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THE PLIGHT OF THE UK PRIVATE COMPANY MINORITY SHAREHOLDER

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Abstract: Agency cost analysis is a fundamental aspect of Anglo-American company law theory. Within the company three types are said to exist: director/shareholder, majority/minority and firm/outside world. Whilst law is, doctrinally, consistent at mitigating the first of these (the paradigmatic corporate agency cost), it fails to mitigate the second. Several features of UK company law exacerbate this agency cost, which is felt most acutely in private companies. Ostensible protections for the minority fail to mitigate these issues. This raises questions for company law theory: should law provide additional minority protections, or do fundamental differences exist between categories of agency costs identified within the company?

1. INTRODUCTION

Agency cost analysis pervades Anglo-American company law discussion.1 This analysis arises from the simple observation that whenever a first person performs services for a second person involving the first’s discretion, the first has incentives to exercise this discretion to their advantage, rather than that of the first – with any loss caused by such incentive being an ‘agency cost’.2 Directors are an evident causer of such costs.3 The cost-sufferer is normally considered to be the shareholders.4 This was the paradigmatic agency cost first identified in company law, and followed neatly from the then-dominant analysis concerned with a ‘separation of ownership and control’ within a public company.5 Bainbridge argues that, when faced with unexpected profits, each director must think "I can either spend $100

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million on a new corporate jet or I can distribute the $100 million to the shareholders by increasing the size of the dividend.” Can anyone doubt that some board will buy the jet?6 This article is concerned with reviewing doctrinal UK company law in light of a different category of agency cost: that arising between the majority and the minority, especially in private companies.

Agency costs consist of three elements: bonding costs (the costs agreed to be paid to bond the agent to you), monitoring costs (the costs that you incur to check that the agent is doing what they should) and the residual loss.7 The residual loss is the difference between what the principal could have obtained themselves, and what the agent obtains. This arises because the agent’s interests are not fully aligned with the principal: as they do not receive the benefit of the contract, they are less likely to push for the best deal. Residual loss can be split into two costs: rent-seeking8 and shirking.9 Rent seeking involves the agent using their position to extract economic benefits in excess of their worth: for example, by diverting the principal’s resources to themselves in addition to receiving the pre-agreed bonding cost. Shirking occurs when the agent simply does not try as hard to obtain the best deal as they could for their principal: not just the ordinary word meaning of avoiding working hard, but also not acting in the best interests of your principal. We can see bonding costs and monitoring costs as ex ante methods to avoid ex post suffering of residual loss,10 however whichever component a principal suffers, and whether they suffer such costs ex ante or ex post, they still suffer an agency cost.

Director/shareholder agency costs arise due to formal separation of roles between directors and shareholders.11 Private companies are generally more closely held, and closely held companies generally have lower director/shareholder agency costs as shareholders have greater control over directors.12

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6 Bainbridge, n. 1 above, 6.
11 Ss 11 – 12 Companies Act 2006.
Conversely, listed companies with wide shareholder bases have high director/shareholder agency costs\textsuperscript{13} given the power disparity between centralised management and diverse, small shareholders. This risk is partially mitigated by the public market for shares which enables shareholder exit when dissatisfied with management.\textsuperscript{14}

Normative statements abound that law should do all it can to reduce agency costs.\textsuperscript{15} For our purposes, it is sufficient to note that UK law (used throughout this article as shorthand for provisions which apply under both English and Scots law) often does act to reduce agency costs – but only for the paradigmatic agency cost. Thus we see protection within this paradigmatic agency cost against rent seeking residual loss,\textsuperscript{16} shirking costs,\textsuperscript{17} bonding costs,\textsuperscript{18} and monitoring costs.\textsuperscript{19} These protections are higher where they are needed most – within publicly traded companies.


\textsuperscript{16} E.g. by requiring shareholder approval for the company to enter into substantial transactions with shareholders (ss 190 and 197 Companies Act 2006).

\textsuperscript{17} For example, by way of duties owed by directors to the company - see Parker Hood, \textit{Directors’ Duties under the Companies Act 2006: Clarity or Confusion?} 13 Journal of Corporate Law Studies 501 (2013); Rosemary T. Langford, \textit{General law and statutory directors’ duties: “unmixed oil and water” or “integrated parts of the whole law?} 131 Law Quarterly Review 635 (2015); Deirdre Ahern, \textit{Directors’ Duties, Dry Ink and the Accessibility Agenda} 128 Law Quarterly Review 114 (2012).

\textsuperscript{18} By restricting long term service contracts with directors – s 188 Companies Act 2006, and requiring shareholders to approve substantial remuneration to directors in public companies - Companies (Directors’ Remuneration Policy and Directors’ Remuneration Report) Regulations 2019 (SI 2019/970). This report has been required in some form since 2003 – see Betty H.T. Wu, Iain MacNeil and Katarzyna Chalaczewicz-Ladna, ‘Say on pay’ regulations and directors remuneration: evidence from the UK in the past two decades 20 Journal of Corporate Law Studies 541 (2020).

\textsuperscript{19} For example, due to requirements to have independent directors (Financial Reporting Council, \textit{UK Corporate Governance Code} (2018) (available at \url{https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d244f8069b2/2018-UK-Corporate-Governance-Code-FINAL.pdf} accessed 15 December 2020), provisions 9 and 11, applied by FCA, \textit{Listing Rules}, Rule 9.8.6(6) (available at \url{https://www.handbook.fca.org.uk/handbook/LR.pdf} accessed 15 December 2015). These adopt a ‘comply or explain’ basis (see Konstantinos Sergakis, \textit{Deconstruction and reconstruction of the ‘comply or explain’ principle in EU capital markets} 5 Accounting, Economics and Law 233 (2015)).

Two other agency costs are said to apply to companies: majority/minority agency costs, and agency costs between the company itself and the outside world.20 This article argues that, doctrinally, UK law fails to mitigate the former agency cost, which differs from the approach of UK law outlined above in respect of the paradigmatic director/shareholder agency cost. This article’s novelty is in reviewing doctrinal UK company law through the lens of components of majority/minority agency costs. Its insights are most important where the potential for majority/minority agency costs is greatest – being within private companies.

