DISPUTE RESOLUTION IN FAMILY COMPANIES[†]

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I. Introduction

The Bubble Act of 1720 made corporate charters relatively difficult to obtain. As a response to the Bubble Act and prior to the general right to incorporation by registration in the mid-Nineteenth Century,[1] an early form of unincorporated company developed. The deeds of settlement creating the unincorporated companies almost always contained dispute resolution clauses.[2] Once incorporation by registration became possible, the internal governance of companies was determined by articles of association. Companies were permitted to draft their own articles or to adopt provisions from Table B, later Table A, which were found in the schedules to the Acts. Dispute resolution clauses were not included in Table B or Table A. But arbitration clauses were nevertheless often included in articles of association for companies for a period from the late Nineteenth Century onwards in the articles of smaller private or proprietary companies that developed at that time and, in particular, where Palmer's *Company Law Precedents*[3] were adopted. The demise of the adoption of the provisions coincided with questions about their enforceability brought about by cases such as *Beattie v E & F Beattie Ltd*[4] in 1938 where a dispute clause in articles of association was held to be unenforceable against directors. Even though those enforceability issues probably no longer exist, dispute resolution clauses are rarely found in the constitutions of modern companies.

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1 Joint Stock Companies Act 1844, Joint Stock Companies Act 1856, Companies Act 1862 (UK)

2 Information extracted from the database R Pearson, M Freeman and J Taylor *Constructing the Company: Governance and Procedures in British and Irish Joint Stock Companies, 1720-1844* (SN 5622, UK Data Archive, Colchester, Essex September 2007).

3 FB Palmer *Company precedents: For Use in Relation to Companies Subject to the Companies (Consolidation) Act 1908: with Copious Notes, and an Appendix* (11th ed, Stevens, London, 1912).

4 *Beattie v E & F Beattie Ltd* [1938] Ch 708.

This article examines and critiques the legal framework around dispute resolution in family-owned companies and argues for the inclusion of dispute resolution clauses in some form in constitutions of companies. The article contains two simple empirical surveys that show that the failure to include dispute resolution clauses in constitutions and the absence of other dispute resolution mechanisms for family companies leaves the courts as the only recourse for resolution of disputes.

II. Dispute Resolution Processes in a Corporate Environment

A. Types of Family Businesses and Mechanisms to Resolve Conflicts[5]

Conflict often arises in family companies and can be divided into intra-family, intra-family business, inter-family and family business conflicts. In a classic study Fred Neubauer and Alden Lank[6] state:

- Over time, conflict is inevitable within families (and between the family and its business).
- Conflict is not inherently bad; it can be healthy or unhealthy, functional or dysfunctional.
- How conflict is managed is a determinant of the degree to which a family (and its business) remains healthy and strong.
- There are several conflict management strategies; no single one is a panacea.
- Pre establishment of the "rules of the game" can obviate many family (and family business) conflicts.
- The goal should be to maximise the "win-win" prospects of all the parties concerned and arrive at the best decision, given the family's (and the family business's) mission, goals and objectives.

This section sets out the most common types of family business conflict and the issues that arise with these.

Husband and Wife Conflict- A dysfunctional marriage can lead to a dysfunctional business. If there is a divorce, then the business is likely to be matrimonial property to be divided by agreement or by the court. If the business was formed and operated by one party before the marriage, it may stay

5 See H Levinson "Conflicts that Plague the Family Business" (1971) 49 Harvard Business Review 90; AB Ibrahim and WH Ellis *Family Business Management-Concepts and Practice* (Kendall/Hunt Publishing Co., Dubuque, 1994) at 125-134; RI Sorenson "Conflict Management Strategies Used in Successful Family Business" (1999) 7 Family Business Review 133.

6 F Neubauer and A Lank *The Family Business: Its Governance for Sustainability* (Macmillan Press Ltd, London 1998) at 74.

with that party according to a prenuptial agreement. Exactly what happens otherwise will depend on the circumstances and the relative contributions. A mediated solution may lead to the best result.

Father – Son or Daughter Conflict- Family business is often started by a dynamic parent who finds it difficult to hand over control to his or her children. Here a succession plan or third party intervention may help to resolve the conflict. *Re HR Harmer Ltd*[7] was a creative use of the statutory minority shareholders proceedings for this purpose. Here the order effectively kicked a difficult old founder of a business upstairs.

Sibling Rivalry- Where siblings are involved in the business there can often be friction. Here there are a number of mechanisms available. These include:[8]

- Succession planning
- job definitions
- confrontation meeting or family council meeting
- introduction of professional management of sibling rivalry.

This is well documented in the business literature

Conflict involving Second Marriages and Stepchildren- Remarriage often leads to further complexities for family business especially when it comes to inheritance. Entitlements often follow bloodlines. Where a step family is harmonious the best thing is to treat children equally. However this will be varied where some have played an active role in the management of the family business.

Conflict between other family members- This is most likely to occur where there are second and third generations in a family. The non-litigious solutions are similar to those set out above but might also involve formulating a code of conduct. The leading New Zealand case, *Thomas v HW Thomas Ltd*[9]*,* is an example of unsuccessful use of the statutory minority shareholder proceedings by a third generation member of a family who was impatient with conservative management by the older generation.

Conflict between family and non-family members- Here job definitions are desirable. Clear policies concerning career development and communication will also be useful. The introduction of professional management may be necessary for the survival of the business. *Ebrahimi v Westbourne Galleries Ltd*[10] was an example of the need to use winding up on the just and equitable ground where a partnership company fell apart on the admission of the son of one of the original partners as a director and shareholder. Two is company, three is a crowd.

7 *Re HR Harmer Ltd* [1959] 1 WLR 62. The 88 year old founder had his powers removed but was made Chairman of the Board for life.

8 F Neubauer and A Lank *The Family Business: Its Governance for Sustainability* (Macmillan Press Ltd, London 1998).

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

10 *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360.

B. Sources of Corporate Conflict in a Family Company[11]

Let us now consider in more detail the sources of conflict between minority and majority shareholders in a family company.[12] The source of the conflict provides one basis for dealing with the important "diagnostic" question, namely which dispute resolution process is appropriate for which kind of dispute. It is suggested here that there are four major sources of conflict between the two groups:

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

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

Personal Relations Breakdown- As in any closed social system a breakdown in the personal relations between directors, shareholders and employees can be a cause of conflict, or can at least exacerbate conflict caused by other factors. The breakdown can be caused by loss of trust, poor communication, stereotypes of gender or class, or high levels of emotion. Emotions can become the controllers of behaviour, particularly where there have been repetitive patterns of negative interaction over time. Personality clashes,

11 This section of the article draws on previous work on the unfair prejudice remedy by two of the authors. See J Farrar and L Boulle "Minority Shareholder Remedies - Shifting Dispute Resolution Paradigms" (2001) 13 Bond Law Review 272 at 273, 281-286.

12 See for example B Mayer *The Dynamics of Conflict Resolution* (Jossey-Bass, San Francisco, 2000) at 8-16; L Boulle *Mediation: Principles Process Practice* (Butterworths, Sydney, 1996) at 43-44.

cultural or gender tensions, autocratic or uncooperative behaviour, the death of a founding or key shareholder and the drive of superior talent all figure in analyses of conflict in this context.

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

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

C. Levels of Responding to Conflict

Modern dispute resolution theory also identifies different levels at which conflict can be dealt with.[13] This again acknowledges the diversity in the nature of conflicts and the need for different matters to be dealt with at different levels. The majority rule principle under which companies are operated makes it possible for those who control the majority of shares in the company to use that power to the detriment of those who hold fewer shares, the minority shareholders.

