COMPANY LAW AND ALTERNATIVE DISPUTE RESOLUTION: AN ECONOMIC ANALYSIS

Stephen Copp*

12th April 2002

[This article was first published in (2002) 23 The Company Lawyer 361 - 375 by Sweet & Maxwell]

ABSTRACT

This article analyses the causes of company disputes and the legal mechanisms for their resolution, from both a legal and an economic perspective. The economic analysis of disputes is set out in terms of their causes and the procedures for their resolution, and whether the use of alternative dispute resolution in this context is consistent with economic efficiency. In conclusion, it is argued that a more effective solution to company disputes would be a radical reform of the contractual framework within which companies operate.

INTRODUCTION

Disputes between those involved in the governance of companies have become notorious for their complexity and acrimony and for the time and expense of their resolution. The *Civil Procedure Rules 1998*, introduced after the *Woolf Report*, have permitted judges in company disputes, for example, to adjourn proceedings to enable parties to reach agreement by way of arbitration or mediation and to take into account a refusal to go to alternative dispute resolution ("ADR") in determining costs. This, in effect, goes some way towards it being quasi-mandatory for those involved in such disputes to submit to ADR. While, on the face of it, this would appear to be a highly desirable and commendable initiative, there are grounds for doubting its potential effectiveness. This article analyses the causes of company disputes and the legal mechanisms for their resolution both from a legal and an economic perspective. It argues that the true cause of many company disputes lies in weaknesses in the contractual base of company law. It argues that the failure to rectify these weaknesses has led to the need for company law to provide remedies which are insufficiently focused and which have in turn led to restrictive judicial interpretation of these remedies and a move to ADR. However, there

---

* Stephen Copp, School of Finance and Law, Bournemouth University. This article is an updated version of a paper delivered at the Institute of Advanced Legal Studies on 30th April 2001 as one of the Company Lawyer series of lectures sponsored by Sweet & Maxwell, to whom thanks are due. The paper and this article build on an earlier article by Copp, S.F. and Astbury, N. "ADR and Shareholder Disputes – an Alternative to Using CA 1985, s. 459" (2000) 1 Journal of ADR, Mediation and Negotiation 51. I am grateful to the late Dr C.W. Maughan, Reader in Law and Economics, Bournemouth University, and to R. Goddard, Aston University, for their comments on earlier drafts of this article. The law is stated as at 12th April 2002.

are potentially significant difficulties posed by the use of ADR in this context, not least what exactly is meant by ADR, what are its goals, how it relates to existing mechanisms and how parties can be protected from unfairness. This article sets out an economic analysis of disputes, in terms of their causes and the procedures for their resolution, and whether the use of ADR in this context is consistent with economic efficiency. In conclusion, it is argued that a more effective solution to company disputes would be a radical reform of the contractual framework within which companies operate.

There has been a significant growth in the litigation of company disputes since the enactment of *s. 459 Companies Act 1985*. This litigation has been shown to possess a range of characteristics which give cause for concern: unpredictability; triviality; hostility; disproportionality; and general undesirability[1]. Such characteristics may be seen either as inherent in the provision of a legal remedy based on a concept as nebulous as unfairness or as simply a temporary phase in the evolution of the remedy and the establishment of a body of precedent: let a thousand flowers bloom. Perhaps unsurprisingly therefore, the problem of shareholder disputes was the first aspect of company law to be referred to the Law Commissions and has continued to feature in the deliberations of the Company Law Review Steering Group. It has also been affected by the momentous changes in litigation law and practice introduced following the Report of the Woolf Committee and the introduction of the *Civil Procedure Rules 1998*. In addition, *s. 459 Companies Act 1985* has been considered in the House of Lords for the first time in *O'Neill v. Phillips*[2], the ramifications of which are continuing to be explored by the courts[3].

There is a danger that the increased complexity of company law – not least the growth in volume of reported case law – may result in important linkages and theoretical perspectives not receiving the emphasis that they merit. This is particularly so in the case of company law where there is much overlap between issues[4]. There are at least two broad ways in which an article providing an economic analysis of the role of ADR in company law disputes could be constructed. The narrow approach would involve a comparison of the economic consequences of ADR as against traditional forms of litigation by reference to any perceived special attributes of such disputes. The wider approach is to pose the question as to why ADR has become seen as desirable and/ or necessary as an alternative to litigation in company disputes, and what the economic rationale for this is, and only then consider whether ADR is likely in economic terms to provide a satisfactory solution to the underlying problem or whether a more radical solution is required. This article will adopt the wider approach and will therefore examine: (1) the historical origins of company law procedures for dispute resolution and the tensions between the role of contract and judicial discretion in determining issues of

[1] See further Copp, S.F. and Astbury, N., "ADR and Shareholder Disputes – An Alternative to Using CA 1985, s. 459" (2000) 1 Journal of ADR, Mediation and Negotiation 51.
[2] [1999] 1 W.L.R. 1092; [1999] 2 All E.R. 961; [1999] B.C.C.600; [1999] 2 B.C.L.C. 1, HL.
[3] See, for example, Re Guidezone Ltd [2001] B.C.C. 692; [2000] 2 B.C.L.C. 321, Ch D; and Anderson v. Hogg, 2002 S.C. 190; 2002 S.L.T. 354, Ex D.
[4] A clear example of this occurred when the Law Commissions were first asked to produce a report on shareholders' remedies and then subsequently on directors' duties. The deficiencies of the report on shareholders' remedies argued to have arisen from this were widely commented on.

fairness; (2) the causes of disputes within companies and the role that contract plays and might play in these; (3) the role of ADR; and (4) how such disputes and their resolution might be explained from an economic perspective.

THE ORIGINS OF COMPANY LAW PROCEDURES FOR DISPUTE RESOLUTION

It is valuable to commence by tracing the historical origins of the company law procedures for dispute resolution. The reason for this is that it was during the period from 1844 to 1856 that many of the core concepts which continue to dominate company law were settled, and the rationale for their introduction and rejection of alternatives remains relevant. What this brief review will do therefore is examine the rationale for the role of dispute resolution in early company law, why alternatives such as arbitration were then rejected and how subtle changes have altered the framework put in place by the Victorian legislators.

Prior to the *Joint Stock Companies Act 1844*, despite legislative measures to encourage simplified forms of incorporation, most large trading enterprises were conducted through the medium of partnerships. Disputes appear to have been common in such large partnerships and formed a major concern of the Bellenden Ker Report on the Law of Partnership in 1837[5]. The Report identified that the principal difficulty in the partnership law of the time lay in legal proceedings by, against or between partners where partners were numerous, with a further difficulty lying in the want of adequate remedies between partners, whether or not partners were numerous[6]. The source of the problem is now long gone, lying in the lack of fusion of common law and equity, which meant that, at common law, no dispute could be determined until the partners had settled an account between themselves. It was seen as difficult at common law for an account to be taken, seemingly because of lack of legal and judicial expertise[7], and because the examination of the partners could only be compelled in equity, which would not intervene unless a dissolution was sought[8]. The Report observed that, as a consequence, the practice had arisen for partners to insert an agreement to submit all disputes to arbitration in their partnership deed[9]. However, such agreements were undermined by the courts: at common law only nominal damages would be awarded for breach of such an agreement; and equity would rarely have regard to such an agreement[10]. The Report noted views that arbitration was ineffective, with more delay and more expense than court proceedings, as well as arguments to the contrary that arbitration was essential to the settlement of such disputes because of the lack of competence within the courts to deal with accounts. Generally, it was noted that those connected with commerce favoured compulsory arbitration, whereas lawyers were opposed[11]. In conclusion, it was recommended that the

[5] Report on the Law of Partnership (1837) B.P.P., Vol. XLIV *[the references below are to the page references in the original Report]*
[6] Ibid., p. 3.
[7] Ibid., p. 13.
[8] Ibid., p. 3.
[9] Ibid., p. 3.
[10] Ibid., p. 4.
[11] Ibid., p. 13.

courts should be enabled to give effect to arbitration agreements within partnership agreements[12].

The Gladstone Committee Report of 1844[13], which led directly to the introduction of the *Joint Stock Companies Act 1844,* was mainly focused on problems of fraud and mismanagement of companies. It divided "bubble companies" into three classes: (1) those which were faulty in their nature, being based on unsound calculations, and which therefore could not succeed; (2) those which were so ill-constituted that it was probable they would suffer in the same way as mismanaged companies; (3) those which were faulty or fraudulent in their objects, which aimed at raising funds to be shared between those who started the company. Much concern was levelled at what would now be considered as securities' law, and at fraudulent practices, for example, advertising as directors those who either had not sanctioned the use of their names or who were not the persons they were supposed to be. The remedy recommended for such practices generally was to require the provision of information, for example, as to directors. Greater difficulty was seen in dealing with ill-constituted companies where informational requirements would not be effective. Instead, the solution was thought to be requirements to hold meetings periodically; the production and publication of accounts; and, significantly in terms of company disputes, making directors more immediately accountable to shareholders by facilitating and improving the remedies available to companies and their shareholders *inter se*[14]. Disappointingly, this latter conclusion was repeated in the Resolutions of the Gladstone Committee without further explanation[15]. In fact, a fair level of protection was given to shareholders in the 1844 legislation which included: requiring a minimal level of constitutional provision to be made[16]; providing for the binding nature of the constitution[17]; reserving key powers over changes in the constitution and changes in directors and auditors to shareholders[18]; ensuring the right to participate in general meetings[19]; requiring accounts to be prepared[20] and made available

[12] Ibid., p. 18. It is noteworthy in the context of an economic analysis of company disputes as to how much of the Report was expressed in "efficiency" terms, however efficiency might have been seen. Accordingly, it was thought that the courts "could be rendered more efficient" (p. 13), and evidence that " a more efficient mode of taking accounts by Courts of Equity should be provided" (p. 15). In addition, the rationale for the conclusion was that "it was founded on the agreement of the parties instead of being compulsory" (p. 18).

[13] First Report of the Select Committee on Joint Stock Companies (1844) B.P.P., Vol. VII. *[the references below are to the page references in the original Report]*

[14] Ibid., p. v.

[15] Ibid., p. xiii.

[16] S. 7 and Sched. A. However, an indicative list of constitutional matters to be addressed was set out rather than a model set of clauses. Furthermore, each member was required to execute the deed of settlement or a deed referring to it.

[17] S. 11. The Deed of Settlement was deemed to contain a covenant by each shareholder to perform the " … several Engagements in the Deed contained on the Part of the Shareholders."

[18] S. 25. Albeit this power appears to have been limited in practice by the ability of directors to entrench themselves in ways now effectively subjected to s. 303 Companies Act 1985.