Majority/minority agency costs provide a plight for UK private company minority shareholders. First, whilst risks arise in public companies,21 in private companies majorities are more likely to form22 thus giving them more power, exacerbating this type of agency cost.23 Second, dominant shareholders of listed companies have to enter into binding agreements to limit their dominance over the company,24 whereas no equivalent exists within UK private companies. Third, UK private company majorities lack an easy exit, as they cannot withdraw their funds25 and have no liquid secondary market.26 UK law does not restrain the majority as it does directors. Indeed, UK company law enables majority capture of directors allowing triangulation of such costs through directors. Triangulation does not affect the core agency issue (the majority remain the agent and the minority the principal, in agency theory terms), but does affect how it is manifested: actions of one other than the agent cause the cost. Indeed, in this triangulation the agent effectively utilises their own agent to inflict the cost on the underlying principal. This triangulation is caused by two features of majority control in UK company law: shareholders dictate the division of powers within the company, and shareholders can remove directors.27 These two powers are controlled by the majority, and risk directors acting as conduits for inflicting majority/minority agency costs. Whilst UK law provides certain restraints on rent seeking by the

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20 Kraakman et al, n. 1 above, 2 & ch 2.
22 Enriques and Volpin, n. 12 above, 112-115.
23 Ross, n. 9 above.
26 Not only is there no liquid market, private company articles of association frequently provide restrictions on the transfer of shares – see Jonathan Hardman, Articles of Association in UK Private Companies: An Empirical Leximetric Study (forthcoming) European Business Organization Law Review. In addition, if they are able to sell, the market is likely to be monopsonistic – giving the buyers a disproportionate power to set prices, especially if coupled with an eager seller – see Dan D. Prentice, The closely-held company and minority oppression 3 Oxford Journal of Legal Studies 417 (1983).
27 Caused by the balance of power between directors and shareholders being controlled by the shareholders, and shareholder ability to remove directors under s 168 Companies Act 2006. See discussion in part 4 below.
majority, it provides no restraint on shirking: indeed, it encourages it by encouraging majority capture of the board of directors.

This does not matter if other areas of UK law provide mitigation. If directors’ duties are incapable of majority capture, or the minority enjoy adequate remedies, the risk of such triangulation is mitigated. Unfortunately, neither is the case.

This presents a particularly negative outcome for minority shareholders in UK private companies. Incentives are higher for them to suffer these costs than minority shareholders in listed companies generally. Unlike director/shareholder agency costs in listed companies, there is no right of exit, so equivalent disciplining effects to those of the market applicable to public companies do not apply to UK private companies. The minority lack protections against majority/minority agency costs, other than some protections against rent seeking. Worse, this manifestation can be triangulated by the directors, and the rest of UK company law exacerbates matters.

This analysis demonstrates that UK law does not respond uniformly to different types of agency costs within companies. Either there are unexplored differences between agency costs depending on who suffers them which justify such differences, or UK law is inconsistent. It also shows us that majority/minority agency costs require further analysis, as do the economic forces within private companies.

Until these are addressed, there remains an imbalance within UK company law – causing quite a plight for UK private company minority shareholders. This article proceeds as follows. Part 2 outlines the theories and the UK doctrinal basis for majority rule, the cause of majority/minority agency costs. Part 3 explores what restraints exist on majority voting under UK law, and finds that they do not protect the minority from majority oppression. Part 4 explores the UK doctrinal rules which enable the majority to capture the board, thus exacerbating the plight of the minority. Part 5 reviews whether other areas of doctrinal UK company law could act to mitigate these issues, and finds that they cannot be said to do so. Part 6 outlines implications of this analysis and part 7 concludes.

2. MAJORITY RULE

Majority/minority agency costs arise from shareholder majority rule. They could not arise if every shareholder decision required unanimity. Majority rule originated in the UK from necessity – as how the East India Company and Virginia Company managed large shareholder bases.

Arrow argues majority rule is flawed in businesses.\textsuperscript{30} It is not economically efficient.\textsuperscript{31} Eisenberg argues its use is merely practical. He explains unanimity may work in partnerships, which can be terminated and capital withdrawn,\textsuperscript{32} so failure to obtain unanimity is short term. However, companies are (without a supervening event) perpetual.\textsuperscript{33} Accordingly, unanimity provides each shareholder with a perpetual veto, trapping funds.\textsuperscript{34} Easterbrook & Fischel state unanimity risks ‘deadlock’, ‘paralyzing the firm’.\textsuperscript{35} Berle & Means state ‘the disadvantages of the ‘liberum veto’ are too great ... The granting of control to a majority of stockholders has therefore been a natural and generally acceptable step.’\textsuperscript{36}

‘Liberum veto’ was the ability of any legislator in the historic Polish-Lithuanian Commonwealth to veto legislation, which is blamed for causing corruption-induced paralysis.\textsuperscript{37} This phrase, therefore, transcends practicality: unanimity enables each minority shareholder to extract benefits for her cooperation. This is called ‘hold out’, which is economically inefficient, rent-seeking behaviour.\textsuperscript{38} Accordingly, unanimity lets each shareholder hold out for their own private interests and so rent seek, which creates an agency cost and is inefficient for the company. Majority rule resolves this, as the consent of another, fungible shareholder could be sought. Cheffins agrees with this rationale for majority rule.\textsuperscript{39} As such, majority rule removes the potential for minority opportunism and so a rent seeking agency cost caused by the minority.

Berle & Means state effective aggregation of capital requires some loss of control.\textsuperscript{40} Unanimity makes it harder for shareholders to act, including to discipline delinquent managers. Majority rule therefore reduces director/shareholder agency costs. A labour law analogy is helpful – UK trade unionism was historically justified as capital is automatically collectivised, whereas labour is dispersed, so collectivisation of labour equalised the bargaining position.\textsuperscript{41} Similarly, majority rule enables disparate shareholders to collectivise without hold outs: it makes holding managers to account easier, which reduces any agency costs arising from directors by way of shirking and monitoring costs.

\textsuperscript{32} For the UK position, see s 32 Partnership Act 1890.
\textsuperscript{34} Melvin Eisenberg, *The Structure of the Corporation, A Legal Analysis*, 16 (Washington: Beard Books, 1976).
\textsuperscript{36} Berle & Means, n. 5 above, 67.
\textsuperscript{40} Berle and Means, n. 5 above, 67.
Accordingly, in addition to majority rule preventing oppression by the minority, it further reduces director/shareholder agency costs.

