business efficacy.[124]

The relationship between equitable constraints and formal agreements under the English approach shows that the approach is using literal agreement as its proxy for fairness. The role of equity is effectively limited to requiring parties to honour literal non-contractual agreements (when they do not contradict formal agreements), and preventing literal agreements being forcibly maintained in situations analogous to frustration. Essentially equitable constraints exist under this approach to avoid transaction costs, by preventing the need to put all agreements into contractual form. The need to do this is prevented by making informal agreements enforceable and subject to frustration in the same way that contractual agreements are. Equitable considerations essentially expand the scope of parties' bargains by making informal agreements enforceable. As they are subordinate to the literal terms of agreements, however, they do not limit the use of corporate power resulting from the literal terms of parties' bargains.

Equitable constraints do not have to be applied so narrowly in relation to formal agreements. Lord Wilberforce, when talking about the practice of liquidating a company on "just and equitable grounds", explains equity's traditional relationship with legal rights. He explains how the just and equitable wind up rule:[125]

> "does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way."

Although the English courts do not currently do so, the concept of equitable constraints could be expanded so as to prevent the legal rights created by the literal

[124] *Nugent v Benfield Greig Group Plc* [2001] BCLC 92.

[125] *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL) at 379.

terms of agreements being used in certain situations. Equitable constraints could be used to prevent the literal terms of agreements being used opportunistically; opportunistic use of a literal term is using it to do something the other party would not have agreed to if they had been consulted about it at the time of the agreement.[126] Expanding equitable constraints to allow them to prevent the opportunistic use of literal agreements would allow enforcement of the parties' "real bargains".

The fact that equitable constraints could be applied more expansively means we have two potential formations of the rule from *O'Neill*. England's current application of *O'Neill*, under which equitable constraints are treated as implied terms in relation to formal agreements, will be referred to as the "narrow O'Neill approach". The potential application of *O'Neill*, in which equitable constraints prevent opportunistic use of the terms of literal agreement, will be referred to as the "wide O'Neill approach". The approaches could potentially be referred to as the "contractual O'Neill approach" and the "equitable contractual O'Neill approach". These labels, however, are potentially misleading as equitable considerations do feature in the narrow O'Neill approach although their role under that approach is smaller than their role under the wide O'Neill approach.

E SUMMARY OF ENGLAND'S OPPRESSED SHAREHOLDER RULE

England's oppressed shareholder law used to be very similar to New Zealand's, but following *O'Neill* the two approaches have diverged. Under the narrow O'Neil approach the English courts hold a use of corporate power to be unfair, and therefore in breach of the rule, if it is contrary to a formal agreement between the parties or prevented by equitable constraints. These equitable constraints arise due to informal agreements and situations analogous to frustration. When it is claimed that an equitable constraint exists, when there are relevant formal agreements, the courts apply the *BP Refinery* implied terms test. This makes it nearly impossible to subject literal formal agreements to equitable constraints, as the formal agreements will nearly always be workable without implied terms. The English approach is using literal agreement as a proxy for fairness. As a result of this it upholds parties' bargains when literal agreements are used opportunistically.

It is possible, however, to take a wide approach to O'Neill by giving a larger role to equitable constraints. Under such an approach equitable constraints would prevent literal agreements being used opportunistically. By doing this they would uphold

[126] Benjamin Means " A Contractual Approach to Shareholder Oppression Law" 79 (2011) Fordham. L. R. 1161 at 1198.

parties' "real bargains". The next chapter will show that the wide O'Neill approach is preferable.

CHAPTER FOUR: COMPARISON OF THE WIDE AND NARROW APPROACHES TO O'NEILL.

