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Jonathan Hardman

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An institutional analysis of UK ostensible minority shareholder protection mechanisms

Jonathan Hardman

School of Law, University of Edinburgh, Edinburgh, UK

ABSTRACT
This article argues that there is a conundrum at the heart of the company law understanding of ostensible minority protection mechanisms (the derivative claim and unfair prejudice): they are terrible at protecting those that they are thought to protect. The hurdles to access the remedies are too high, there is undue focus on the behaviour of the wronged party, costs are uncertain, and relief inadequate. This conundrum can be resolved by applying an institutional analysis and exploring the rules from the perspective of the company. Here, a number apparent weaknesses in the regime are mostly strengths for the company. The remedies are important for the company as they act as a 'lightning rod': all complaints by disgruntled shareholders are funnelled through these hegemonic argumentation structures, which protect the institutional arrangement of the company and, in turn, that part of the institutional environment which is company law.

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KEYWORDS Minority protection; unfair prejudice; derivative claim

1. Introduction

This article proposes an alternative analysis of UK ostensible minority shareholder protection mechanisms (the derivative claim and unfair prejudice). The traditional analysis of these mechanisms is that they protect minority shareholders, or 'the minority'. This article argues that such analysis creates a conundrum for company law as such mechanisms are terrible at protecting minority shareholders. We resolve this conundrum by arguing that it is better to review minority protection mechanisms from the perspective of the company. Here, a number of apparent weaknesses in respect of ostensible minority protection mechanisms are strengths: they act to protect the

CONTACT Jonathan Hardman jonathan.hardman@ed.ac.uk School of Law, University of Edinburgh, Old College, South Bridge, Edinburgh EH8 9YL, UK

company from disgruntled and wronged minority shareholders. That ostensible minority protection mechanisms actively protect the company from minority shareholders seems counterintuitive, as these remedies provide relief for minority shareholders which can sometimes be against the company. Intuitively, then, the company would be most protected if law simply disenfranchised minority shareholders and provided them with no remedy at all. This article argues, though, that such ostensible protection mechanisms act as a lightning rod to ensure that all claims are funnelled through these routes. This lightning rod prevents the corporate form from being exposed to potential responses from other areas of the legal taxonomy. Thus, from the perspective of the company, it is better to have a hegemonic set of ostensible minority protection mechanisms with a very high bar than it is to have no ostensible minority protection mechanisms at all.

The basis for this argument is found in the basics of UK company law, in particular the limited rights of minority shareholders and the rationale for limiting such rights. Company law facilitates and requires the centralisation of power away from individuals to the collective endeavour of the company itself.[1] A subscriber swaps the rights that they would obtain as a creditor against the company for a different set of rights as a 'shareholder'. The rights of all subscribers are aggregated, so that rather than each shareholder having a swathe of discrete individual rights, the aggregate class of shareholders as a whole enjoys most of the aggregate power of all shareholders.[2] It would be impractical, especially in larger companies, to require that this class make all decisions that exist within a company,[3] or that those decisions which are taken by this class be taken by unanimous decision of this class.[4] Mechanics therefore exist for the company to be managed (or management overseen by) a separate category of constituent, known as directors,[5] and for

[1]See G Teubner, 'Enterprise Corporatism: New Industrial Policy and the "Essence" of the Legal Person' (1988) 36 American Journal Comparative Law 130.

[2]For discussion of the nature of a shareholder's interest, see P Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 62 Modern Law Review 32; RB Grantham, 'The Doctrinal Basis of the Rights of Company Shareholders' (1998) 57 Cambridge Law Journal 554; RR Pennington, 'Can Shares in Companies be Defined?' (1989) 10 Company Lawyer 140; S Worthington, 'Shares and Shareholders: Property, Power and Entitlement' (2001) 22 Company Lawyer 258.

[3]SM Watson, 'The Significance of the Source of the Powers of Boards of Directors in UK Company Law' [2011] Journal of Business Law 597. See also AA Berle and G Means, *The Modern Corporation and Private Property* (revised edition, Harcourt, Brace & World, Inc. 1967) 67, which argues that a loss of control is inherent in any aggregation of capital. See SM Bainbridge, 'Director Primacy and Shareholder Disempowerment' (2006) 119 Harvard Law Review 1735.

[4]Requiring unanimity of shareholder decisions is impractical – see M Eisenberg, *The Structure of the Corporation: A Legal Analysis* (Beard Books 1967) 16; FH Easterbrook and DRR Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) 248, and risks minority shareholders holding out for inefficient requests – see BR Cheffins, *Company Law Theory, Structure and Operation* (reprint, OUP 2007) 68–69.

[5]See the Model Articles contained in The Companies (Model Articles) Regulations 2008 (SI 2008/3229), Sch 1 para 3. These appear to be rarely deviated from in practice, at least for smaller companies – see J Hardman, 'Articles of Association in UK Private Companies: An Empirical Leximetric Study' (2021) 22 European Business Organization Law Review 517.

decisions of a majority of shareholders to bind a dissenting minority where matters are to be decided by shareholders.[6]

This exposes the minority to the risk that the affairs of the company are run in a way that is contrary to their interests. This can occur at either level: directors can act in their own interests rather than those of the shareholders, or the majority shareholders can use majority rule to the disadvantage of the minority. The former is extensively covered elsewhere, and this article focuses on the latter.

The latter is often considered to be less important than the former, because it is normally thought that the interests of the shareholders are mostly sufficiently homogenous for shareholder interests to align on key issues.[7] The argument goes that whilst a minority may disagree with a decision which benefits the majority, for example to push for dividends on a timescale to benefit the majority's own accounting requirements, it could hardly be argued to be against their interests.[8] Closer examination reveals that the interests of shareholders are not always homogenous.[9] If the majority capture the managerial organs of the company, or utilise their voting rights as majority, to divert funds to themselves rather than other shareholders, the minority shareholder is at risk.[10]

The risk of tangible harm for the minority is thought to be lower in publicly listed companies, due to the availability of a liquid exit at a prevailing rate.[11] Unhappy shareholders will, it arguably follows, simply sell their shares.[12] Sufficient numbers of minority shareholders exiting will drive down share prices, harming the interests of the majority and exposing the company to opportunistic takeover.[13] Arguably, the threat of this acts to mitigate the

[6]Companies Act 2006, ss 281–283.

[7]This is often couched in language which means that shareholders can collectively act to discipline management in their joint interests – eg LA Bebchuk, 'The Case for Increasing Shareholder Power' (2005) 118 Harvard Law Review 833, 883–86 (arguing that concerns in respect of shareholder special interests, short term horizons, and opportunism are not significant); BS Black, 'Shareholder Passivity Reexamined' (1990) 89 Michigan Law Review 520, 608 (arguing that shareholders can overcome collective action problems); SJ Schwab and RS Thomas, 'Realigning Corporate Governance: Shareholder Activism by Labour Unions' (1998) 96 Michigan Law Review 1018, 1083–85 (arguing that shareholders are rational and will act to maximise the recovery of the overall company, which in turn will maximise their return).

[8]At the very least, it has been argued that on key matters shareholders' interests are homogenous, but they may need some protection – see BR Cheffins, *Company Law Theory, Structure and Operation* (reprint, OUP 2007) 68–69.

[9]I Anabtawi, 'Some Skepticism about Increasing Shareholder Power' (2006) 53 UCLA Law Review 561.

[10]See J Hardman, 'The Plight of the UK Private Company Minority Shareholder' (2022) 33 European Business Law Review 87.

[11]See MC Jensen and JB Warner, 'The Distribution of Power among Corporate Managers, Shareholders and Directors' (1988) 20 Journal of Financial Economics 3; AR Admati and P Pfleiderer, 'The "Wall Street Walk" and Shareholder Activism: Exit as a form of Voice' (2009) 22 The Review of Financial Studies 2645.

[12]AO Hirschmann, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organisations and States* (Harvard University Press 1970); BA Korman, 'The Corporate Game of Thrones and the Market for Corporate Control' (2017) 12 Journal of Business & Technology Law 165; BS Sharfman and MT Moore, 'Liberating the Market for Corporate Control' (2021) 18 Berkeley Business Law Journal 1.

[13]HG Manne, 'Some Theoretical Aspects of Shareholder Voting: An Essay in Honor of Adolfe A Berle' (1964) 64 Columbia Law Review 1427; HG Manne, 'Mergers and the Market for Corporate Control'

tangible harm in the first place:[14] to avoid being removed in an opportunistic takeover/a share price drop, directors and majority shareholders will attempt to avoid causing harm. Thus public companies contain exit mechanisms and market discipline which protect the minority, both of which are absent in unlisted companies.[15] Such market discipline is, of course, not particularly helpful for the individual who suffers loss, sells their shares, and only discovers such loss later.[16] The argument of those who hold strongly to the power of exit mechanics, though, is that the eventual subsequent disclosure of wrongdoing would reduce the share price, thus exposing the company to takeover, and that management will therefore try to avoid such situation.[17] In any event, there is at least a greater disciplinary function in listed companies than in private companies.

This, then, seems to expose the minority in UK private companies,[18] and it is frequently argued that they require legal protections.[19] This argument can be advanced through agency cost analysis[20] – shareholders can be seen as either the key principal in the corporate setting,[21] or at least one category of principals within the company.[22] They suffer agency costs from directors[23] and the majority shareholders[24] (sometimes said to be 'principal-principal

(1965) 73 Journal of Political Economy 110; FS McChesney, 'Manne, Mergers, and the Market for Corporate Control' (1999) 50 Case Western Reserve Law Review 245.

[14]Of course, this can be overstated – wrongful behaviour does occur, and so it is perhaps more accurate to say that this mitigates bad behaviour, along with other disciplinary markets such as the intra-firm labour market – see EF Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 Journal of Political Economy 288.

[15]JAC Hetherington and MP Dooley, 'Illiquidity and Exploitation: A Proposed Statutory Solution to the Remaining Close Corporation Problem' (1977) 63 Virginia Law Review 1; EB Rock and ML Wachter, 'Waiting for the Omlette to Set: Match-Specific Assets and Minority Oppression' in RK Morck (ed), *Concentrated Corporate Ownership* (University of Chicago Press 2000).

[16]See discussion in DD Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459–461 of the Companies Act 1985' (1988) 8 Oxford Journal of Legal Studies 55, 64.

[17]This is supported by mechanics requiring disclosure of information to the market – see discussion in RJ Gilson and RH Kraakman, 'The Mechanisms of Market Efficiency' (1984) 70 Virginia Law Review 549.

[18]C Loderer and U Waelchli, 'Protecting Minority Shareholders: Listed versus Unlisted Firms' (2010) 39 Financial Management 33. Any market that there is will be monopsonistic – see DD Prentice, 'The Closely-Held Company and Minority Oppression' (1983) 3 Oxford Journal of Legal Studies 417.

[19]See A Barak, 'A Comparative Look at Protection of the Shareholders' Interest Variations on the Derivative Suit' (1971) 20 International and Comparative Law Quarterly 22; EW Orts, 'Shirking and Sharking: A Legal Theory of the Firm' (1998) Yale Law & Policy Review 265, 318; RB Thompson, 'The Shareholder's Cause of Action for Oppression' (1993) 48 The Business Lawyer 699.

[20]Eg FH Easterbrook and DRR Fischel, 'Close Corporations and Agency Costs' (1985) 38 Stanford Law Review 271.

[21]Normally linked to the residual claim – eg EF Fama and MC Jensen, 'Agency Problems and Residual Claims' (1983) 26 Journal of Law and Economics 327.

[22]MC Jensen and WH Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure' (1976) 3 Journal of Financial Economics 305; R Kraakman and others, *The Anatomy of Corporate Law* (3rd edn, OUP 2017) 29–31.

[23]For example by excessive compensation – see mechanics in LA Bebchuk and JM Fried, 'Executive Compensation as an Agency Problem' (2003) 17 Journal of Economic Perspectives 71.

[24]Sometimes called 'horizontal' agency costs – JC Coffee and others, 'Activist Directors and Agency Costs: What Happens When an Activist Director Goes on the Board?' (2019) 104 Cornell Law Review 381; SM Sepe, 'Corporate Agency Problems and Dequity Contracts' (2010) 36 Journal of Corporation Law 113;

costs',[25] although as the economic principal and agent relationship is very widely drawn[26] it is also legitimate to refer to both categories as agency costs). It has been argued that law is required to protect minority shareholders.[27] Conventional wisdom is that UK law does so by the minority protection mechanisms reviewed below. Thus traditional analysis, buttressed by agency cost considerations, leads to the conclusion that minority shareholders in private companies require, and enjoy, legal protections.

There are two commonly referred to[28] judicial (i.e. available through court process) minority protection mechanisms in the UK, being the derivative claim,[29] and an 'unfair prejudice' claim.[30] These mechanisms are available to any shareholder, and not limited to minority shareholders. However, as majority shareholders enjoy other control mechanisms involving lower costs,[31] their key effect is seen as providing remedies for the minority, and so they are frequently referred to as minority protection mechanisms.[32] Sometimes the ability to petition the court to wind the company up[33] is included.[34] However, there are two key reasons that we do not follow that approach. First, the ability to wind up the company on a just and equitable ground is available in the absence of wrongdoing, and therefore is not seen as a device to protect a wronged minority.[35] Second, it results in the

RP Bartlett III, 'Venture Capital, Agency Costs, and the False Dichotomy of the Corporation' (2006) 54 UCLA Law Review 37.

[25]Eg R Dharwadkar, G George and P Brandes, 'Privatization in Emerging Economies: An Agency Theory Perspective' (2000) 25 Academy of Management Review 650; MN Young and others, 'Corporate Governance in Emerging Economies: A Review of the Principal-Principal Perspective' (2008) 45 Journal of Management Studies 196.

[26]Eg see K Arrow, 'The Economics of Agency' in JW Pratt and RJ Zeckhauser (eds), *Principals and Agents: The Structure of Business* (Harvard Business School Press 1984). As a result, then, all agency relationships are inextricably reciprocal – see JW Pratt and RJ Zeckhauser, 'Principals and Agents: An Overview' in JW Pratt and RJ Zeckhauser (eds), *Principals and Agents: The Structure of Business* (Harvard Business School Press 1984); S Jeon, 'Reciprocal Agency' (2001) Journal of Institutional and Theoretical Economics 246.