Power Responses- Conflict can first be dealt with through a competitive contest of varying degrees of civility or destructiveness. At this level the more powerful group or individual can determine outcomes according to

13 See generally on this topic the "dispute systems design" texts such as W Ury, J Brett and S Goldberg *Getting Disputes Resolved: Designing Systems to Cut the Cost of Conflict* (Jossey-Bass, San Francisco, 1998); W Ury, J Brett and S Goldberg *Managing Conflict: The Strategy of Dispute Systems Design* (Business Week Business Service, New York, 1994); C Constantino and C Merchant *Designing Conflict Management Systems – a Guide to Creating Productivity and Healthy Organisations* (Jossey-Bass, San Francisco, 1996). For a comprehensive Australian perspective see B Wolski "Dispute Systems Design" in JA Riordan (ed) *The Laws of Australia* (Lawbook Co, Melbourne, 1997) at [13.7].

their needs and wishes. Majority rule within company decision-making is an obvious form of response to conflict at this level - the majority view prevails and the minority is required to submit to it. In corporate life power is also exercised in the board room, the general meeting, the chief executive's office, by managers and supervisors at the coal-face, and more informally, in the "corridors of power".

The power-based processes can be entirely appropriate ways of dealing with conflict where decisions have to be made, sometimes with urgency, and the business developed in particular directions. Thus where conflict is occasioned by a shortage of resources it might be entirely appropriate to respond at the power level. However, power-based processes can be partisan, oppressive and prejudicial to the minority. Less civilised forms of power contest can include duress, threats, blackmail, victimization or fraudulent conduct by one or other group. It is where there is an abuse of power, which overrides the rights and interests of the company minority, that more substantial processes are required. It may be possible, as will be suggested, to provide some standard response to the abuse of power through the presumption of prejudicial conduct in the legislation.

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

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

Interest-Based Responses- Much of the dispute resolution literature emphasises the importance of dealing with conflict, at least initially, at the level of interests.[14] Here the term "interests" refers to the motivating needs or

14 See, for example, G Tillett *Resolving Conflict: A Practical Approach* (2nd ed Melbourne: Oxford University Press, Melbourne, 1999) at 63–74.

concerns of the parties, both personal and commercial. Interests[15] are generally more subjective and "soft" in nature than legal rights. An approach at the level of interests also involves consideration of the future to a greater degree than rights approaches, which tend to focus on past events. Thus, while minority shareholders might settle for a legal buy-out of their shares, their interests might revolve more around increased future participation in management and provision of necessary information. The modern ADR movement focuses largely on shifting disputing parties away from a conceptualization of the problem in terms of their competing rights and towards one which identifies their multiple interests, which might, besides being conflicting, also be overlapping and compatible in part. The dispute system designs literature has a similar preoccupation with dealing first with the parties' underlying interests before resorting to a rights-based determination. In the corporate context the interest approach will tend to be appropriate where disputes have been caused by personal relations breakdown.

Prevention- Professor Prentice has commented that a feature of shareholder disputes in smaller companies in particular is a chronic failure by the parties to anticipate the nature, extent and consequences of a breakdown in their relationship.[16] Prevention, as the term implies, involves parties anticipating the future possibility of disputes in their business or personal affairs and making choices about ways of avoiding them or dealing with them when they eventuate. Prevention is claimed to be a high priority of good dispute resolution in terms of the efficiency and effectiveness it provides and it is the foundation of dispute systems design.[17] In order to prevent disputes emerging in the first place emphasis can be placed on effective methods of communication, audits of dispute resolution methods, education and training and other preventative devices. A Family Council can be used to

15 The concept of 'interests' is not without controversy and within the literature distinctions are drawn between subjective and objective interests and between instrumental and ultimate interests. See for example C Provis "Interests vs Positions: A Critique of the Distinction" (1996) 12 Negotiation Journal 305. While the interests approach has its merits it is sometimes difficult to apply. J Bentham in J Burns and H L A Hart (eds) *An Introduction to Principles of Morals and Legislation* (The Athlone Press, London, 1970), said "interest is a primitive term with no known genus". See also R Von Jhering, *Law as a Means to an End* (A M Kelly, New York, 1968) at Chapter III. Von Jhering's approach was adopted by Dean Roscoe Pound in his many writings. See R Pound "A Survey of Social Interest" (1943) 57 Harvard Law Review 1; R Pound "Jurisprudence" (1935) 8 Encyc Soc Sci 477. As to the relationship between 'interest' and 'right' see R Pound *Interpretations of Legal History* (The University Press, Cambridge, 1923) at 159.

16 D Prentice "Protecting Minority Shareholders' Interests" in David Feldman and Frank Meisel (eds.) *Corporate and Commercial Law: Modern Development* (Lloyd's of London Press, London, 1996) at 80.

17 On this topic generally see W Ury, J Brett and S Goldberg *Managing Conflict: The Strategy of Dispute Systems Design* (Business Week Business Service, New York, 1994).; C Constantino and C Merchant *Designing Conflict Management Systems – a Guide to Creating Productivity and Healthy Organisations* (Jossey-Bass, San Francisco, 1996); B Wolski "The Model Dispute Resolution Procedure for Australian Workplace Agreements: A Dispute Systems Design Perspective" (1998) 10 Bond Law Review 7.

ensure that family issues and conflict can be resolved outside the corporate structure. Where a dispute does emerge the emphasis is on early and cost-effective intervention with the object of reducing the impact of the dispute and preventing its escalation; this suggests the need to attempt interest- and rights-based approaches before resorting to power.

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

III. Development of Dispute Resolution Law in the Corporate Environment

A. The First Paradigm - The Rule in Foss v Harbottle[18]

The rule in *Foss v Harbottle*[19] was based on the traditional reluctance of the courts to second guess business judgment. The Rule as set out in *Burland v Earle* in 1902[20] stipulated that for any wrong done to a company, or to recover moneys or damages alleged to be due to the company, the company was the proper plaintiff and normally the company would operate by majority rule.

The references to "wrongs" and "money or damages" clearly reflect judicial predisposition towards rights-based dispute resolution effected through court determination, but only at the instigation of the majority shareholders. In this respect the power of the majority ruled. The rule was, however, subject to exceptions that also enabled minority shareholders to sue. These related to ultra vires or illegal conduct; circumstances where a special procedure had not been followed, where personal rights were infringed, where there was fraud on the minority, or where the interests of justice required it.[21]

The rule was first a recognition that the court wished to avoid a multiplicity of suits and thus "is not required on every Occasion to take over the Management of every Playhouse and Brewhouse in the Kingdom",[22] which

18 *Foss v Harbottle* (1843) 2 Hare 461.

19 Ibid.

20 *Burland v Earle* [1902] AC 83, 93 (PC).

21 See JH Farrar *Corporate Governance: Theories, Principles and Practice* (3rd ed, Oxford University Press, Melbourne, 2008) at Chapter 18.

22 *Carlen v Drury* (1812) 1V&B 154.

would open the floodgates. It was also recognition that the company is a separate entity, distinct from its members. The rule operated with considerable rigour to inhibit shareholder action.[23]

The rule established a rights-based system that inhibited shareholders' suits and did little to counter-balance the power of the majority. The scope of the exceptions was the subject of considerable uncertainty. Thus the "personal rights" category was ill defined and the ambit of fraud on the minority and its relationship to ratification by the general meeting were also the subject of considerable controversy. Some of the difficulties in the use of rights-based approaches were due to the basic problem of distinguishing clearly rights of the company and personal rights of shareholders.[24]

The shortcoming of the rule led to the introduction of the statutory remedy in s 210 of the Companies Act 1948 (UK). However, this was originally limited to oppression as a member and was not widely used. It was, however, adopted in Australia[25] and New Zealand.[26]

B. The Second Paradigm: The Jurisprudence of Ebrahimi v Westbourne Galleries Ltd

The second paradigm dates back to 1972 and the House of Lords decision in the leading case of *Ebrahimi v Westbourne Galleries Ltd*.[27] This was a case involving a partnership of two Persian carpet dealers in London, which was subsequently incorporated. Later the son of one of the directors was made a director and given shares. The father and son ganged up on the other director, Ebrahimi, who was removed from office. All the profits were distributed as directors' remuneration.