Standard law and economics claims that minority shareholders should bargain for protection against opportunism from controlling shareholders. [127] A narrow contractarian view of company law builds upon this premise and concludes that courts should not regulate the relationship between shareholders other than by enforcing their contracts.[128]

The narrow O'Neill approach is not underpinned by such a conservative view, as it enforces equitable constraints arising from informal agreements. Under this approach, however, equitable constraints are just extending the scope of the parties' bargains. The narrow approach does not allow equitable constraints to restrict parties' uses of corporate power arising from literal bargains. Supporters of the narrow O'Neill approach would view the wide O'Neill approach's use of equitable constraints to prevent opportunistic use of literal agreements as rewriting parties' bargains and providing windfalls to those relying on them.[129]They would, therefore, consider it inappropriate. They would prefer to analyse equitable constraints as implied terms in these cases as they would view this as upholding the parties' contracts. The wider role given to equitable constraints under the wide O'Neill approach is justified by a number of factors.

Supporters of the narrow O'Neill approach would likely argue that parties entering into a contract do not know what the future will hold and must allocate risk including unforeseen risk.[130] This would include the risk of corporate power being used in unforeseen situations with undesirable consequences.

This argument is flawed, as it is very unlikely that shareholders will be able to see all contingencies in which they do not want a specific power used. Whether a power can be used in such contingencies will not be the product of agreement on that question in particular, but rather the result of an allocation of unforeseen risk. Behavioural economics shows us that humans are systematically irrationally optimistic. [131] Shareholders, therefore, systematically overvalue the success of a venture and

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[127] Paula J. Dalley "The Misguided Doctrine of Stockholder Fiduciary Duties" (2004) 33 Hofsta L.Rev 175 at 221.

[128] Edward B. Rock & Michael L. Wachter " Waiting for the Omelete to Set; Match-Specific Assets and Minority Oppression in Close Corporations" (1999) 24 913 CORP. L at 915.

[129] Dalley, above n 128, at 221.

[130] Charles J. Goetz & Robert E. Scott "Principles of Relational Contracts" (1981) 67 VA L.REV 1089 at 1090.

[131] Melvin A. Eisenberg "The Limits of Cognition and the Limits of Contract" (1995) 47.

underestimate the risk of conflict.[132] Allocations of unforeseen risk are therefore not products of rational intent. If shareholders are unable to foresee all such contingencies, literal agreement fails to represent the rational intent of the parties, either in the form of an agreement on the issue itself or as a rational allocation of unforeseen risk. Agreement fails to be an effective proxy for fairness in these situations.

Even if we assume that shareholders can foresee all contingencies in which they would not want a corporate power to be used (meaning that literal agreements in these cases are products of rational intent), making explicit contractual exceptions for all these contingencies would be very expensive.[133] Avoiding transaction costs, therefore, provides a justification for the wider role for equitable constraints.

Promoting trust amongst company insiders also justifies the court having the right to rely on equitable constraints to prevent opportunistic use of powers under a formal agreement. A shareholder could then trust the other shareholders not to use a power granted by the literal terms of the agreement opportunistically. If shareholders believe that their business partners will treat them fairly, regardless of whether or not they are legally obliged to do so, they may consider it unnecessary to bargain thoroughly against potential unfair treatment.[134] Arms length bargaining in such situations can also be detrimental to trust.[135] Shareholders may decide that such bargaining is harmful as well as unnecessary. The court should not apply equitable constraints so narrowly that shareholders are forced to enter into extensive arms length bargaining and undermine trust. Trust is worth protecting, as people who feel trusted are more likely to feel personally invested in a business and therefore work harder.[136] Trust and other social norms are often more efficient motivators than money.[137]

Lastly, if equitable constraints are not expanded to prevent the opportunistic use of literal terms of agreements it would be nearly impossible to protect the interest of all shareholders in small companies. "Minority veto and majority fiat can both be used opportunistically".[138] Under the narrow O'Neill approach there will be either few, or

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[132] Eisenberg, above n 132, at 213.
[133] David Charny "Hypothetical Bargains: The Normative Structure of Contract Interpretation" (1991) 89 MICH. L. REV 1871 at 1819.
[134] Elinor Ostrom "Collective Action and the Evolution of Social Norms" (2000) 14 J. ECON. PERSP. 137 at 139.
[135] Eisenberg, above n 132, at 213.
[136] Benjamin Means, above n 127, at1191.
[137] Benjamin Means, above n 127, at 1192.
[138] Benjamin Means, above n 127, at 1166.

no, restrictions on the majority's corporate power. This would enable them to take advantage of minority shareholders through the principle of majority rule, or minority shareholders will be given veto powers that can be used opportunistically against majority shareholders in certain situations. A wider role for equitable constraints allows us to avoid such a stalemate by preventing powers being used opportunistically.