[19] S. 26. However, it is significant that s. 27, which broadly set out the powers and duties of directors, included the limitation that these were subject to " … other special Authority, but not so as to enable the Shareholders to act in their own Behalf in the ordinary Management of the Concerns of the Company otherwise than by means of Directors …". This is a marked contrast to the provision made in s. 90

for inspection[21] and requiring auditors to be appointed[22]. Provision for the dissolution of a company on the "just and equitable" ground was specifically applied to companies with the first companies' insolvency legislation[23]. Perhaps curiously, the matters to be provided for in the constitution did not include arbitration, perhaps because it was seen as inconsistent with the role of the general meeting. This is particularly surprising because the *Company Clauses Consolidations Act 1845* contained detailed arbitration provisions applicable to those companies which were subject to it[24]. It is interesting to consider whether the practice of inserting arbitration clauses into partnership deeds, referred to by the *Bellenden Ker Committee,* survived into companies registered under the *Joint Stock Companies Act 1844* by inertia. To answer this question satisfactorily would require detailed research of early company constitutions which is outside the scope of this article. However, there is some limited support to be gained from early reported case law to indicate that it might have done so[25]. The *Joint Stock Companies Act 1856* refined this framework, relieving members of the need to execute the company's constitution, clarifying the way in which it was binding[26], providing for a model set of constitutional clauses[27] which could be adopted, amended or substituted for, and providing an inspection regime for companies[28], though removing the requirement for auditors and making this a matter for Table B[29]. The basic mechanisms for the resolution of disputes between shareholders were therefore established as the general meeting, the contractual framework and dissolution.

FLAWS AND REFORM IN THE PROCEDURES FOR DISPUTE RESOLUTION

The concept of alternative dispute resolution was arguably incorporated into company law from the outset through the mechanism of the general meeting. This was, of course, totally consistent with judicial thinking of the time. The decision in *Foss v. Harbottle*[30] had been made only in 1843, a year before the Gladstone Committee. It was also totally

---

Company Clauses Consolidation Act 1845, which provided that the exercise of directors' powers was " … subject to the Control and Regulation of any General Meeting ."

[20] S. 35.

[21] S. 37.

[22] S. 38.

[23] S. 5(8) Joint Stock Companies Winding-up Act 1848.

[24] Ss. 128 – 134.

[25] See, for example, Hickman v. Kent or Romney Marsh Sheep-Breeders' Association [1915] 1 Ch. 881, Ch D; Beattie v. E. & F. Beattie Ltd [1938] Ch. 708; [1938] 3 All E.R. 214, CA.

[26] S. 10 dealt with the Articles, saying that: "They shall, when registered, bind the Company and the Shareholders therein to the same Extent as if each Shareholder had subscribed his Name and affixed his Seal thereto or otherwise duly executed the same, and there were in such Articles contained, on the Part of himself, his Heirs, Executors, and Administrators, a Covenant to conform to all the Regulations of such Articles …".

[27] Table B set out "Regulations for Management of the Company" in 87 clauses, many of which recognisably form the basis of the present day provisions.

[28] Ss. 48 – 52. s. 51 empowered shareholders in general meeting to appoint inspectors to examine the affairs of a company who would have all the powers of a Board of Trade inspector but would report to whom the general meeting directed. This therefore was supportive of the role of the general meeting as a principal mechanism for resolving disputes.

[29] Paras. 74 – 84.

[30] (1843) 2 Hare 461.

consistent with the emphasis of the Gladstone Committee (unlike its predecessor the Bellenden Ker Committee) on the problems arising within large companies with numerous shareholders, where the general meeting had the potential to facilitate the resolution of disputes. It was a clear policy goal of the courts that disputes between shareholders should be kept out of the courts as far as possible[31]. As Wedderburn has observed[32] only one true exception – fraud on a minority by wrongdoers in control - was developed successfully in relation to this principle, other exceptions being situations where the rule had no applicability. One such situation where the rule had no applicability was where the member was enforcing a personal right under the company's articles of association[33]. Accordingly, the general meeting would be unable to resolve a dispute with a contractual character, in effect leaving the general meeting as the final arbiter only of disputes which concerned commercial decision-making or those which concerned the internal management of the company where members have no personal right.

The inability of the general meeting to act as an effective alternative dispute resolution mechanism for disputes with a contractual character greatly enhances the importance of the contractual basis of the company in the resolution of any dispute. However, the contractual basis of the company has been weakened by the courts' approach to the statutory contract. An important function of the courts in contract generally has been their activism to ensure that contracts are rendered effective in a business sense. Accordingly, in *Hillas & Co Ltd v. Arcos Ltd*[34], Lord Tomlin stated that:

"The problem for a court of construction must always be so as to balance matters that, without the violation of essential principle, the dealings of men may as far as possible be treated as effective, and that the law may not incur the reproach of being the destroyer of bargains."

It is consistent with this principle that, in appropriate cases, the courts are prepared to infer agreement from conduct[35]; the courts will be reluctant not to enforce a contract because of uncertainty[36]; the courts will imply terms into contracts where appropriate[37];

---

[31] See, for example, the remark, oft-cited in later company cases, of Lord Eldon LC in Carlen v. Drury (1812) 1 Ves & B 154 at 158, that: "This court is not to be required on every occasion to take the management of every playhouse and brewhouse in the kingdom".

[32] Wedderburn, K.W., "Shareholders' Rights and the Rule in Foss v. Harbottle" (1957) CLJ 194.

[33] Generally, the "internal management principle" limits litigation concerning the internal management of a company to the company itself, but there is unfortunately no generally accepted test of when the court will regard a matter as being a matter of internal management affecting the running of the company's affairs generally or a matter personal to the shareholder.

[34] (1932) 38 Com Cas 23 at 29.

[35] See, for example, Brogden v. Metropolitan Railway Company (1877) 2 App. Cas. 666; and, more recently, G. Percy Trentham v. Archital Luxfer Ltd [1993] 1 Lloyd's Rep. 25, CA; but see also Gibson v. Manchester City Council [1979] 1 W.L.R. 294; [1979] 1 All E.R. 972, HL, where the House of Lords indicated that, where a contract was alleged to have been made by an exchange of correspondence, the usual rules of offer and acceptance should not be departed from so as to infer agreement based on the correspondence as a whole and the conduct of the parties.

[36] As Denning L.J. put it in Nicolene v. Simmonds [1953] 1 Q.B. 543; [1953] 2 W.L.R. 717; [1953] 1 All E.R. 822, CA: "It would be strange indeed if a party could escape from every one of his obligations by

and the courts will be flexible in their approach to remedies[38]. Nonetheless, statutory intervention has been required in the general law of contract and, of course, in many other specific examples of contract[39]. The point is that after about 150 years of independent development, there is some merit in evaluating the structure of company law by comparison with its contractual origins. Contract law, after all, has scarcely stood still over that time[40].

The public policy goal of rendering contracts effective has not been applied by the courts with the same vigour to the statutory contract contained in a company's Memorandum and Articles of Association and Shareholders' Agreements intended to supplement these. Instead, the courts appear to have given undue weight to other public policy goals, usually the protection of members and creditors, perfectly worthy but often misconceived. The justification for this is that the articles are binding not because they derive from any bargain struck by the parties but because of their statutory character[41]. The courts have taken a near contemptuous attitude to parties drafting the objects clauses of a company to give the company the flexibility they desired[42]. The courts have taken a restrictive approach to the accountability of directors to shareholders at the general meeting by seeking to construe various versions of Table A as ineffective to confer on

---

inserting a meaningless exception from some of them … You would find defaulters all scanning their contracts to find some meaningless clause on which to ride free."

[37] There is considerable flexibility in the approach adopted, including the "business efficacy" test deriving from The Moorcock (1889) L.R. 14 P.D. 64, the "officious bystander" test deriving from Shirlaw v. Southern Foundries (1926) Ltd [1939] 2 K.B. 206 at 227, CA, and the very expansive approach of the House of Lords in Liverpool City Council v. Irwin [1977] A.C. 239; [1976] 2 W.L.R. 562; [1976] 2 All E.R. 39, HL, towards terms implicitly required by the contract itself.

[38] See, for example, Anglia Television Ltd v. Reed [1972] 1 Q.B. 60; [1971] 3 W.L.R. 528; [1971] 3 All E.R. 690, CA.

[39] Such as employment law, landlord and tenant law, etc.

[40] Consider, for example, the current debate over what the role of the doctrine of good faith should be in general contract law, which potentially could have important ramifications for how the company contract is perceived. In two recent cases on implied terms, Gan Insurance Co. Ltd v. Tai Ping Insurance Co. Ltd (No. 2) [2001] EWCA Civ 1047; [2001] 2 All E.R. (Comm) 299; [2001] C.L.C. 1103, CA, and Paragon Finance plc v. Nash [2001] EWCA Civ 1466; [2002] 1 W.L.R. 685; [2002] 2 All E.R. 248, CA, the Court of Appeal recognised that an apparently unfettered discretion given to one party would be subject to an implied term as to its exercise and referred to good faith, while in O'Neill v. Phillips [1999] 1 W.L.R. 1092; [1999] 2 All E.R. 961; [1999] B.C.C. 600; [1999] 2 B.C.L.C. 1, HL, Lord Hoffmann did not see any advantage in abandoning traditional English contract theory based on distinguishing legal and equitable principles to introduce a Continental approach of a general requirement of good faith, which he believed achieved the same result.

[41] See Steyn L.J. in Bratton Seymour Service Co. Ltd v. Oxborough [1992] B.C.L.C. 693 at 698 but contrast with Vaisey J. in Rayfield v. Hands [1960] Ch. 1; [1958] 2 W.L.R. 851; [1958] 2 All E.R. 194, Ch D; that "… the proper way to construe the articles of association of a company is as a commercial or business document to which the maxim 'validate if possible' applies …".

[42] See, for example, Lord Wrenbury in Cotman v. Brougham [1918] A.C. 514 at 522 – 523, who commented: "There has grown up a pernicious practice of registering memoranda of association which, under the clause relating to objects, contain paragraph after paragraph not specifying or delimiting the proposed trade or purpose, but confusing power with purpose and indicating every class of act which the corporation is to have power to do. The practice is not one of recent growth. It was in active operation when I was a junior at the bar. After a vain struggle I had to yield to it, contrary to my own convictions." The ground for this was that it appeared to conflict with the intention of the Act.

shareholders a general supervisory power over directors[43] and by overriding attempts in the articles of association to achieve this[44]. The courts have been unwilling to enforce provisions of a company's articles of association which constitute "outsider rights"[45], although this is subject to a rather sterile academic controversy[46]. The courts have treated provisions which would prevent a company from altering its articles as invalid[47]. The courts have taken a very restrictive approach to the implication of terms in articles of association, taking the view that terms can only be implied from necessity in order to make the articles workable[48], that they are not entitled to look at the surrounding circumstances[49], and similarly will not order the rectification of articles of association even where it can be shown that they do not accord with the parties' true intentions[50]. This judicial conservatism has also extended to shareholders' agreements outside the articles of association[51]. The argument that the statutory contract should be treated

---

[43] See, for example, Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cuninghame [1906] 2 Ch. 34, CA; Salmon v. Quin and Axtens Ltd [1909] 1 Ch. 311, CA; and Breckland Group Holdings Ltd v. London and Suffolk Properties Ltd (1988) 4 B.C.C. 542; [1989] B.C.L.C. 100. These decisions were decided on the basis of versions of Table A pre-dating the present version which requires directions by shareholders to be by special resolution rather than by ordinary resolution.