Mr Ebrahimi sued on the basis of the statutory minority shareholder remedy, which was then limited to oppression as a member, and also sought winding up on the just and equitable ground. He failed on the first but succeeded on the second. Lord Wilberforce delivering the leading speech reformulated the basis of the just and equitable winding up jurisdiction. He abandoned the earlier approach of strict categorisation stating that the foundation was in the term "just and equitable" and, if anything, courts had been too reluctant to give those words full force: [28]

23 This was in spite of ingenious suggestions by learned academics: see the summary in LCB Gower and PL Davies *Gower's Principles of Modern Company Law* (Sweet & Maxwell, United Kingdom, 1997) at 666 (dropped from later editions) and misconceived enthusiasm by the UK's largest institutional investor in one leading case *Prudential Assurance Co v Newman Industries Ltd* [1982] Ch 204.

24 See LCB Gower and PL Davies *Gower's Principles of Modern Company Law* (Sweet & Maxwell, United Kingdom, 1997) at 666.

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

26 The Companies Act 1955, s 209 was essentially a reproduction of s 210 of the Companies Act 1948 (UK).

27 *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360.

28 Ibid, at 379A–379G.

> The words are a recognition of the fact that a limited company is more than a mere legal entity, with a personality in law of its own: that there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations inter se which are not necessarily submerged in the company structure. That structure is defined by the Companies Act and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The "just and equitable" provision does not, as the respondents suggest, entitle one party to disregard the obligation he assumes by entering a company, nor the court to dispense him from it.

Lord Wilberforce declined to predetermine the circumstances where equitable considerations, that is, considerations of a personal character between individuals, may arise and justify intervention, pointing out that on its own being a small company was not enough as in many of those the association is merely commercial. Something more was needed; in particular:

- an association formed or continued on the basis of a personal relationship, involving mutual confidence - often where a partnership has been converted into a limited company;
- an agreement, or understanding, that shareholders shall participate in the conduct of the business;
- restriction upon the transfer of the members' interest in the company.[29]

This part of the judgment has three important implications. The first is that, instead of formulating a general approach based on good faith, the House of Lords attempted to formulate objective standards of fairness to be observed by the majority shareholders. Secondly, the decision reflected a greater willingness by the judiciary to intervene in the affairs of companies than was recognised under the first paradigm. Thirdly, the House of Lords showed a willingness to consider unfairness in a capacity other than that of shareholder.[30] These three aspects determined the character of the second paradigm and reveal more openness to the array of competing interests present in any company situation. From a corporate law perspective, the decision is attractive because it recognises that the default position is that the corporate form is not an incorporated partnership. Rather it imposes a partnership overlay over the relationships between shareholders when the circumstances make it just and equitable to do so.

29 Ibid.

30 See the useful article by D Prentice "Winding Up on the Just and Equitable Ground: The Partnership Analogy" (1973) 89 Law Quarterly Review 107 and also the discussion below about the more restrictive approach to rights within a company epitomised in cases such as *Beattie v Beattie* [1938] Ch 708.

The decision in *Ebrahimi* was influential and was followed throughout the British Commonwealth.[31] It also played its part in influencing law reform which led to reformulation of the statutory minority shareholder remedy, expanding the grounds for relief, and also to the enactment of statutory derivative action procedures. The extension of the statutory remedy to unfairly prejudicial conduct was recommended by the UK Jenkins Report[32] in 1962 although the phrase had been used in connection with variation of class rights since 1928. The first British Commonwealth jurisdictions to adopt the reform were Canada in the 1970s[33] followed by the United Kingdom[34] in 1980 and Australia[35] in 1981.

Ebrahimi marks a shift in emphasis to an interest based approach[36] to dealing with conflicts, but still within a determinative procedure. The attempt to distinguish between corporate and personal rights seems to have been abandoned. The grounds of relief and the remedies seem to confuse the two, no doubt reflecting the impossibility of drawing a sharp line between them.

In relation to the themes of this article it can be seen that historically the law developed a rights-based, determinative approach through the rule in *Foss v Harbottle*[37] and its exceptions, which were restrictive of minority shareholder actions. Because of these restrictions, parliaments in many jurisdictions introduced a statutory remedy, but this too proved to be too narrow and restrictive and did not effectively curb the power of the majority. Out of despair minority shareholders had to resort to the drastic remedy of seeking winding up on the just and equitable ground, another rights-based determinative approach. This was a terminal and destructive remedy in its nature, however the presentation of a petition often motivated the majority to arrive at a settlement which accommodated some of the minority interests but still reflected the power of the majority. Later the statutory remedy was reformed, and more recently there has been the introduction of a statutory derivative action, as well as remedies such as a statutory injunction and orders for inspection of books and documents, which reflect some of the contemporary approaches to responding to conflict and dispute resolution.

31 See LCB Gower and PL Davies *Gower's Principles of Modern Company Law* (Sweet & Maxwell, United Kingdom, 1997) at 321 and JH Farrar *Corporate Governance: Theories, Principles and Practice* (3rd ed, Oxford University Press, Melbourne, 2008) at Chapter 18.

32 Board of Trade *Report of the Company Law Committee: Presented to Parliament by the President of the Board of Trade by Command of Her Majesty* (Cmnd 1749, Her Majesty's Stationary Office, London, June 1962).

33 Business Corporations Act 1970 (Ontario), Canada Business Corporations Act 1975.

34 Companies Act 1980 (UK), s75.

35 Companies Act 1981 (Cth), s 320.

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

37 *Foss v Harbottle* (1843) 2 Hare 461.

The corporate and commercial areas have been highly receptive to the introduction of ADR processes since the very start of their modern existence.[38] This was promoted initially by the attraction of the business community to processes which were less costly and more time efficient than the traditional litigation process and which could provide remedies more suited to commercial realities than to legal niceties. It was reinforced more recently by strong judicial acceptance and endorsement of ADR processes[39] and by the increasing use of ADR within case management systems.[40] While extravagant claims should not be made about mediation, there is evidence that it can improve relationships for the future,[41] a significant issue for corporate life.

IV. Current Approaches

A. Conservative Revisionism in the UK – O'Neill v Phillips

Over a number of years Lord Hoffmann, sitting at different levels, had expressed scepticism about minority shareholder actions and commented critically about litigation practices.[42] In 1999 he had the opportunity of expressing his views at the highest level in the House of Lords in *O'Neill v Phillips.*[43] The case concerned a building company where the owners gave the plaintiff, an employee, a minority shareholding and directorship. Later he acted as a de facto managing director. There were discussions about an

38 See, for example, P Dwight "Commercial dispute resolution: some trends and misconceptions" (1989) 1 Bond Law Review 1; M Fulton *Commercial Alternative Dispute Resolution in Australia* (Law Book Co., Sydney, 1992). In Australia ADR has also been used extensively in the development of industry-based dispute resolution schemes, such as in the banking and insurance industry – See T Sourdin "Case Management" in J Riordan (ed) *The Laws of Australia* (Lawbook Co, Melbourne, 1993) at 120-122.

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

40 Here case management refers to the introduction of managerial interventions in the litigation process conducted by judges or other court officials, operating both generally in civil procedure and specifically in relation to interlocutory proceedings and involving the use of ADR processes in the discretion of the court. On case management generally see T Sourdin "Case Management" in J Riordan (ed) *The Laws of Australia* (Lawbook Co, Melbourne, 1993) at 120-122.