PART THREE

CHAPTER FIVE: RESPONDING TO THE NEW ZEALAND COURT OF APPEAL'S REJECTION OF THE NARROW O'NEILL APPROACH.

A THE COURT OF APPEAL'S CRITICISMS

In *Latimer* the New Zealand Court of Appeal considered whether to follow the narrow O'Neill approach, but chose not to do so. They gave three reasons for their decision these reasons are as follows:

i) They thought there was an economic danger "that a restrictive approach may involve senior executives and directors avoiding smaller companies out of a fear of being unduly locked in".[139]
ii) They thought there was a doctrinal danger in adopting the approach "something may be lawful and "expected", but still unduly prejudicial".[140]
iii) They claimed the benefits of what is the narrow O'Neill approach had been overstated as they claimed it had not reduced oppressed shareholder litigation in the United Kingdom (UK).[141]

A supporter of New Zealand's current discretionary approach would likely use the same criticisms against the wide O'Neill approach. Both the potential O'Neill approaches differ from our approach in the same ways, it is the relative extent of these differences that vary. The first two criticisms stem from the narrower O'Neill approach being more restrictive then the New Zealand approach. The wide O'Neill approach would, however, also be more restrictive then our current approach. The final criticisms are derived from the allegation that the narrow O'Neill approach does not achieve its perceived goal of increased certainty. The wide O'Neill approach also aims to increase certainty relative to the New Zealand approach. Both versions of the O'Neill approach attempt to do this by defining fairness by reference to agreement. They differ in regards to how widely they use equitable constraints and therefore, whether they are enforcing real or literal bargains. It is necessary to respond to these

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[139] *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* , above n 5 , at [95].
[140] At [95].
[141] At [97].

criticisms in order to show why the wide O'Neill approach is preferable to our current discretionary approach.

1 Economic

Adopting the wide O'Neill approach would only affect the behaviour of a small number of directors. Section 174 only provides remedies for shareholders, not directors per se. The only directors whose decisions would be effected by a change in approach are those considering buying shares and assuming management positions in companies. In addition to this they must be considering buying shares in a non-listed company. If they were considering buying shares in a listed company they can exit via the market, meaning that the change to a more restrictive approach would not affect their behaviour. A change in approach would, therefore, only affect the behaviour of directors looking to buys shares in privately held companies.

It is only very slightly more difficult for a director to exit a company under the wide O'Neill approach than under the current New Zealand approach. The Court of Appeal in *Latimer* agreed with Lord Hoffman's statement in *O'Neill* that shareholders should not have the right to exit a company at will.[142] The correct comparison is therefore not between the wide O'Neill approach and a right to exit at will, directors of small companies in New Zealand would still have to establish conduct that is unfair as per New Zealand's discretionary approach to be able to exit.[143] The only sorts of conduct allowing a shareholder to exit under the New Zealand approach, and not the wide O'Neill approach, are those in which a judge exercising their discretion as to what is fair decides something is unfair without breaching a formal or informal agreement, or a shareholder uses an agreement opportunistically. The wide O'Neill approach would allow exit in cases in which a shareholder who has informally agreed that they will have a management position is excluded from management.[144] Shareholders who view their management role as pivotal to their investment are, therefore, either covered by the approach or have run the risk of being excluded from management by not making their investment conditional on a continued management position. If a shareholder is prepared to run this risk they are very unlikely to alter their behaviour in response to the more restrictive test. Shareholders who have corporate power used against them in some way they would not have agreed to had they considered its use are also covered, as are shareholders whose basis for buying shares has been frustrated. The only shareholders who would not be covered are those who have knowingly granted other shareholders the power to carry out a certain course of action

[142] At [95].
[143] As shown in chapter one New Zealand courts apply a discretionary test based on fairness when applying the rule.
[144] *Frank Digrado v. Antonio D'Angelo, Abbington Hotel Ltd*, above n 109.

and are consciously running the risk of them using it.