[44] See, for example, John Shaw and Sons (Salford) v. Shaw [1935] 2 K.B. 113, CA; against this approach see Marshall's Valve Gear Co. Ltd v. Manning Wardle and Co. Ltd [1909] 1 Ch. 267, Ch D.

[45] See Eley v. Positive Government Security Life Assurance Co. Ltd (1875 - 1876) L.R. 1 Ex. D. 88, CA; but see Salmon v. Quin and Axtens Ltd [1909] 1 Ch. 311, CA. The rationale for this departure from usual principles of contract law appears to be a public policy that the memorandum and articles of association should define the position of a shareholder in that capacity and not affect him as an individual. There might be some merit to this argument if there were reasonable grounds for concern that unscrupulous corporators might seek collateral advantages from members in the articles but such a principle is not necessary for the decision in Eley where the matter could have been disposed of by some extension of ordinary contract law principles that certain contract provisions are void or voidable as infringing public policy.

[46] The literature on this controversy is valuably summarised by Drury, R.R., "The Relative Nature of a Shareholder's Right to Enforce the Company Contract" [1986] CLJ 219 at pp. 226 – 229 who argues for a "relational" approach to the company contract (p. 224), the aim of dispute resolution machinery being the preservation of the long-term relationship between the parties (p. 246). Grantham, R. "The Doctrinal Basis of the Rights of Company Shareholders" [1998] CLJ 554 at 580, in considering the "nexus of contracts" theory, observes that this theory relies upon a conception of contract which " modern contract scholars would find quaintly old-fashioned. In its reliance on consent as both the descriptive and normative basis of contracting … the theory is clearly out of step with modern contractual theory …".

[47] See, for example, Walker v. London Tramways Co. (1879) 12 Ch.D. 705.

[48] See Re Benfield Greig Group plc, Nugent v. Benfield Greig Group plc [2000]2 B.C.L.C. 488 at 512. It is interesting to compare the approach of Jenkins L.J. in Holmes v. Keyes [1959] Ch. 199 at 215, who observed that the articles " … should be regarded as a business document and should be construed so as to given them reasonable business efficacy."

[49] See Bratton Seymour Service Co. Ltd v. Oxborough [1992] B.C.C. 471; [1992] B.C.L.C. 693, CA; more recently in Folkes Group plc v. Alexander [2002] EWHC 51, Ch D, Rimer J. confirmed that the court, when interpreting articles of association, could not have regard to evidence of negotiations and statements of intention but it could take into account background knowledge which would reasonably have been available to the contracting parties: see also Equitable Life Assurance Society v. Hyman [2002] 1 A.C. 408; [2000] 3 W.L.R. 529; [2000] 3 All E.R. 961, HL. For a useful categorisation of "implicit" contracts in a corporate context, see Riley, C.A. "Implicit Dimensions of Contract: Lessons From The Corporate Context", (paper delivered at the "Implicit Dimensions of Contract" Seminar, London School of Economics, 2001), pp. 5 – 6.

[50] See Evans v. Chapman (1902) 86 L.T. 381; Scott v. Frank F. Scott (London) Ltd [1940] Ch. 794, CA.

[51] See Russell v. Northern Bank Development Corporation Ltd [1992] 1 W.L.R. 588; [1992] 3 All E.R. 161; [1992] B.C.C. 578; [1992] B.C.L.C. 1016, HL.

differently from other contracts may have some merit to it, for example, if there are special issues of privity to be considered[52] but the statutory character of the contract should not be a sufficient reason *per se*[53].

The remedy of dissolution, now winding-up, has been approached in a more flexible way by the courts, perhaps on account of its historical origins. The conditions placed on a petition are reasonable, for example, that the petitioner must have a tangible interest in the winding up[54] and must not have been guilty of misconduct[55], although the courts remain reluctant to wind up a successful and prosperous company[56]. From early on the courts recognised the applicability of the remedy to cases where trust and confidence between members had broken down[57], where there had been unjustifiable exclusion of one or more members from management[58] or where the directors had demonstrated a lack of probity[59]. Nonetheless, one recent application of the principles espoused in *O'Neill v. Phillips* has been that " … the winding-up jurisdiction is, at the very least, no wider than the s. 459 jurisdiction …"[60].

The principles discussed briefly in this section concern some of the most discussed doctrines of company law and it is possible for their familiarity to obscure some very basic and practical issues. If the purpose of the general meeting in the light of the rule in *Foss v. Harbottle* [61] is viewed as an attempt to give rise to a form of mandatory alternative dispute resolution mechanism then it must be seen as seriously flawed. First, it is unclear as to what type of disputes can be resolved by it; for example, many disputes of a contractual character can be litigated instead. So it is not comprehensive. Secondly, its goal as an alternative dispute resolution mechanism is unclear. The rationale appears dominated by considerations of the interests of the judicial system, such as avoiding the

---

[52] See, in particular, the argument of Drury, R., n. 46 above; see also Riley, C.A., "Contracting Out of Company Law: Section 459 of the Companies Act 1985 and the Role of the Courts" [1992] 55 MLR 782, who argues that there should be a greater degree of judicial activism and construction than is common in many other areas of contract activity because the inter-shareholder contract will often be relatively informal and quite confused. See also Maughan, C.W., McGuinness, K. and Copp, S.F., "Defining the Boundaries of Contract: A Law and Economics Rationale for the Doctrine of Privity of Contract" [1999] 10 Journal of Inter-disciplinary Economics 395.

[53] Although there are aspects of the statutory contract which distinguish it from others: Mayson, S.W., French, D. and Ryan, C., "Mayson, French & Ryan on Company Law" (Blackstone, 2001), p. 99 observe that s. 14 does not in fact form any bilateral or multilateral contract but merely deems that each member is subject to an unilateral contract.

[54] Re Rica Gold Washing Co. (1879) 11 Ch.D. 36.

[55] See, for example, Ebrahimi v. Westbourne Galleries Ltd [1973] A.C. 360; [1972] 2 W.L.R. 1289; [1972] 2 All E.R. 492, HL.

[56] See, for example, Cumberland Holdings Ltd v. Washington H. Soul Pattinson and Co Ltd (1977) 13 A.L.R. 561, PC.

[57] See, for example, Symington v. Symington's Quarries Ltd (1905) 8 F. 121.

[58] See, for example, Re Davis and Collett Ltd [1935] Ch. 693, Ch D.

[59] See, for example, Loch v. John Blackwood Ltd [1924] A.C. 783, PC.

[60] Re Guidezone [2000] 2 B.C.L.C. 321 at 357 per Jonathan Parker J. As he put it: " … it is difficult to believe that Lord Hoffmann would have placed the limits on the s. 459 jurisdiction which he did, had he thought that, by doing so he was in effect transferring business from the s.459 jurisdiction to the winding-up jurisdiction."

[61] See above.

courts being flooded with such litigation, the lack of competence of the judges in commercial matters and so on[62]. So, it was to stifle litigation and not necessarily to provide a resolution of the dispute, depending on what constitutes a resolution of a dispute. Essentially, the role of the general meeting should be regarded as a forum for collective decision-making and the language of dispute resolution abandoned. Thirdly, the general meeting operates in the shadow of personal contractual entitlements and quite correctly cannot determine these. However, once dispute resolution depends on contractual rights in a company context, it can be seen that there are significant flaws in the enforcement of those rights. Perhaps unsurprisingly in the light of the ineffectiveness of the general meeting and the flaws in contractual protection, the remedy of winding up became the principal remedy for general grievances within the company. This is perhaps singularly disappointing from the perspective of alternative dispute resolution since some of the most significant of the grounds for a winding up are based on relationship issues, for example, a breakdown in trust and confidence - exactly the sort of issue which it is claimed are suitable for alternative dispute resolution mechanisms such as mediation. However, the solutions that were introduced successively by *s. 210 Companies Act 1948* and what is now *s. 459 Companies Act 1985* failed to address either the underlying weaknesses of the general meeting or the contractual framework of the company. Had the Cohen Committee[63] and the Jenkins Committee[64] paid more attention to the need for an alternative dispute resolution framework at the core of company law operating in the shadow of an effective contractual framework, it might have been unnecessary to enact those provisions and to have better predicted their weaknesses. Instead, *s. 459 Companies Act 1985* opened the floodgates of litigation with the range of characteristics mentioned at the beginning of this article: unpredictability; triviality; hostility; disproportionality; and general undesirability.

The main problems perceived with shareholder remedies by the Law Commissions were the obscurity and complexity of the law on derivative actions and the efficiency of *s. 459 Companies Act 1985,* with a third problem being identified as the enforcement of shareholders' contractual rights under the articles of association[65]. The guiding principles for the exercise included support for those principles that restrict litigation (i.e. the proper plaintiff rule, the internal management rule, respect for commercial decision-making and freedom from unnecessary shareholder interference) as well as sanctity of contract[66]. The principle of sanctity of contract interestingly upheld the usual contractual principle that a member should be bound by the company contract whether or not he appreciated its meaning but that the law should no longer continue to treat him as bound if it is shown

[62] Whincop, M.J. in "An Economic and Jurisprudential Genealogy of Corporate Law" (Ashgate, 2001), argues that the decision demonstrates "governance deference", i.e. that the law encourages the formation of governance institutions by deferring to their operation and limiting their judicial review, enabling person involved in a business to act on information they can observe but which a court may be unable to verify. Seen in this way, the decision recognises the role of shareholders in *ex post* trade in fiduciary entitlements: see ibid., pp. 123 and 140.
[63] Report of the Committee on Company Law Amendment, Cmnd. 6659 (1945); see especially paras 58 - 60.
[64] Report of the Company Law Committee, Cmnd. 1749 (1962).
[65] Law Commission, "Shareholder Remedies" (Law Commission Report No. 246, 1997), pp. 1 – 4.
[66] Ibid., pp. 142 – 144.