41 SC Sable "Changing Assumptions about Mediation in Commercial Matters: Resolving Disputes and (Re)Building Relationships" (2001) 12 Australasian Dispute Resolution Journal 180.

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

43 *O'Neill v Phillips* [1999] 1 WLR 1092. Cited in *Fedorovitch v St Aubins Pty Ltd* (1999) 17 ACLC 1558, 1560 and *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd* (2001) 37 ACSR 672. Noted by J Payne and D Prentice "Section 459 of the Companies Act 1985 – The House of Lords' View" (1999) 115 LQR**,** 587; R Goddard "Taming the Unfair Prejudice Remedy: Sections 459–461 of the Companies Act 1985 in the House of Lords" (1999) 58 CLJ 461 at 487; and B Hannigan, *Company Law* (3rd ed, Oxford University Press, Oxfor, 2012) at 17-33. See also the valuable article by G Shapira "The Hand that Giveth is the Hand That Taketh Away – *O'Neill v Phillips* and the Shareholder Legitimate Expectations" (2000) 11 Australian Journal of Corporate Law 260.

increased shareholding but these never came to anything. Later still the company experienced a downturn and the plaintiff left the company and brought an application under the minority shareholder section of the UK Companies Act 1985. The plaintiff lost at first instance,[44] won in the Court of Appeal[45] and lost in the House of Lords.[46] The proceedings thus represented something of a lottery.

In the leading speech Lord Hoffmann said that, even though Parliament had chosen fairness as the criterion for relief and gave courts a wide power to do what was just and equitable, that did not mean "a court can do whatever the individual judge happens to think fair." Fairness must be based on rational principles that will depend on the context in which it is used: Companies, as commercial associations of persons, set out the way in which their affairs will be conducted in the articles of the companies. But: [47]

> … there will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith.

Lord Hoffmann then recanted his earlier views on legitimate expectations,[48] stating that "The concept of a legitimate expectation should not be allowed to lead a life of its own, capable of giving rise to equitable restraints in circumstances to which the traditional equitable principles have no application". That is what seems to have happened in this case.[49]

His Lordship did not favour a "no fault divorce" concept even though he acknowledged that the section sometimes resembles divorce proceedings.[50] (Here his Lordship made no reference to the appraisal right in United States, Canadian and New Zealand law.[51])

On the other hand, where relief is sought, he considered that there should be an offer made to buy out the applicant coupled with an offer as to costs if necessary. Unfairness does not usually consist merely in the fact of breakdown. but in failure to make a suitable offer.[52]

His Lordship's analysis thus seems to balance scepticism about contemporary English minority shareholder litigation with strong pragmatism. However, to the extent that the former leads him to a rights based revisionist approach to interpretation of what is essentially interest based legislation, it seems unjustifiable. Basing the approach on good faith also seems problematic. Judicial policy concerns about certainty are no justification for cutting down

44 *O'Neill v Phillips* [1997] 2 BCLC 739.
45 *O'Neill v Phillips* [1997] 2 BCLC 739.
46 *O'Neill v Phillips* [1999] 1 WLR 1092.
47 Ibid at 1098D–1099A.
48 *In re Saul D Harrison & Sons Plc* [1995] 1 BCLC 14, 19.
49 *O'Neill v Phillips* [1999] 1 WLR 1092 at 1102B–1102F.
50 Ibid, at 1104B-1105B.
51 See V Mitchell "The US approach the acquisition of minority shares: Have we anything to learn?" (1995) 14 Company and Securities Law Journal 283.
52 *O'Neill v Phillips* [1999] 1 WLR 1092 at 1107C-1108B.

the broad jurisdiction conferred by the legislation. The prolix pleadings are a result of litigants' concern about the courts' uncertain approach to a jurisdiction based on interest, principle and categories of indeterminate reference. What is called for is better case management by the courts themselves, suited to the jurisdiction given to them.

The terms of reference of the English Law Commission's work on shareholder remedies included a review of the unfairly prejudicial remedy.[53] In that regard, the main concerns which emerged about section 459 related not so much to the scope of the provision but to the length and complexity of the proceedings.[54] The tendency was for the litigation to become a Chancery version of a bitterly contested divorce with grievances from the history of the marriage dredged up and hurled about in an attempt to blacken the opposing party. In many ways these complaints about length and costs were complaints about civil litigation generally not problems peculiar to section 459 petitions. Bearing that in mind, the Law Commission, drawing on the recommendations of Lord Woolf on the Civil Justice System,[55] concentrated on procedural issues and, in particular, on the importance of active case management of petitions.

The Company Law Review strongly supported stronger case management and this was introduced.[56] The case management powers that now exist in the Civil Procedure Rules have helped to reduce the length and cost of proceedings and also helped to ensure that matters are dealt with as quickly and fairly as possible. Case management has been introduced into many common law systems over the past decade and generally has provided a more managerial role to judges and court officials in the conduct of litigation, with a view to making it more efficient and effective. Together with ADR processes it has resulted in common law litigation becoming considerably less "adversarial" than it has traditionally been.

Another idea considered by the Commission was the voluntary introduction of an exit article.[57] This again has been dropped, this time because the company formation specialists indicated they would delete it in their standard form constitutions. The proposed form of exit article is

53 See The Law Commission *Shareholder Remedies* (Law Commission Report No 246, Cm 3769, Stationary Office, London, 1997).

54 The Law Commission found, for example, that the hearing of the petition in *Re Elgindata Ltd* [1991] BCLC 959. See also the unreported case of *Re Freudiana Music Co Ltd* (1993) that lasted 43 days, costs totalled £320,000 and the shares, originally purchased for £40,000, were finally valued at only £24,600.

55 Lord Woolf *Access to Justice – Final Report to the Lord Chancellor on the Civil Justice* (Department for Constitutional Affairs, London, 1996). <webarchive.nationalarchives.gov.uk> <www.dca.gov.uk>. See now the new case management powers under the Civil Procedure Rules (1998) (UK), SI 1998/3132 and *North Holdings Ltd v Southern Tropics Ltd* [1999] 2 BCLC 625; *Re Rotadata Ltd* [2000] 1 BCLC 122.

56 Board of Trade *Modern Company Law for a Competitive Economy Final Report* (Consultation Paper, London, DTI 2001).

57 See A McGee "Exit Mechanisms in Private Companies" (1993) 3 Company Financial and Insolvency Law Review 52.

appended as Appendix D. The Law Commission also favoured greater case management of applications and statutory presumptions of unfair prejudicial conduct and a pro rata basis for share buy-outs. It also considered introducing an arbitration and ADR article into Table A but due to a lack of enthusiasm by the legal profession the proposal was dropped.[58] The form of that draft article is attached as Appendix E.

The Company Law Review strongly supported stronger case management but considered that it was not possible to prescribe in advance a fair exit regime. The Review did not favour reversing *O'Neill*.[59]

Section 994(1) of the Companies Act 2006 (UK) allows a member of a company to apply to the court to petition on the ground that the affairs of the company are being conducted in a manner unfairly prejudicial to its members or some part of the members, including himself, or a proposed act or omission would be so prejudicial. The Court can make any order it thinks fit. Also cases will now be struck out if the petitioner has received a fair offer that would give him everything he would have been entitled to under the Act.[60]

B. The Current Position in Australia

O'Neill v Phillips[61] was discussed by the New South Wales Court of Appeal in *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd*[62] which involved the largest private business group in Australia. A brother and sister ganged up against another brother after the death of their parents and it was held that their conduct amounted to oppression and unfairly prejudicial conduct, under what was then section 260 of the Corporations Law, now section 232 of the Corporations Act 2001.