Despite benefits of majority power, it exposes the minority to opportunistic activity. Berle & Means dismiss this, as majority and minority interests mostly align. Where not, this is a cost of being a minority shareholder.\(^\text{42}\) Easterbrook and Fischel disagree, arguing that legal protection of the minority may be necessary.\(^\text{43}\) Cheffins agrees with Easterbrook and Fischel.\(^\text{44}\)

Therefore, majority voting protects against minority holdout (rent seeking) and helps protect against director/shareholder agency costs. However, it only displaces those: it exposes the minority to potentially oppressive actions of the majority and may require legal mitigation. Do these oppressive actions equate to an ‘agency cost’? Ross defined agency for the purposes of agency costs as arising ‘between two (or more) parties when one, designated as the agent, acts for, or on behalf of, or as representative for the other, designated the principal, in a particular domain of decisional problems.’\(^\text{45}\) Majority rule means that the majority bind the minority, so the minority in effect delegate their decision making to the majority meeting this definition. Similarly Jensen and Meckling define such a relationship as ‘a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent’\(^\text{46}\) Majority rule also make majority/minority relationships fit into this definition, as the majority make decisions which bind shareholders as a whole, which includes the minority. The *Anatomy of Corporate Law* have an even wider definition of an agency relationship, in which an agency problem ‘arises whenever one party, termed the “principal”, relies upon actions taken by another party, termed the “agent”, which will affect the principal’s interest’.\(^\text{47}\) Decisions taken by the majority also bind the minority, and as such they undoubtedly affect the interest of the minority. Accordingly, under each of these three definitions, the relationship between minority and majority can be said to be a principal/agent relationship. As such, majority rule creates ‘horizontal’ agency costs.\(^\text{48}\) Even if majority/minority relationships cannot be defined as agency relationships, the same incentives for opportunism at the expense of one party arise, and as such create the same structural disadvantage for the minority as exist within the paradigmatic agency cost.

\(^{42}\) Berle and Means, n. 5 above, 67.
\(^{43}\) Easterbrook & Fischel, n. 35 above, 248. Thompson also argues that there is a particular vulnerability that minority shareholders in private companies are exposed to as a result of majority rule – see Robert B. Thompson, *The Shareholder’s Cause of Action for Oppression* 48 The Business Lawyer 699 (1993).
\(^{44}\) Cheffins, n. 1 above, 68–69.
\(^{45}\) Ross, n. 9 above, 134.
\(^{46}\) Jensen and Meckling, n. 2 above, 308.
\(^{47}\) Kraakman et al, n. 1 above, 29.
Majority rule is enshrined in UK company law. No shareholder resolutions require unanimity under UK law.\(^{49}\) An article of association may be ‘entrenched\(^{50}\) in the constitution of a UK company, so require more than 75 per cent to amend it which could protect the minority. Unfortunately, entrenchment is voluntary – on incorporation or by unanimity afterwards.\(^{51}\) For entrenchment to protect the minority under UK law, the majority must agree, ultimately, to alienate future amendment rights, and expose themselves to future minority rent seeking. This undermines any minority protection potential for entrenchment. It is very rarely used in practice,\(^{52}\) further lowering the protective qualities.

Majority voting gives rise to majority/minority agency costs, primarily the residual loss of shirking costs (as the majority can ignore the minority) and rent seeking (as the majority can try to divert funds to themselves). As noted above, these are higher in private companies than traded public companies. Easterbrook & Fischel downplay the relevance of a lack of secondary market, stating ‘consider the extreme case in which a majority shareholder appropriates 100 per cent of the firm’s income for himself. Even if a minority stockholder had an unrestricted ability to sell his shares, nobody would buy them. Illiquidity is not the problem.’\(^{53}\)

However, illiquidity prevents a disciplining effect equivalent to the market for corporate control mitigating the issue. Whilst it does not cause the underlying problem, it denies the minority a market-based solution.\(^{54}\) Easterbrook & Fischel identify four further problems: valuation of a shareholding is difficult; investors prefer distribution over exit; monitoring & constraining managers is harder; and capital raising is more difficult (as valuation is).\(^{55}\) Accordingly, monitoring costs are higher in private companies as the market fails to provide an exit: leading to higher agency costs for minorities in private companies.

Rock & Wachter offer three illustrations of residual loss which can be suffered by minority shareholders. First, if minority and majority shareholders are employed by the company, profit

\(^{49}\) There are two types of majority rule: ordinary (50 per cent + 1) and special (75 per cent) resolutions – s 281 Companies Act 2006. Major matters require special resolutions, otherwise ordinary will suffice – see s 21 (1) and s 281 (3) Companies Act 2006. Risks to the minority in majority rule are often acknowledged – see Sevilleja v. Marex Financial Ltd [2020] UKSC 31, [107]. The situation is worse in the US where directors are elected normally by way of a plurality of votes, which has been argued to relegate the effect of shareholder voting to being merely symbolic – Joseph A. Grundfest, Just Vote No: A Minimalist Strategy for Dealing with Barbarians inside the Gates 45 Stanford Law Review 857 (1993). It is empirically argued, however, that plurality voting and majority voting create the same results – see Jay Cai, Jacqueline L. Garner and Ralph A. Walking, A Paper Tiger? An Empirical Analysis of Majority Voting 21 Journal of Corporate Finance 119 (2013).

\(^{50}\) S 22 (2) Companies Act 2006.

\(^{51}\) ibid, as discussed in Rita Cheung, The use of statutory unanimous shareholder agreements and entrenched articles in reserving minority shareholders’ rights: a comparative analysis 29 The Company Lawyer 234 (2008).

\(^{52}\) See Hardman, n. 26 above.

\(^{53}\) Easterbrook and Fischel, n. 12 above, 275.

\(^{54}\) See Hetherington and Dooley n. 39 above.

\(^{55}\) Easterbrook and Fischel, n. 12 above, 275–276.
Empirically, majority shareholders receive greater
diversity than minorities in companies, and recompense the majority for part of their
private benefits of control in return for them monitoring management. This is true to an extent –
given that having a majority reduces director/shareholder agency costs, the minority is likely to be
willing to pay an agreed bonding cost to the majority, and recompense the majority for part of their
costs in monitoring management.

However, there are no restrictions preventing this agreed bonding cost from transcending into an
opportunistic shirking or rent seeking agency cost. Any particular shareholder’s personal interests are
unlikely to fully and completely align with the interests of the body of shareholders as a whole, providing them with an incentive to cause a residual loss to the minority. This creates a need for the minority to monitor the majority, incurring additional monitoring costs. Whether arising by way of bonding cost or monitoring cost, the majority’s higher reward is a further manifestation of majority/minority agency costs. It is unclear why the majority shirking or rent seeking is embraced, but directors doing so is seen as unacceptable. Either both are an inherent risk of the corporate contract, or neither are. An arch-contractarian is likely to argue that both director/shareholder agency costs and majority/minority agency costs can be contracted away. However, the act of contracting is expensive: whilst providing a cohesive contract is likely to reduce monitoring costs and residual loss, putting in place the cohesive contract will cost money – increasing the bonding cost.