that the parties had come to some other agreement or understanding not reflected in it, noting that, in some situations, this principle might have to give way to the jurisdiction under s. 459, without explaining why. The proposals in the Law Commissions' report were commendably balanced, combining reform to the underlying company contract, to the substantive rights conferred by s. 459 and to the procedures for litigating such cases. Accordingly, Table A should be amended, including a shareholder exit article; s. 459 itself should be amended to include a presumption of unfair prejudice, broadly, in exclusion cases; and the courts should have greater powers to actively manage proceedings in line with the then prospective Civil Procedure Rules, including an express power to adjourn proceedings to permit ADR and the imposition of a limitation period on allegations[67]. Indeed, the emphasis on ADR has been continued by the Company Law Review Steering Group, which seeks to encourage mediation and arbitration as alternatives to litigation, in particular by creating an arbitration scheme designed specifically for shareholder disputes[68]. In the meantime, however, *s. 459 Companies Act 1985* received its first consideration by the House of Lords in *O'Neill v. Phillips*[69]. Noteworthy in the judgement of Lord Hoffmann in this context was the following statement defining fairness:

> "In the case of section 459, the background has the following two features. First, a company is an association of persons for an economic purpose, usually entered into with legal advice and some degree of formality. The terms of the association are contained in the articles of association and sometimes in collateral contracts between the shareholders. Thus the manner in which the affairs of the company may be conducted is closely regulated by rules to which the shareholders have agreed. Secondly, company law has developed seamlessly from the law of partnership, which was treated by equity … as a contract of good faith … These principles have, with appropriate modification, been carried over into company law.
>
> The first of these features leads to the conclusion that a member of a company will not ordinarily be entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted. But the second leads to the conclusion that there will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith …
>
> Another approach, in a different legal culture, might be simply to take a less literal view of "legal" construction and interpret the articles themselves in

[67] Ibid., Part 8 generally.
[68] Company Law Review Steering Group, "Modern Company Law for a Competitive Economy: Final Report" (DTI, URN 01/942 and URN 01/943, July 2002), pp. 69 – 70.
[69] [1999] 1 W.L.R. 1092; [1999] 2 All E.R. 961; [1999] B.C.C. 600; [1999] 2 B.C.L.C. 1, HL. For more detailed consideration of the issues arising, see Copp, S.F. and McGuinness, K., "Protecting Shareholder Expectations: A Comparison of U.K. and Canadian Approaches to Conduct Unfairly Prejudicial to Shareholders, Parts I and II" [2000] 11 ICCLR 184 and 217, esp. 222 – 224.

> accordance with … "the plain meaning of the deed". Or one might, as in Continental systems, achieve the same result by introducing a general requirement of good faith into contractual performance."

This judgement then goes a long way to restoring the relationship between unfairness and contract which was perhaps being lost with the development of judicial doctrines such as that of "legitimate expectations." Although Lord Hoffman did not go so far, it might be reasonable to suggest that revisiting the contractual basis of the company would potentially allow s. 459 to be done away with perhaps by a substantial revisiting of s. 14 and Table A, applying instead the familiar mechanisms of statutory implied terms. The Company Law Review Steering Group consulted on whether *O'Neill v. Phillips* should be reversed because it potentially undermined the Law Commissions' proposal to amend s. 459, or whether s. 459 should instead be amplified[70]. However, it has been decided not to reverse the decision and that the best way of focusing allegations under s. 459 would be " … the notion of departure from an agreement, broadly defined, between those concerned, to be identified from words or conduct" and "that, in clear cases of unfairness, where the conduct of the respondent is evidently outside the scope of the prior mutual contemplation of the parties, the courts will have no difficulty in identifying the conduct as beyond the scope of the agreement between them, as so broadly defined"[71].

It is very significant that the Company Law Steering Group has made radical proposals in relation to the company contract. They argue that[72]:

> "The present contractual character of the constitution under section 14 is in any case severely qualified under the Act. Many of the normal incidents of contractual relations and remedies available to the parties do not apply. Once this is recognised the issue becomes one of ensuring that the present rules apply subject only to the changes we are proposing. Arguably, whether the relationships are described as contractual or statutory becomes a matter of nomenclature rather than of substance. Whether a modified contract, which we recognise may well be the best means of capturing the consensual character of relationships under the constitution becomes a matter of drafting. We proposed to suggest that the desired

[70] Company Law Review Steering Group, "Developing the Framework" (DTI, URN 00/656, 2000), pp. 121 – 123.

[71] Company Law Review Steering Group, "Completing the Structure"(DTI, URN 00/1335, 2000), pp. 96 – 98. In the Final Report, n. 68 above, pp. 163 – 164, it was again recommended that O'Neill v. Phillips should not be reversed, while interestingly it was stated that the majority of views responding on this issue were in favour of doing so. On p. 171 it was noted that "… the effect of these proposals would be to make it clear that the majority is, subject of course to the constitution, free to exercise its powers as it wishes, apart from the cases we have mentioned … cases of breach of an agreement, actual or implied, amounting to unfairly prejudicial conduct for the purposes of s. 459 as interpreted in the light of O'Neill v. Phillips; cases involving changes in the articles or class rights; and resolutions ratifying or condoning wrongs. It has to be recognised that this may lead in some cases to outcomes which are prejudicial or unfair in some sense to the minority and for which there would be no remedy. We generally believe that, in the interests of certainty it is not desirable to recognise in law some further standard of fairness or unconscionability against which majority decisions are to be assessed."

[72] "Completing the Structure", n. 71 above, p. 93. In the Final Report, n. 68 above, p. 161 it was stated that this approach was cautiously welcomed and was therefore recommended.

result should be explained to the draftsman and the best way of expressing it then explored in drafting."

In addition, they submit that instead of attempting to resolve the problems of defining personal rights under the constitution, that all obligations imposed by the constitution should be enforceable by individual members and that this should apply both to existing and new companies[73]. It is submitted that these proposals are correct and if enacted could go some way to reducing the incidence of company disputes, for as will be demonstrated in the next section of this article, there appears to be a strong link between the extent of contractual protection and the incidence of company disputes under the present legislation.

THE CAUSES OF DISPUTES WITHIN THE GOVERNANCE OF COMPANIES

Reliable empirical evidence as to disputes within companies, their causes and their resolution, is in short supply and likely to remain so. The overwhelming number of companies are private companies with a small number of shareholders and directors who are often the same people, who may be linked by ties of family or friendship, and therefore any dispute is likely to resemble a matrimonial dispute. As a consequence, there may be significant problems of research access. The best available evidence therefore is likely to be that deriving from disputes where legal proceedings have been initiated. Nonetheless, considerable caution should be applied in the interpretation of such evidence: in particular, disputes which give rise to legal proceedings may be different in character to other disputes. This is because such disputes will probably be those where there is a potential remedy in law and therefore the provision of a legal remedy may well influence the incidence of disputes. Where the legal remedy is ill-defined, therefore, it is possible that this would encourage a greater incidence of disputes which would otherwise remain either unresolved or be resolved without recourse to law. In addition, *O'Neill v. Phillips* has brought about such a change in the interpretation of the law in this area that litigant behaviour may well change as a consequence.

The most authoritative source of empirical evidence as to shareholder disputes in the United Kingdom is that conducted by the Law Commissions, based on a survey of petitions presented to the Companies Court at the Royal Courts of Justice between January 1994 and December 1996 seeking relief under *s. 459 Companies Act 1985*[74]. Nonetheless, it is noteworthy that this sample consisted of 254 petitions presented during the period of which 233 were inspected. Accordingly, the number of such petitions averaged in the region of 85 in each year. Taken against a total population of around a million companies, therefore, the number of such disputes involving presentation of a petition in this court amounted to only 0.0085% of the total population. While the question must be raised as to whether such petitions might have been commenced in other courts there can be little doubt that this figure probably represents a high proportion of the more complex cases and is in fact minute. Since anecdotally it seems that the

[73] "Completing the Structure", n. 71 above, p. 95. This approach is confirmed in the Final Report, n. 68 above, p. 161.
[74] "Shareholder Remedies", n. 65 above, Appendix J.

number of cases handled by company solicitors is in fact much higher than this, it would seem a reasonable assumption that many such disputes do not involve the presentation of a petition and are therefore resolved without recourse to law. Further, it is important to observe that the sample mainly consisted of small companies: 82% concerned companies with 5 or fewer shareholders, and, therefore, that the information elicited may say little of the incidence or resolution of disputes in companies with a greater number of shareholders.

What is more significant is whether the survey provides any valuable information on the role of contract in company disputes. The survey is limited to petitions presented under *s. 459 Companies Act 1985*. However, we can see that 61.8% involved s. 459 alone, a further 37.8% were combined with *s. 122(1)(g) Insolvency Act 1986*, and 1.3%, a mere 3 petitions, were combined with either *s. 54 Companies Act 1985* or *s. 371 Companies Act 1985*. None was combined with *s. 14 Companies Act 1985,* which is surprising given that 11.2% of petitions included an allegation of a breach of the articles. It is interesting to speculate whether the reason for this is that, were an action substantially based upon breach of the articles, then it would be brought under *s. 14 Companies Act 1985* and, given the limitations upon judicial creativity in the interpretation and enforcement of the statutory contract, there might be a perceived risk of such an action being unsuccessful and therefore the probability of an action arising would be lower. Nonetheless, it is useful to analyse the nature of the allegations included in petitions under *s. 459 Companies Act 1985* and the role that contract played, or might have played, in these. One approach is to attempt to recategorise the (on occasions, multiple) allegations as between: (1) those disputes which involved contractual provision, (2) those disputes for which contractual provision could have been made, and (3) those disputes for which contractual provision could not have been made (for example, in the sense that the matter was already the subject of statutory or other regulation). The results of this analysis are shown in Table 1.

Table 1

Potential/ actual role of contracts in disputes

Disputes involving contractual provision

Breach of articles	11.2%
Breach of agreement	25.8%
	37.0%

Disputes for which contractual provision might have been made

Exclusion from management	64.4%
Failure to provide information	39.9%
Excessive remuneration	15.5%
Failure to remunerate/ pay dividend	22.7%
Improper allotment/ unfair increase in capital	11.6%
Unfair offer for shares/ failure to purchase	6.4%
Deadlock	15.0%
	175.5%

Disputes for which contractual provision could not have been made

Mismanagement	27.5%
Misappropriation of assets	39.9%
Failure to register	1.7%
Breach of statute	21.0%
Other breach of fiduciary duty	30.0%
	120.1%

Other	24.5%

[It should be borne in mind that the percentages cited reflect the number of allegations pleaded and therefore total in excess of 100%.]

It will be seen in conclusion that the overwhelming majority of allegations are in respect of matters for which contractual provision could have, but was not, made, followed by matters for which contractual provision could not reasonably have been made. Only a tiny proportion concern matters where there was contractual protection, either in the articles of association, or elsewhere. While it is possible that some of the allegations have been categorised in a fashion which does not reveal their contractual basis (for example, an allegation of exclusion from management may conceal an allegation of a contractual entitlement to participation), there is no reason to doubt the overall impression given.