[27]BR Cheffins, *Company Law Theory, Structure and Operation* (reprint, OUP 2007) 68–69; CD Israels, 'Close Corporations and the Law' (1948) 33 Cornell Law Review 488.

[28]Eg J Armour, 'Enforcement Strategies in UK Corporate Governance' in J Armour and J Payne (eds), *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart 2009) 79; S Worthington and S Angew, *Sealy & Worthington's Text, Cases & Materials in Company Law* (12th edn, OUP 2022) 490–590; B Hannigan, *Company Law* (6th edn, OUP 2021) paras 19-9–19-13. See also *Sevilleja v Marex Financial Ltd* [2020] UKSC 31 at paras [36], [81] and [83] per Lord Reed.

[29]Companies Act 2006, Part 11.

[30]Companies Act 2006, Part 30.

[31]Not only over the articles of association, but also in respect of removing directors – Companies Act 2006, s 168.

[32]Eg in respect of unfair prejudice, Prentice states, '[t]he phrase "minority shareholder oppression" is not being used in any technical sense, but broadly to denote a situation where the right or expectations of a shareholder (whether or not a minority shareholder) have been transgressed' – DD Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459–461 of the Companies Act 1985' (1988) 8 Oxford Journal of Legal Studies 55, 55.

[33]Insolvency Act 1986, s 122(1)(g).

[34]This can be to group the three remedies together – eg L Roach, *Company Law* (2nd edn, OUP 2022) 392 – or as part of a wider list of remedies, including the Secretary of State's powers to investigate the company – eg J Dine and M Koutsias, *Company Law* (9th edn, Palgrave 2020) ch 10; D French, *Mayson, French & Ryan on Company Law* (37th edn, OUP 2021) ch 18.

[35]It also exists as 'a remedy for paralysis' – see *Chu v Lau* [2020] UKPC 24 at para [17] per Lord Briggs.

winding up of the company.[36] It is thus terminal for the company, and so fundamentally different from both other court-based processes.[37] The derivative claim allows a shareholder to make the company attempt to obtain redress against a wrongdoer if the main decision-making organs of the company have failed to do so.[38] The unfair prejudice remedy allows shareholders to petition for relief in their personal capacities against 'unfair prejudice' that has been suffered by a shareholder following the company being run a certain way.[39] These mechanisms are considered to protect minority shareholders.[40]

The problem with this analysis is that, as we shall argue, these mechanisms provide scant protection for minority shareholders. This exposes the conundrum of company law's understanding of ostensible minority protection mechanisms: if their primary objective is protecting the minority then they are very weak at it.

This article aims to resolve this conundrum by re-examining these ostensible minority protection mechanics from an institutional perspective. The rules are best understood as a way to protect the institutional arrangement of the company from minority shareholders should their interests conflict, rather than minority shareholders from the actions of others. From the company's perspective, the restrictive content of ostensible minority protection rules act to bolster the institution rather than undermine it. As such, these mechanisms are not best understood as primarily protecting the minority. The primary effect is, instead, to protect the institution of the company.

If this is correct, why have ostensible minority protection mechanisms? It seems from the company's perspective that a shareholder having no ability to petition for recourse would be better than providing a minority shareholder with any right, however weak. In other words, it appears as if the company would be stronger without any ostensible minority protection mechanisms at all. There are times when wrong-doer conduct can hurt the institution but not be remedied within normal corporate procedures, in particular where the collective decision making processes of the company have been captured for personal gain. These rules could arguably overcome that, by providing an imperfect ground for the minority shareholders to help

[36]This makes it an insolvency remedy rather than a company law remedy, as the effect is to appoint a liquidator – see Insolvency Act 1986, s 130.

[37]Winding the company up remains an optional remedy for the court when faced with an unfair prejudice remedy.

[38]See J Armour, 'Derivative Actions: A Framework for Decisions' (2019) 135 Law Quarterly Review 412; A Keay, 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 Journal of Corporate Law Studies 39.

[39]For the line between the two, see B Hannigan, 'Drawing Boundaries between Derivative Claims and Unfairly Prejudicial Petitions' [2009] Journal of Business Law 606.

[40]They provide 'a much more comprehensive form of protection for shareholders' – PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 14-012.

discipline wrongdoers in the institution and protect the institution by providing recourse when its decision making processes have been compromised. However, high hurdles to access the remedy do not automatically correlate with filtering out 'bad' claims and allowing 'good' claims to proceed, and so this cannot explain these mechanisms on its own.

More importantly, an absence of these rules would leave space for other areas of the legal taxonomy to provide remedies to wronged minority shareholders. Instead, rules with high hurdles occupy this space. Thus any wronged minority shareholder is funnelled into these rules. This can already be seen in the prohibition on the recovery of reflective loss. Here, courts have refused recourse to shareholders on alternative grounds which would divert resources away from the company because they have minority protection mechanisms available to them. Ostensible minority protection rules thus act as a lightning rod for wronged shareholders: by funnelling shareholders into attempting to meet the high hurdles from these rules, with limited recourse if they do, the institution is further protected. A comparison can be drawn to piercing the veil within group companies, where company law tried to hold to a strict entity-by-entity approach,[41] providing the conceptual space for other areas of the legal taxonomy to create their own doctrines to provide such remedy.[42] Thus a total absence of an ostensible remedy for minority shareholders may, counterintuitively, result in them attaining increased protection likely at the expense of the institution of the company. Minority protection mechanisms thus act as hegemonic argumentation structures[43] in the context of minority protection. They remove analytical oxygen from more effective minority shareholder protections, preventing them from circumventing the institutional protection provided by such restrictive rules.

This article does not argue that this is the intention of minority protection mechanisms, nor that the rules should necessarily operate in this manner (it advances a tentative normative position, but does not evaluate it against competing normative approaches). It concedes that minority shareholders, and those interested in furthering their protections, still face a conundrum. The argument is, instead, merely that company law's conundrum of minority shareholder protection mechanisms (that they appear to be bad at what we think they do) can be resolved by seeing such ostensible remedies as protecting the institution of the company instead. The conundrum is resolved by taking an institutional analysis of the problem, and exploring the issue from the perspective of the institution in question – the company. To do so, we foreground the company and its interests as an institution distinct

[41]See *Hurstwood Properties (A) Ltd v Rossendale Borough Council* [2021] UKSC 16.
[42]See discussion in J Hardman, 'Fixing the Misalignment of the Concession of Corporate Legal Personality' (2023) 43 Legal Studies 443, 454–57.
[43]D Kennedy, *The Dark Sides of Virtue: Reassessing International Humanitarianism* (Princeton University Press 2004).

from the individuals related to it. Such analysis runs counter to the contractarian school of thought,[44] which reduces the relevance of the company to merely being a simplified default set of rules for parties to voluntary deviate from if they like.[45] It has been argued that contractarianism is not descriptively accurate for UK company law.[46] Contractarianism is conceptually connected to agency theory analysis – that the company is best analysed as a series of agency problems and categories of legal solution to such problems.[47] From an agency cost perspective, minority shareholder protection mechanisms in private companies constitute a puzzle, as legal protections are too weak to protect them – demonstrating that law responds unevenly to different categories of agency costs.[48] However, these rules act to protect the institution – directly (by making their own operation difficult), and indirectly (by occupying the emancipatory space for minority shareholders). Thus rather than a failure of agency cost analysis, they are a victory for institutional analysis: the rules protect the institution of the company from its constituencies, rather than protect those constituencies.

The analysis outlined by this article, then, hints that other areas of company law may also be better analysed from the perspective of the institution of the company, rather than the individuals who interact with and around the company. If this is the case, then there is a chance that not only is agency cost analysis the incorrect analytical tool to understand the legal framework, it risks distracting us from accurate conceptual analysis of legal doctrines and phenomena.

The rest of this article proceeds as follows. Section 2 rehearses the traditional view of ostensible minority protection mechanisms. Section 3 identifies the puzzle inherent within such analysis – that ostensible minority protection mechanisms are bad at protecting the minority as they set the barriers to the remedy too high and provide limited remedies. Section 4 then

[44]Set out most clearly in FH Easterbrook and DRR Fischel, 'The Corporate Contract' (1989) 89 Columbia Law Review 1416.

[45]M Klausner, 'The Contractarian Theory of Corporate Law: A Generation Later' (2006) 31 Journal of Corporation Law 779; MA Eisenberg, 'The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm' (1999) 24 Journal of Corporation Law 819; LA Bebchuk, 'Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments' (1989) 102 Harvard Law Review 1820; LA Bebchuk and A Hamdani, 'Optimal Defaults for Corporate Law Evolution' (2002) 96 Northwestern University Law Review 489.

[46]MT Moore, 'Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism' (2014) 34 Oxford Journal of Legal Studies 693; D Attenborough, 'Empirical Insights into Corporate Contractarian Theory' (2017) 37 Legal Studies 191; D Gibbs-Kneller, D Gindis and D Whayman, 'Not by Contract Alone: The Contractarian Theory of the Corporation and the Paradox of Implied Terms' (2022) 23 European Business Organization Law Review 573.

[47]See R Kraakman and others, *The Anatomy of Corporate Law* (3rd edn, OUP 2017) ch 1 and ch 2. For the arguments as to how and why, see JW Pratt and RJ Zeckhauser, 'Principals and Agents: an Overview' in JW Pratt and RJ Zeckhauser (eds), *Principles and Agents: The Structure of Business* (Harvard Business School Press 1985).

[48]J Hardman, 'The Plight of the UK Private Company Minority Shareholder' (2022) 33 European Business Law Review 87.

undertakes an institutional analysis, argues that these rules are best viewed from the perspective of protecting the institution, and explores implications flowing from such institutional analysis. Section 5 outlines why such rules are required from the perspective of the institution: they act as a lightning rod for wronged minority shareholders. Section 6 outlines the wider implications of this analysis and concludes.

2. The traditional view of minority protection mechanisms

A. The derivative claim

We note in the introduction the perceived need to provide mechanisms to protect minority shareholders, and that the conventional wisdom is that the UK delivers these with the derivative claim and a claim for unfair prejudice. We must start by outlining the relevant rules for these mechanisms, and how they are considered to protect minorities, prior to exploring the conundrum inherent within such analysis. The derivative claim arose against the backdrop of the 'proper plaintiff' rule.[49] An exception developed if wrongdoers used their corporate rights to perpetrate a fraud on the minority.[50] Here, the court allowed the minority to commence action on behalf of the company against the wrongdoer.

The statutory derivative claim[51] applies where a member of a company wishes to raise proceedings to obtain relief on behalf of that company in respect of a wrong done to the company.[52] This is available to *any* shareholder, not only minority shareholders. However, it is perceived to protect minority shareholders.[53] The wrong undertaken must be 'arising from an actual or proposed act or omission involving negligence, default, breach of duty or trust by a director of the company'.[54] As such, it requires breach by directors.[55] The action can, though, be against a non-director.[56]

[49] *Foss v Harbottle* (1843) 2 Hare 461; KW Wedderburn, 'Shareholders' Rights and the Rule in Foss v Harbottle' (1957) 15 Cambridge Law Journal 194.

[50] *Edwards v Halliwell* [1950] 2 All ER 1064, 1066–1069; *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204, 210–211. For an overview of the common law position, see Editorial, 'A Statutory Derivative Action' (2007) 28 Company Lawyer 225.

[51] Constituted in the Companies Act 2006 – see A Reisberg, 'Derivative Claims under the Companies Act 2006: Much Ado about Nothing?' in J Armour and J Payne (eds), *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart 2009). The extent to which the statutory process represents a fundamental replacement of the common law regime with something entirely novel, or whether it merely codifies and continues the common law regime is moot. Compare J Armour, 'Derivative Actions: A Framework for Decisions' (2019) 135 Law Quarterly Review 412, 413 with D Kershaw, 'The Rule in *Foss v Harbottle* is Dead: Long Live the Rule in *Foss v Harbottle*' [2015] Journal of Business Law 274.

[52] Companies Act 2006, s 260(1).

[53] On the grounds that the majority have other rights available to them – see discussion in PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 15-005.

[54] Companies Act 2006, s 260(3).

[55] PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 15-009.

[56] Companies act 2006, s 260(3).

Court permission is required to commence the claim. Such permission requires a prima facie case[57] or must be dismissed.[58] Should one exist, the court has to decide whether to give the shareholder permission to continue the case. The court must refuse in three circumstances. First, if someone acting in the best interests of the company would not continue the claim.[59] Second, if a future act or omission has been authorised by the company.[60] Third, if a past act or omission was either authorised or subsequently ratified.[61] Thus shareholder approval – ex ante by authorisation, or ex post by ratification – results in a mandatory refusal of permission to continue the claim.

Following this stage, the court has wide discretion whether to allow the claim to proceed. The court must take into account various statutory considerations,[62] including the views of disinterested members.[63] If the claim proceeds, usually the company pays the claim's costs.[64] This is tempered by two connected rules. First, the court is keen to remain neutral in the dispute, and is aware that granting costs may help one side.[65] Second, seeking an indemnity for costs influences whether someone acting in good faith in the interests of the company would continue the claim.[66]

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[57] A Keay and J Loughrey, 'Something Old, Something New, Something Borrowed: An Analysis of the New Derivative Action Under the Companies Act 2006' (2008) 124 Law Quarterly Review 469.

[58] Companies Act 2006, s 261. A member of a company can also apply for permission to continue a claim already brought by the company – see Companies Act 2006, s 262 – and by other members – see Companies Act 2006, s 264. These fill important 'gap filling' roles, as they stop claims being raised by the company then settled or dropped, leaving no space for a derivative claim to arise.

[59] Companies Act 2006, s 263(2)(a); A Keay, 'Applications to Continue Derivative Proceedings on Behalf of Companies and the Hypothetical Director Test' (2015) 34 Civil Justice Quarterly 346.

[60] Companies Act 2006, s 263(2)(b). There are ex ante rules which prevent a director voting on matters in their own interest – such as declarations of interests in proposed transactions to the other directors – Companies Act 2006, see ss 177 and 182. These can be supplemented by shareholders under the constitution to exert more control over directors conflicts – see PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 10-062.

[61] Companies Act 2006, s 263(2)(c). There are *ex post* rules which prevent a directly interested director or any member of the company directly connected to her from voting on any ratification of a wrong act – see Companies Act 2006, s 239, discussed in C Riley, 'Derivative Claims and Ratification: Time to Ditch Some Baggage' (2014) 34 Legal Studies 582.