57 This is a particular issue for unlisted companies as, again, there is no disciplinary market. Here, the company acts as the price-setter. If it sets the price too low, no-one will take up the offer. Accordingly, that someone accepts the offer indicates that the buyback is at or above the amount that they value the shares at. As such, having a selective buyback allows not only a return on capital to the majority, but potentially a generous return on capital to the minority. See discussion in Prentice, n. 56 above, 60. In addition, any prejudicial behaviour towards the minority is likely to drive down the value of their shares (Hetherington and Dooley, n. 39 above, 5-6).
60 Ronald J. Gilson, Controlling shareholders and corporate governance: Complicating the comparative taxonomy 119 Harvard Law Review 1641 (2005); Manne, n. 14 above.
63 Fama, n. 19 above, and Easterbrook and Fischel, n. 12 above, respectively.
than an expensive but complete contract will provide opportunity for the divergent interests of principal and agent to manifest into monitoring costs and residual loss. Accordingly, the contractual approach cannot fully resolve agency costs, merely replace monitoring costs and residual loss with bonding costs.65

A response to this argument is that a potential investor will not become a minority shareholder in a private company unless they are satisfied that all terms of the bargain are satisfactory: in other words, that they are satisfied with the potential risk for residual loss.66 However, this oversimplifies agency cost mechanics: as residual loss is ex post, it is unknowable in advance. The decision is therefore not as simple as establishing whether a known risk is worth a perceived upside. Instead, they are evaluating a perceived risk against a perceived upside. When making an investment, investors are likely to experience overconfidence in their own ability to identify both the investment opportunity (the upside) and the nature of those that they are proposing to invest alongside (the risk).67 We cannot therefore discern that a decision to invest itself provides an acceptance of all ex post agency costs which may arise – merely an acceptance of the investor’s perception of the risk that the majority will undertake ex post abuses. If, as is common, overconfidence means that the investor unilaterally perceives the risk as lower than it is without prompting, they have no protection. This is likely to be exacerbated by starting the process for negotiating ex ante protections against residual loss, and thus incurring bonding costs: all time and money spent on such negotiation represents a sunk cost that the investor will not be able to recover should they not invest, but may be able to recover should they invest.68 So not only are the minority likely to underestimate the majority’s likelihood of causing them residual loss, any attempt to start the process of incurring ex ante costs makes the investor more likely to complete the transaction, even if they fail to obtain the protections that they considered necessary. They will, therefore, struggle to compare likely agency costs with the opportunity costs of incurring costs themselves or an alternative way.69 In addition, it is not inevitable that minorities will even undertake such a stark economic ‘cost benefit’ analysis of their decision to invest – decisions may be taken on the basis of relationships rather than pure economic benefit.70 In either case, the argument that the

65 We make no comment as to whether the bonding cost incurred is less than the residual loss and monitoring cost saved. It may well be, but for our purposes suffice to note that having increased contractual protection does not entirely resolve agency costs – the cost incurred as part of such negotiation form part of agency costs, meaning agency costs are inherent.

66 See Easterbrook and Fischel, n. 12 above, 300 – 301.


69 Goshen and Squire, n. 9 above.

70 See the discussion in Croly v. Good [2010] EWHC 1 (Ch). Certainly, private companies are more likely to revolve around the family, and if so minorities are less likely to make decisions purely on economic grounds – see Lorraine
minority investing a minority stake is sufficient evidence that they have undertaken a fully informed cost-benefit analysis is flawed. More importantly and perniciously, any attempt to advance such an argument would, of course, reveal a doctrinal double standard: director/shareholder agency costs have legal protections under the UK regime, and it is not argued that shareholders must have agreed to untrammelled residual loss from directors by dint of investing as a shareholder in the company.

Accordingly, contractual resolutions of minority agency costs do not protect the minority, and having to rely on such protections would highlight a double standard. Market based resolutions of agency costs are predicated upon a public market. As controlling agency costs in some form is seen as universally important across schools of thought, an inability for contractual or market mechanisms to control them means there is a role for UK law to control them – as it does for the paradigmatic agency cost.

Listed company minorities are protected as majorities are less likely to form, and the market disciplines: if all minority shareholders exit, the share price will drop. In addition, even in unlisted UK plcs, minority shareholders are protected by the takeover code: a shareholder must offer for all shares if she hits an ownership threshold in a UK plc (currently 30 per cent), discouraging passing this threshold. Accordingly, to generate majority/minority agency costs, a shareholder must form a coalition. However, acting in concert results in the threshold being triggered. Majories do not, of course, have to be absolute - comparative majorities can exist. If one shareholder holds 29.9 per cent and all other shareholdings are 0.1 per cent each, the first is dominant. However, the collective ability of other shareholders to override the dominant shareholder lowers all components of majority/minority agency costs. Further, as noted above, dominant shareholders are required to agree to curtail their influence. As such, the minority in private companies suffer the most from this agency cost created by majority rule.

3. CONSTRAINTS ON THE MAJORITY

Majority rule risks majority/minority agency costs. UK law mitigates director/shareholder agency costs. Unfortunately, it does not do so to the same extent for majority/minority agency costs. To explore this, we start by examining whether UK law restricts how the majority votes.

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71 E.g. Fama, n. 19 above; Manne, n. 14 above.

72 See views from Easterbrook & Fischel, n. 62 above, 1436-1437 to Kraakman et al, n. 1 above, 30.


75 *ibid*, D14 Rule 2.7.
A. The Base Position

The classic formulation of voting obligations for shareholders in UK companies arises in North-West Transportation v. Beatty. Here a majority shareholder/director (Beatty) agreed to sell his personal steamer, The United Empire, to the company. The United Empire suited the company’s needs at a good price. Nonetheless, the shareholders only narrowly voted for the purchase. Beatty’s shares constituted the majority. The minority commenced action to restrain the purchase.

The Privy Council held Beatty’s directorship meant the general meeting could ratify or repudiate the contract. Beatty could vote as he wanted. Sir Richard Baggallay stated:

[T]he resolution of a majority of the shareholders … is binding upon the minority and consequently upon the company, and every shareholder has a perfect right to vote upon any such question, although he may have a personal interest in the subject-matter opposed to, or different from, the general or particular interests of the company.