An alternative approach would instead be to focus on the nature of the remedy sought as an indicator of the true grievance between parties, whilst again seeking to apply the same approach to categorisation adopted in Table 1. This analysis is set out in Table 2.

Table 2

Recategorisation of remedies sought as indicator of true nature of grievance

Disputes involving contractual provision	
Compensatory damages	7.3%
Disputes for which contractual provision might have been made	
Purchase of petitioner's shares	69.5%
Sale of respondent's shares	23.6%
Purchase or sale of shares in related company	1.3%
Rectification	5.2%
Appointment of receiver	3.0%
	102.6%
Disputes for which contractual provision could not have been made	
Regulation of company's affairs	10.7%
s. 461(2)(c)	11.6%
Duty to account	15.0%
Just and equitable winding up	37.3%
	74.6%
Other	
Injunction	23.2%
Declaration	13.3%
Interest	3.0%
Other statutory relief	4.3%
Other	8.2%
	52.0%

[It should be borne in mind that the percentages cited reflect the number of allegations pleaded and therefore total in excess of 100%.]

While again there are difficulties in placing too great a reliance on such statistics (for example, there is a large "other" category which might conceal disputes of a contractual

character, such as declarations and interest), there is no reason to doubt the overall impression since such distortions might equally apply to other categories. What is clear is the minute number of disputes which involve contracts, compared with the very large number of disputes where contractual provision might have been made. This is particularly so if the figure for the "just and equitable" remedy is assumed to be substantially lower on the basis that this was at the time often pleaded in the alternative even where it was not the principal remedy sought, often as a bargaining counter. In conclusion, it is clear that many company disputes could be avoided if the parties made express contractual provision for the issues or were subjected to a more extensive default regime in Table A.

THE ROLE OF ADR

A simple definition of ADR is that it is an alternative to the procedures of formal dispute resolution, namely, litigation and arbitration[75]. As such, it has the potential to be a broad concept capable of embracing a wide range of practices, some of which are well established[76]. In practice, the U.S. roots of ADR in the 1960s mean that it has tended to be associated with a philosophical position concerned with the peaceful resolution of disputes in a community context[77] and which therefore tends to be antagonistic to traditional litigation. An example of this approach is provided by Marshall in a discussion of the role of ADR in neighbour disputes. He observes that the informing philosophy of ADR is that of co-operative problem-solving. Amongst the principles identified for this are that " … the procedure should integrate the parties, not divide and oppose them as does the adversarial dynamic of law", and that " … [t]he process should be forward-looking – problem-solving, rather than assigning blame …"[78]. There may indeed be merit in this, depending on whether a resolution is more important than the underlying legal rights. Yet there must be a very real danger, especially in a commercial context, that such an approach simply opens the way for a bully to create a dispute by unilateral and unwarranted demands and then demonstrate a willingness to compromise, provided some ill-gotten gain is kept. This question of values goes to the heart of the problem in defining alternative dispute resolution: if the goal is the peaceful resolution of a dispute, the practices required for this might be very different from those designed to achieve, say, the goal of justice or economic efficiency. Although these will often be coterminous, it would be expected that true reconciliation would be unlikely to be achieved by an unjust solution and just solutions are often those which are economically efficient.

---

[75] See, for example, Brooker, P., "The 'Juridification' of Alternative Dispute Resolution" (1999) 28 Anglo-American Law Review 1 at 1. On ADR, see generally, Brown, H. and Marriott, A., "ADR Principles and Practice" (London: Sweet & Maxwell, 1999).

[76] As Applebey, G., "Alternative Dispute Resolution and the Civil Justice System" in Mackie, K.J. (ed.), "A Handbook of Dispute Resolution" (London and New York: Routledge and Sweet & Maxwell, 1991), p. 26 at pp. 28 – 29, points out, a whole range of non-judicial remedies have been established during the twentieth century, including tribunals, ombudsmen and the Police Complaints Authority, and that arbitration (excluded from the definition of ADR adopted here) goes back to the seventeenth century.

[77] See Mackie, K.J., "Dispute Resolution: the New Wave", in Mackie, n. 76 above, p. 2.

[78] See Marshall, T.F., in Mackie, n. 76 above, pp. 67 – 68.

The impetus for reform of dispute resolution is not one which is limited to company law matters but forms part of a wider pattern of dissatisfaction with the civil justice system in England and Wales. The system of civil justice in England and Wales was subject to a wide-ranging review by the Woolf Committee which produced an Interim Report in June 1995[79] and a Final Report in July 1996[80]. The Interim Report included a chapter[81] on "alternative approaches to dispensing justice", including as forms of ADR, arbitration, administrative tribunals, mini-trials, ombudsmen and mediation[82]. It argued that the main reason for the inclusion of ADR in the enquiry was an increasing recognition of its contribution to the fair, appropriate and effective resolution of civil disputes, and a second reason to increase awareness of what ADR had to offer[83]. However, it was not proposed that ADR should be compulsory, either as an alternative or as a preliminary to litigation, on the ground that compulsory ADR had been introduced in some US jurisdictions because of a lack of court resources for civil trials and this was inapplicable in the United Kingdom[84]. The Final Report emphasised the role of ADR, perhaps unsurprisingly, when the first two features that "the new landscape" was intended to possess were that litigation will be avoided wherever possible and that litigation would be less adversarial and more co-operative[85]. Accordingly, it was stated that people would be encouraged to start court proceedings as a last resort and after using other more appropriate means where available; information on sources of ADR would be provided at all local courts; legal aid funding would be available for pre-litigation resolution and ADR; there would be an expectation of openness and co-operation from the outset; the court would encourage the use of ADR at case management conferences and pre-trial reviews and would take into account whether the parties have unreasonably refused to try ADR or behaved unreasonably in the course of ADR.

Apart from the obvious cynicism such features might be expected to attract, for example, as to the level of co-operation that might be expected from many reluctant defendants, the values of ADR permeate the Woolf Reports. Sadly, there appears to have been relatively little discussion of exactly what was meant by ADR, when it would be unreasonable to refuse to try ADR or what would constitute behaving unreasonably in the course of ADR. If, for example, a company dispute turned around the breach of a complex contractual right contained in a shareholder agreement, obtained after extensive negotiation with both parties benefiting from legal advice, would it be appropriate to insist on the "mediation" form of ADR? Would it be appropriate in effect to instruct a party to submit to the mediation of, perhaps, a non-legally qualified person who might not be able to understand the agreement and then penalise that party for refusing to act co-operatively in signing away his legal rights? It is submitted that this would place the value of co-

[79] Lord Woolf, "Access to Justice: Interim Report to the Lord Chancellor on the Civil Justice System in England and Wales" (June 1995).
[80] Lord Woolf, "Access to Justice: Final Report" (HMSO, July 1996).
[81] Interim Report, n. 79 above, Chapter 18.
[82] Ibid., pp. 137 – 138.
[83] Ibid., p. 136.
[84] Ibid., p. 136. There has been much criticism of this approach: see, for example, Carr, C.A. and Jencks, M.R. "The Privatisation of Business and Commercial Dispute Resolution: A Misguided Policy Decision" (1999) 88 Kentucky Law Journal 183.
[85] Final Report, n. 80 above, pp. 4 – 5.

operative dispute resolution above both justice and economic efficiency. It would be too open to manipulation. There must be a question mark as to the introduction of such general principles to litigation across the board and there was, unfortunately, relatively little discussion of this issue in company law circles prior to the enactment of the *Civil Procedure Rules 1998* [86].

The enactment of the *Civil Procedure Rules 1998* was accompanied by some initial doubt as to their applicability to what is probably the most common form of company dispute under *s. 459 Companies Act 1985*. This is because petitions for unfair prejudice were governed by the *Companies (Unfair Prejudice Applications) Proceedings Rules 1986* [87]. Rule 2(2) provided that the Rules of the Supreme Court and the practice of the High Court applied to proceedings in the High Court " … except so far as inconsistent with the Act and these Rules …" However, the *Civil Procedure Rules 1998* did not exclude proceedings under *section 459 Companies Act 1985* and the preferred view appeared to be that the *Civil Procedure Rules 1998* applied to such proceedings[88]. This has been subsequently confirmed in a series of decisions on *s. 459 Companies Act 1985* [89]. Dicta in these decisions go some way towards settling issues raised above as to the possible way(s) in which ADR might develop[90].

First, the lack of clarity as to what exactly constitutes ADR and whether ADR is being required of parties can be seen. So, for example, Aldous L.J. in *North Holdings Ltd v. Southern Tropics Ltd*[91] comments how the *Civil Procedure Rules 1998* represent a new way of conducting litigation and observes how ample use should be made of the power to require a joint expert or an assessor to be appointed – an eminently sensible and practical view – but no mention is made as to whether this is intended as a form of ADR which it clearly resembles. Indeed, although *O'Neill v. Phillips* did not directly refer to the *Civil Procedure Rules* on the point or ADR, it is interesting to note Lord Hoffmann's observation that " ... parties ought to be encouraged, where at all possible, to avoid the expense of money and spirit inevitably involved in such litigation (see Shakespeare, Sonnet 129) by making an offer to purchase at an early stage"[92]. In Lord Hoffmann's view, expressed in terms which are suggestive of an ADR procedure, exclusion from

[86] Which took effect on 26th April 1999. There is a potential infringement of Article 6(1) European Convention on Human Rights, and therefore of the Human Rights Act 1998, if a court were to order parties to participate in ADR but seemingly not if there is free consent: Deweer v. Belgium (1980) 2 E.H.R.R. 439. See further Smythe, M., "Business and the Human Rights Act 1998" (Bristol: Jordans, 2000), p. 157.
[87] S.I. 1986, No. 2000. See further Axelsson v. Sweden, No. 11960/86, decision of July 13 1990 unreported, ECHR; and Pastore v. Italy No. 46483/99, decision of May 25, 1999, unreported, ECHR.
[88] Plant, C., "Blackstone's Civil Practice 2000" (Blackstone, 2000), p. 914.
[89] See Blythe v. Sams, 15th December 1999, CA, LEXIS transcript; North Holdings Ltd v. Southern Tropics Ltd [1999] B.C.C. 746; [1999] 2 B.C.L.C. 625, CA; Re Rotadata [2000] B.C.C. 686; [2000] 1 B.C.L.C. 122, Ch D; and West v. Blanchet [2000] 1 B.C.L.C. 795, Ch D.
[90] For an example of the impact of case management on s. 459 litigation, see Kranidiotes v. Paschali [2001] EWCA Civ 357; [2001] C.P. Rep. 81, CA.
[91] [1999] B.C.C. 746; [1999] 2 B.C.L.C. 625, CA. See also Fuller v. Cyracuse Ltd [2000] 1 B.C.L.C. 187 and Re Robor Cartons Ltd, LEXIS transcript, 31st March 2000.
[92] O'Neill v. Phillips [1999] B.C.C. 600 at 613.

management would not be unfairly prejudicial where the petitioner had made a reasonable offer[93].