The change in approach will not have any adverse economic effect. It only has the potential to affect directors who want to own shares in privately held companies. The chance of a change in approach forcing these shareholders to remain in a company against their will is very small. The only shareholders who may be forced to remain are those consciously running the risk of corporate power being used in a certain way. Very few, if any, of these directors are likely to decide not to become a shareholder in response to this change of approach. Even if some directors do change their behaviour, there will be too few of them to cause any economic impact.

2 Doctrinal

The Court of Appeal's statement that "something may be lawful and 'expected', but still unduly prejudicial" amounts to an explicit retention of the ability to overturn bargains and exercise discretion when determining what is fair. Such discretion creates problems of a lack of predictive certainty, conceptual impropriety, and limiting of parties autonomy. The New Zealand approach does not have an objectively better ability to reach fair results; consequently there is no justification for the limitations of the approach. People will not necessarily agree that the results reached under the discretion are fair; people's views of fairness in a certain context may differ from those exercising the discretion. The wide O'Neill approach avoids literal agreements being used opportunistically. It therefore represents parties' real bargains and makes agreement as persuasive a proxy for fairness as possible. Differences in the fairness of results reached under the proposed approach, therefore, fail to justify the limitations associated with the approach.

3 Outcomes And Implicit Claim About Certainty

The wide O'Neill approach will increase predictive certainty relative to our current discretionary approach. The Court of Appeal claims that the narrow O'Neill approach has been ineffective, as it has not reduced shareholder litigation in the UK. It is implicit in this criticism that the Court of Appeal is claiming the narrow O'Neill approach has not increased certainty. The implicit premise is flawed as it fails to recognize the amount of litigation is a product of a number of factors, including, but not limited to, the predictive certainty of the result.[145] A recent study in the UK reported a "strong consensus" amongst practitioners that the narrow O'Neill approach "had enhanced legal certainty regarding the application of the statutory minority

[145] A. Posner "Explaining the Variance in the Number of Tort Suits across U.S. States and between the United States and England" (1997) 26 J. Legal Stud 477.

remedy."[146] The implicit claim that O'Neill is uncertain is not made out. As a consequence of this any claim that the wide O'Neill approach would not increase certainty is also unfounded, as both approaches increase predictive certainty by explicitly defining fairness as adherence to agreement.

B CONCLUSION

Despite the fact that a supporter of our current discretionary approach would attempt to use these criticisms against the wide O'Neill approach they do not provide persuasive reasons for retaining our current approach. None of these criticisms are accurate; our current discretionary approach has no advantages relative to the wide O'Neill approach to justify the limitations of the current approach discussed in chapter two.

[146] Muhammed Asim Iqbal "The effectiveness of shareholder dispute resolution in private companies under UK companies legislation: an evaluation" (November 2008) <http://irep.ntu.ac.uk/306/1/194154_Iqbal.pdf> at 134.

CHAPTER SIX: ANALYSIS OF THE THREE APPROACHES IN THE CONTEXT OF STURGESS v DUNPHY.

A STURGESS v DUNPHY

Greymouth Petroleum Holdings Ltd (Greymouth) was incorporated by Messrs Dunphy, Masfen and Sturgess[147] and, in conjunction with associated entities, they collectively held all of the shares.[148] At the relevant times they were the sole directors.[149] The Court of Appeal likened Greymouth to a joint venture,[150] with the underlying expectation of Messrs Dunphy, Masfen and Sturgess being that they "would work closely together"[151] in a "co-operative manner".[152] Indeed, Messrs Dunphy, Masfen and Sturgess had created "powerful incentives" to ensure "cooperat[ion]" between them.[153] Their shareholder agreement, for example, required that Board decisions be unanimous.[154] Additionally, cl.6.1 of the agreement - the 'deadlock' provision - provided that "if a resolution submitted to the Board by a director is not passed" and the resolution "is not resolved within 90 Working Days" any shareholder could "require that all the Shares in the Company be sold to a third party".[155] If a purchaser could not be found the company would be liquidated unless one or more of the shareholders agreed to buy the other's shares.[156]