The Court of Appeal did not seem impressed by Lord Hoffmann's concept of legitimate expectation, nor by his recantation of it. Spigelman CJ emphasised discretionary elements in the grounds of relief[63] but Priestley JA[64] gave a long citation from Lord Hoffmann's speech. However, it is not clear whether the Court of Appeal agrees with this conservative revisionism. One detects a mild scepticism in the judgments.

The term "legitimate expectations" is still used by the Australian courts. For example, in *Mopeke Pty Ltd v Airport Fine Foods Pty Ltd*[65], Brereton J stated that the denial of legitimate expectations would be sufficient grounds for a

58 The Law Commission *Shareholder Remedies* (Law Commission Report No 246, Cm 3769, Stationary Office, London, 1997) at 279.
59 Board of Trade *Modern Company Law for a Competitive Economy Final Report* (Consultation Paper, London, DTI 2001).
60 B Hannigan *Company Law* (3nd ed, Oxford Press, New York, 2012) at 17-69.
61 *O'Neill v Phillips* [1999] 1 WLR 1092.
62 *Fexuto Pty Ltd v Bosnjak Holdings Pty Ltd* (2001) 19 ACLC 856.
63 Ibid, at 859.
64 Ibid, at 913 et seq??.
65 *Mopeke Pty Ltd v Airport Fine Foods Pty Ltd* (2007) 61 ACSR 395 at [45].

successful application under s 232.[66] In terms of case law, Australian courts have in the past followed *Thomas*[67] and *Wayde*.[68] There is no compulsion to follow the conservative revisionism of *O'Neill v Phillips*[69] which did not refer to and was arguably per incuriam those decisions.

In the Australian context there has been none of the systematic reform which occurred in the United Kingdom, but there has been a major growth in case management practices and in the development of ADR processes. These provide the infrastructure for more deliberative reforms.

C. The Current Position in New Zealand[70]

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

Latimer Holdings Ltd v SEA Holdings New Zealand Ltd[71] is perhaps the most significant recent New Zealand case. The plaintiffs in the *Latimer* case were shareholders in a listed company and brought a case under s 174 of the Companies Act 1993 alleging that the company had been managed in an unfairly prejudicial manner. In particular, they claimed that their legitimate expectation of a return on their investment had not been met and that the company's management policy was flawed. The Court of Appeal (upholding the decision of the High Court) held that, although s 174 does apply to listed companies, in this case the plaintiffs were not entitled to a remedy. In the case of a large, publicly listed company, minority shareholders have no legitimate expectation of being involved in management or influencing decision making. In such companies the company constitution will generally set out the parties' rights and obligations exhaustively, which will not necessarily be the case in small, closely held companies.In coming to this decision Hammond J, delivering the court's judgment, noted that Williams J in the High Court had questioned "whether the *Thomas* principles should continue to apply in a climate of what the judge perceived to be the recent change in approach by the English courts".[72] In response to this question, the Court of Appeal considered both the decision in *O'Neill* and the alternative approach employed in *Thomas* and subsequent cases in some detail, and came

66 RP Austin and IM Ramsay *Ford's Principles of Corporations Law* (15th ed, Lexis Nexis Butterworths Australia, Chatswood, 2013) at [10.450].

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

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

69 *O'Neill v Phillips* [1999] 1 WLR 1092.

70 This section draws on previous work by the authors including the chapter M Berkahn S Watson "The Unfair Prejudice Remedy" in J Farrar (ed) *Company and Securities Law in New Zealand* (Thomson Reuters, Wellington, 2008) at Chapter 13; and C Noonan and S Watson "Distilling their Frenzy: the Conceptual Basis of the Oppression Remedy in New Zealand Company Law" (2005) 11 New Zealand Business Law Quarterly 288.

71 *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328 (CA); affirmed by the Supreme Court: *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* (2004) 17 PRNZ 552 (SC).

72 *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328, 340-341 (CA).

out firmly on the side of the latter. Hammond J noted the lack of any concern by the New Zealand courts as to the essential approach adopted in *Thomas*[73] and, after considering recent analysis of unfair prejudice cases in the United Kingdom,[74] identified the main problem in that country to be the length and complexity of proceedings brought under the United Kingdom provision and the costs thereof, rather than any fault in the courts' approach per se. He also noted the English Law Commission's recommendation that the way forward was through better case management, and not through changing the law.[75] His conclusion was that the House of Lords was correct in its statement that the remedy should not provide a "right to exit at will" for disgruntled company shareholders — a right of "no fault divorce" as Lord Hoffmann put it[76] — but that the *O'Neill* approach should nonetheless be rejected on three grounds:[77]

(1) The economic danger that senior executives and directors might avoid smaller companies for fear of being unduly locked in.

(2) The doctrinal danger that the *O'Neill* approach effectively narrows what is "fair" down to what is defined by pre-existing formal arrangements. Hammond J said that, although this corresponds with the economists' theory of the firm (as a nexus of agreements), the approach in *Thomas* is more appropriate: "This is because something may be lawful and 'expected', but still be unduly prejudicial".[78]*

(3) The problem of excessive, time-consuming and costly litigation, which seems to have been behind the *O'Neill* decision to a large extent, has not in fact been solved by the restrictive approach adopted by Lord Hoffmann.[79]

The acceptance of a more open-ended approach (which appears to be the effect of *Latimer*) may be a reflection of the numbers of closely held companies in New Zealand. While the protection of minority shareholders has been a major issue in a number of countries, it has not attracted the same level of interest in the United Kingdom because, unlike many other countries, most large companies in the United Kingdom are publicly quoted and share ownership in such companies is widely dispersed.[80] With a separation of

73 *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328, 341 (CA).

74 See The Law Commission *Shareholder Remedies* (Law Commission Report No 246, Cm 3769, Stationary Office, London, 1997) at Part 9.

75 *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328, 342 (CA). See The Law Commission *Shareholder Remedies* (Law Commission Report No 246, Cm 3769, Stationary Office, London, 1997) at Part 17.

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

77 *Latimer Holdings Ltd v SEA Holdings New Zealand Ltd* [2005] 2 NZLR 328, 344-345 (CA).

78 This is in accord with the comments in *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, 379, that "a limited company is more than a mere judicial entity, … 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 …".

79 Hammond J noted the survey of post-*O'Neill* unfair prejudice case law by Milman "Unfair Prejudice: The Litigation Goes On, and On …" (2004) 13 Sweet & Maxwell's Co Law Newsletter 1.

80 Brian Cheffins "Minority Shareholders and Corporate Governance" (2000) 20 Company Lawyer 41.

ownership and control, investors are rarely in a position to intervene in the running of a company's business. Share ownership in large companies in New Zealand is not nearly as widely dispersed as in the United Kingdom.[81] Indeed, while Trans Tasman Properties Ltd (the company in the *Latimer* case) may have had a large number of shareholders, its controlling shareholder held about 55 per cent of the shares. As Cheffins argues, this is likely to produce a different policy focus:[82]

> Since investors in a country with an "outsider/arm's length" system of ownership and control have good reason to be fearful of 'agency costs' arising from self-serving managerial conduct, a key corporate governance objective should be to improve the accountability of corporate executives … On the other hand, in countries with an "insider/control-oriented" system of ownership and control, strengthening managerial accountability is unlikely to be a matter of great urgency. When control in a company is highly consolidated, the dominant shareholders should have a strong financial incentive to keep a watch on what is going on. As well, they should have sufficient incentive to discipline and ultimately remove disloyal or ineffective managers … It follows that, in insider/control-oriented jurisdictions, providing suitable protection for minority shareholders should be a higher priority than reducing agency costs and fostering managerial accountability.