This case demonstrates that ‘in general, members are entirely free to exercise their own judgement as to how to vote’. The Privy Council followed the existing UK judicial approach that shares are the property of the shareholder. Jessop MR stated ten years earlier ‘if these shareholders have a right of property, then…the motives which induced them to exercise it are entirely beside the question.’ If shares are the property of the shareholders, then shareholders can vote shares as they like, including ignoring court orders binding the company. Walton J explained:

The fact that the result of the voting… will bind the company cannot affect the position that, in voting, he is voting simply in exercise of his own property rights… a director is an agent… a shareholder who casts his vote in general meeting is not casting it as an agent of the company in any shape or form… they have no duties to consider the minority when exercising that decision.

However, this rings hollow: majority rule means the actions of the majority bind the minority. Nonetheless, a shareholder in a UK company can vote only in their own interests, and ignore other shareholders’, and the company’s, interests. Indeed, it is possible for a shareholder in a UK company to cast their vote deliberately to harm another shareholder and even act with ‘malice’ towards other
shareholders. This position has been criticised, but remains the doctrinal base position. In addition, UK courts have expressed general unwillingness to interfere in internal company decisions.

### B. Ostensible Exceptions to the Rule

Thus, the default position under UK law is that shareholders can vote however they like, providing no protection to minorities against bonding costs, monitoring costs or the residual losses caused by shirking or rent seeking. This disadvantages the minority in UK companies in comparison with the paradigmatic ‘vertical’ agency cost: whilst directors of UK companies face legal restraints on incurring agency costs, the majority generally do not. Exceptions to this stark proposition were acknowledged even in *Northwest v. Beatty*. Palmer provides three: undervalued transactions; economically damaging the minority; and amending class rights. Unfortunately, these only protect the minority against certain categories of rent seeking, but no other components of agency costs.

The first exception under UK law is stated to be undervalued transactions. In *Menier v. Hooper* a majority voted to appropriate company property, which the court struck down. Palmer argues this demonstrates the majority in a UK company cannot vote to appropriate company assets at undervalue. Here, the undervalue was effectively a distribution, without distributable profits being available, and so constituted an invalid dividend. This would have failed even with unanimity of shareholder votes. The opposite issue arose in *Atwool v. Merryweather*, where two promoters promoted a company to buy for £7,000 their mine worth £4,000. The balance would be shared between the

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89. S 239 (4) Companies Act 2006 prevents a shareholder voting to ratify her own acts as director. Accordingly, *North-West v. Beatty* would be decided differently today for a UK company – Davies, n. 24 above, 378. However, this only arises for a specific type of resolution, rather than as a general statement in respect of the rights of voting of shareholders.
91. Morse et al, n. 76 above, para. 7.630.
92. This is sometimes referred to as an obligation of good faith when amending articles of association (see Brenda Hannigan, *Company Law*, paras 5-15 – 5-30 (Oxford: OUP, 5th edn, 2018); Alan Dignam and John Lowry, *Company Law*, paras 8.44-8.46 (Oxford: OUP, 11th edn, 2020); Sarah Worthington, *Sealy & Worthington’s Text, Cases, & Materials in Company Law*, 231-247 (Oxford: OUP, 11th edn, 2016)). If viewed in this light, the line of authorities becomes difficult to follow – see Constable v. Executive Connections Ltd [2005] 2 B.C.L.C. 638, Ch D, 652, as discussed in Brenda Hannigan, *Altering the articles to allow for compulsory transfer – dragging minority shareholders to a reluctant exit* Journal of Business Law 471 (2007). We adopt a broader interpretation for two reasons. First, narrowing to amending articles of association would provide even less protection for the minority already. Second, it is more appropriate to discuss whether this can be seen as a general obligation – see Davies and Worthington, n. 28 above, paras 19-4 and 19-5.
94. ibid, 354.
95. Morse et al, n. 76 above, para. 7.632.
96. A position which has been affirmed in *Averling Barford Ltd v. Perion Ltd* [1989] 4 WLUK 159.
97. For the modern law, see Ferran, n. 25 above.
promoters (also the majority). Once other shareholders realised the value, they summoned a meeting to litigate. With the promoters’ votes the vote lost; without them the vote won.

Wood VC considered the company merely a fraud. As such, the minority had not genuinely subscribed for shares. They were, accordingly, entitled to *restitutio*. The issue of voting constraints never arose. All transactions were unwound to the position pre-fraud. Accordingly, such authority does not protect the minority against majority voting power under UK law, absent fraud or illegal distribution.

The second exception is the putative inability of a UK company’s majority to undermine the minority’s economic interests. The classic case is *Allen v. Gold Reefs of West Africa, Limited*. Here, articles of association provided a lien over partially paid shares. Most shareholders had only partially paid shares, although Zuccani also had fully paid shares. Zuccani died, and his estate financially struggled. A shareholder resolution extended the lien to fully paid shares, against the estate’s interests. The directors called unpaid amounts on shares. Zuccani’s estate could not pay, so the company had a lien over all Zuccani’s shares which the directors enforced. This small constitutional change therefore disenfranchised Zuccani’s estate, who challenged the lien.

Lindley MR famously held that voting by shareholders in UK companies must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised... bona fide for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied, and are seldom, if ever, expressed.

This dictum’s value is limited. The majority voted to deprive Zuccani’s estate – not ‘bona fide for the benefit of the company as a whole’. Nonetheless, the amendment stood. Lindley MR held the court could not restrict freedom to amend articles. However, he could have implied his dictum to the exercise of such freedom. He then considered whether any agreement between Zuccani and the company estopped the amendment. He found none, despite ‘endeavouring in vain’ to.

He needed not endeavour had he applied his own dictum. His analysis moved seamlessly from ‘each shareholder of a UK company always has a duty’ to ‘no agreement created a duty’. Agreements are irrelevant under his initial dictum. A majority-favourable and minority-detrimental amendment was upheld and Lindley MR’s dictum found wanting. *Allen*, ultimately, fails to provide adequate protection

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99 ibid, 464.
101 See Morse et al, n. 76 above, para. 2.1135.
102 *Allen v. Gold Reefs of West Africa, Limited* [1900] 1 Ch 656.
103 See Davies and Worthington, n. 28 above, paras 19-4 and 19-5; Morse et al, n. 76 above, paras 2.1148 and 2.1149.
105 ibid.
106 ibid, 672.
107 ibid, 675.
to minorities in UK companies. This dictum apparently equates majority voting with director voting, however ‘[t]his would be highly misleading… and the decisions do not support any such parallel.’\textsuperscript{108}

Nevertheless, it has ostensibly been followed in the UK. A new article dispossessing minority rights for competition with the company was upheld accordingly.\textsuperscript{109} In \textit{Dafen}\textsuperscript{110} majority proposals would let directors offer any shareholder’s shares to anyone at a price fixed by the directors. Peterson J invalidated the amendment following this dictum.\textsuperscript{111} However, there was no general duty on the majority to consider the minority when voting. The issue was forfeiture of the minority’s property (i.e. shares themselves) without their consent. This prevents forfeiture of the minority’s shares without their agreement but is not of wider application. Once again, Lindley MR’s dictum is undermined, and the minority in a UK company exposed.