Secondly, it does seem that ADR is gaining some quasi-mandatory status. In a case not concerning company law, *Muman v. Nagasena*[94], a court has been prepared to stay charity proceedings brought by trustees pending authorisation of the proceedings combined with an order that the stay should not be lifted until the parties had made an attempt to resolve their dispute by mediation[95]. In *Re Rotadata*[96], Neuberger J. observed that the parties had been discussing ADR in correspondence and that, in accordance with the *Civil Procedure Rules,* it was appropriate to express the view that ADR should be used so as to avoid costs and court time. He then went further to observe that, if a party had set his face against ADR there might be little more to be said about it, but that a refusal to go to ADR could be taken into account by the court when considering costs. There is much at first sight to commend this on the particular facts – in Neuberger J.'s estimation the costs of the case were likely to exceed the value of the shares, which it seemed were worth in the region of £300,000. A different approach with similar effect can be seen in *Blythe v. Sams*[97]. Here, the Court of Appeal adjourned an application for a winding-up petition under *s. 122(1)(g) Insolvency Act 1986*, where there was a cross-petition under *s. 459 Companies Act 1985*, to enable the parties to reach agreement by way of arbitration or mediation. When no agreement was reached as to the appointment of either a mediator or an investigating accountant, the matter returned to the Court of Appeal, with Chadwick L.J. rejecting an appeal from a winding up order saying that justice did not require the relevant party to have more court time since justice required that the case be dealt with in a way which was proportionate to the amount involved and the financial position of each party, having proper regard to the need to make the courts resources available to other parties.

Since ADR now has a role in the resolution of company disputes it is valuable to consider in detail what forms it may take and its potential application to company disputes. This will be done by reference to: the existing contractual mechanisms for dispute resolution which may be available to the parties; mediation; early neutral evaluation/ expert appraisal/ judicial appraisal; and mini-trial. These have been ordered in this fashion to reflect the degree of juridification of the procedure[98].

---

[93] Ibid.,p. 614. The principles he established were: (1) the offer must be to purchase the shares at fair value; (2) the value, if not agreed, should be determined by a competent expert; (3) the offer should be to have the value determined by the expert as an expert; (4) the offer should provide for equality of arms between the parties (i.e. as to rights of access to information and to make submissions); and (5) the question of costs.

[94] [2000] 1 W.L.R. 299; [1999] 4 All E. R. 178, CA.

[95] But see Jewco Ferraus BV v. Lewis Moore (A Firm) [2001] Lloyd's Rep. P.N. 6; [2001] P.N.L.R. 12, CA.

[96] [2000] B.C.C. 686; [2000] 1 B.C.L.C. 122, Ch D.

[97] 15th December 1999, CA, LEXIS transcript.

[98] For a useful categorisation of disputes resolution processes, see Goldberg et al., in Mackie, n. 76 above, pp. 14 –15, which analyses all such processes by reference to whether they are voluntary/ involuntary, binding/ non-binding; and so on.

Company law and practice has long incorporated a very wide range of dispute resolution mechanisms which are alternatives to litigation. The breadth of definition of ADR is sufficient to encompass many such existing forms of agreement parties may have concluded either within a company's articles of association or in a shareholders' agreement. A brief review of contemporary precedents for company matters confirms the degree of creativity which exists in providing means of avoiding disputes within a contractual framework. Typically, such arrangements geared to the protection of minority shareholders include the following key elements[99]:

(1) The adoption of a constitutional structure with particular rights attaching to blocks within the company, for example, a division between "A" and "B" shareholders and "A" and "B" directors, so as facilitate the creation of more specific obligations than are possible with the assumption that all shareholders and directors are homogenous.

(2) The requirement of unanimity on the part of shareholders or directors, as appropriate, for a wide range of specified decision-making purposes.

(3) Extended protection from financial risk, in terms of how subscription monies may be used, how further finance may be contributed on an equitable basis, how guarantee liabilities will be apportioned and as to dividend policy.

(4) Extended protection in realising investment in the company, both in terms of facilitating share sales on an equitable basis and the imposition of restrictive covenants.

(5) An attempt to ensure that the agreement survives changes in composition of shareholders or directors.

(6) Where such an agreement is between parties who may potentially be deadlocked, provision may be made to attempt to end that deadlock, for example, by ensuring that the deadlock has first been reached at a general meeting, and then providing for the appointment of an expert (and not an arbitrator) to determine the dispute[100].

The articles of association will be tailored to achieving the same objectives. In particular, there will usually be detailed provisions to regulate share transfers, based around a pre-emption rights framework whilst extending its actual operation beyond how this is often understood. Common issues[101] relate to: what event will trigger the operation of the pre-emption rights, for example, the removal of a director may be deemed to do so, in effect enabling a compulsory sale of shares; when the restrictions do not apply, for example, to family members; how the shares are to be valued, for example, how an expert may be selected and what basis is to be applied, for example, net asset value or market value as well as any assumptions to be applied. These provisions will usually be drafted in

[99] See Stedman, G. and Jones, J., "Shareholders' Agreements" (London: Longman, 1990), Precedents A and B. See also Thomas, K.R. and Ryan, C.L., "Section 459, public policy and freedom of contract, Parts 1 and 2" (2001) 22 Company Lawyer 177 and 198.
[100] See generally, for example, Stedman and Jones, n. 99 above, Precedent E.
[101] See ibid., Precedent B.

considerable detail because of fears as to the restrictive interpretative and gap-filling role of the court.

It is quite possible that the future may see the introduction of "partnering" approaches to dispute resolution common in extended agreements in the construction industry, being adopted in company's individual contractual arrangements[102]. The significance of such approaches is that they rely upon establishing a detailed framework of operational procedures and dispute resolution procedures intended to prevent disputes of a legal character arising.

Case law on *s. 459 Companies Act 1985* has shown that many disputes themselves concern the operation of such forms of ADR or the satisfactoriness of the outcome actually or potentially produced, for example, where it could be argued that the articles of association provided an unnusual or arbitrary method of valuation[103]. Nonetheless, what is immediately apparent is the way in which these procedures have become juridified. What is less clear is the relationship such procedures (or other ADR-style procedures which parties may agree to incorporate in the light of the new Civil Procedure Rules) may bear to ADR, which may be encouraged by the court following a s. 459 petition. Is it reasonable for parties to be expected to pursue ADR if the reason they petitioned was the failure of an ADR-style procedure which the parties had at an earlier stage agreed upon? If the dispute concerns the failure of a contractual mechanism because of some ambiguity or omission, it is desirable that ADR should be encouraged or that a definitive court ruling should be readily available to determine this so that what is in effect an ADR procedure can be allowed to follow its natural course? These and many other questions will need to be authoritatively determined as the new approach evolves.

Mediation can be defined as " … a form of facilitated negotiation where a neutral third party guides the parties to their own solution"[104]. Its key characteristics are that: it is voluntary; if there is agreement it is enforceable as a contract; it involves a party-selected outside facilitator, usually with specialised subject expertise; it is usually informal and unstructured; it involves unbounded presentation of evidence; a mutually acceptable outcome is sought; and it is private[105]. Accordingly, it does not result in a determinative adjudication but is a form of facilitated negotiation where a neutral third party guides the party to their own solution which may not have been one which would have been possible through a strict application of the law[106]. Early neutral evaluation, expert appraisal and judicial appraisal are various methods in which a non-binding assessment of the merits of a case may be obtained[107]. A "mini-trial" involves the appointment of a

---

[102] See Copp, S.F., "Developing a Relationally Based Law of Contract: A Question of Good Faith?", in P. Beaumont and K. Wotherspoon (eds), "Christian Perspectives on Law and Relationism" (Paternoster, 2000), Chapter 3.
[103] See, for example, Re XYZ Ltd [1987] B.C.L.C. 94. However, the authority of such decisions may be doubtful in the light of O'Neill v. Phillips.
[104] Interim Report, n. 79 above, p. 138.
[105] See Mackie, K.J., n. 77 above, p. 14. citing Goldberg et al.
[106] Interim Report, n. 79 above, p. 138.
[107] See The Law Society, "Alternative Dispute Resolution – A Way Forward" (February 2000), p. 10; and Beecher, G. and Lanoe, M., "Advanced Litigation: Commercial" (Jordans, 1999) p. 175 (who add that, with

neutral person who will sit as chairman of a tribunal composed of that person and a senior representative of each of the parties, who may not be immediately connected with the dispute but with authority to reach agreement[108]. Its key characteristics are that: it is voluntary; that where there is agreement it may be enforced as a contract; it involves a party-selected neutral adviser sometimes with specialised subject expertise; it is less formal than adjudication and the procedural rules may be set by the parties; there is opportunity and responsibility to present summary proofs and arguments; a mutually acceptable agreement is sought; and it is private[109].

It is very difficult to attempt to make an assessment of each different form of ADR in the context of company disputes because of the enormous variety of such disputes and because so many of the features of the forms of ADR are flexible and depend on what the parties agree. Disputes can be categorised between: those which are grievance-based (usually reflecting an imbalance of power); those which are rights-based (usually seeking to enforce the terms of a contract or legal rule); and those which are interests-based (usually reflecting an impasse over one party attempting to establish a new relationship)[110]. Company disputes may manifest any combination of these. The most common type of dispute involves the exclusion of a party from management: this may give rise to a grievance-based dispute where it has resulted from the superior voting power of a party; it is less likely to be rights-based if it assumed that many such exclusions do not involve any contractual breach; and it is less likely to be interests-based, although this is possible. It is submitted that mediation may be useful in such a dispute where relationship factors may loom large. For example, it is valuable where parties have stopped communicating with each other or feel they may lose face[111]. However, the next two most common types of disputes – failure to provide information and misappropriation of assets – may involve different considerations. Assuming that such disputes are likely to be rights-based, and assuming that the allegations made in the dispute have some substance, it is harder to see how mediation might be successful other than by insisting that the relevant rights be upheld. The strengths of mediation lie for example where the parties cannot find their own solution[112]: the solution in such rights-based cases may be straightforward. However, in a rights-based dispute it may well be that another form of ADR might be more effective, in particular, a mini-trial or rent-a-judge would seem appropriate.