[62] See Companies Act 2006, s 263. The presence of an alternative remedy does not automatically preclude utilising derivative claims – see EC Mujih, 'The New Statutory Derivative Claim: A Paradox of Minority Shareholder Protection: Part 2' (2012) 33 Company Lawyer 99.

[63] Companies Act 2006, s 263(4).

[64] *Wallersteiner v Moir (No. 2)* [1975] QB 373 CA; A Reisberg, 'Derivative Actions and the Funding Problem: The Way Forward' [2006] Journal of Business Law 445.

[65] 'It seems to me that court can be properly concerned that in a dispute between shareholders, an indemnity given by the company to one side or the other gives an unfair advantage to that side' – *Hook v Sumner* [2015] EWHC 3820 (Ch), para [139].

[66] See *Cullen Investments Ltd v Brown* [2015] EWHC 473 (Ch), where it was held that since the minority shareholder rather than the company 'will be liable for the adverse costs consequences in the event of failure, it is difficult to see any reason why a hypothetical director would not want to continue the litigation. Its funds cannot be diminished but may very well be enhanced, possibly to a very significant extent' para [55].

Conventional wisdom is thus that the statutory derivative claim fills an important protective need,[67] to sweep up wrongdoing missed through usual channels. Armour argues that a derivative claim is only applicable if there is no independent organ of the company (directors or shareholders) able to decide the merits of progressing the claim linked to director wrongdoing.[68] Thus the derivative claim helps protect shareholders against insider control of decision making organs by providing a judicial remedy should this occur. It therefore deters wrongdoing by directors.[69] This reduces the risks identified in the introduction, that the organs of the company may be captured and wrongdoing ignored. It therefore, according to traditional analysis, protects the minority by allowing wrongdoing to be pursued even where the company's decision making organs are compromised, and (in turn) thus deterring future wrongdoing. It reduces agency costs.[70] The statutory form is easier to access than the previous common law system,[71] thus its protective function must be even higher.

Derivative claims are meant to be used sparingly, and only when usual litigation decision-making channels are compromised. The various stages required to advance a claim are considered necessary to avoid a floodgate of disgruntled minority shareholders challenging every decision.[72] Most jurisdictions thus attempt to throttle the ease at which shareholders can launch derivative claims, and the UK's approach of a preliminary procedure is seen as good practice.[73]

A number of other jurisdictions have explored introducing the derivative claim as a way to protect minority shareholders.[74] Similarly, it has been proposed that the derivative action be expanded[75] to be available to other constituencies.[76]

[67] A Reisberg, 'Shareholders' Remedies: The Choice of Objectives and Social Meaning of Derivative Actions' (2005) 6 European Business Organization Law Review 227, 233.

[68] J Armour, 'Derivative Actions: A Framework for Decisions' (2019) 135 Law Quarterly Review 412, 436.

[69] A Reisberg, 'Shareholders' Remedies: The Choice of Objectives and Social Meaning of Derivative Actions' (2005) 6 European Business Organization Law Review 227, 249–52; OC Schreiner, 'The Shareholder's Derivative Action – A Comparative Study of Procedures' (1979) 96 South African Law Journal 203, 211; SJ Choi, J Erickson and AC Pritchard, 'Piling on? An Empirical Study of Parallel Derivative Suits' (2017) 14 Journal of Empirical Legal Studies 653.

[70] By providing additional disciplinary mechanisms where they may be lacking, thus disincentivising agency costs becoming manifested.

[71] M Almadani, 'Derivative Actions: Does the Companies Act 2006 Offer a Way Forward?' (2009) 30 Company Lawyer 131.

[72] See D Arsalidou, 'Litigation Culture and the New Statutory Derivative Claim' (2009) 30 Company Lawyer 205.

[73] M Gelter, 'Preliminary Procedures in Shareholder Derivative Litigation: A Beneficial Legal Transplant?' (2022) 19 European Company and Financial Law Review 3.

[74] See G Zouridakis, 'Introducing Derivative Actions to the Greek Law on Public Limited Companies: Issues of Legal Standing and Lessons from the German and UK Experience' (2015) 26 International Company and Commercial Law Review 271; MP Richard, 'Re-Examining the Basis of Derivative Action in Nigeria: the Need for Reforms' (2017) 28 International Company and Commercial Law Review 54; SH Goo, CK Low and P von Nessen 'The Statutory Derivative Action: Now Showing Near You' [2008] Journal of Business Law 627; Z Zhao, 'A More Efficient Derivative Action System in China: Challenges and Opportunities through Corporate Governance Theory' (2013) 64 Northern Ireland Law Quarterly 233.

[75] A Hudson, 'BHS and the Reform of Company Law' (2016) 37 Company Lawyer 364.

[76] N Safari and M Gelter, 'British Home Stores Collapse: The Case for an Employee Derivative Claim' (2019) 19 Journal of Corporate Law Studies 43.

As such, it is reasonable to infer that it is seen as meeting its objectives – or at least contains sufficient potential to meet its objectives that it should be accepted generally and adjusted where required.

B. Unfair prejudice

The second ostensible UK minority shareholder protection mechanism is the statutory ability to obtain recourse if the company has been run in a manner unfairly prejudicial to a shareholder's interests.[77] Whilst the derivative claim is a remedy for the company, the unfair prejudice petition is a personal remedy for the wronged shareholder.[78] The remedy originated in the Cohen Report of 1945, which recommended that, given risks identified earlier, the court should have the general power to grant whatever remedy it saw fit to solve minority oppression.[79] The first attempt to implement this[80] was considered overly restrictive given uncertainty as to what qualified as oppression and so of limited use to minority shareholders.[81]

This 'perceived inadequacy'[82] was rectified in 1985, by allowing a member to apply to the court if the company's affairs were 'conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members'.[83] This change was considered to 'accord significant protection for the interests of minority shareholders'.[84] However, it arguably provided too broad a jurisdiction, as it became difficult to identify unifying themes within the concept.[85]

The sprawling nature of the remedy was tamed[86] in the key case of *O'Neill v Phillips*.[87] Here, Lord Hoffman stated that the key test for unfairness was whether the conduct complained of 'would be contrary to what the

[77]Companies Act 2006, s 994.

[78]See B Hannigan, 'Drawing Boundaries between Derivative Claims and Unfairly Prejudicial Petitions' [2009] Journal of Business Law 606.

[79]Report of the Committee on Company Law Amendment 1945 (Cmd. 6659) para 60.

[80]Companies Act 1948, s 210.

[81]This was primarily due to the complex interaction with the company's constitution and that the remedy was only available if the court could wind the company up, but the facts meant an alternative remedy should be preferred (Companies Act 1948, s 210(2)(b)). See discussion in H Rajak, 'The Oppression of Minority Shareholders' (1972) 35 Modern Law Review 156; KW Wedderburn, 'Oppression of Minority Shareholders' (1966) 26 Modern Law Review 321; LS Sealy, 'Company Law – Protection of Minority Shareholders' (1976) 35 Cambridge Law Journal 235.

[82]C Riley, 'Contracting Out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts' (1992) 55 Modern Law Review 782, 792.

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

[84]DD Prentice, 'The Theory of the Firm: Minority Shareholder Oppression: Sections 459–461 of the Companies Act 1985' (1988) 8 Oxford Journal of Legal Studies 55, 91.

[85]DD Prentice, 'Protecting Minority Shareholder Interests: Recent Developments with Respect of Sections 459–461 of the Companies Act 1985', in D Feldman and F Meisel (eds), *Corporate and Commercial Law: Modern Developments* (Lloyds of London 1996) 79. For judicial exposition, see *Re A Company (No. 00314 of 1989)* [1990] BCC 221.

[86]R Goddard, 'Taming the Unfair Prejudice Remedy: Sections 459–461 of the Companies Act 1985 in the House of Lords' (1999) 58 Cambridge Law Journal 487.

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

parties, by words or conduct, have actually agreed. Would it conflict with promises they appear to have exchanged?'[88] This is not the only test – it also covered situations to which the minority could not be said to have agreed to.[89] There is thus a contractual aspect to the operation of unfair prejudice. Professor Cheffins has justified such a contractual approach, arguing that testing the remedy against the agreement of the shareholders is superior to mandatory applications of an objective test.[90]

Lord Hoffman also clarified that the remedy was only available if the wronged party had not received an offer to buyout their shares at a reasonable price.[91] His discussion of a reasonable offer was described as 'both imaginative and commercially sensible, and will go a long way to dealing with one of the worst shortcomings … namely their costs'.[92] It still left matters so broad, though, that shareholders could use the 1985 formulation to obtain recourse for the company,[93] thus leaving the remedy's ambit uncertain.

The general framework remains,[94] and generally follows the 1985 test.[95] Should the court agree, it can grant relief as it sees fit.[96] The remedy has bounds – there must be both unfairness and prejudice,[97] which avoids the floodgates being opened for any internal dispute to be advanced through the courts. The remedy is not intended to be a 'no-fault divorce'.[98] Nevertheless, unfairly prejudicial conduct based on loose underlying agreements has been held to have occurred where those in control of the company have excluded the minority from management,[99] delayed holding a meeting,[100] not paid dividends,[101] paid excessive remuneration,[102] made the company

[88]*O'Neill v Phillips* [1999] 1 WLR 1092, 1101.
[89]*O'Neill v Phillips* [1999] 1 WLR 1092, 1101.
[90]BR Cheffins, 'An Economic Analysis of the Oppression Remedy: Working towards a More Coherent Picture of Corporate Law' (1990) 40 University of Toronto Law Journal 775, 812.
[91]*O'Neill v Phillips* [1999] 1 WLR 1092, 1107.
[92]J Payne and DD Prentice, 'Section 459 of the Companies Act 1984 – the House of Lords' View' (1999) 115 Law Quarterly Review 587, 590.
[93]J Payne, 'Sections 459–461 Companies Act 1985 in Flux: the Future of Shareholder Protection' (2005) 64 Cambridge Law Journal 647. This is not inevitable and other jurisdictions navigate the divide between corporate remedy and personal remedy – see P Koh, 'The Oppression Remedy – Clarifications on Boundaries' (2015) 15 Journal of Corporate Law Studies 407.
[94]See R Goddard, 'The Unfair Prejudice Remedy' (2008) 12 Edinburgh Law Review 93.
[95]Companies Act 2006, s 994. This now includes someone to whom shares have been transferred – s 994 (2). Private action by another shareholder can also trigger the regime, but only to the extent that this can be adequately linked to the conduct of the company – eg *Re Kings Solutions Group Ltd* [2021] EWCA Civ 1943.
[96]Companies Act 2006, s 996(1).
[97]*Re Annacott Holdings Ltd* [2012] EWCA Civ 998. See E Lim, 'Unfair Prejudice and Judicial Ingenuity' (2013) 34 Company Lawyer 115.
[98]*O'Neill v Phillips* [1999] 1 WLR 1092, 1105.
[99]*O'Neill v Phillips* [1999] 1 WLR 1092, 1106–1109.
[100]*McGuiness v Bremner plc* 1988 SLT 891.
[101]*Re AMT Coffee Ltd* [2019] EWHC 46 (Ch).
[102]*Fowler v Gruber* [2010] 1 BCLC 563, [183]-[187].

undertake a rights issue that the majority knew the minority would not be able to afford,[103] and stacked the board with conflicted directors.[104]

The unfair prejudice regime thus is also perceived to help minority shareholders. It does so by providing the court with wide discretion as to the relief granted – one option being to provide a wronged minority shareholder with an exit at a then prevailing rate, thus remedying one of the principle reasons why the minority in a private company is at a disadvantage. This provides not only an exit, but a disciplinary function to deter wrongdoing against the minority. Any shareholder can petition in respect of unfair prejudice.[105] However, it is perceived to have the *effect* of protecting the minority,[106] not least because it is presumed that the majority would exercise their non-judicial company law powers,[107] rather than incurring court costs under this remedy.

Our conventional wisdom, then, is that minority shareholders require protections, and that UK law provides these two mechanisms to protect them. It thus ties in to the very contractarian analysis that company interactions are best analysed by a series of bilateral relationships that run through the company. In this conventional narrative, there is no place for the company: instead, there is a wronged party and a wrongdoer. For unfair prejudice, the wronged party is the minority shareholder and the wrongdoer is normally the majority. For derivative claims, the wrongdoer is a director, and the wronged party is the minority shareholder who is excluded from obtaining their indirect portion of redress for such wrong. These remedies thus appear to be bilateral and support a contractarian viewpoint: the company is merely the conduit through which such connections flow.[108] The conventional wisdom reflects such contractarian analysis by focusing on individuals who reflect certain constituencies within the company, rather than the company itself. It also reinforces it, by focusing on shareholder petitioners rather than the company. The company, and company law as a result, is thus at best a mere vehicle for contracting through,[109] and at worse irrelevant or trivial.[110]

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[103] *Re Cumana* [1986] BCLC 430.

[104] *Whyte, Petitioner* (1984) 1 BCC 99044.

[105] Companies Act 2006, s 994.

[106] 'Controlling shareholders are not in terms excluded from using the section, although normally any prejudice they suffer will be remediable through the use of the ordinary powers they possess by virtue of their controlling position, and so the conduct of the minority cannot be said in such a case to be *unfairly* prejudicial to the controllers. Section 994 thus operates primarily as a mechanism for minority protection' – PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 14-012.

[107] Eg to remove directors – Companies Act 2006, s 168 – and thus shape the board in a manner less likely to continue the complained of action.

[108] Either as the nexus of contracts – MC Jensen and WH Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure' (1976) 3 Journal of Financial Economics 305 – or as a nexus *for* contracts – R Kraakman and others, *The Anatomy of Corporate Law* (3rd edn, OUP 2017) at 5. See also J Hardman, 'The Nexus of Contracts Revisited: Delineating the Business, the Firm and the Legal Entity' (2022) 34 Bond Law Review 1.

[109] Eg MA Eisenberg, 'The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm' (1999) 24 Journal of Corporation Law 819.

3. The conundrum of minority protection mechanisms

Yet a tension exists. Minority protection mechanisms are actually quite weak at protecting the minority. Empirically, very few derivative claims take place in the UK,[111] or under equivalent jurisdictions.[112] Unfair prejudice has been stridently criticised. Four main critiques of the mechanisms are advanced. First, that the hurdles attached to the remedies are too high to provide meaningful relief. Derivative claims have high evidential burdens for shareholders to be able to proceed,[113] reducing their disciplinary function. The two-step process required is uncertain and too high a bar to make it an effective deterrence against misbehaviour.[114] Courts restrict access to derivative claims, in ways which are not always coherent with each other, creating uncertainty as to when this remedy will actually be available.[115] Whilst derivative claims may protect against some of the most blatant and egregious wrongs, it is possible that the high hurdles deter those pursuing such blatant wrongs from commencing the litigation in the first place. As a result, derivative claims cannot be said to provide general protection to the minority.