Mr Sturgess was also Greymouth's Chief Operations Officer (COO).[157] He held this role as a result of a management services contract between Greymouth and a company that he had an interest in: John Sturgess and Associated Limited (JSAL).[158] In turn, Mr Dunphy was Greymouth's Executive Chairman.[159] Despite Mr Sturgess's executive position, the shareholders' agreement provided that "all matters and decisions relating to management of the Company are decided by the Board".[160] The agreement specified a range of decisions that

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147 *Sturgess v Dunphy,* above n 2, at [1].
148 At [2]. In conjunction with their associated entities, they 'individually' held 52.144%, 34%, and 13.856% of the shares respectively
149 At [3].
150 At [1] and [5].
151 At [142].
152 At [147].
153 At [8].
154 At [7].
155 At [58].
156 At [58].
157 At [3].
158 At [3].
159 At [3].
160 At [142].

illustrated 'management decisions'.[161]

Unfortunately, the relationship between Messrs Dunphy, Masfen and Sturgess deteriorated.[162] Largely preferring the views of Messrs Dunphy and Masfen, the Trial Judge found that Mr Sturgess acted unilaterally in regard to a number of operational managerial decisions that should have been reported to Mr Dunphy and to the Board. The Court of Appeal saw no reason to overturn these decisions.[163]

Mr Dunphy suspended JSAL's management services contract.[164] The Trial Judge found that the suspension and later purported termination was unlawful.[165] He also found that Mr Sturgess had behaved oppressively and the other shareholders were entitled to relief under s 174; this was to cancel the management services contract.[166]

Returning to the factual narrative, in response to the purported suspension of the management services contract, Mr Sturgess proposed a Board resolution; as described by the Court of Appeal, this was "to the effect that [Greymouth] supported suspension of the contract".[167] An issue before the Trial Judge was whether the proposed resolution "triggered rights" under the 'deadlock' provision.[168] The Trial Judge concluded that it did not[169] and the Court of Appeal was "not persuaded that the Judge erred" by this finding.[170] In any event, the Court of Appeal proceeded to consider the relationship between the deadlock provision and s 174, "reject[ing the argument] that "deadlock provisions must prevail over s 174 in this case".[171] In so doing the Court of Appeal, quoting from *Jacobsen Venue Management New Zealand Ltd v Worldwide NZ LLC*[172], noted that "it is settled law that section 174 characteristically operates so as to limit the exercise of legal powers; in other words to stop, or grant a remedy in respect of what would otherwise be lawful".[173]

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161 At [103].
162 At [10].
163 At [84]-[86], [100], [112]-[113], [116]-[118] and [129].
164 At [11].
165 At [18].
166 At [18].
167 At [56].
168 At [60].
169 At [60].
170 At [64].
171 At [62]
172 [2008] NZCA 105 at [16].
173 *Sturgess* at [62].

The Court of Appeal also noted that Mr Sturgess's omission to report back to Mr Dunphy and the Board regarding managerial decisions coming within the Board's decision-making powers "predated the alleged deadlock and, by leading Mr Dunphy to suspend the management services contract, may be said to have caused it".[174]

The judgment of the Court of Appeal is of further interest for the Court's recognition that for the purposes of s 174 proceedings "the locus of corporate power is a practical question of fact and law".[175] As a consequence, "it is possible for a minority shareholder to behave in a manner that oppresses a majority".[176] So too a manger, even one acting as an agent of a company, such as JSAL, providing management services, could "conduct the affairs of a company oppressively".[177] Drawing these two points together, the Court observed[178]:

> "[Greymouth's] governance is vested in the Board to an unusual extent and Mr Sturgess was a director, able under Greymouth's constitutional arrangements to veto Board decisions. These arrangements permitted deadlock at shareholder and Board levels. Deadlock alone need not justify relief under s 174. But Mr Sturgess was also JSAL's nominated COO under a management services contract that the Board could not terminate, and because he was a director the Board was substantially powerless to discipline any unauthorised conduct in his managerial capacity. (The agreement could be terminated for breach, but of course the Board would have to make that decision.) It is we think manifest that Mr Sturgess enjoyed the capacity, as a matter of fact and law, to behave in a manner that oppressed the majority shareholders."