It can be seen that there are some significant reservations as to the use of ADR in company disputes: the philosophical basis of ADR places apparently little weight on the role of legal rights and therefore may assist the bully; the relationship between ADR and existing contractually based approaches to non-litigious dispute resolution such as the appointment of expert valuers has been insufficiently explored and may lead to duplication of efforts; and the quasi-mandatory status, which ADR appears to be attaining

---

judicial appraisal, it is a matter for the parties' agreement as to whether the opinion is to be binding but presumably this is the case in all these scenarios).

[108] Beecher & Lanoe, n. 107 above, p. 174.

[109] Mackie, n. 77 above, 15.

[110] Ibid., p. 12.

[111] Ibid. p. 88.

[112] Ibid. p. 88.

in practice in company disputes, seemingly conflicts with the essentially voluntary nature of ADR. Nonetheless, there are clearly some types of disputes, especially those which are grievance-based or interests-based which may well be suited to ADR, not least some of the most common disputes which relate to exclusion. This article will consider next the framework for the economic analysis of ADR in the context of company disputes.

ASSUMPTIONS AND LIMITATIONS OF THE ECONOMIC MODEL ADOPTED

The approach to economic analysis adopted in this article is that of micro-economic analysis, which is defined by Posner as:

" …the science of rational choice in a world … in which resources are limited in relation to human wants. The task of economics, so defined, is to explore the implications of assuming that man is a rational maximiser of his ends in life, his satisfactions – what we shall call his 'self-interest'"[113].

The basis of micro-economic analysis is the value placed on economic efficiency, a concept embracing productive efficiency, allocative efficiency and dynamic or innovative efficiency[114]. Much controversy has arisen over the use of this analysis because of claims that it can be used in a positive manner to predict future economic events and therefore the outcome of changes in the law and that it can be used in a normative manner as a desirable goal for society[115]. Similarly, much controversy has arisen over the assumptions on which such analysis is based which include individual rationality, the rule of law with appropriate protection for the person, property and promises, and perfectly competitive markets with no transaction costs. It is not the purpose of this article to re-examine these controversies[116] except where issues peculiar to the application of economic analysis to ADR arise. Nor is it the purpose of this article to explore the role of non-economic considerations such as justice or non-legal considerations such as the role of social norms, notwithstanding their importance. It is recognised that non-efficiency criteria may validly be pursued provided that the cost of doing so is recognised and that non-legal norms may have an important role in constraining conduct without the need for legal intervention.

In economic analysis the decision to assert a legal claim is seen as a decision under uncertainty to be solved recursively by computing the expected values of subsequent stages in the dispute[117]: in other words, a rational claimant compares the cost of the complaint and the expected value of the legal claim[118]. Trials are regarded as inefficient

---

[113] Posner, R.A., "Economic Analysis of Law" (4th ed., Little, Brown & Co, 1998), p.3.
[114] See further Maughan, C.W. and Copp, S.F., "The Law Commission and Economic Methodology: Values, Efficiency and Directors' Duties" (1999) 20 Company Lawyer 109 at 113.
[115] See, for example, ibid., p. 113.
[116] For a further consideration of some of the issues raised, see Maughan, C.W. and Copp, S.F., "Company Law Reform and Economic Methodology Revisited" (2000) 21 Company Lawyer 14.
[117] Cooter, R.D. and Rubinfeld, D.L., "Economic Analysis of Legal Disputes and Their Resolution" (1989) 27 Journal of Economic Literature 1067 at 1070.
[118] Cooter, R.D. and Ulen, T., "Law & Economics" (Reading, Massachusetts, US: Addison, Wesley, Longman, 2000) p. 377.

because before any trial takes place there will have been an opportunity for a settlement reached by bargaining which would have left both parties better off[119]. A "co-operative surplus" is obtained by the parties equal to the difference between the joint payoffs from a settlement and the sum of the individual payoffs from a trial[120]. Social costs (i.e. the costs of administration and of errors) will be reduced where a settlement replicates the expected judgement at trial and therefore the law should encourage such settlements[121]. The question may therefore be posed as to why in economic terms a party would consider litigating. The explanation lies in the problem of relative optimism, i.e. each party expects to gain more from a trial than he could from a settlement acceptable to the other side[122]. It is argued that the cause of relative optimism is that the expected value of a legal claim diverges for the parties because of private information, i.e. one party possesses information not possessed by the other[123]. Voluntary disclosure of information occurs before trial as each party seeks to correct the other side's relative optimism (i.e. bad news is free) and parties tend to withhold information that would correct the other party's relative pessimism, and in each instance this will promote settlement[124]. Compulsory disclosure of information tends therefore to operate to correct the parties' relative pessimism and therefore causes them to demand better terms to settle out of court[125]. At all stages it is important to note that bargaining occurs in the shadow of the law, in other words, expectations about trials determine the outcomes of settlements. This in turn depends on the quality of the underlying laws: it has been argued that vague laws cause litigation and that laws whose inefficiency derives from their vagueness will tend to be litigated until the courts achieve a clear allocation of the underlying entitlements[126]. For this reason it is significant that adjudication by the courts has two distinct products: dispute resolution and rule making[127].

AN ECONOMIC EXPLANATION FOR DISPUTES WITHIN THE GOVERNANCE OF COMPANIES

In economic terms the company has been seen since Coase as an alternative to exchange within a market environment, arising because of the way in which the company operates to reduce transaction costs. In particular, the company can be seen as reducing the transaction costs arising from multiple contracting[128]. This analysis is borne out by the early history of the development of the company[129]. Perhaps surprisingly, much of the

[119] Ibid., p. 399.
[120] Ibid., p. 399.
[121] Ibid., p. 400.
[122] Ibid., p.401. But see the alternative explanation provided by "loss aversion" (ibid., p. 395).
[123] Ibid., p. 392.
[124] Ibid., pp. 392 – 393.
[125] Ibid., p. 394.
[126] Cooter, R.D. and Rubinfeld, D.L., n. 117 above, pp. 1092 – 3.
[127] Ibid., p. 1070.
[128] See further Maughan, C.W. and McGuinness, K., "Towards an Economic Theory of the Corporation" [2001] 1 Journal of Corporate Law Studies 141, which focuses on the frequency of transacting.
[129] See Copp, S.F., "Early Company Law in England: Is It Consistent With Economic Theory" (paper delivered at the Company Law Section, SPTL Conference, University College London, 20th September 2000).

literature has instead focused on the company as a source of transaction costs. As Williamson and Masten put it[130]:

"Contracting man is distinguished from the orthodox conception of maximising man in two respects. The first of these is the condition of bounded rationality. Secondly, contracting man is given to self-interest-seeking of a deeper and more troublesome kind than his economic man predecessor … This self-seeking attribute is variously described as opportunism, moral hazard, and agency …"

This first problem of bounded rationality is defined by Williamson as[131]:

"… behavior that is intendedly rational but only limitedly so; it is a condition of limited cognitive competence to receive, store, retrieve and process information."

He therefore concludes that all complex contracts are unavoidably incomplete because of bounds on rationality[132] and that therefore the *ex post* side of a contract, including the structures that facilitate gap-filling, dispute settlement, adaptation, and the like become central, rather than being suppressed if the assumption of comprehensive *ex ante* contracting is made[133]. The second problem of self-interest-seeking gives rise to monitoring costs. Hansmann argues that these should be subsumed under the general concept of costs of ownership, and in addition he added the costs of collective decision-making and risk-bearing[134]. A valuable aspect of his analysis is the comparison of investor-owned firms, worker-owned firms and firms without owners, which leads to the conclusion that a fundamental consideration in the reduction of the costs of collective decision-making is whether or not the owners have essentially identical interests: costs can be low where interests are homogenous but high where they are heterogenous[135]. It would be a reasonable assumption therefore that disputes within companies will arise from an economic perspective on account of both self-interested behaviour and bounded rationality. The two can immediately be seen to overlap. Were it not for the problem of bounded rationality the problem of self-interested behaviour could almost invariably be checked by contractual provision: this is consistent with Goddard's argument that contractual incompleteness is a major factor contributing to minority shareholder oppression[136]. It is valuable therefore to examine this problem of contractual incompleteness in more detail.

---

[130] Williamson, O.E. and Masten, S.E. (eds), "Transaction Cost Economics" (Edward Elgar, 1995).
[131] Williamson, O.E., "The Mechanisms of Governance" (New York: Oxford University Press, 1996), p. 377.
[132] Ibid., p. 377. For a valuable review of the literature on contractual incompleteness see Goddard, R. "Enforcing the hypothetical bargain: sections 459 – 461 of the Companies Act 1985" (1999) 20 Company Lawyer 66 at 68 – 70.
[133] Williamson, n. 131 above, p.13.
[134] Hansmann, H., "The Ownership of the Firm" (1988) 4 Journal of Law, Economics, and Organisation 267, cited in Romano, R., "Foundations of Corporate Law" (New York: Oxford University Press, 1993), p. 18.
[135] Ibid., pp. 20 –24. This can in fact be seen as another form of self-interested behaviour, but this time on the part of the owners rather than on the part of directors: hence, Hansmann gives as an example the strong incentive for individuals to form coalitions to shift benefits in their direction (p. 20).
[136] Goddard, R., n. 132 above, p. 68.

There is a widespread acceptance of the concept of contractual incompleteness and of its specific application to the company. It is a seemingly powerful notion to assume that because the company contract involves the exercise of rights and the performance of duties over a potential limitless period into the future, that the rights and duties conferred by that contract must be incomplete. In reviewing the literature, Goddard[137] identifies the following ways in which the contract may be considered incomplete. A contract in general terms fails to fully realise the potential gains from trade in all states of the world; may be relational in the sense of providing a framework to govern a relationship rather than a discrete transaction; and may be such that the parties cannot reduce important terms to well-defined obligations or either fail to do so at all or insufficiently tailored to economically relevant future events. The explanations for this state of affairs is argued to lie in transaction costs and the parties' strategic behaviour. Yet these arguments merit challenging. Whilst it is true that the company contract for many contracts is comprised of a default provision rather than an individually negotiated contract, many of its terms are of a technical and uncontroversial nature such that, if an "officious bystander" asked a potential shareholder whether the rule was acceptable, they would answer "of course". Parties have had the freedom to alter or substitute this pretty much as they please within limited constraints imposed by company law and, since many of these amendments appear in publicly available precedent books and there has been much scope for the authors of such precedents or their users to influence the development of generations of Table A, it would be reasonable to assume that there has been opportunity for amendment to be made to Table A. Perhaps, far from the company contract failing to reduce important terms into well-defined obligations, it has for much of its life done precisely that. In many commercial contracts the range of potential uncertainties for which contracts have to provide are almost infinite and therefore incompleteness is inevitable: in contrast, many of the provisions of Table A provide for the operation in effect of a closed model and incompleteness may not therefore be so inevitable.