Similar issues affect unfair prejudice. Efforts to avoid a no-fault divorce require a breach of either a positive agreement or action egregious to the general spirit of agreement. The relief may be available in other situations, but clarity as to them is lacking.[116] Thus paradigmatic unfair prejudice occurs upon breach by the wrongdoer of an overt or tacit agreement. To meet this hurdle, the minority must incur the time and cost of negotiating the agreement in the first place.[117] This just offsets one agency cost – residual loss – by the need to incur another agency cost,

[110]Eg BS Black, 'Is Corporate Law Trivial: A Political and Economic Analysis' (1989–1990) 84 Northwestern University Law Review 542.

[111]D Gibbs-Kneller and C Ogbonnaya, 'Empirical Analysis of the Statutory Derivative Claim: De Facto Application and the Sine Quibus Non' (2019) 19 Journal of Corporate Law Studies 303; A Keay, 'Assessing and Rethinking the Statutory Scheme for Derivative Actions under the Companies Act 2006' (2016) 16 Journal of Corporate Law Studies 39.

[112]See SS Tang, 'The Anatomy of Singapore's Statutory Derivative Action: Why do Shareholders Sue – or Not?' (2020) 20 Journal of Corporate Law Studies 327; IM Ramsay and BB Saunders, 'Litigation by Shareholders and Directors: An Empirical Study of the Australian Statutory Derivative Action' (2006) 6 Journal of Corporate Law Studies 397.

[113]D Gibbs-Kneller and D Gindis, '*De jure* Convergence, *de facto* Divergence: A Comparison of Factual Implementation of Shareholder Derivative Suit Enforcement in the United States and the United Kingdom' (2019) 30 European Business Law Review 909.

[114]J Tang, 'Shareholder Remedies: Demise of the Derivative Claim?' (2012) 1 UCL Journal of Law and Jurisprudence 178; Q Jailani, 'Derivative Claims under the Companies Act 2006: In Need of Reform?' (2018) 7 UCL Journal of Law and Jurisprudence 72.

[115]A Keay and J Loughrey, 'Derivative Proceedings in a Brave New World for Company Management and Shareholders' [2010] Journal of Business Law 151.

[116]PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 14-023.

[117]J Hardman, 'The Plight of the UK Private Company Minority Shareholder' (2022) 33 European Business Law Review 87, 96–98.

bonding costs.[118] The remedy can also be triggered where the majority act in a way that the minority could not be said to have agreed to,[119] however it is very difficult to succeed under such heading.[120] Similarly, the contractual nature of the remedy means that it is possible for the majority and minority to agree to contract out of the provisions, for example by an arbitration agreement.[121] Thus not only do the minority normally need to incur costs and expenses to establish agreement in order to be protected, such protection can be removed by contractual agreement. The remedy is most likely to be required where the bargaining disparity between the majority and the minority is greatest.[122] Reliance on contractual resolution is flawed when the party with potential to abuse has a stronger bargaining position: the stronger party will likely push for opt-out.[123] As a result, such a contractual approach involves 'conceptual difficulties and internal contradictions in its explanation of unfair prejudice'.[124] For our purposes, it means that the hurdles to access the unfair prejudice remedy, too, are too high to adequately protect the minority.

Second, both ostensible remedies place misguided focus on the conduct of the wronged party. Requirements that the party commencing the derivative claim does so in good faith[125] puts 'impossible' demands on them.[126] Such requirements should be unnecessary from the conventional wisdom standpoint – if wrong has been done, then the activities of the wrongdoer should be key. Similar issues affect unfair prejudice. Thus if the minority has acquiesced[127]

[118]As such, incurring an ex ante bonding cost is often seen as a way to mitigate ex post residual loss – OE Williamson, 'Corporate Finance and Corporate Governance' (1988) 63 The Journal of Finance 567, 572.

[119]*O'Neill v Phillips* [1999] 1 WLR 1092, 1101.

[120]See *George v McCarthy* [2019] EWHC 2939 (Ch). Gower's Company Law states, after citing this case on the relevance of an agreement, that '[p]robably for this reason alone, no further clearly defined categories of unfair prejudice can be found in the authorities, although isolated instances exist' – PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 14-023.

[121]This occurred in *Fulham Football Club (1987) Ltd v Richards* [2011] EWCA Civ 855. The implications of this on the protective function of the framework is aptly put in H McVea, 'Section 994 of the Companies Act 2006 and the Primacy of Contract' (2012) 75 Modern Law Review 1123. For an arbitration perspective, see P Jorgensen, 'Unfair Prejudice in the United Kingdom: An Inalienable Right for Shareholders Comes to an End as Courts Resolve Split between *Exeter* and *Vocam*' (2012) 4 Arbitration Law Review 316.

[122]The comparative strength of other shareholders will dictate how far they are able to prevent wrongdoers – see V Atanasov, BS Black and CS Ciccotello 'Law and Tunnelling' (2011) 37 Journal of Corporation Law 1, 38. On the legal need to restrain controlling shareholders, see RJ Gilson and JN Gordon, 'Controlling Controlling Shareholders' (2003) 153 University of Pennsylvania Law Review 785.

[123]A Choi and G Triantis, 'The Effect of Bargaining Power on Contract Design' (2012) 98 Virginia Law Review 1665; D Kennedy, 'Form and Substance in Private Law Adjudication' (1976) 89 Harvard Law Review 1685; M Galanter, 'Why the "Haves" Come out Ahead: Speculations on the Limits of Legal Change' (1974) 9 Law & Society Review 95.

[124]P Paterson, 'A Criticism of the Contractual Approach to Unfair Prejudice' (2006) 27 Company Lawyer 204, 215.

[125]Companies Act 2006, s 263(3)(a).

[126]SS Tang, 'Corporate Avengers Need Not be Angels: Rethinking Good Faith in the Derivative Action' (2016) 16 Journal of Corporate Law Studies 471, 471.

[127]*Re Hardy Estates Ltd* [2014] EWHC 4001 (Ch).

or consented to[128] the wrongdoing, they cannot continue the claim. As such in both remedies we have an unnecessarily high burden against wrongdoing arising from a flawed focus on the activities of the wronged. This means that their ability to truly protect the minority is limited.

Third, the costs of both are uncertain. Unfair prejudice costs follow usual court costs requirements – thus the claimant will receive their costs if they win.[129] It is difficult to know this in advance. This further deters raising actions. We noted above that derivative actions do typically result in cost orders requiring the company to pay for the action. These, however, are of limited help. In addition to the court being keen, as noted above, to avoid preferring one party, and taking the costs to the company into account when deciding whether to allow the claim, there is a major time delay in obtaining such an order.[130] Orders for costs follow the decision to commence litigation, meaning that they mitigate expenses incurred rather than act as an incentive to commence litigation.[131] The two step process links the ability to proceed to the awarding of costs, so a claimant's costs are not covered if the court does not allow the claim to continue.[132] More generally, the court exercises discretion as to whether to grant such an order in the first place,[133] and this discretion generally operates on the basis of financial need.[134]

As such, it has been argued that there should be public funding of derivative claims[135] as the deterrence caused by the derivative claim provides a positive externality.[136] The availability of a derivative claim in one company will deter another company's directors from wrongdoing. Such ex ante deterrence, though, is not easy to measure.[137] The neatest argument is that deterrence is clearly linked to the chance of success – the higher the threat of

[128] *Jesner v Jarrad Properties Ltd* [1992] BCC 807.

[129] For cost orders in the context of unfair prejudice, see A Reisberg, 'Indemnity Costs Orders under s.459 Petition?' (2004) 25 Company Lawyer 116. For a more recent overview of issues in respect of the awarding of costs, see M Ahmen, 'Bridging the Gap between Alternative Dispute Resolution and Robust Adverse Cost Orders' (2015) 66 Northern Ireland Legal Quarterly 71.

[130] A Reisberg, 'Funding Derivative Actions: A Re-Examination of Costs and Fees as Incentives to Commence Litigation' (2004) 4 Journal of Corporate Law Studies 345, 353.

[131] ibid 355.

[132] ibid 357.

[133] ibid 359. For current rules, see Civil Procedure Rules 1998 (SI 1998/3132) (as amended) r 19.19 – '[t]he court *may* order the company, body corporate or trade union the benefit of which a derivative claim is brought to indemnify the claimant against liability for costs incurred in the permission application or in the derivative claim or both' [emphasis added to demonstrate the court's discretion].

[134] ibid 360.

[135] A Reisberg, 'Access to Justice or Justice Not Accessed: Is There a Case for Public Funding of Derivative Claims?' (2012) 37 Brooklyn Journal of International Law 1022.

[136] Positive externalities are when the actions of parties have a positive effect on others – examples have been given of a lighthouse – H Sidgwick, *The Principles of Political Economy* (3rd edn, MacMillan 1901) 406; advantages of cross-fertilisation in nature between bees and orchards – JE Meade, 'External Economies and Diseconomies in a Competitive Situation' (1952) 62 The Economic Journal 54; and network advantages – ML Katz and C Shapiro, 'Network Externalities, Competition and Compatibility' (1985) 75 American Economic Review 424.

[137] Q Curtis, 'Information and Deterrence in Shareholder Derivative Litigation' (2021) 23 American Law and Economics Review 395.

liability, the greater the deterrence.[138] Thus positive externalities are reduced by high hurdles for access and uncertainty as to costs. For our purposes, the protective function of both of the UK's ostensible minority protection remedies is reduced by cost uncertainties.

Fourth, the relief provided by both remedies is unsatisfactory for minority shareholders. For derivative claims, any relief comes to the company.[139] As such, they are very unpopular. As Payne puts it, '[i]n small private companies it is difficult to see why a derivative action will ever be used again'.[140] This has resulted in the argument that the derivative claim is an 'outmoded superfluousness'.[141] Each shareholder only enjoys an indirect proportion of any successful recovery, further disincentivising them from commencing the claim. This further undermines the notion that the derivative action works in any way to protect minority shareholders.

Parallel issues affect unfair prejudice. Despite the wide discretion given to the court, their preferred option is to order the buyout of the minority's shares.[142] Emphasis on buyout as a remedy is evident – Lord Hoffman stated that relief would not be granted where a reasonable offer had been made to buy the wronged party's shares.[143] This minimises litigation.[144] The court's order may not be the remedy sought by the wronged shareholder.[145] Accordingly, the minority can lose out, even on a buyout.[146] The buyout remedy provides a final exit, which is not perfect if there are differences in expectation in respect of the future financial performance of the company.[147] Court orders can also require the minority to purchase the

[138]A Reisberg, 'Shareholders' Remedies: The Choice of Objectives and Social Meaning of Derivative Actions' (2005) 6 European Business Organization Law Review 227, 255–58.

[139]Companies Act 2006, s 260(1)(b).

[140]J Payne, 'Shareholders' Remedies Reassessed' (2004) 67 Modern Law Review 500, 501. Of course, as Payne goes on to note, the derivative claim will remain important where the unfair prejudice regime is unavailable – see discussion in J Payne, 'Section 459 and Public Companies' (1999) 115 Law Quarterly Review 368. Whilst these articles predate the current regime, the point they evidence remains the same under the current regime.

[141]AM Gray, 'The Statutory Derivative Claim: an Outmoded Superfluousness?' (2012) 33 Company Lawyer 295.

[142]AK Koh, 'Shareholder Withdrawal in Close Corporations: An Anglo-German Comparative Analysis' (2022) 22 Journal of Corporate Law Studies 197, 214–15.

[143]'But the unfairness does not lie in the exclusion alone but in exclusion without a reasonable offer. If the respondent to a petition has plainly made a reasonable offer, then the exclusion as such will not be unfairly prejudicial and he will be entitled to have the petition struck out'. – *O'Neill v Phillips* [1999] 1 WLR 1092, 1107 per Lord Hoffman.

[144]See discussion in SK Miller, 'How Should UK and US Minority Shareholder Remedies for Unfairly Prejudicial or Oppressive Conduct be Reformed?' (1999) 36 American Business Law Journal 579.

[145]The remedy remains discretionary, and the 'petitioner must still convince the court that it is fit to make an order granting the relief which he seeks' – *Antoniades v Wong* [1998] BCC 58, 63 per Mummery LJ.

[146]For example, if articles set out 'bad leaver' provisions governing the purchase of shares – see *Re Braid Group (Holdings) Ltd* [2016] CSIH 68.

[147]Some guidance is available – *Profinance Ltd SA v Gladstone* [2002] 1 WLR 1024, but this does nothing to resolve underlying heterogenous expectations in respect of the company's performance, which often need the skills of lawyers to resolve – see RJ Gilson, 'Value Creation by Business Lawyers: Legal Skills and Asset Pricing' (1984) 94 Yale Law Journal 239.

majority's shares, providing a wronged shareholder with a financial outlay to the wrongdoer.[148]

Lord Hoffman reduced access to the remedy by limiting it to absence of a reasonable offer to buy shares. He outlined the paradigmatic perfect way in which a reasonable offer can be made. However, he did not outline general rules to differentiate reasonable from unreasonable offers. As such, the edges of what makes a reasonable offer remain very uncertain.[149] This thus provides a further hurdle to the wronged party in the standard case: they have to prove that conduct breached prior informal agreement, that they did not agree to the conduct, and that any offer they have received was unreasonable. Buyout mechanics are thus rather complicated,[150] with a myriad of issues of valuation to navigate.[151] Accordingly, the operation of the unfair prejudice remedy cannot be said to be particularly effective at protecting minority shareholders.

The statutory derivative claim is seen as an improvement for the minority than the old common law rules.[152] However, it is not particularly good at protecting minority shareholders.[153] Similarly, the unfair prejudice remedy provides scant relief to a wronged minority shareholder. The combinations of high hurdles to access the remedy, the focus on the conduct of the parties, high costs which may not be reimbursed, and weak remedies means that these ostensible minority shareholder protections do not act to protect minority shareholders. This creates a conundrum: commentators consider these mechanisms protect minority shareholders, yet the operation of the rules means that they are very bad at fulfilling this role.[154]

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[148]Eg *Re Brenfield Squash Racquet Club Ltd* [1996] 2 BCLC 184 Ch D. Here, though, this was the requested remedy.