In a later passage the Court of Appeal noted that Mr Sturgess[179]:

> "attended the Board in both capacities, and what he knew in his capacity as COO he also knew qua director. As COO he was able to deny Mr Dunphy and the board information they needed for decisions that were theirs to make."

The Court of Appeal concluded that Mr Sturgess's conduct "was oppressive and unfairly

[174] At [62].
[175] At [135].
[176] At [135].
[177] At [139].
[178] At [136].
[179] At [139].

prejudicial" towards the other shareholders.[180]

As noted earlier, the courts concluded that Mr Sturgess had never exercised the right conferred in the shareholder agreement to "vet[o] any Board decisions",[181] thereby engaging the deadlock provisions. A question for this paper is the importance of the background matrix of facts to the decision whether a contractual right can be exercised oppressively or unfairly prejudicial for the purposes of s 174. Assume, for example, that a resolution to terminate the management services contract had come before the Board and Mr Sturgess had exercised his right to vote against it, thereby engaging the deadlock provisions. The reasoning of the Court of Appeal suggests that the answer to this 'hypothetical' may turn on earlier behaviour and the circumstances leading to the exercise of the right.

But would similar results occur under either the narrow or wide *O'Neil* approach?

B APPLICATION OF THE NARROW O'NEILL APPROACH.

Application of the narrow O'Neill approach, which is underpinned by agreement and gives only a minor role to equitable constraints, may reach the conclusion that in the hypothetical the exercise of the veto would not be oppressive, irrespective of the background. The exercise of the veto would not breach any formal agreement between the parties; therefore, it would only be oppressive if the exercise of the veto was prevented by an equitable constraint. And to determine whether an equitable constraint did restrict the power, the *BP Refinery* implied terms test would be applied. It is arguable that the narrow O'Neill approach would preclude the use of the veto only if a term along the lines of: 'no board member shall exclude any other board members from important business decision making' could be implied.

Such a term would fail the *BP Refinery* test, as the shareholders' agreement is effective without it. The deadlock provision provides a process for resolving the dispute.

C APPLICATION OF THE WIDE O'NEILL APPROACH.

The result using the wide O'Neill approach response to the hypothetical may be similar to the

[180] At [143].
[181] At [139].

one that this paper predicts New Zealand courts may come to – in essence, depending upon the background matrix of facts, the use of the contractual power may be oppressive. Indeed, in *Sturgess* the Court of Appeal notes the reference in *Thomas v HW Thomas Ltd*[182] to the reasoning of Lord Wilberforce in *Ebrahimi* regarding "equitable considerations".[183] When viewed against the backdrop of Mr Sturgess's 'omissions' found by the Trial Judge and accepted by the Court of Appeal, it may be argued that the "exercise of legal rights" - the veto and the deadlock provisions – in that context would be 'inequitable' as between the shareholders. On this approach, the function of the deadlock provisions can be seen as encouraging the directors/shareholders to reach unanimity when making important business decision, and to give each director/shareholder the ability to avoid their capital being committed to business decisions that they did not agree with.

D COMPARISON OF THE DIFFERT APPROACHES.

Neither the New Zealand approach nor the narrow O'Neill approach operates satisfactorily when applied to the hypothetical. The narrow O'Neill approach lacks the ability to prevent unfair results. The New Zealand approach is still subject to the shortcomings resulting from overturning bargains discussed in chapter two, despite reaching what most people would likely see as a fair result. The wide O'Neill approach, however, does operate satisfactorily in this context. The wider role it gives to equitable constraints allows it the flexibility to reach results most people would see as fair, whilst remaining principled and avoiding the use of a free floating discretionary notion of fairness, which can lead to bargains being overturned.