Even if it accepted that many company contracts are incomplete, the question arises as to the role of *s. 459 Companies Act 1985* as an appropriate gap-filling mechanism. Riley[138] has argued that s. 459 is not to be regarded as a default provision, implied into the inter-shareholder bargain, yet capable of being validly excluded. He prefers the notion that s. 459 should be regarded as a mandatory, non-excludable provision. In particular, he argues that s. 459 provides the judiciary with a mechanism for the *ex post* control of the inter-shareholder bargain and that the reality is that some terms are implied, not to fill gaps, but to control the operation of the parties' express terms. Indeed, he goes so far as to argue that the courts create gaps by holding that even apparently explicit and unambiguous terms do not govern the specific dispute so that courts can then fill the gaps so created. In terms of the approach taken by the courts to the substance, rather than the procedure, of gap-filling, he applies the economic concept of the "hypothetical bargain" and supports it by reference to judicial practice in trying to reflect typical relationships within the class of company concerned. More recently, and in the light of *O'Neill v.*

[137] Ibid. See also MacNeil, I. "Company Law Rules: An Assessment From the Perspective of Incomplete Contract Theory" (2001) 1 J.C.L.S. at 112 – 118 who is sharply critical of incomplete contract theory.
[138] Riley, C.A., n. 52 above, pp. 796 – 797.

Phillips, Riley has argued that the courts are now retreating to a new "middle-ground" approach to the construction of shareholder relationships, being prepared to look to informal agreements, including those made subsequently to the original settling of the constitutional documentation (provided, perhaps, that there is reliance)[139]. Goddard[140] likewise sees s. 459 as a gap-filling mechanism and argues that the courts enforce two types of hypothetical bargain, a generalised bargain encompassing shareholder expectations often described as "universal" and a particularised bargain reflecting expectations which are "personal" in nature. There is considerable force in their arguments. However, it is questionable whether it is desirable for such a broad provision as s. 459 to be used to enforce hypothetical bargains rather than operating along usual contract principles, and, of course, the *O'Neill* decision represents a major change of judicial emphasis.

The concept of contractual incompleteness is widely accepted, and is a powerful tool of analysis in considering the efficiency of gap-filling mechanisms, such as s. 459. However, it is worth challenging the true utility of this concept to a contract such as the company contract where there is such an extensive range of default provisions provided by Table A combined with other mandatory provisions deriving primarily from company law. However, even if the concept were strongly applicable it must be applied cautiously before it is used to justify any particular form of judicial intervention or any form of hypothetical bargain.

AN ECONOMIC EVALUATION OF ADR

ADR possesses qualities which are both consistent and inconsistent with the attainment of economic efficiency. It has been shown that trials are inefficient because parties would be better off settling a dispute beforehand by agreement and if ADR is successful it will avoid a trial, although if the method of ADR selected is a mini-trial the conceptual distinction would appear to be limited. ADR is usually voluntary and voluntary agreements tend to be more consistent with economic efficiency than an imposed solution. However, there are some important reservations. Perhaps the most significant relates to the perceptions of rationality which provide the philosophical underpinnings for economic analysis and ADR. In economic analysis, people are seen as self-interested; in ADR, people are seen as co-operative. However, in game theory, the enforceability of contractual promises is seen as giving rise to credible commitments which in turn lead to co-operation[141]. There is a distinction between self-interested co-operation and co-operation *per se*. After all, if the parties to company disputes were perfectly co-operative then it is doubtful whether they would be in dispute anyway. A further issue which arises out of perceptions of rationality relates to how ADR might change the cost-benefit analysis of litigation in parties' perceptions . Secondly, if ADR is consistent with economic efficiency because it relies upon voluntariness and agreement, then there must

[139] Riley, C.A., n. 49 above, p. 19. Although the economic reasoning is hidden, he argues that this development reflects a continuing process of trying to identify an efficient set of default laws: ibid., p. 21.
[140] Goddard, R., n. 132 above, p. 66. Goddard concurs in these observations, preferring an approach based upon expectations, linked to the value of autonomy.
[141] Cooter, and Ulen, n. 118 above, pp. 187 – 188.

be a major reservation where ADR is sought to be compelled through civil procedure. Further, there is a risk that voluntariness and agreement may be distorted where there is a power imbalance and bullying is possible. In addition, this may have a potential impact on contracting patterns if parties see ADR as something to seek to contract around or to define contractually. Thirdly, the assumptions for economic efficiency to result include the protection of property rights and promises. Certain aspects of the philosophy of ADR are inconsistent with the rigorous upholding of such rights in the interests of obtaining a co-operative solution.

An alternative approach to economic analysis of ADR is to focus on the market for dispute resolution. Cooter and Rubinfeld[142] question whether the disinterestedness of judges provides the best incentive structure or whether competition among adjudicators might improve the efficiency of dispute resolution, citing in support the use by parties in California of retired judges (albeit in a legal system in which the judge was bound by the state's substantive laws but not by its procedural laws, and where, after filing, the decision acquired the force of law). On this basis, private judges would maximise their own incomes by deciding disputes so as to maximise the demand for their services: if a judge's decisions were not on the Pareto frontier, a rival judge could lure away the former's customers by offering decisions that both parties prefer[143]. There would therefore be a strong incentive for private judges to achieve Pareto efficiency with respect to disputants[144]. However, the parties to such a dispute would not internalise all the benefits of improving the law[145]. Better rules would benefit future cases to which the parties would not be involved and therefore judges might lack incentives to create new laws[146]. Such an approach raises many interesting questions when applied to company disputes. To date, the market for dispute resolution has been confined to the role of the state and a limited role conferred on experts by contract. The state has been unresponsive to demand, as evidenced by the judicial use of "floodgates" arguments to seek to restrict demand. One solution to this is to attempt to open up a competitive market in the provision of dispute resolution as ADR might be seen. The presence of competition is usually positive but may be limited. One solution might appear to be licensing alternative courts with powers equivalent to those of state courts. Yet this might neglect the important public goods role of the state courts in developing legal rules. Nonetheless, there might be some benefits in extending this approach to analysis which falls outside the scope of this article.

CONCLUSIONS

Alternative dispute resolution is not a new concept in company law and practice. The Bellenden Ker Committee in 1837 carefully considered the problems of partnership disputes and recommended that arbitration agreements within partnership agreements should be enforceable in the courts (which lacked the ability to deal with such disputes

[142] Cooter and Rubinfeld, n. 117 above, p. 1093.
[143] Ibid., p. 1093.
[144] Ibid., p. 1093.
[145] Ibid., p. 1093.
[146] Ibid., p. 1093.

principally because of their accounting complexity). However, the attention of the Gladstone Committee in 1845 was focused more upon the problem of "bubble companies" than on shareholder disputes. Notwithstanding this, early companies' legislation developed the core mechanisms for dealing with company disputes: the general meeting; the contractual framework; and dissolution where just and equitable. These mechanisms were flawed from the outset, certainly in respect of smaller companies. The general meeting appears to have been regarded as a form of alternative dispute resolution with the intention that company disputes should only rarely come before the courts, for example, where there was fraud on a minority by wrongdoers in control. However, it was unfitted for such a role by the inherent limitations of a decision-making body where decisions are taken by majority vote and personal contractual disputes did not fall within its remit. The limitations imposed by judicial interpretation on the statutory contract ensured that this also failed to realise its potential as a means to resolve company disputes. This left the remedy of winding up - widely seen as inappropriate - to develop as the principal remedy for many grievances. *Section 459 Companies Act 1985* provided a broad remedy for unfairness but has been restricted by the House of Lords largely to a contractual view of what constitutes unfairness which in turn has been followed by proposals from the Company Law Review Steering Group for a less restrictive approach to be taken to the statutory contract. A review of the causes of company disputes provides support for the proposition that – in relation to smaller companies at least - relatively few company disputes directly result from contractual provision but that many relate to matters for which contractual provision could have been made.

The role of ADR within company law and its underpinning by co-operative values was considered. The background to the *Civil Procedure Rules 1998* was considered, and revealed a lack of clarity as to what was meant by ADR, when it would be unreasonable to refuse ADR and what would constitute behaving unreasonably in the course of ADR. Recent case law on *s. 459 Companies Act 1985* was reviewed, and this confirmed the lack of clarity as to what would be regarded as ADR and the quasi-mandatory status of ADR. The latter in particular caused concern, as it appeared to be in conflict with the inherent nature of ADR. Company law and practice in relation to contractual drafting was considered and it was seen that there were highly developed mechanisms being employed which could lead to a duplication of effort with the employment of ADR during the course of litigation. It was seen how rights-based disputes might pose particular problems and how ADR might be beneficial to a bully if inappropriately constructed. However, grievance and interests-based disputes might be well-suited to ADR, including the most common form of exclusion case.

The approach to economic analysis was then explained, in particular the value placed on efficiency and its assumptions as to individual rationality and the need for appropriate protection of the person, property and promises and perfectly competitive markets with no transaction costs. The nature of a legal dispute was analysed in cost-benefit terms, the problem of how to correct relative optimism by requiring the compulsory disclosure of information. The inefficiency of vague laws was observed. The causes of company disputes was analysed in economic terms and in particular the problem of contractual

incompleteness and the role of the courts as gap-fillers. It was seen that the courts' approach to gap-filling has primarily been analysed in terms of the hypothetical bargaining model and how this diverged from the ordinary role of the courts in contractual matters. ADR was then analysed from an economic perspective and it was seen that, in some respects, it was consistent with economic efficiency but that there were serious reservations whereby it might be inconsistent, not least if due regard was not paid to the protection of legal rights in the interests of promoting a resolution of a dispute. In addition, it was observed that there were some promising linkages to be derived from analysis of the market in dispute resolution.

Ultimately, ADR and economic analysis are based on different values, and therefore which is preferred will depend upon which is more consistent with the underlying beliefs which underpin these values. However, the apparent tensions between the two in practice may be less significant than might be supposed, and might be reduced if: (1) ADR is encouraged rather than co-erced; (2) ADR is not used where existing agreed dispute mechanisms have been ineffective (except to render the latter effective); and (3) ADR is used cautiously so that legal rights are protected. Nonetheless, ADR should not be seen as the principal solution for the problems generated by company disputes identified at the beginning of this article. The real solution is to revisit – and update - the contractual framework of the company so that it conforms as much as possible to general principles so that any more broadly based remedy which deviates from these can be more clearly focused.

A form of ADR – the general meeting - was placed at the heart of early companies' legislation and there is much scope for developing this principle in the light of ADR techniques aimed at preventing disputes arising such as partnering within the construction industry. To do so requires a radical rethink of the company contract which still resembles its Victorian origins. The Company Law Review Steering Group should be commended for their willingness to do so.