This analysis is reinforced by disenfranchisement mechanisms: even punitive undervalued sales for irrelevant reasons are valid under UK law, so long as the mechanic was agreed.\textsuperscript{112} Such disenfranchisement is common in UK private companies.\textsuperscript{113} These mechanics are normally included early in the corporate contract. This can be contrasted with an ex post majority attempt at minority disenfranchisement. However, it is not linked to any general majority voting duty: it stops nothing short of the majority removing rights attaching to the minority’s shares, providing minimal minority protection against shirking or other forms of rent seeking.

In \textit{Shuttleworth}\textsuperscript{114} the court held the test must be subjective to the majority,\textsuperscript{115} unless no reasonable person could think the relevant outcome of the shareholder vote was beneficial to the company.\textsuperscript{116} This rendered the dictum tautologous as majority voting allowed conflation between majority interests and all shareholders’ interests. \textit{Greenhalgh v. Arderne}\textsuperscript{117} involved a company with transfer pre-emption rights, which were amended to allow the general meeting to approve any transfer. Evershed MR held the amendment would be valid unless it discriminated against the minority (he held it did not).\textsuperscript{118}

\begin{thebibliography}{118}
\bibitem{108} Davies and Worthington, n. 28 above, para. 19-4.
\bibitem{110} \textit{Dafen Tinplate Company, Limited v. Llanelly Steel Company (1907) Limited} [1920] 2 Ch 124.
\bibitem{111} \textit{ibid}, 140.
\bibitem{112} \textit{Phillips v. Manufacturer’s Securities Ltd} (1917) 86 LJ Ch 305.
\bibitem{114} \textit{Shuttleworth v. Cox Brothers and Company (Maidenhead) Limited} [1927] 2 KB 9.
\bibitem{115} \textit{ibid}, 22.
\bibitem{116} \textit{ibid}, 18.
\bibitem{117} \textit{Greenhalgh v. Arderne Cinemas, LD and others} [1951] Ch 286.
\bibitem{118} \textit{ibid}, 291. Interestingly, on different litigation between the two parties five years earlier resulting from articles stating that votes of preference shares will have one vote per vote cast by one ordinary share, with the ordinary shares then being subdivided to give more votes to ordinary shareholders, the then Master of the Rolls agreed with the analysis set out in this article, stating: ‘The only right of voting which is attached in terms to the shares of that class is the right to have one vote per share … that right has not been taken away. Of course, if it had been attempted to reduce that voting right, e.g. by providing or attempting to provide that there should be one vote for every five of such shares, that would have been an interference with the voting rights attached to that class of shares… As a matter of law, I am quite unable to hold that, as a result of the transaction, the rights are varied; they remain what they always were – a
\end{thebibliography}
However, the majority only had received a favourable offer for their shares. Accordingly, the amendment in practice did discriminate. Once again, ostensible dicta purport to help minority shareholders in UK Companies, but are undermined by the outcome of the case.

Some minority shareholders in UK companies have received protection under the apparent application of this dictum. *Clemens*\(^\text{119}\) involved two shareholders – a niece (with 45 per cent shareholding) and aunt (with 55 per cent shareholding). The niece objected to share issues which would reduce her shareholding below 25 per cent. Foster J held whilst the aunt genuinely believed the issue benefitted the company, she nevertheless was acting in a manner designed to ensure the niece lost her ability to block special resolutions. He therefore invalidated the share issue. This decision is ‘remarkable’ and ‘much criticised’.\(^\text{120}\) Joffe said it ‘warms the heart’,\(^\text{121}\) but its reasoning would destroy the shareholder’s right to take account of her own interests.\(^\text{122}\) He argues that the result ‘subverts the present basis of the law by displacing the principle of majority rule. The majority would have to satisfy the court that it acted in what the court, not the majority, thinks is in the best interests of the company—a notion elsewhere expressly rejected.’\(^\text{123}\)

This follows the analysis advanced: the negative right to block a resolution of the company is not normally considered a shareholder right.\(^\text{124}\) Gibson J formulated the UK position under the relevant authorities as being:

> All resolutions must be passed bona fide for the benefit of the company as a whole, but that requirement does not have the same content for a board of directors, all of whom are fiduciaries, as it does for a general meeting of the company. The law is not so foolish as to prevent a shareholder from voting in his own private interests.\(^\text{125}\)

This is an accurate but unhelpful summary of the confused dicta: here, the bona fide requirement is subsidiary to the general proprietary right, but we do not know why. Gower’s Modern Company Law argues these were issues, instead, of unfair prejudice to the minority.\(^\text{126}\) This is not entirely accurate. This line of cases is still casually referred to as imposing general restraints on the majority under UK law.\(^\text{127}\) However, the cases do not: they only prevent the majority in a UK company appropriating the minority’s personal property without their agreement. This mitigates certain blatant

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\(^\text{119}\) *Clemens v. Clemens Bros Ltd* [1976] 2 All ER 268.


\(^\text{122}\) ibid., 72.

\(^\text{123}\) ibid., 73.

\(^\text{124}\) See *White v. Bristol Aeroplane Co Ltd* [1953] Ch 65, where dilution by the issue of new shares did not affect the rights the shareholder had prior to the share issue. See also discussion in Hannigan, ‘Altering the articles’, n. 92 above.


\(^\text{126}\) Davies, n. 120 above, 717.

\(^\text{127}\) *Sevilleja v. Marex Financial Ltd* [2020] UKSC 31, [127].
manifestations of rent seeking, but no more. There is limited minority protection: the majority of a UK company can act in their own interests provided they do not actively remove property from the minority. Other types of rent seeking (e.g. trying to extract more than their proportional share from the company) are not protected against, neither are shirking, bonding costs or monitoring costs.