The narrow O'Neill approach continues to use 'agreement' as a proxy for the consideration of the background matrix of facts. Indeed, when the terms of an agreement are used in a way the other party (or parties) had not considered, and would not have agreed to had they considered them, they no longer represent the party's rational intent. The upholding of rational intent is considered "fundamental to most philosophical arguments for upholding promises".[184] 'Agreement' is not a suitable proxy for fairness when it does not embody the rational intent of the parties to it.

The narrow O'Neill approach is still predictively certain as it clearly articulates how courts

[182] [1984] 1 NZLR 686.
[183] At [132].
[184] S. Geis "Economics as Context for Contract Law" (2008) 75 U CHI L REV 569 at 597.

will decide cases. This, however, is not enough to make its operation satisfactory in cases with background complicated facts. The rule needs to prevent oppressive conduct as well as being predictively certain. If predictive certainty was the only requirement for the success of the rule, there would be no need for an oppressed shareholder rule at all. We could allow all uses of corporate power, this would be completely predictively certain.

The New Zealand approach, as evidenced by the reasoning in *Sturgess* and its application to the hypothetical, with its discretionary approach to fairness leads to the same result as an attempt to enforce the parties' 'real bargain'. As a result of its use of a discretionary notion of fairness, however, the New Zealand approach is subject to the shortcomings discussed in chapter two. Its ability to overturn bargains means that it is predictively uncertain, disrespectful of parties' autonomy, and conceptually inappropriate and overly paternalistic for a rule applied to cases falling within the bargaining paradigm. The New Zealand approach reaches an appropriate result by an inappropriate process.

The wide O'Neill approach manages to reach an appropriate result through an appropriate process. The wide O'Neill approach's broad use of equitable constraints allows it look beyond the literal terms of an agreement to enforce the 'real bargain'. By using the parties' 'real bargain' as a proxy for fairness it avoids the shortcomings of the New Zealand rule. Specifically, it is more predictively certain, does not disrespect the parties' autonomy, and operates in a conceptually appropriate way for a rule which operates in situations falling within the bargaining paradigm. It also manages to reach results most people would view as fair. The use of 'real bargain' means that it only upholds agreements when they are justified by the parties' rational intent, increasing its ability to reach results most people would see as fair.

CHAPTER SEVEN: RECOMMENDATIONS FOR REFORM

We should adopt the wide O'Neill approach. This will allow the courts to uphold parties' "real bargains". By expressly defining fairness in reference to agreement and clearly defined equitable constraints, this change will avoid the shortcomings caused by our current rule's ability to overturn bargains. More specifically we can increase the predictive certainty of the rule, make it conceptually appropriate, and prevent it limiting parties' autonomy.

We should adopt the wide O'Neill approach, rather than the narrow O'Neill approach. The wide O'Neill approach is more effective at reaching fair results as it can prevent the opportunistic use of literal agreements. In order to maintain predictive certainty it is important to clearly define the relationship between equitable constraints and literal terms of agreement under the wide O'Neill approach. Under this approach equitable constraints will result in the opportunistic use of literal terms of agreements being seen as unfair. A literal term of an agreement is used unfairly if it is used in a way the other party would not have agreed to if that possibility had been drawn to their attention.[185]

The proposed definition of fairness should be put into statute. Under the act, unlike the Companies Act 1955, the distribution of power within a company comes from direct operation of statute rather then a deemed contract.[186] Putting the definition into the statute would make it clear that the parties' real bargains are being used as a tool to define fairness, which gives the statutory rule operational content. This is distinct from agreement being used to enforce a deemed contract between members of a company. While the wide O'Neill approach receives theoretical support from the nexus of contracts theory this does not mean it is actually ensuring the enforcement of a deemed contract. This distinction would be less clear if the New Zealand courts were to start applying the wide O'Neill approach without it being explicitly adopted into the act.

In addition to this, putting the wide O'Neill approach into statute increases the predictive certainty of the rule. This is the case as it gives the courts direction as to how the approach is to be applied.

[185] Means, above n 127, at 1198.
[186] Law Commission, above n 66, at 1.