The implication is that New Zealand could legitimately be more concerned about the possibility of oppressive or unfairly prejudicial conduct than the United Kingdom. Although Australia has a lower proportion of SMEs than New Zealand, the arguments also have some force in an Australian context.

The other distinguishing characteristic of the New Zealand regulatory regime is the existence of the North American appraisal remedy, described as minority buy-out rights in New Zealand.[83] If a shareholder has consistently opposed a major transaction of the company, which the company then proceeds with, the shareholder may have buy-out rights. Similarly, if the company, by means of a special resolution, adopts a constitution or alters or revokes its existing constitution where the change imposes or removes a restriction on the activities of the company, shareholders affected by the change have buy-out rights. Such a right could be compared with the common law right of individuals to wind up companies which had lost their substratum. At common law, the companies were liquidated; under the 1993 Act the company may continue to operate but disaffected individuals can choose to divest themselves of their shares. Similarly, if the class rights attaching to a minority shareholder's shares are altered and a shareholder has consistently opposed the alteration, buy-out rights exist.

81 M J Roe *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford University Press, Oxford, 2003) at 16–17; RP Austin *What is Corporate Governance? Precepts and Legal Principles* (Paper presented at Legal Research Foundation Conference: Corporate Governance at the Crossroads, Auckland, 2005).

82 Brian Cheffins "Minority Shareholders and Corporate Governance" (2000) 20 Company Lawyer 41 at 41–42 (footnotes omitted).

83 Companies Act 1993, s 110.

To compel the company to buy the shares, the shareholder must follow a specified procedure laid down in the Act. The shareholder must have opposed the exercise of the power by casting all votes against it, either in the meeting of the company or in the resolution in lieu of the meeting. In *Hinton v Heartland Prime Meat*,[84] Master Venning confirmed that the exercise of buy-out rights does not affect any remedies shareholders may have against directors of the company.[85]

For shareholders who wish to divest themselves of their shares in a family company, the buy-out rights provide an exit mechanism that does not involve litigation. The buy-out rights can however only be exercised if one of the events set out above takes place and the putative exiting shareholder votes against the resolution. The buy-out rights are therefore likely to be of limited efficacy in a dispute centred on a relationship breakdown, a common situation in a family company dispute.

V. Dispute Resolution in Family Companies in the Courts

A. Corporate Law Cases Heard by the New Zealand Courts 2009 – 2010

This section contains two empirical surveys. The empirical surveys can be found in Appendixes A and B. The first sets out the number of corporate law cases heard by the New Zealand courts in 2009 and 2010 that have involved family businesses where there is a dispute between family members as a percentage of the total number of corporate law cases heard by the courts during that period. New Zealand is a small enough jurisdiction to make such a survey possible. It is our assumption that the comparable regulatory framework in Australia and the United Kingdom would mean that there are a similar percentage of disputes in those jurisdictions as in New Zealand. The second survey involves an examination of a randomised sample of constitutions of New Zealand companies in order to determine what percentage of constitutions contain dispute resolution clauses. Where possible family businesses are identified. The constitutions of the identified companies that had disputes between family members are also examined.

The cases that involved disputes between family members are summarised and available on request. Many of the cases provide a sorry litany of family breakdown played out through the courts. One series of cases, *Ma v Ming*

84 *Hinton v Heartland Prime Meat* (1999) 8 NZCLC 261,885.

85 For detailed discussion of the appraisal remedy in New Zealand see L Taylor "Controlling Shareholders" in J Farrar (ed) *Company and Securities Law in New Zealand* (Thomson Reuters, Wellington, 2008) at 524-538.and C Schackenberg "The Shareholder's Right to Fair Value and the Reform of the Minority Buy-Out Provisions of the Companies Act 1993" [2005] NZ Law Rev 533. For a discussion of the appraisal remedy in general, see JG MacIntosh "The Shareholders' Appraisal Right in Canada: A Critical Reappraisal," (1986) 24 Osgoode Hall LJ 202.

Shan Holdings Ltd[86] is in many ways typical. It involves the breakdown in a family company involving two brothers and relates to a dispute over funds. Another series of cases, *Wong v Fong*,[87] which eventually found its way to the Supreme Court, involved a dispute over fair value for the transfer of shares. That case involved a father and son-in-law and daughter. In most of the cases set out in Appendix C, it is difficult to envisage the family relationships that sit behind the companies, remaining anything but fragmented.

The Companies Act 1993 remedies also can constrain the courts from giving a remedy when one might be justified. Dispute resolution provisions might allow a mediator or arbitrator to better address underlying wrongs. For example, in *Quek v Lavenders Restaurant & Bar Ltd*[88] the company, which operated a restaurant, was small and closely held between two interrelated families. There was no shareholder agreement or constitution. A serious breakdown in relationships led to the restaurant closing abruptly and never reopening. It was argued that there was a breach of equitable duties but without reliance being placed on a "statutory gateway" such as ss 174 or 241 of the Companies Act 1993. Joseph Williams J distinguished *Ebrahimi* – holding that it cannot apply to shareholders of an incorporated company other than where it is invited by statute. He quoted from the Supreme Court in *Maruha v Amaltal Corporation Ltd*:[89] "As partners they would have owed fiduciary duties to one another, but their relationship no longer took that incorporated form. They deliberately substituted the Companies Act for the Partnership Act."

The results of the study identify the extent of disputes involving family members that find their way into the courts. If creditor dispute cases are excluded, 15 of 89 company cases litigated through the New Zealand courts in 2009 and 2010 involved intra-familial disputes. That is seventeen per cent of cases heard by the courts. Many involve numerous hearings. There is no reason to believe, given the broadly similar legislative framework, that the percentage of cases would be lower in Australia or the UK.

The failure to include dispute resolution clauses in the constitution of companies is also notable. It is possible that companies may have dispute resolution clauses in shareholder agreements; as these documents do not need to be filed in the Companies Office; we were unable to ascertain if these existed. Within the random sample of constitutions of family company, two out of 30 or seven per cent only had general disputes resolution clauses. Notable also was that, in all the intra-familial disputes but one that were heard in 2009 and 2010, none of the constitutions contained dispute resolution clauses. Nor was there evidence of shareholders' agreements containing these.

86 *Ma v Ming Shan Holdings Ltd* [2010] NZCA 325.

87 *Wong v Fong* (2010) 10 NZCLC 264,660 (HC); *Fong v Wong* [2010] NZCA 301; [2011] NZCCLR 2; *Fong v Wong* [2010] NZSC 120; *Fong v Wong* [2010] NZSC 152.

88 *Quek v Lavenders Restaurant & Bar Ltd* HC Wellington CIV-2006-485-1890 14 April 2010.

89 *Maruha v Amaltal Corporation Ltd* [2007] NZSC 40 at [19].

In the one case, *Adam v Pelf Ltd*,[90] where the constitution and shareholder agreement contained such clauses, the court was able to require the parties to comply with the dispute resolution clauses.

The data shows that the absence of dispute resolution clauses in constitutions of companies did not just lead to the demise of most of the businesses surveyed but in fact threatens the very sustainability of family business companies. Dispute and disagreement are inevitable in the life of a business. Resolution through the courts is the bluntest of dispute resolution mechanisms. The adversarial basis of the court process must almost inevitably lead to the breakdown of the relationships that underpin the family businesses and also to the wider relationships within families.

VI. Developing a New Paradigm

Shareholder disputes will not go away. The law should not close the door on minority shareholders. The question is what the best forum is for dealing with such disputes, and what approaches should be adopted. Modern Alternative Dispute Resolution processes might provide relevant options. In fact the case for dispute resolution clauses in small company constitutions is so compelling that the question must be asked why those have not been standard clauses in the past. The answer to that question is that their inclusion in the articles of association of small private companies was commonplace for a period but their demise was brought about in the early Twentieth Century because of questions about their enforceability. But the *Ebrahimi* line of cases make it likely that enforceability is no longer an issue and thus their non-inclusion less acceptable.