[149]See analysis in A Pavlovich, '"Reasonable Offers" as a Defence to Unfair Prejudice Petitions: *Prescott v Potamianos*' (2020) 83 Modern Law Review 443.

[150]See V Joffe and others, *Minority Shareholders: Law, Practice and* Procedure (6th edn, OUP 2018) ch 7. This goes beyond an issue of UK law – any form of buyout is quite complicated – see C Veziroğlu, 'Buy-Out of the Oppressed Minority's Shares in Joint Stock Companies: A Comparative Analysis of Turkish, Swiss and English Law' (2018) 19 European Business Organization Law Review 527; AK Koh, 'Shareholder Withdrawal in Close Corporations: An Anglo-German Comparative Analysis' (2022) 22 Journal of Corporate Law Studies 197.

[151]For example, is it appropriate to apply a discount to the minority's shareholding because it is a minority stake? The general rule seems to be that there can be no discount where there is no quasi partnership – see *CVC/Opportunity Equity Partners Ltd v Demarco Almeida* [2002] BCC 684, [41]. However, the no discount rule is not absolute – see *Phoenix Office Supplies Ltd v Larvin* [2002] EWCA Civ 1740, [28]–[34]. A different approach altogether, that a discount can only be applied where shares were purchased at a discount, has also been advanced in *Re Blue Index Ltd* [2014] EWHC 2680, [21]–[29], [34]–[38] and [48]–[51]. This demonstrates merely one small complication to be navigated prior to obtaining relief.

[152]M Almadani, 'Derivative Actions: Does the Companies Act 2006 Offer a Way Forward?' (2009) 30 Company Lawyer 131.

[153]D Gibbs, 'Has the Statutory Derivative Claim Fulfilled Its Objectives? The Hypothetical Director and CSR: Part 2' (2011) 32 Company Lawyer 76.

[154]EC Mujih, 'The New Statutory Derivative Claim: A Paradox of Minority Shareholder Protection: Part 2' (2012) 33 Company Lawyer 99.

4. Resolving the conundrum: an institutional analysis

A. Institutional analysis

The foregoing can be resolved if we consider matters from an institutional perspective. Such analysis involves acknowledging that when humans agree to act as a group, they sacrifice individual freedom and autonomy to protect that group.[155] Law actively facilitates the exchange of personal rights for participation rights within a wider group context.[156] An institutional analysis, then, ultimately involves reviewing the issue of minority protection mechanisms not from the perspective of the individual minority shareholders' rights, or even the rights of minority shareholders as a whole, but instead from the perspective of the institution of the company. We can thus shift the analysis of these mechanisms away from providing individual rights to shareholders, towards buttressing the collective endeavour that is embodied in the company.

To build the case for an institutional analysis of these mechanisms, we must first discuss what an institution is. North argued that '[i]nstitutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights)'.[157] Institutions can thus be thought of in a number of ways. Accordingly, they have an indeterminacy that is important to understand as it undermines the concept of an uncontroversial universal and definitive 'institutional analysis', but does develop a number of themes that we use in this article. First, institutions are sometimes thought of as the rules of the game.[158] These rules provide social acceptance for this group behaviour.[159] Under such analysis, the company is the institution under which group behaviour operates. As such, under such analysis it is usual for the firm itself to be considered as an institution.[160] The company, after all, filters those interacting with it into various different capacities (eg

[155]On group dynamics, see P French, 'The Corporation as a Moral Person' (1979) 16 American Philosophical Quarterly 207; P French, 'Types of Collectivities and Blame' (1975) 56 The Personalist 160.

[156]As Frank put it: 'men lose their individual freedom in an organization and assume rights and obligations peculiar to the group, and the group's task, and their various dealings are as one group member to the group, rather than as a person to a person' – LK Frank, 'Institutional Analysis of the Law' (1924) 24 Columbia Law Review 480, 490.

[157]DC North, 'Institutions' (1991) 5 Journal of Economic Perspective 97.

[158]This is the traditional view – see GM Hodgson, 'What are Institutions?' (2006) 40 Journal of Economic Issues 1; DC North, *Institutions, Institutional Change and Economic Performance* (CUP 1990) 3–4; T Parsons, 'The Place of Ultimate Values in Sociological Theory' (1935) 45 International Journal of Ethics 282, 299.

[159]JR Searle, 'What is an Institution?' (2005) 1 Journal of Institutional Economics 1.

[160]See GM Hodgson, 'What are Institutions?' (2006) 40 Journal of Economic Issues 1, 2; SS Klammer and EA Scorsone, *The Legal Foundations of Micro-Institutional Performance: A Heterodox Law & Economics Approach* (Elgar 2022) 11–15; GM Hodgson, 'Taxonomic Definitions in Social Science, with Firms, Markets and Institutions as Case Studies' (2019) 15 Journal of Institutional Economics 207.

shareholders, directors, employees). It then provides the various rights and obligations that each capacity has in respect of the joint endeavour.[161]

Second, institutions can be understood as equilibria achieved under a set of rules – the norms arising thereunder and the repeated plays of players under the game.[162] Here, then, law has a role in endowing parties with certain rights and thus influencing the equilibrium.[163] This then would define each company as an institution as it is the repeated play under the rules of the game. Third, it has been argued that institutions are best understood as a hybrid of the two approaches – that an institution is both the established rules and the equilibrium achieved under it.[164] We do not need to explore which of these is correct. Whilst the differences between the three matter for economic analysis, a number of themes run through all three.[165] Under all three approaches, the company is an institution. It can therefore be the subject of analysis – we can reconceptualise ostensible minority shareholder protections from the perspective of the institution of the company.[166]

We can add some clarity in differentiating between institutional environments and institutional arrangements.[167] The former is the environment in which certain decisions are taken, and the latter are the specific arrangements made against the backdrop of such environment. The former reflects underlying rules that allow the organisation of individuals, and the latter are specific arrangements entered into under this environment.[168] Both fall within the wider category of an 'institution'. For our purpose, we could consider company law itself to be a key part of the institutional environment against which the operation of companies occurs. This would make companies themselves the institutional arrangements entered into within such institutional environment. Such an approach allows both company law and the company to fall into the wider institutional analysis: we can refer to the

[161]For example, articles of association set the balance of power between shareholders and directors – SM Watson, 'The Significance of the Source of the Powers of Boards of Directors in UK Company Law' [2011] Journal of Business Law 597.

[162]See RL Calvert, 'Rational Actors, Equilibrium, and Social Institutions' in J Knight and I Sened (eds), *Explaining Social Institutions* (University of Michigan Press 1998).

[163]H Gintis, 'The Evolution of Private Property' (2006) 64 Journal of Economic Behaviour & Organization 1.

[164]F Hindriks and F Guala, 'Institutions, Rules and Equilibria: A Unified Theory' (2015) 11 Journal of Institutional Economics 459. For a critique of this approach, see GM Hodgson, 'On Defining Institutions: Rules *Versus* Equilibria' (2015) 11 Journal of Institutional Economics 497.

[165]SES Crawford and E Ostrom, 'A Grammar of Institutions' (1995) 89 American Political Science Review 582; M-L Djelic, 'Institutional Perspectives – Working towards Coherence or Irreconcilably Diversity?' in G Morgan, JL Campbell, C Crouch, OK Pederson and R Whitley (eds), *The Oxford Handbook of Comparative Institutional Analysis* (OUP 2010).

[166]This provides evident parallels to the analysis of separate legal personality, which ultimately conceptualises the legal person as merely the subject of rights and duties – see J Dewey, 'The Historic Background of Corporate Legal Personality' (1926) 35 Yale Law Journal 655.

[167]See OE Williamson, 'The New Institutional Economics: Taking Stock, Looking Ahead' (2000) 38 Journal of Economic Literature 595.

[168]See DC North, *Institutions, Institutional Change and Economic Performance* (CUP 1990) 24.

institution of 'company law', and also to the institution of each 'company'. We use institution in this article for stylistic purposes, but this is shorthand: the analysis in this article is focused on the institutional arrangement of the company unless otherwise highlighted.

Each definition of institution discusses the notion of 'rules', which provides space for law in an institutional analysis. Legal rules themselves have been identified as one of the few objective methods in which institutions can be measured.[169] Law is important in the development of institutions (under any definition).[170] This is particularly important in respect of business entities – where the business activity itself requires some form of legal means through which to undertake the activity.[171] This is evident in the case of the company, which only exists because law provides a legal form, established by the state, known as a company.[172] It has been argued that corporate law is best understood as providing a series of property rights – provided both to law's new person and in respect of that person.[173] As such, corporate law could be seen as, effectively, facilitating the lock in of capital into an autonomous corporate fund.[174]

Any attempt to focus on this fund – the core of the institutional arrangement that is the company – is thus an institutional analysis.[175] Other versions of institutional analysis are of course possible, but throughout this article when we refer to an institutional analysis, we mean one that foregrounds the legal institution of the company, rather than looks through the company to identify those behind it and their relationships.

Those seeking to invest in a business entity must choose the type of form that they invest in.[176] They must also choose the form of investment that they make. They could invest by way of debt, which would give them certain protections from the law of debt.[177] These protections would be further enhanced should security be granted in respect of such debt.[178] Becoming

[169] S Voigt, 'How (Not) to Measure Institutions' (2013) 9 Journal of Institutional Economics 1.

[170] GM Hodgson, 'Much of the "Economics of Property Rights" Devalues Property and Legal Rights' (2015) 11 Journal of Institutional Economics 683. Law also constitutes institutions – see N MacCormick, *Institutions of Law: An Essay in Legal Theory* (OUP 2007) ch 2. Law, of course, also has its own institutions, and various elements of the legal taxonomy also have their own institutions.

[171] S Deakin and others, 'Legal Institutionalism: Capitalism and the Constitutive Role of Law' (2017) 45 Journal of Comparative Economics 188; S Deakin, D Gindis and GM Hodgson, 'What is a Firm? A Reply to Jean-Philippe Robé' (2021) 17 Journal of Institutional Economics 861.

[172] SM Watson, 'The Corporate Legal Person' (2019) 19 Journal of Corporate Law Studies 137.

[173] J Armour and MJ Whincop, 'The Proprietary Foundations of Corporate Law' (2007) 27 Oxford Journal of Legal Studies 429; MM Blair, 'The Neglected Benefits of the Corporate Form: Entity Status and the Separation of Asset Ownership from Control' in A Grandori (ed), *Corporate Governance and Firm Organization: Microfoundations and Structural Forms* (OUP 2004).

[174] SM Watson, 'The Corporate Legal Entity as a Fund' [2018] Journal of Business Law 467.

[175] For example, by arguing that overall company value is detached from pure shareholder value – see JE Fisch, 'Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy' (2006) 31 Journal of Corporation Law 637.

[176] See EF Fama and MC Jensen, 'Organizational Forms and Investment Decisions' (1985) 14 Journal of Financial Economics 101; OE Williamson, 'Comparative Economic Organization: The Analysis of Discrete Structural Alternatives' (1991) 36 Administrative Science Quarterly 269.

a shareholder involves foregoing these rights in respect of the relevant investment,[179] and in most jurisdictions (including the UK) locking in such investment.[180] Shareholders decide to do so.[181] They do so because they obtain the residual claim of the joint investment[182] – they sacrifice direct rights in exchange for future returns.[183] Their present rights are limited,[184] to protect the institution of the company from shareholders making short term decisions to the detriment of the institution. This institutional analysis goes beyond a purely theoretical approach, then, to reflect the reality of corporate law. From such perspective, corporate law acts to protect the joint vehicle from actions of individual shareholders which could undermine the success of the vehicle.

Our institutional analysis thus explores matters from the perspective of the segregated corporate fund of the company, and how best to protect this corporate fund. It therefore focuses on the company as the owner of property, rather than being the mere object of property;[185] as an autonomous social phenomenon rather than a private contract.[186] Protections for minority shareholders are not usually analysed through this lens.[187] In other contexts it is common to undertake a comparative institutional analysis to compare as between institutions.[188] This is implicit in our analysis – that the institutional conception offered by this article is better than the contractual institutional perspective that is dominant in corporate law analysis. However, the intention here is less to be directly comparative, and more to merely build an

[177]Eg the right to obtain repayment – see E McKendrick, *Goode and McKendrick on Commercial Law* (6th edn, Penguin 2020) para 22.05.

[178]TH Jackson and AT Kronman, 'Secured Financing and Priorities Among Creditors' (1979) 88 Yale Law Journal 1143.

[179]AK Sundaram and AC Inkpen, 'The Corporate Objective Revisited' (2004) 15 Organization Science 350.

[180]See discussion in AK Koh, 'Shareholder Protection in Close Corporations and the Curious Case of Japan: The Enigmatic Past and Present of Withdrawal in a Leading Economy' (2021) 53 Vanderbilt Law Review 1207.

[181]FH Easterbrook and DR Fischel, 'Close Corporations and Agency Costs' (1985) 38 Stanford Law Review 271, 301.

[182]SM Bainbridge, 'In Defense of the Shareholder Wealth Maximisation Norm: A Response to Professor Green' (1993) 50 Washington and Lee Law Review 1423.

[183]LA Stout, 'Bad and Not-so-Bad Arguments for Shareholder Primacy' (2002) 75 Southern California Law Review 1189. The extent to which this creates an inherent conflict between the interests of shareholders and the company depends on your view of shareholders – see JG Hill, 'Good Activist/Bad Activist: The Rise of International Stewardship Codes' (2018) 41 Seattle University Law Review 497.

[184]Eg *Macaura v Northern Assurance Company, Limited* [1925] AC 619, 626–627.

[185]P Ireland, 'Corporate Schizophrenia: The Institutional Origins of Corporate Social Irresponsibility' in N Boeger and C Villiers (eds), *Shaping the Corporate Landscape* (Hart 2018).

[186]WT Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 Cardozo Law Review 261.

[187]For an archetypal analysis that links minority protection to a shareholder-focused narrative to the exclusion of the institution, see DG Smith, 'The Shareholder Primacy Norm' (1998) 23 Journal of Corporation Law 277, 310–22.