In practice the wide O'Neill approach should be incorporated into the act through changing the wording in s 174 and introducing a definition section for s 174. Currently the rule is contained in s 174 (1) as follows:[187]

> (1) A shareholder or former shareholder of a company, or any other entitled person, who considers that the affairs of a company have been, or are being, or are likely to be, conducted in a manner that is, or any act or acts of the company have been, or are, or are likely to be, **oppressive, unfairly discriminatory, or unfairly prejudicial** to him or her in that capacity or in any other capacity, may apply to the court for an order under this section.

The key words are "oppressive, unfairly discriminatory, or unfairly prejudicial". As discussed in chapter one, however, these words amount to prohibiting unfair conduct. The phrase "oppressive, unfairly discriminatory, or unfairly prejudicial" should be replaced with "unfair". Another section, or subsection, should be added to the act defining what is "unfair" for the purpose of s 174. This should be formulated as follows:

"In the context of s 174 the affairs of a company, or any act, or acts of the company, are conducted in a way that is "unfair" if the affairs, act, or acts:

(a) Breach a formal agreement.
(b) Breach an informal agreement.
(c) Amount to forcibly maintaining the company in a situation analogous to frustration.
(d) Use a literal term of a formal agreement opportunistically.
    (i) A literal term is used opportunistically if it is used in a way another party to the agreement would not have agreed to if they had considered the possibility of it being used in this way.

[187] Companies Act 1993 Cite s 174 (1). Emphasis added.

CONCLUSION

This dissertation has focused on how the oppressed shareholder rule should distinguish between appropriate and inappropriate uses of corporate power. It has done this by looking at the New Zealand approach, England's current narrow O'Neill approach, and a potential wide O'Neill approach giving a larger role to equitable constraints. It has identified shortcomings in the New Zealand approach arising due to the rule's ability to overturn bargains. These shortcomings are its lack of predictive certainty, disrespect for parties' autonomy, and its overly paternalistic and conceptually inappropriate way of operating within a paradigm bargain context. It has also identified the inability of the narrow O'Neill approach to prevent the literal terms of agreements being used opportunistically.

It has been argued that a wide application of the O'Neill approach provides a satisfactory middle ground between the flawed position of the New Zealand approach and the narrow O'Neill approach. The wide O'Neill approach enforces parties' "real bargains", and uses these "real bargains" as a proxy for fair results. This allows it to avoid the shortcomings associated with overturning bargains, as well as the ineffectiveness at preventing unfair results that arises when literal terms of agreements can be used opportunistically.

The wide O'Neill approach is the most appropriate method for distinguishing between appropriate and inappropriate uses of corporate power. As one academic explains:[188]

> Some flexibility is critical if courts are to identify and redress oppression; at the same time, it is fundamental to contract law that a court "may not substitute its own notions of fairness for the terms of the agreement reached by the parties."

The wide O'Neill approach should be put into the act. This maintains predictive certainty and helps to ensure the use of the nexus of contract theory is not confused with an attempt to enforce a deemed contract as per the Companies Act 1955.

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[188] Means, above n 127, at 1200.

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APPENDIX

A Companies Act 1993

174 Prejudiced shareholders

(1) A shareholder or former shareholder of a company, or any other entitled person, who considers that the affairs of a company have been, or are being, or are likely to be, conducted in a manner that is, or any act or acts of the company have been, or are, or are likely to be, oppressive, unfairly discriminatory, or unfairly prejudicial to him or her in that capacity or in any other capacity, may apply to the court for an order under this section.

(2) If, on an application under this section, the court considers that it is just and equitable to do so, it may make such order as it thinks fit including, without limiting the generality of this subsection, an order

(a) Requiring the company or any other person to acquire the shareholder's shares; or

(b) Requiring the company or any other person to pay compensation to a person; or

(c) Regulating the future conduct of the company's affairs; or

(d) Altering or adding to the company's constitution; or

(e) Appointing a receiver of the company; or

(f) Directing the rectification of the records of the company; or

(g) Putting the company into liquidation; or

(h) Setting aside action taken by the company or the board in breach of this Act or the constitution of the company.

(3) No order may be made against the company or any other person under subsection (2) unless the company or that person is a party to the proceedings in which the application is made.