The third ostensible exception to the general rules as to shareholder voting under UK law are the rules relating to ‘class rights’. The key case is Holders Investment Trust where it was proposed shares due for redemption be exchanged for unsecured debt. The overall majority held most of the shares which were due for redemption and voted for the exchange. The minority objected. Megarry J set aside the majority’s votes as not being in the best interests of their class. This creates problems: objectively, on any vote, one option will be ‘best’ for any class. This logic stops the rights of a class being compromised, whatever the overall benefit, and cannot be correct. It is submitted that some analytical steps are truncated: the majority voted to deprive the minority of their existing rights of redemption. Accordingly, the issue in Holders Investment Trust was the same as in all other cases noted above. There is no duty to vote to benefit the class under UK law, but there is a duty on the majority to not deprive the minority of their existing positive rights. In this case, the majority/minority division was obscured by share classes. But the ‘majority’ was the same in both classes, so the case is a majority/minority issue rather than a discrete class rights issue. Instead of providing general qualifications to shareholder voting, it prevents a shareholder voting for a class-right variation which compromises rights from that class and benefits themselves in a different capacity. As such, the duty under UK law is merely to not deprive others of their existing positive rights. Once again, this formulation prevents the majority from appropriating the rights of the minority: it prevents the majority directly rent seeking from the minority, but not rent seeking from the company, nor shirking. However, it does not mitigate against any of the components of agency costs identified above by Easterbrook & Fischel, Rock & Wachter, or this article.

There are, of course, certain matters that the shareholders cannot procure under UK company law – particularly, limitations on distributions, and prescribed rules for removing directors that shareholders cannot unilaterally vary. However, for those decisions that the shareholders can take, majority power is untrammelled unless they try to deprive the minority of positive rights attaching to

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129 e.g. Davies and Worthington, n. 28 above, para. 19-12.

130 In re Holders Investment Trust Ltd [1970] 1 WLR 583.

131 ibid, 589E.

132 This analysis also resonates in Prudential Assurance Co Ltd v. Newman Industries Ltd (No 2) [1982] Ch 204, where one of the rationales for rejecting a claim of reflective loss by a shareholder was ‘[t]he plaintiff’s shares are merely a right of participation in the company on the terms of the articles of association. The shares themselves, his right of participation, are not directly affected by the wrongdoing. The plaintiff still holds all the shares as his own absolutely unencumbered property’ (at 223).

133 Precision Dippings Limited v. Precision Dippings Marketing Ltd. 1985 WL 1167741; Ferran, n. 25 above.

their shares – any other form of rent seeking is permissible under UK shareholder voting laws, as is shirking.

4. **BOARD CAPTURE BY THE MAJORITY**

Not only are the minority unprotected under UK law, majority rule exacerbates their plight. Agency costs can be manifested directly or indirectly. A direct manifestation is manifested through the cost-causer, such as a director increasing her own salary. It is easy to imagine a director triangulating through a third party – e.g. procuring the company contract favourably with her other company. This seems independent from the director but is equally a manifestation of a director/shareholder agency cost.

The minority experience double agency costs: both manager/owner and majority/minority. UK law is thorough in tackling director/shareholder agency costs, but less so in restraining the majority. These two agency costs interact: the majority can triangulate majority/minority agency costs through the directors. Actions taken to reduce director/shareholder agency costs under UK law normally try to align directors’ interests to those of the shareholders. Given the majority’s wide powers under UK law, however, any such action harms the minority – it provides a mechanism for the majority to act on such incentives for agency costs, and manifest them to be suffered by the minority.

Two features of UK company law risk such majority board capture: shareholder/director division of powers, and shareholders’ ability to remove directors. There is little evidence of either being utilised widely, but their presence lets the majority threaten the directors. Worse, directors may appease the majority to avoid these rights being exercised. Even without overt threat, these powers incentivise directors to appease the majority, and ignore the minority. In other words, these powers both encourage the directors to provide the majority with as much as possible to keep them content.

There are many ways that the directors may act to appease the majority shareholders: for example, by providing them with disproportionate benefits (an example of rent seeking for the majority), or by ignoring the interests of the minority and only caring what the majority say (an example of shirking against the minority). Each of these increases the agency costs on minority shareholders. It may be that these two powers which cause such board capture exist to provide protections elsewhere in the UK company law landscape. If these powers exist to provide important protections, and serve to meet those reasons, then there may be a valid policy choice between such reason and protecting minority shareholders in UK companies: exposing minority shareholders to agency costs caused by board capture by the majority may be justified. However, the default division of powers does not exist for a

135 See Fama, n. 19 above.
136 Contained in Sch 1 The Companies (Model Articles) Regulations 2008 (SI 2008/3229) and s 168 Companies Act 2006 respectively.
valid reason, and whilst the ability for shareholders to remove directors does, such ability is neutered by judicial interpretation.

A. Division of Powers

Initially\(^{139}\) the board of a UK company enjoyed statutory management powers - subject to the articles.\(^{140}\) An 1845 restatement excluded directors from making decisions on matters ‘to be transacted’ by general meeting, and subjected them to the general meeting’s ‘control and regulation’.\(^{141}\) This was tested in *Isle of Wight Railway Company*.\(^{142}\) Shareholders requisitioned a meeting for two purposes, and the directors convened a meeting for only the first. The shareholders then convened a meeting for both. The directors litigated to restrain the shareholders’ meeting. Cotton LJ stated a general meeting is ‘the only way’ shareholders can ‘interfere’, accordingly directors must enjoy otherwise exclusive powers; and that directors propose matters, and shareholders restrain them if necessary.\(^{143}\) Lindley LJ identified that the court frequently rejected shareholders’ claims unless they had held general meetings, so it would need to be a very strong case to prevent a general meeting being held.\(^{144}\) This echoes Cotton LJ: the general meeting was the shareholders’ only voice and, therefore, the court should be slow to stop one.

1855 introduced the major innovation\(^{145}\) of limited liability to shareholders in UK companies.\(^{146}\) UK statutes were consolidated in 1856.\(^{147}\) Here, division of powers between shareholders and directors moved to the articles.\(^{148}\) This change was accidental, rather than philosophically driven.\(^{149}\) Nonetheless, it means shareholders (acting by majority rule) set the division of powers in UK companies: so directors may appease the majority to maintain powers. Given the lack of fetters on the majority’s power to inflict most components of agency costs on minority shareholders, this contributes to a minority shareholder’s plight in a UK private company.

UK courts have struggled with the policy underpinning this switch – declaring strident dicta which ostensibly support the minority, but providing the majority with means to inflict residual loss upon the minority. In *Automatic*,\(^{150}\) a dominant shareholder agreed to sell company assets to his other company. A resolution approving such was passed due to the dominant shareholder’s shares. The

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\(^{139}\) Watson, n. 137 above.

\(^{140}\) S 27 Joint Stock Companies Act 1844.