[188]Eg D Acemoglu and S Johnson, 'Unbundling Institutions' (2005) 113 Journal of Political Economy 949. For the use of such tools by lawyers, see SM Franken, 'Cross-Border Insolvency Law: A Comparative Institutional Analysis' (2014) 34 Oxford Journal of Legal Studies 97; DH Cole, 'The Varieties of Comparative Institutional Analysis' [2013] Wisconsin Law Review 383.

alternative conception for company law which centres on the institutional arrangement of the company.

B. Implications for ostensible minority protection mechanisms

From our institutional perspective law's primary objective is to protect such fund from the activities of those who may attempt to appropriate fund assets. This includes shareholders attempting to obtain recourse for wrongs done to them. Thus, from our institutional perspective, the key is protecting the institution from shareholders rather than protecting shareholders. This is a subtle shift in emphasis, and arises because the key part of forming a group is subordinating your personal interests to a wider group interest.[189] In company law, this is achieved by changing the capacity in which you hold rights:[190] rather than having a direct proprietary interest in the business assets, subscribers instead acquire personal rights against the new legal person.[191] Our institutional perspective is that the interests of the group – here, the company – should take precedent over the interests of any individual constituent.

From such an institutional perspective, the institution should prevail in the event of any clash between the interests of shareholders and the interests of the institution. Such interests will not always clash. This institutional analysis will produce the same outcome as traditional shareholder-centric approaches so long as there is no clash between the interests of the two. This primarily arises in two situations. First, so long as the interests of the shareholder and the institution align – for example to grow the overall value of the institution[192] – then there will be no difference between traditional shareholder-centric narratives and institutional accounts. Directors are meant to take into account the interests of all shareholders, including minority shareholders, when acting in the best interests of the company.[193] As such, in a large number of situations there will be no conflict between the interests of minority shareholders and the company. Second, the same is true where shareholders can enforce their rights without affecting the rights of the

[189] LK Frank, 'Institutional Analysis of the Law' (1924) 24 Columbia Law Review 480.

[190] The 'mysterious rite of incorporation' (EM Dodd, 'For whom are corporate managers trustees' (1932) 45 Harvard Law Review 1145, 1160) results in shareholders exchanging the rights they would have as owners or creditors for a new, prescribed set of rights as a 'shareholder' – Companies Act 2006, s 16(2).

[191] This legal person is thus subject and object of legal rights – K Iwai, 'Persons, Things and Corporation: The Corporate Personality Controversy and Comparative Corporate Governance' (1999) 47 American Journal of Comparative Law 583.

[192] Eg restraining self-interested behaviour by management through internal corporate procedural channels – LA Bebchuk, 'The Case for Increasing Shareholder Power' (2005) 118 Harvard Law Review 833.

[193] Companies Act 2006, s 172. For the extent to which this is effective, see A Keay, 'Moving Towards Stakeholderism – Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado about Little' (2011) 22 European Business Law Review 1; A Keay and T Iqbal, 'The Impact of Enlightened Shareholder Value' [2019] Journal of Business Law 304.

institution.[194] However, if there is a clash between the rights of the two, and shareholders enforcing their rights challenge the interests of the institution, then the interests of the latter should prevail. By acquiring shares in a company, you exchange the rights that you could have as creditor for a different set of rights. That includes the right to participate (eventually) in the financial growth of the company.[195] With this exchange comes the subordinating of personal interests to group interests if those interests clash.

The ostensible minority protection mechanisms discussed above inherently create costs for the company. Direct costs are discussed above. Of bigger cost, though, is the indirect cost to the company of the diversion of corporate time and interests away from usual corporate activity. The company is a party to any derivative claim,[196] and must provide evidence if requested by the court.[197] Unfair prejudice claims are only applicable if the complaint relates to how the company is being run.[198] It therefore follows that defending an unfair prejudice claim will take the time and resources of those who run that part of the company's activities.

Pursuing any claim on behalf of the company inevitably diverts corporate resources away from the core profit making activities of the business run by the company, even if the claim is started by a shareholder on behalf of the company. The application of both remedies, then, inevitably provides a disadvantage to the company. It is worth noting that such analysis places the interests of the company and shareholder in conflict any time that a shareholder attempts to assert a judicial right, unless the company's resources are not diverted at all. This implies that the analysis may extend beyond the two remedies identified, and be applicable to minority shareholder protections more broadly.

Benefits may exist for the institution of the company under either ostensible shareholder protection mechanism, through the receipt of funds through a derivative claim, or intangible improvement in governance through an unfair prejudice petition. However, such benefits are difficult to quantify in advance. In respect of derivative claims, it is a business decision to work out whether the subject matter of the claim is worth pursuing or not. Part

[194]See discussion by Lord Bingham in *Johnson v Gore Wood & Co* [2002] 2 AC 1, 35–36, which has been accepted in *Sevilleja v Marex Financial Ltd* [2020] UKSC 31, [89] per Lord Reed.

[195]This is often referred to as the 'residual claim' – see discussion in FH Easterbrook and DRR Fischel, 'Voting in Corporate Law' (1983) 26 Journal of Law and Economics 395.

[196]Civil Procedure Rules 1998 (SI 1998/3132) (as amended) r 19.14.

[197]Companies Act, s 261(3)(a). Whilst it is theoretically possible to include such time in damages calculation – eg *Aerospace Publishing Ltd v Thames Water Utilities Ltd* [2007] EWCA Civ 3 – this only applies if the claim is successful, and is fraught with quantification and proof challenges – P Hurst, *Civil Costs* (6th edn, Sweet & Maxwell 2018) para 20-031. Similarly, cost recoveries do not deal with the immediacy of particular staff time – it is likely to be less important that, for example, the costs of a temporary replacement finance director's time can be reimbursed later, than that the normal finance director be available to further the profit of the company at that particular time.

[198]*Re Kings Solutions Group Ltd* [2021] EWCA Civ 1943; *Graham v Every* [2014] EWCA Civ 191.

of subordinating personal interests to the interests of the institution lie in accepting the decision making processes inherent within such institution. In line with other business decisions,[199] this balance is best undertaken by those delegated the management of the company. From an institutional perspective, then, the court should only be able to allow such derivative claim when dominant individuals capture these processes to the detriment of the institution.[200] Unfair prejudice causes similar indirect costs to the institution. As noted above, company processes fall under the microscope in unfair prejudice cases, requiring input from the company. As the remedy for unfair prejudice is personal to the shareholder, there can be no financial upside for the company.

For both remedies, then, there are tangible downsides for the company in these remedies being triggered, and uncertain upsides. The company's position is strengthened by avoiding these claims, as then the tangible downsides are avoided. This places the interests of the company in conflict with the interest of individual shareholders, and accordingly the latter should be subordinated to the former. It should be noted that the downside of both remedies – the costs of the internal diversion of corporate resources – will occur regardless of the merits of the litigation. The higher the hurdles for litigation, the fewer claims are likely to be raised.[201] Conversely, the lower the hurdles of bringing action, the more action is likely to be brought, diverting more company resources away from maximising profit within the company.[202] Raising the hurdles for access to both claims thus reduces potential costs for the institution of the company. Our institutional analysis thus indicates that both rules should be difficult to invoke, as they provide costs to the company.

It is submitted that viewing minority protection rules through this lens resolves the conundrum outlined above in company law analysis. Most of the reasons that make the UK's minority shareholder protections weak from the perspective of the minority shareholder make them strong from the perspective of the institutional arrangement of the company.

Thus high hurdles for a shareholder to trigger ostensible UK minority protection mechanisms strengthen the company, by avoiding the diversion of

[199]See A Keay and J Loughrey, 'The Concept of Business Judgment' (2019) 39 Legal Studies 36; A Keay and others, 'Reviewing Directors' Business Judgements: Views from the Field' (2020) 47 Journal of Law and Society 639.

[200]See E Micheler, *Company Law: A Real Entity Theory* (OUP 2021), 29–32. See also J Armour, 'Derivative Actions: a Framework for Decisions' (2019) 135 Law Quarterly Review 412.

[201]There is a vast raft of literature on this point – see E Kamar, 'Shareholder Litigation under Indeterminate Corporate Law' (1999) 66 University of Chicago Law Review 887; R Kraakman, H Park and S Shavell, 'When are Shareholder Suits in Shareholder Interests?' (1994) 82 Georgetown Law Journal 1733; A Reisberg, *Derivative Actions and Corporate Governance* (OUP 2007), ch 6.

[202]See discussion in LA Hamermesh, 'A Most Adequate Response to Excessive Shareholder Litigation' (2016) 45 Hofstra Law Review 147; EPM Vermeulen and DA Zetzsche, 'The Use and Abuse of Investor Suits' (2010) 7 European Company and Financial Law Review 1.

resources away from the institutional objective. The number of hoops that a minority shareholder has to leap through to launch a derivative claim is helpful from the perspective of the company, as it means that the company only has to incur these costs when faced with the most egregious wrongdoing where wrongdoers retain control of the organs of the company.[203] Requiring high hurdles for derivative actions thus protects the institution. They enable the capture of some of the most egregious wrongdoing whilst filtering out less evident cases.[204] This reduces the risk that resources (assets and time) of the institution are diverted into disputes unless it is evident that the company will benefit from such use of resources. The requirements that there be some form of breach of agreement prior to the grant of relief for unfair prejudice have the same function: they allow certain egregious wrongs to be remedied, without dragging the court into review of corporate decisions that they would not normally be involved in.[205]

We do not argue that there is a direct relationship between cost level and filtering of 'good' and 'bad' claims. Differentiating between meritorious and frivolous claims is very difficult,[206] and higher hurdles cannot be said automatically to filter out the latter whilst still encouraging the former. The foregoing analysis implies that we should aim to minimise the claims advanced using these remedies, given known downsides and uncertain upsides place the interests of shareholders and the company in conflict when shareholders enforce personal rights that affect the company. That the remedies leave open potentially beneficial recoveries in the case of some of the most evident breaches provides some benefit and helps deter the most egregious of conduct. It thus has a form of disciplinary function. This disciplinary function is weakened by high hurdles to commence litigation. However, from the institutional perspective, this is secondary to the general deterrence of claims, as such general deterrence minimises leakage of resources away from the company's primary activities. If there is a hypothetical trade-off between the disciplinary function (maximised by low hurdles and easy access to the remedy) and minimising company resources being diverted (maximised by high hurdles and throttled access to the remedy), then institutional analysis tells us we should pick the latter.

[203] J Armour, 'Derivative Actions: a Framework for Decisions' (2019) 135 Law Quarterly Review 412.

[204] Whilst the legal profession should assist with this, rent-seeking behaviour by lawyers can undermine the filtering of the raising of frivolous claims – see JC Coffee, 'Rethinking the Class Action: A Policy Primer on Reform' (1987) 62 Indiana Law Journal 625.

[205] For exposition that a minority remedy with easier access requires more judicial oversight into business operations than exist under standard review, see DK Moll, 'Shareholder Oppression & Dividend Policy in the Close Corporation' (2003) 60 Washington & Lee Law Review 841 at 870. See also DK Moll, 'Minority Oppression & (and) the Limited Liability Company: Learning (Or Not) from Close Corporation History' (2005) 40 Wake Forest Law Review 883.

[206] Eg see EPM Vermeulen and DA Zetzsche, 'The Use and Abuse of Investor Suits' (2010) 7 European Company and Financial Law Review 1.

The focus on the conduct of claimants also becomes evident when viewed from the company's perspective, where it is important that claimants are commencing claims for the right reasons, helping to filter out apparently frivolous claims. There is a risk that disgruntled minority shareholders could be so determined to obtain redress that the company becomes accidental collateral damage in disputes. This could occur by the minority trying to end the life of a viable company, or simply being so determined to damage the majority's interests that they also damage the company, for example by public disclosure that could harm the company. The company, then, has an interest in filtering out such claims, by ensuring that those raising claims under these headings acting in good faith when doing so. This applies equally to both remedies. A similar logic applies in respect of uncertainty of costs – it is in a company's interests for these protections to not become seen as a 'free' ability for a minority to use the company's resources to pay for legal disputes. Thus, once again, from the company's perspective, uncertainty as to fees reduces the risk that the minority will not abuse the remedy, and that the company's resources will only be utilised where company decision making processes have been compromised. Thus the fact that the cost mechanics under both remedies deter minority actions is a benefit from the perspective of the company. Both remedies require expenditure of company costs, which are unlikely to be recoverable.[207] The current rules in respect of costs help ensure that the company does not always underwrite every claim raised by any disgruntled shareholder.

The biggest evident benefit of such an institutional analysis lies in exploration of remedies. For the derivative action, relief comes to the company. Thus the company directly benefits from any relief so granted. Once more, the same feature that appeared a weakness under the traditional analysis of shareholder protection is a strength under this institutional analysis. The same is true for remedies under unfair prejudice, which mostly ignore the company. The court's preferred remedy is to have shares bought. There are three options here: that the majority buy out the minority,[208] that the minority buy out the majority,[209] or for the company to buy out the minority's shares.[210] The first of these is most common.[211] Either of the first two is

[207]See n 197 above.

[208]Eg *Martin v Hughes* [2021] CSOH 109.

[209]This happened in *Re Brenfield Squash Racquets Club Ltd* [1996] 2 BCLC 184 Ch D, but here it was the remedy requested by the minority shareholder – see G Morse and others, *Palmer's Company Law* (release 176, Sweet and Maxwell2022) para 8.3820. Koh identified 'not even a single case where the court made a clearly innocent member liable to the withdrawing member against the former's will' – AK Koh, 'Shareholder Withdrawal in Close Corporations: an Anglo-German Comparative Analysis' (2022) 22 Journal of Corporate Law Studies 197, 215.

[210]Companies Act 2006, s 996(2)(e).

[211]See discussion in *Ming Siu Hung v JF Ming Inc* [2021] UKPC 1. Gower's Company Law calls this 'the most common remedy' – PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 14.029. Palmer's Company Law states that such a remedy 'has

neutral for the company: shares are merely transferred. As one of the key purposes of the corporate form is to provide a permanent entity that survives such changes,[212] the company itself will not be affected.