The extent to which the conservative revisionism of Lord Hoffmann in *O'Neill v Phillips* may affect the willingness of the courts to give weight to arbitration or dispute resolution clauses in the constitutions of family companies remains to be seen. The approach in *O'Neill* has not been adopted in Australia or New Zealand. Even Lord Hoffmann in *O'Neill* acknowledged that fairness in a family may be different to fairness between competing businessmen.[91] It is when the two are combined within the straitjacket of the corporate form that problems can arise. In this context too the importance of dispute resolution clauses in constitutions should be highlighted. Judges may not allow litigants to bypass dispute resolution mechanisms to proceed straight to liquidation pursuant to section 174. In the New Zealand case *Allan v Pelf Ltd*[92] Associate Judge Doogue declined to make order for liquidation when there were dispute resolution provisions in a shareholders' agreement and in the constitution of the company.

90 *Allan v Pelf Ltd* HC Christchurch CIV-2009-409-2263 22 March 2010.

91 *O'Neill v Phillips* [1999] 1 WLR 1092 at 1098F: "Conduct which is perfectly fair between competing businessmen may not be fair between members of a family."

92 *Allan v Pelf Ltd* HC Christchurch CIV-2009-409-2263 22 March 2010.

The position may be less clear cut if actions are brought other than through s 174. A derivative action by the company against directors pursuant to s 165 may not be prevented by an arbitration clause.[93] A determined litigant could circumvent an arbitration clause by framing a shareholder dispute that involved abuse of management power as a wrong to the company and thus bring a derivative action. There may of course be policy reasons why such cases should be considered by the courts although in fact some New Zealand judges are reluctant to grant leave for derivative actions in closely held companies where there are disputes between shareholders. In *Frykberg v Heaven*,[94] Heath J discussed the appropriateness of the derivative action as a remedy in such cases. The Court considered that the indirect effect of permitting a derivative action is that one shareholder, at least in part, funds an action brought against him or herself in the capacity of director.

VII. Conclusion

As St. Paul in his First Epistle to the Corinthians said, it is better to resolve disputes without going to Law. The Law has failed family business and minority shareholders. As has been shown, the first paradigm for corporate dispute resolution was based on a rights approach. The second was based more on an interests approach which conservative revisionism is seeking to retranslate into a rights-based approach. Any blueprint for a third paradigm involves making a decision as to which approach is to be adopted for minority shareholder disputes. There is much to be said for retention of the principles underlying the second paradigm, which are now contained in the wording of section 232 of the Corporations Act 2001 (Cth) and s 174 of the Companies Act 1993 (NZ) combined with rejection of the conservative revision by the House of Lords. Nevertheless, the use of the court system to resolve family businesses is far from ideal. The empirical studies show the extent to which intra-family disputes in companies go to Law in New Zealand and there is no reason to believe that a similar rate of litigation does not exist in Australia or the UK.

The article also shows that the number of constitutions containing dispute resolution mechanisms that permit alternative dispute resolution is low. Instead of being the last resort, the courts have become the only mechanism to resolve corporate disputes, including disputes between family members who are also shareholders or directors of companies.

It is our argument that there is merit in the development of a dispute resolution regime for family business companies that involves the inclusion of dispute resolution clauses in constitutions. The example in Appendix E was drafted by the English Law Commission. One approach could be the introduction of replaceable rules in the Companies Act 1993 to encourage

93 See the discussion by L Taylor "Derivative Action" in J Farrar (ed) *Company and Securities Law in New Zealand* (Thomson Reuters, Wellington, 2008) at 547–558.

94 *Frykberg v Heaven* (2002) 9 NZCLC 262,966 (HC).

parties to sort out areas of potential conflict at the outset and in particular a replaceable rule allowing for the adoption of an exit procedure in terms of the draft Regulation 119 proposed for the UK Table A (set out in Appendix D). The latter would provide for adoption of a procedure by ordinary resolution, tailored to the company's situation.[95]

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

Appendix A: New Zealand Corporate Cases 2009 and 2010

The first survey identified all corporate law cases heard by the New Zealand courts in 2009 and 2010. In our study, we examined and categorised all cases on the Brookers Online database: "Company and Securities Cases" for 2009 and 2010.[96] Two broad relevant categories were identified. These were corporate dispute cases, being disputes between shareholders or directors and including disputes with creditors where there are related shareholdings between companies. We identified shareholders and directors by looking at the company's annual return filed online at the Companies Office.[97]

The second broad category was disputes with creditors. These mainly involving procedural matters such as creditors serving statutory demands or placing companies into liquidation. The cases within the two broad categories were counted and sorted into the subcategories identified below. Cases with related proceedings were counted as a single case.

We further divided the cases into subcategories.

For corporate dispute cases these were:

- Cases involving family disputes – Where the disputing shareholders or directors have familial relations;
- Cases involving disputes between linked parties in closely held companies – Where there are non-commercial relationships between the disputing shareholders or directors but no legal familial relationships;[98]
- Cases where disputes involve families but the disputing parties are unrelated – There are no legal familial relationships between the disputing parties in these cases and the judgments did not explicitly mention non-commercial relationships between the parties;
- Other corporate dispute cases.

Disputes with creditors:

- Creditor disputes involving family companies – "Family company" was restricted to a company which only had shareholders and directors who shared the same last name or lived at the same address;99
- Creditor disputes involving sole shareholder/director companies;
- Creditor disputes which did not involve any family companies.

Results

96 Brookers Online *Company and Securities Cases* (Thomson Reuters, Wellington).
97 Companies Office <www.business.govt.nz/companies>.
98 The non-commercial relationships were identified and commented on in the judgments.
99 One disputing party meeting the definition of "family company" was sufficient for the case to fall under this subcategory.

Corporate dispute cases 2009-2010:

Total corporate dispute cases	**89**
Cases involving family disputes	15
Cases involving disputes between linked parties in closely held companies	15
Cases where disputes involve families but the disputing parties are unrelated	25
Other corporate dispute cases	34

Cases involving disputes with creditors:

Total cases involving disputes with creditors	**210**
Creditor disputes involving family companies	73
Creditor disputes involving sole shareholder/director companies	37
Creditor disputes which did not involve any family companies	100

The following categories of cases were identified to be irrelevant–

- Tax cases: disputes with the Commissioner of Inland Revenue
- Insolvency procedures: voluntary administration matters, receivers or liquidators seeking court direction or approval, individual bankruptcy
- Resource Management Act proceedings brought by the council
- Body Corporate residential tenancy disputes
- Cases which did not involve companies at all: property and insolvency cases involving incorporated societies and clubs, partnerships, trusts
- Employment grievance cases which did not involve shareholders or directors

Appendix B: Dispute Resolution Clauses In Company Constitutions

For the second stage of the study, we looked at company constitutions. First we carried out a random sample of New Zealand family companies' constitutions. Companies were selected using a random number generator to generate company numbers within the available seven digit range [=RAND()*9999999].

"Family company" was restricted to a company which only had shareholders and directors who shared the same last name or lived at the same address.

Discarded results –

- Invalid company numbers;
- Companies with shareholders or directors who had no familial relationships;
- Sole shareholder/director companies;
- Companies struck off the register.