The opposite may be the case, though, if it has to buy back the shares: this would be a reduction of the corporate fund, thus a reduction of the company's assets. The company would have to find the cash to pay the wronged party out. Thus a remedy requiring company resources to be diverted to the wronged party is unsatisfactory from the perspective of the company. However, this remedy is very rarely deployed. Koh argues that this is 'exceedingly rare', and identified only a single case where this occurred[213] – *Re Edwardian Group Limited*.[214] Here, the share purchase order was made against both the wrongdoing majority and the company, due to the company being responsible for a 'failed investigation and the misleading report to shareholders, and responsible through its board for the improper exercise of its remuneration powers'.[215] The company was clearly solvent and a going concern.[216]

If the court orders the company to purchase any shares as part of the relief granted, the court must order the reduction of the company's capital accordingly.[217] This initially seems to be mere tidying up, to avoid a mismatch between the company's shares in issue and its share capital, requiring the company to hold repurchased shares in treasury.[218] However, it has a much more important institutional implication which has been alluded to in a second case, *Shah v Shah*.[219] Here, the wronged minority shareholder was 'neutral' as to whether the wrongdoing majority or the company itself was the purchaser, 'so long as it is lawful' in the case of the company.[220] This focus on legality of purchase demonstrates that this remedy is only available where the company would be able to reduce its share capital, in terms of the capital maintenance rules applicable specifically to companies.

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the undoubted advantage in small companies, where personal relations between the petitioner and the other members have broken down irretrievably, that it may provide both redress in relation to past wrongs and, through the exit, take the petitioner out of the path of any future unfair prejudice' – G Morse and others, *Palmer's Company Law* (release 176, Sweet and Maxwell 2022) para 8.3820.

[212] MA Eisenberg, *The Structure of the Corporation: A Legal Analysis* (reprint, Beard Books 2006), 17; MM Blair, 'Corporate Personhood and the Corporate Persona' [2013] University of Illinois Law Review 785.

[213] AK Koh, 'Shareholder Withdrawal in Close Corporations: an Anglo-German Comparative Analysis' (2022) 22 Journal of Corporate Law Studies 197, 215.

[214] *Re Edwardian Group Ltd* [2018] EWHC 1715 (Ch).

[215] ibid [630].

[216] ibid [651]–[654].

[217] Companies Act, s 996(2)(e).

[218] See Companies Act 2006, Part 18 Ch 6. Treasury shares could only be utilised by public companies until 2013 – see Companies Act 2006, s 724(2) as originally enacted. For an overview of the liberalisation, see PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 17-023.

[219] *Shah v Shah* [2011] EWHC 1902(ch).

[220] ibid [57].

A UK company cannot redeem its share capital[221] other than in certain circumstances.[222] There are two legal ways for the company to reduce its share capital. First, private companies can reduce their capital if directors swear a statement that each director believes that there is no ground for the company to not be able to pay its debts as they fall due, and that the company will be able to pay its debts as they fall due for a further year.[223] Here, then, the company must be solvent in order to reduce its capital. The second capital reduction method is to apply to the court to do so. This is open to public and private companies.[224] Every creditor of the company who has a claim against the company, or can show that there is a real likelihood that a reduction would result in the company being unable to discharge its debt as they fell due can object to the distribution.[225] The court can direct that any creditor it thinks necessary receives security for its claim.[226] Thus under both the legal methods to reduce capital, the interests of the company are considered – either by consideration by the directors or by creditors being able to present their likelihood of repayment to the court.

Mr Justice Roth's reference in *Shah v Shah* to the company being the purchaser *if lawful* clearly means that the company will only be required to purchase the shares if, ultimately, it is legally able to reduce its share capital. Mr Justice Roth then discussed that there was 'no realistic prospect' of creditors objecting to the company's involvement (the requirement for a court order to reduce share capital), and thus left it to the parties to decide who would buy the shares.[227]

The remedy provided in respect of unfair prejudice, then, also reinforces our institutional analysis: the company will be agnostic as to most remedies, and will only be involved directly itself if two conditions are met. First, if there is some form of wrongdoing that is attributable to the company itself (per *Edwardian Group*). Second, if the financial viability of the company is unaffected (per *Shah*). From the perspective of the wronged minority shareholder, these act to reduce potential remedies available. From our institutional analysis, however, these limitations act to protect the company –

[221]Companies Act 2006, s 641, the statutory form of a long-standing rule – *Trevor v Whitworth* (1887) 12 App Cas 409.

[222]These circumstances have become more liberal over time – see discussion in J Armour, 'Legal Capital: An Outdated Concept?' (2006) 7 European Business Organization Law Review 5; E Ferran, 'Revisiting Legal Capital' (2019) 20 European Business Organization Law Review 521 – but remain exceptions rather than the heart of the rule.

[223]Companies Act 2006, ss 642–644. For discussion of such solvency statements in practice, see P Graham, 'A Note on the Decisions in BTI 2014 LLC v Sequana SA and BAT Industries plc (BAT) v Sequana SA' (2017) 38 Company Lawyer 116.

[224]Companies Act 2006, ss 645–649.

[225]Companies Act 2006, s 646(1).

[226]Companies Act 2006, s 646(4) and s 646(5).

[227]*Shah v Shah* [2011] EWHC 1902(ch),[57].

which will only have to reduce its capital if deemed culpable in wrongdoing and legally able.

Thus we resolve the conundrum of company law's understanding of ostensible minority protection mechanisms by undertaking an institutional analysis of the provisions. High hurdles to access the remedies and restrictions on complainer conduct help act as a filter, to ensure that only the most egregious conduct falls within the purview of the remedies: where corporate decision making processes have been abused. Cost mechanics similarly avoid any intra-shareholder dispute utilising these remedies. The relief granted by the remedies themselves also further the institution: by resources returning to the company, or by mostly avoiding the company unless its continued profitability will not be affected.

5. The lightning rod of 'minority' protection

Our institutional analysis thus can help resolve the existing conundrum of company law's understanding of minority protection mechanisms. However, questions remain. After all, the derivative claim still requires corporate resources to be utilised, and the unfair prejudice remedy will still distract those with control over the company and risks company resources being paid to the wronged party. Wouldn't it, then, be advantageous from our institutional perspective to remove these mechanisms?

These provisions do help capture some of the most egregious of wrongdoings. The derivative claim allows those who have wronged the company to be held to account for the benefit of the company. Unfair prejudice lets one party exit following a wrong, or allows the court to make any other order necessary to remedy the wrong. Setting the bars high do allow for some deterrence of the most egregious of wrongdoing, as the wrongdoer opens themselves to potential litigation. However, given the costs of the remedies for the institution of the company, this is a minor benefit that could be achieved by other ways. Whilst we can say that the remedies are available for the most egregious of wrongs, we cannot say that the mechanisms will be attempted only when faced with such most egregious wrongs. Such high hurdles are also likely to provide a chill to pursuing some of the most egregious of wrongs. As such, the deterrence of egregious conduct is thus not a sufficient reason to justify retaining these mechanisms.

There is a stronger rationale, though, as to why these provisions are actively helpful from our institutional perspective. These mechanisms act to squeeze out other potential remedies for minority shareholders. As such, without them other areas of law may provide other avenues for wronged minority shareholders to obtain recourse, potentially directly from the company itself. We have noted above that these remedies are hard to trigger, and their remedies generally act to the benefit of the institution of the company. Their removal could create conceptual space for courts to create (or utilise) alternative remedies that were easier to trigger and more harmful to the institution of the company. There are two examples of minority shareholder protection squeezing out alternative remedies – in the prohibition on reflective loss and in an attempt to wind up the company on just and equitable grounds.

First, we turn to the reflective loss principle. Shareholders cannot recover any loss which is purely reflective of the loss that the company has suffered.[228] This prohibition exists to protect the institution of the company from the acts of shareholders, by ensuring that any rights that are vested in the company are exigible by the company, to be used in accordance with the usual company law rules, rather than being diverted to particular constituents. This prohibition has thus been argued to be the logical extension of the proper plaintiff rule in *Foss v Harbottle*.[229] It therefore shares genealogical roots with the derivative claim. Recently, the Supreme Court had to decide the scope of this rule – whether it arose from company law, which would deny shareholders a claim at all, or from private law, which would agree that shareholders had a claim which was somehow postponed to the claim of the company.[230] The court narrowly held that the former was the case.[231] The minority of the Supreme Court argued that this was 'unjust' to shareholders.[232] The majority[233] held that it was not unjust: the appropriate remedy for wronged shareholders was to make the company claim by a derivative claim, or seek the unfair prejudice remedy.[234]

Thus the argument that prohibiting shareholders from recovering reflective loss was unfair on shareholders was able to be dismissed due to the presence of ostensible minority protection mechanisms. The message for shareholders, then, was that when faced with a wrong they must follow one of these minority protection mechanisms rather than seek direct relief. Without such minority protection mechanisms existing, this argument would be harder to advance, so it is more likely that the prohibition would have remained in private law and continued the 'Japanese Knotweed' of

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[228] The prohibition first appears in *Prudential Assurance Co Ltd v Newman Industries Ltd (No. 2)* [1982] Ch 204.

[229] PL Davies, 'Reflecting on "Sevilleja v Marex Financial"' (Oxford Business Law Blog, 5 August 2020) <https://www.law.ox.ac.uk/business-law-blog/blog/2020/08/reflecting-sevilleja-v-marex-financial>.

[230] See discussion in J Hardman, 'Sevilleja v Marex Financial Ltd: Reflective Loss and the Autonomy of Company Law' (2022) 85 Modern Law Review 232.

[231] *Sevilleja v Marex Financial Ltd* [2020] UKSC 31; [2021] AC 39.

[232] ibid [156] per Lord Sales.

[233] Lord Reid's judgement was supported by two other judges, Lord Sales' by two other judges, and Lord Hodge gave his own judgment generally agreeing with Lord Reid. As such, plurality is technically more accurate than majority – see S Laing, 'Reflective Loss in the UK Supreme Court' (2020) 79 Cambridge Law Journal 411.

[234] *Sevilleja v Marex Financial Ltd* [2020] UKSC 31; [2021] AC 39, [36], [81] and [83] per Lord Reid, [103] per Lord Hodge.

interactions with a company.[235] Situating the prohibition within this taxonomic foundation would have increased the number of times that shareholders could advance their claims in competition to the company. As such, having some ostensible remedy for minority shareholders thus provides a lightning rod for claims in competition to the institution of the company, and avoids deployment of other parts of the legal taxonomy, which are likely to apply rules which may defer less to the institution of the company. More than this, that part of the institutional environment which is company law itself is protected: rather than other institutions of law (such as tort law) needing to provide a remedy, company law was able to resolve the issues complained of within its own part of the institutional environment.

Second, a similar analysis applies at the end of the company's life. Here, shareholders may petition the court to wind up the company, which will be successful if the court believes that it is just and equitable to wind it up.[236] The court can still wind up a company if other remedies are available to a petitioner, however it shall not do so if it thinks that the petitioner is acting unreasonably in seeking to have the company wound up instead of pursuing that other remedy.[237] Palmer's Company Law argues that the unfair prejudice regime's purpose was to provide an alternative to winding up the company and thus save a viable company. Accordingly the requirement to act reasonably in pursuing a winding up over another remedy is primarily targeted at the interaction between winding up and unfair prejudice.[238] It is clear that there can be an overlap between a wronged shareholder being able to advance a claim for unfair prejudice and seeking to wind up the company on just and equitable grounds.[239] However, it is easy to conceive of situations in which the court considers it unreasonable to wind up the company where the minority could be bought out. So much so, in fact, that a practice direction has been issued to request that winding up petitions should not be requested automatically as an alternative to an unfair prejudice remedy request unless winding up is the preferred/only remedy available.[240] Once more, then, the presence of ostensible minority protection mechanisms acts as a lightning rod for wronged shareholders to the benefit of the company: in a world with no unfair prejudice remedy, more otherwise viable companies would be wound up on this ground.

[235] A Tettenborn, 'Creditors and Reflective Loss – a Bar Too Far?' (2019) 135 Law Quarterly Review 182, 183.

[236] Insolvency Act 1986, s 122(1)(g). This formulation, as a catch all ability for the court, was first provided for in Joint Stock Companies Winding-Up Act 1848, s V(8).

[237] Insolvency Act 1986, s 125.

[238] G Morse and others, *Palmer's Company Law* (release 176, Sweet and Maxwell 2022) para 8.3912.

[239] See *Jesner v Jarrad Properties* 1993 SC 34; *Anderson v Hogg* 2002 SC 190, 197–198 and 201; *Hawkes v Cuddy* [2009] EWCA Civ 291.

[240] Civil Practice Directions, Practice Direction – Insolvency Proceeding, para 22.1. Available at <https://www.justice.gov.uk/courts/procedure-rules/civil/rules/insolvency_pd#22>.

The development of those aspects of company law, then, demonstrates that the presence of minority protection mechanisms preclude other areas of the legal taxonomy from providing remedies to shareholders. Minority shareholder protections act not only to protect the institutional arrangement of the company, but also the subset of the institutional environment that is company law by ensuring that disputes between corporate constituents are funnelled through company law, rather than allowing other areas of the legal taxonomy conceptual space for recourse. Such analogies could, of course, well be isolated incidents without universal application. It seems likely, though, that these rules systemically protect the institution of the company.

To advance this argument, we will explore an international law argument, in which David Kennedy has previously argued that human rights discourse was hegemonic.[241] The argument is that such hegemony throttles the analytical space for other approaches within the field – every issue is considered through such an analytical lens.[242] There are three aspects to Kennedy's claim. First, that human rights discourse's hegemony 'crowds out other ways of understanding harm and recompense'.[243] Thus the hegemonic argumentation structure dominates the allocation of resources – including intellectual resources. In other words, anytime an issue arises in the field, intellectual resources (academic views, judicial statements, etc) are driven towards a response from the hegemonic argumentation structure. Thus the presence of a hegemonic argumentation structure starves alternatives of intellectual oxygen in respect of any particular issue. Second, maintaining the hegemony involves 'implicit or explicit delegitimation' of other possible argumentation structures.[244] In other words, not only does a hegemonic argumentation structure result in intellectual resources flooding to that structure when a problem is presented, but the presence of a hegemonic argumentation structure acts as a tacit criticism of any alternative approach. If most analysis utilises approach X, then an attempt to utilise Y can appear pointless or unconnected to the real debate.[245] Third, the combination of these two features distorts the way in which problems are 'imagined and framed'.[246] Kennedy explains that 'a "universal" idea of what counts as a problem and what works as a solution snuffs out all sorts of promising

[241]D Kennedy, *The Dark Sides of Virtue: Reassessing International Humanitarianism* (Princeton University Press 2004).
[242]ibid ch 1.
[243]ibid 9.
[244]ibid 9.
[245]JK Galbraith, *The Affluent Society* (40th anniversary edition, Penguin 1999) 9. See discussion in J Hardman and G Ramírez Santos, 'Empirical Evidence for the Continuing Need to "Think Small First" in UK Company Law' (2022) 24 European Business Organization Law Review 117.
[246]D Kennedy, *The Dark Sides of Virtue: Reassessing International Humanitarianism* (Princeton University Press 2004) 9.

local political and social initiatives to contest local conditions in other terms'.[247] His argument was that the hegemony of global rights discourse meant that issues were funnelled through such discourse that could have been better funnelled through alternative analytical channels to more effective ends.

Ostensible minority protection mechanisms occupy an analogous analytical space in respect of issues faced by minority shareholders. In the context of reflective loss ostensible minority shareholder protection acts as a hegemonic argumentation structure for grievances advanced by shareholders. They thus act as a funnel, or lightning rod, for shareholder disputes. This allowed the majority in *Sevilleja v Marex* to disregard any effect that their jurisprudence may have on individual shareholders – they have minority protection remedies, and thus they should use them. This evidences Kennedy's first critique – the presence of minority shareholder protections crowd out other avenues for shareholders to obtain recourse. Thus judicial time and opinions focus through these remedies, actively denying alternative remedies the judicial oxygen required to provide effective protection to shareholders. From our institutional perspective, then, the presence of this hegemonic argumentation structure is helpful, as it avoids other remedies being explored – including remedies that are more harmful to the institution. This maps neatly onto Kennedy's second critique of human rights – other attempts to obtain remedies for shareholders are funnelled through these particular channels, delegitimising the use of others. We have thus seen that attempts to wind up the company where unfair prejudice was available can only be justified if the claimant has a good reason for choosing winding up over the alternative remedy. As such, the presence of these remedies infiltrates alternative remedies. The opportunity to raise an alternative approach is thus limited. There are clear parallels between Kennedy's argument and the operation of minority protection mechanisms. This works to prevent potential alternative routes for recourse for shareholders. From our institutional perspective, then, the converse of this is that it protects the institution of the company by freezing out alternative paths to relief which may benefit individual shareholders more directly.[248] The absence of a hegemonic argumentation structure would, then, provide the possibility for such other routes to appear. As such, not only do the presence of minority shareholder remedies help to protect the institution of the company, their removal may well harm it.

[247]D Kennedy, *The Dark Sides of Virtue: Reassessing International Humanitarianism* (Princeton University Press 2004) 10.

[248]Gower's Company Law even states that 'there is some evidence that the unfair prejudice remedy, whatever its imperfections, has successfully "crowded out" alternative techniques of controlling the exercise of majority power through board decisions' – PL Davies, S Worthington and C Hare, *Gower Principles of Modern Company Law* (11th edn, Sweet & Maxwell 2021) para 14-035.

This risk is not purely analytical, as it has happened in an analogous situation. Many words have been written on the concept of piercing the veil.[249] Its judicial development, though, carries with it an institutional warning. The availability of piercing the veil has narrowed considerably. In *DHG v Tower Hamlets*, the court ignored the legal aspects of a group structure to, effectively, treat all group companies as part of one combined business.[250] This was narrowed by *Woolfson v Strathclyde Regional Council*, so that the appropriate test became that the corporate veil could be pierced where the company was a 'mere façade'.[251] As a result, *Adams v Cape Industries* held that justice was insufficient to pierce the corporate veil.[252] The façade test was doubted by the Supreme Court obiter in *VTB Capital v Nutritek*.[253] It was finally clarified in *Prest v Petrodel Resources Ltd*, indicating that veil piercing was a last resort,[254] a position to which the Supreme Court are holding firm.[255] The ability to pierce the veil has thus narrowed.[256] The author has argued elsewhere that this is an abrogation of corporate law: as unlimited self-selection of the boundaries of corporate entities is unsustainable,[257] the trajectory of veil piercing precludes company law from resolving the issues that it creates and forces alternative analytical approaches to fill the gap.[258] It can as such be contrasted with ostensible minority protection mechanisms, which are deemed the preferred recourse in areas that seem unrelated to it. Conversely, veil piercing has been called a 'limited principle' by the Supreme Court in a case to discuss its parameters.[259] It has thus become the opposite of a hegemonic argumentation structure – the

[249]Eg S Ottolenghi, 'From Peeping Behind the Corporate Veil, to Ignoring it Completely' (1990) 53 Modern Law Review 338; IM Wormser, 'Piercing the Veil of Corporate Entity' (1912) 12 Columbia Law Review 496; D Cabrelli, 'The Case Against Outsider Reverse Veil Piercing' (2010) 10 Journal of Corporate Law Studies 343.

[250]*D.H.N. Food Distributors Ltd v Tower Hamlets Borough Council* [1976] 1 WLR 852. See discussion in D Powles, 'The "See-through" Corporate Veil' (1977) 40 Modern Law Review 339.

[251]*Woolfson v Strathclyde Regional Council* (1978) SC (HL) 90, 96. See discussion in FG Rixon, 'Lifting the Veil between Holding and Subsidiary Companies' (1986) 102 Law Quarterly Review 415.

[252]*Adams v Cape Industries plc* [1990] Ch 433, 536. See discussion in MT Moore, '"A Temple Built on Faulty Foundations": Piercing the Corporate Veil and the Legacy of *Salomon v Salomon*' [2006] Journal of Business Law 180.

[253]*VTB Capital plc v Nutritek International Corp* [2013] UKSC 5, [124] per Lord Neuberger.

[254]For the current law, see G Allan, 'To Pierce or Not to Pierce? A Doctrinal Reappraisal of Judicial Responses to Improper Exploitation of the Corporate Form' [2018] Journal of Business Law 559; EC Mujih, 'Piercing the Corporate Veil: Where is the Reverse Gear?' (2017) 133 Law Quarterly Review 322.

[255]*Hurstwood Properties (A) Ltd v Rossendale Borough Council* [2021] UKSC 16. See discussion in A Musk, 'Piercing the Corporate Veil: Post-Prest' (2022) 43 Company Lawyer 133.

[256]See A Dignam and P Oh, 'Rationalising Corporate Disregard' (2020) 40 Legal Studies 187.

[257]Eg see H Hansmann and R Kraakman, 'Towards Unlimited Shareholder Liability for Corporate Torts' (1991) 100 Yale Law Journal 1879. This is even more acute in the group situation – see M Petrin and B Choudhury, 'Group Company Liability' (2018) 19 European Business Organization Law Review 771; C Witting, 'The Corporate Group: System, Design and Responsibility' (2021) 80 Cambridge Law Journal 581.

[258]See discussion in J Hardman, 'Fixing the Misalignment of the Concession of Corporate Legal Personality' (2023) 43 Legal Studies 443.

[259]*Prest v Petrodel Resources Ltd* [2013] UKSC 34,[35] per Lord Sumption.

retreat of veil piercing has left a gap for other areas to fill. The gap has been filled by tort law: so that the effect of veil piercing is achieved by extending certain duties of care to parent companies, rather than piercing the veil between the companies.[260]

From an institutional perspective for the company, then, the retreat of veil piercing seems like a win, as a lack of veil piecing respects the company's boundaries more. However, overall this harms the institution, as companies are more likely to be held liable in tort than they would have been if the tort cases were forced to funnel their arguments through a hegemonic argumentation structure with high hurdles. The tort cases do not mention veil piercing once, as the Supreme Court clarified that its role was reduced. This is the opposite of the outcome in respect of reflective loss and ostensible minority protection mechanisms. This further evidences the benefit of ostensible minority protection mechanisms for the company: not only is their puzzle resolved by reviewing them from the perspective of the company, but they provide a further lightning rod to channel all disgruntled shareholders through the high requirements for their operation by acting as a hegemonic argumentation structure, removing oxygen from alternative potential remedies. The failure of company law to provide such an argumentation structure in respect of the boundaries of the corporate form provides an important lesson for the institution of the company: a hegemonic minority protection mechanism with high boundaries could well be better for the company than merely removing the remedies.

Not only this, but the institutional environment of company law has been weakened by the veil piercing approach – rather than being perceived as a company law matter, such issues become a tort law matter. This allows other institutions into areas that should be within the purview of company law, weakening the institution. Minority shareholder protection mechanisms act in the opposite way – protecting the institution of company law by acting as a hegemonic argumentation structure.

6. Wider implications and conclusions

This article, then, has identified that the UK's ostensible minority protection mechanisms are bad at their perceived function, resulting in a conundrum for company law's understanding of the mechanisms. Neither the derivative claim nor unfair prejudice are particularly helpful at protecting the minority – their hurdles are too high, they place unnecessary requirements on claimants, the ability for claimants to recover costs are vague and often arise too late, and their remedies are unsatisfactory.

[260]See *Vedanta Resources plc v Lungowe* [2019] UKSC 20; *Okpabi v Royal Dutch Shell plc* [2021] UKSC 3; C van Dam, 'Breakthrough in Parent Company Liability: Three Shell Defeats, the End of an Era and New Paradigms' (2021) 18 European Company and Financial Law Review 714.

We can resolve this conundrum, though, by reviewing these legal tools through our institutional lens. By focusing on the institutional arrangement of the company, in particular whether its decision making processes have been compromised, a number of weaknesses in the regime become strengths. This does not, of course, resolve the issue for minority shareholders – they still suffer the same risks outlined at the start of this article. Minority shareholders, and legal scholars seeking to protect them, will not be aided by this analysis. However, it helps resolve the conundrum for company law and our analysis of these legal tools. The claim is not that this is how the law should operate (although we have advanced a tentative normative implication, we do not argue for the supremacy of this normative position), or even that it is how law is intended to operate. Rather, our institutional analysis provides a way to descriptively understand the rules in question: it helps us to understand the operation of minority shareholder protection mechanisms. From this perspective, the presence of these rules help benefit the institution of the company by acting as a lightning rod for shareholder claims. We have seen this lightning rod in action in the area of reflective loss. By acting as a hegemonic argumentation structure, ostensible UK minority protection mechanisms starve the oxygen from alternative grounds of relief. We can look at veil piercing as a cautionary tale from an institutional perspective: if minority protection mechanisms were removed, it seems likely that intellectual oxygen would be available for alternative remedies, acting to provide an overall harm to the company. As a corollary to this, such a hegemonic argumentation also strengthens the institutional environment of company law by preventing other areas of the legal taxonomy from having space to provide their own remedies.

However, viewing matters from the perspective of the company runs counter to the dominant contractarian approach to company law, which disaggregates institutions to the various parties that make them up. It has previously been argued that contractarianism is descriptively inaccurate for UK company law.[261] The analysis advanced in this article, then, argues that viewing ostensible UK minority shareholder protection mechanisms from our institutional perspective is superior to a traditional contractarian analysis (which also uses an institution – but the institution of contract rather than the version set out in this article). By using our institutional analysis to foreground the company, though, we are advancing arguments which are diametrically opposed to contractarian analysis, for which the company is merely one particular way to achieve private ordering.[262] The analysis suggests, then, that focusing purely on contractarian analysis may not present the complete picture: by looking through the company, we are not able to look at things

[261]See above (n 46).
[262]BS Black, 'Is Corporate Law Trivial: A Political and Economic Analysis' (1989–1990) 84 Northwestern University Law Review 542.

from the perspective of the company. This can result in an apparent conundrum in legal analysis that can be resolved by our institutional analysis, as in the case of ostensible minority protection mechanisms.

This somewhat begs the question, then, as to whether our institutional analysis can resolve other apparent puzzles that exist within existing analysis of company law. It also begs the question as to whether we may obtain a better understanding of legal phenomena that are already explained through contractarian analysis by adopting institutional analysis. In other words, it may be that such a company-focused institutional analysis is not only needed when contractarianism produces an unclear result, but instead to provide an alternative analysis of currently understood phenomena. It could be that such an institutional analysis provides a better understanding than currently accepted positions.

It is possible, then, to fit contractarianism into Kennedy's arguments. Its widespread deployment within company law commentary could, *itself*, be argued to act as a hegemonic argumentation structure. This has the effect of removing analytical oxygen from alternative analysis, such as a company-centric institutional analysis as outlined in this article. Such hegemony risks painting alternatives as irrelevant, risking a myopic view of legal problems – which can only relate to individuals as we look through the company – and legal solutions, which focus on individuals rather than the company. This creates a risk that our understanding of corporate law is too narrow and requires to be widened. After all, as David Kennedy says elsewhere, to someone with a hammer, every problem looks like a nail.[263]

Not every problem is a nail, though, and not every corporate law aspect should be viewed through a contractarian lens. It is possible that contractarianism's hegemonic status risks deficiencies in our understanding of the operation of company law,[264] which require other argumentation structures to provide holistic understanding. The argument is not that we should replace contractarianism with a company-centric institutional analysis wholesale. Instead, the argument is that we need to obtain several views of the cathedral to understand what the cathedral looks like.[265] Once we have fully developed an array of alternative argumentation structures we can begin to synthesise them to fully understand the company and corporate law.[266] First, though,

[263]Eg D Kennedy, *A World of Struggle: How Power, Law and Expertise Shape Global Political Economy* (Princeton 2016), 135.
[264]See MJ Whincop, 'Painting the Corporate Cathedral: The Protection of Entitlements in Corporate Law' (1999) 19 Oxford Journal of Legal Studies 19.
[265]Monet painted over 30 paintings of Rouen Cathedral in different times of day, weathers and seasons. The philosophical question is which one shows the cathedral – see discussion in G Calabresi and AD Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 Harvard Law Review 1089.
[266]See J Hardman, 'Atomising Corporate Law: A Battle Cry for Splitters' in C Bruner and MT Moore (eds), *Research Agenda for Corporate Law* (Elgar 2023).

we need to develop alternative argumentation structures. Resolving puzzles in contractarian analysis through alternative analytical tools such as our institutional analysis is a helpful start in the wider analytical journey that corporate law analysis needs to undertake. It is not, though, the final destination.

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Notes on contributor

Dr ***Jonny Hardman*** is a senior lecturer in company and commercial law at the University of Edinburgh. He writes on a variety of corporate law issues from a number of different perspectives. He is one of the founders and co-organisers of the Global Seminars in Corporate Law seminar series, and the convenor of the SLS Company Law subject section. Further details as to his research are available at www.hardmanlaw.co.uk.

ORCID

Jonathan Hardman http://orcid.org/0000-0002-1794-0424