Results

Total Number of Family Companies in Sample	**40**
Total in sample with accessible Constitutions	30
Total with explicit general disputes resolution clause	2
Total with explicit disputes resolution sub-clauses for directors	8
Total with explicit Minority Buy-Out Rights clauses	10
Total with explicit Interest Group Buy-Out Rights clauses	8

Appendix C: Constitutions of Family Corporate Disputes

Name	Constitution	General Dispute Resolution Clause	Directors Disputes Resolution Sub-clause	Minority Buy Out Rights	Interest Group Buy-Out Rights
Morrison Short Term Investments Ltd (in liq) v Coakle	Y	N	N	N	N
Allan v Pelf Ltd	Y	N	Y	N	N
Quek v Lavenders Restaurant & Bar Ltd	N	N/A	N/A	N/A	N/A
Parbery Heat Exchanger Services Ltd	Y	N	Y	Y	Y
Yang v Chen	Y	N	N	Y	N
RPB Solutions Ltd v Avoca Holdings Ltd	N	N/A	N/A	N/A	N/A
Ma v Ming Shan Holdings Ltd	Y	N	Y	Y	Y
Causer v Causer	N	N/A	N/A	N/A	N/A
Ruddock v Brown	Y	N	Y	Y	Y
Isaldn View Estates Ltd (in liq) v Mainline Contracting Ltd	Y	N	N	N	N
Wong v Fong	Y	N	N	N	N
Fox v Jubilee Management Ltd	Y	N	N	N	N
Yarrow v Yarrow	Y	N	N	Y	N
Delany Transport Ltd v Steel	Y	N	N	N	N
Lawrence v Glynbrook 2001 Ltd	Y	N	N	N	N

Appendix D: Draft Regulation 119: Exit Right

(1) The company in general meeting may at any time pass an ordinary resolution under this regulation, and in this regulation -

'specified' and 'named' respectively mean specified and named in the resolution;

references to an independent person are to be construed in accordance with paragraph (13).

(2) The resolution may provide that if a specified event (or one of a number of specified events) affects a named shareholder he has an exit right which -

(a) is exercisable by notice given to the company and named shareholders within a specified period, and

(b) consists of the right to require those shareholders to buy the affected shareholder's shares for a fair price.

(3) A specified event may be, for example -

the removal of a shareholder who is a director from his position as a director, otherwise than where he is in serious breach of his duties as a director; the death of a shareholder.

(4) The affected shareholder's shares are shares in the company which fulfill these conditions-

they must be held by him when the notice is given;

they must have been held by him when the resolution was passed or have been allotted directly or indirectly in right of shares so held.

(5) If a specified event is the death of the affected shareholder the person entitled to shares by reason of the death may exercise the exit right to which the affected shareholder was entitled.

(6) The resolution is invalid unless it contains provision as to the meaning of a fair price, and in particular it may provide for any of the following -

(a) a price which represents a fair value as decided by an independent person (acting as an expert value and not as arbitrator or arbiter);

(b) a price representing a rateable value (found as mentioned in paragraph (7));

in the case of shares which carry a right to participate in surplus assets on a winding up, a price representing their net asset value as decided by an independent person;

in the case of shares which do not carry a right to participate in surplus assets on a winding up, a price equal to the capital paid up on them;

and the resolution may contain different provision for different

7) A rateable value of shares of a particular class (the shares in question) is one decided by an independent person (acting as an expert valuer and not as an arbitrator or arbiter) by taking the market value of all the shares of that class in issue and multiplying it by the fraction -

whose numerator represents the capital paid up on the shares in question, and

whose denominator represents the capital paid up on all the shares of that class in issue;

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

(8) The resolution may provide that the net asset value of shares is to take account of or to disregard intangible assets (depending on the terms of the resolution).

(9) Unless the resolution otherwise provides, any value must be found by reference to the state of affairs obtaining at the beginning of the day when the notice exercising the exit right is given.

(10) The following rules apply if a value has to be decided by an independent person for the purposes of the resolution -

(a) as soon as is reasonably practicable after it receives the notice the company must instruct the independent person to decide the value;

(b) as soon as the reasonably practicable after it receives the decision the company must give notice of it to the named shareholders;

half the costs of the independent person must be borne by the affected shareholder or, if he is dead, the person entitled to his shares by reason of his death;

half the costs of the independent person must be borne by the shareholders who are required to buy;

the shareholder who are required to buy must bear that half in proportion to the number of shares they are required to buy.

(11) Subject to any provision in the resolution and to any agreement by all the parties concerned -

(a) the shareholders who are required to buy must buy the shares in proportion to the number of shares registered in their names in the company's register of members at the beginning of the day of which the resolution was passed (treating joint holders as a single holder);

(b) all parties must do their best to secure that the purchase is completed before the expiry of the relevant period (defined in paragraph (12));

at completion a buyer must pay a proper proportion of the price (in cash and in full) against delivery to him of a duly executed form of transfer.

(12) The relevant period is a period of three months starting with -

(a) the day when the company gives notice to the shareholders of the decision of the independent person (if paragraph (10) applies), or

(b) the day when the notice exercising the exit right was given (in any other case).

(13) References in this regulation to an independent person are to an independent person who appears to have the requisite knowledge and experience and who is appointed in such manner as is specified.

(14) A resolution is invalid unless every names shareholder gives a notice to the company (before the resolution is passed) stating that he consents to it.

(15) A resolution ceases to be effective if a named shareholder dies or an event occurs after which he holds none of the following shares -

shares held by him when the resolution was passed;

shares allotted directly or indirectly in right of such shares.

(16) Paragraph (15) has effect subject to the following rules -

if a notice exercising the exit right has already been given paragraph (15) does not apply as regards that notice;

if the death of the named shareholder is a specified event paragraph (15) does not apply as regards that event;

paragraph (15) does not apply if the resolution disapplies it.

(17) A resolution ceases to be effective if there is agreement to that effect by all relevant persons; and a relevant person is any person who is -

a named shareholder, or

a person entitled to a named shareholder's shares by reason of his death.

(18) Regulations 111, 112 and 114 and 116 apply to a notice exercising the exit right as if it were a notice given by the company.

(19) If a notice exercising the exit right is given it cannot be withdrawn without the consent of all relevant persons (within the meaning given by paragraph (17)).

(20) If while a resolution is effective a named shareholder transfers shares, and after the registration of the transfer he would hold none of the shares mentioned in paragraph 15(a) and (b), the directors of the company must refuse to register the transfer unless all relevant persons (within the meaning given by paragraph (17)) notify the company in writing that they consent to the transfer, and consent unreasonably withheld must be taken to be so notified.

(21) If a resolution is passed under this regulation -

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

Appendix E: Arbitration Article

A. Arbitration Article - Draft Regulation 120

(1) If a dispute arises between the company and any member or between any members about the construction of these regulations or any act or omission of the company, the dispute shall be referred to arbitration. But if at any time the parties agree to seek to resolve the dispute through an alternative dispute resolution procedure (ADR) acceptable to them, the arbitration shall be suspended. The parties to a dispute must consider whether the dispute is appropriate for ADR when one of them notifies the other(s) of his intention to refer the dispute to arbitration.

(2) If a dispute is referred to arbitration, there shall be a sole arbitrator chosen by the parties or in default by the President of the Institute of Chartered Accountants in England and Wales. If the registered office of the company is in Scotland, the word “arbiter” shall be substituted for “arbitrator” and he shall be chosen by the President of the Institute of Chartered Accountants in Scotland, if the parties cannot agree.

(3) This regulation applies only to disputes arising out of a member's contract of membership and not to disputes arising out of any separate contract between the member and the company or any other member.

(4) The company does not by this regulation agree to submit to arbitration at the instance of a member unless that member could maintain legal proceedings against it in respect of the complaint proposed to be remitted to arbitration.

(5) This regulation applies only if the company resolves that it should apply to the company but it shall not in any event apply to any dispute which has already arisen by the date of the resolution unless the parties agree.

(6) For the purposes of this regulation, "member" includes any person to whom any share has been transferred or transmitted by operation of law.