\(^{141}\) S 90 Companies Clauses Consolidation Act 1845.

\(^{142}\) *Isle of Wight Railway Company v. Tahourdin* (1884) LR 25 Ch D 320.

\(^{143}\) *ibid*, 329.

\(^{144}\) *ibid*, 331.


\(^{146}\) The Limited Liability Act 1855.

\(^{147}\) Joint Stock Companies Act 1856; De Koker, n. 145 above, 130.

\(^{148}\) S IX Joint Stock Companies Act 1856; Watson, n. 137 above.

\(^{149}\) Watson, n. 137 above; Lesley A. Walcott, *The conundrum: Resolving the statutory contract in the Commonwealth Caribbean* 38 The Company Lawyer 248 (2017). The default regime remained the same as had been the case under the statutory regime (Art 46, Table B, Joint Stock Companies Act 1856), however now could be amended by shareholders.

\(^{150}\) *Automatic Self Cleansing v. Cuninghame* [1906] 2 Ch 34.
directors objected. Warrington J sided with the directors, whilst indicating that director management protects the minority.\textsuperscript{151} This is persuasive: strong powers to directors let them act independently of the majority, and so prevent majority capture, and prevent components of agency costs from being inflicted upon the minority. However, this protection is neutered under UK law by the ability of the shareholders (by majority action) to vary the articles to assume this power. On appeal, the Master of the Rolls agreed with Warrington J, and held such an amendment would be the only way to overcome the minority’s will.\textsuperscript{152} Whilst this furthers Warrington J’s analysis it highlights a bigger issue: if it is not generally fair for a majority to remove directors’ powers, why does it become so with a special resolution? If an 80 per cent shareholder resolved to transfer all of a UK company’s assets to itself for one pound (an undervalue),\textsuperscript{153} this would clearly constitute majority abuse, and manifest rent seeking behaviour by the majority, and so create agency costs for the minority. Why could such costs be achieved by a special resolution to divert powers to the (majority controlled) general meeting? As such, \textit{Automatic} provides inadequate but some protection: the majority must use formal mechanisms to assume directors’ powers.

\textbf{Automatic} ultimately held that powers are delegated by the general meeting to directors.\textsuperscript{154} \textit{Marshall’s Valve Gear}\textsuperscript{155} involved a company with four directors who were also shareholders. Individual A held most votes, but less than 75 per cent of the votes. The directors had a disagreement, with A on one side and the other three directors on the other side. The company had a patent, and the other three directors had substantial shareholdings in a competitor which owned a competing patent. A attempted to raise an action to litigate against this competitor. The three objecting directors voted against, but A commenced action anyway on behalf of the company. Neville J pointed out that the three directors were somewhat conflicted,\textsuperscript{156} stating ‘in the absence of any contract to the contrary the majority of the shareholders in a company have the ultimate control of its affairs.’\textsuperscript{157} He therefore distinguished \textit{Automatic} as there the shareholders had bound themselves to only act following extraordinary resolution, whereas \textit{Marshall’s} shareholders did not. This is a logical development – shareholders of UK companies can, provided they follow any procedural hoops set out in the articles, take control of the affairs of the company. However, it is flawed for the same reasons as noted above: it leads to majority capture of the board, exacerbating the plight of the minority shareholder in a UK company.

In \textit{Shaw v. Shaw},\textsuperscript{158} the company had been run poorly by three Shaw brothers. It was agreed that each brother pay an amount established by an independent accountant. In addition, two independent

\textsuperscript{151} ibid, 38.
\textsuperscript{152} ibid, 42-43.
\textsuperscript{153} Assuming the company has sufficient distributable profits to distribute the undervalue, and that the company was otherwise solvent, avoiding challenges identified above.
\textsuperscript{154} Davies and Worthington, n. 28 above, para. 14-2.
\textsuperscript{156} ibid, 271.
\textsuperscript{157} ibid, 272.
\textsuperscript{158} \textit{John Shaw & Sons (Salford) Ltd v. Shaw} [1935] 2 KB 113.
directors were appointed to the board, with decisions on the Shaw brothers’ debt reserved to them. The independent directors resolved that the company sue the brothers. The brothers’ votes qua shareholders carried a resolution to restrain the litigation. The court supported the independent directors, stating shareholders ‘cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders.’

We see increasingly strident language – in Automatic the court held director powers protect the minority; in Shaw, the court held shareholders cannot ‘usurp’ directors’ powers. Once more, the analysis is inconsistent: why should shareholders be unable to ‘usurp’ powers using certain techniques, but able to ‘usurp’ powers using others? In both Automatic and Shaw, the court identified a majority/minority rent seeking agency cost and prevented that wrong. However, each such wrong could have been achieved by the majority using other procedures. This is consistent with the legislative framework. However, the majority could have achieved their goals simply through a different resolution. UK courts have stated that directors can ignore even unanimous shareholder resolutions, once more to protect the minority. This protection is undermined if a simple article amendment by the majority can undo it.

The 1985 default articles of association, Table A, provided directors’ powers were subject to the articles and any directions given by special resolution. This formulation remains in the current UK regime: the division of powers is for the articles. Setting the current regime, the UK government stated, ‘it is worth setting out in the articles the breadth of directors' general authority as agents of the company’. This 'general' authority, however, is only a default rule and can be amended by a 75 per cent majority. The UK Model Articles link directors’ powers to their responsibilities. Here, we start to see contractions within the current UK regime, as this link in the Model Articles is only correct if directors have all powers, which is not the case. Directors’ duties apply automatically to directors, even if they do not manage the company. Indeed, directors can be liable for breaches caused by others. Within the category of ‘directors’ there are differences in the extent of responsibility borne.

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159 ibid, 134.
162 Art 70, Table A, Companies (Tables A to F) Regulations 1985 (SI 1985/805). This framework has been used to justify company law as ultimately reflecting shareholders' bargains – see Richard C. Nolan, The Continuing Evolution of Shareholder Governance 65 Cambridge Law Journal 92 (2006). Given majority rule, this must be read as reflecting the bargain of the majority.
164 Art 3, Sch 1, The Companies (Model Articles) Regulations 2008 (SI 2008/3229.
165 Eclair Group Ltd v. JKX Oil & Gas Plc [2013] UKSC 71.
166 Re Baring Plc (No 5), Secretary of State for Trade and Industry v. Baker (No 5) [1999] 1 BCLC 433.
However, under UK law, duties cannot switch such that an active shareholder (who is not a shadow director) assumes such duties. If directors can exercise the company’s powers because they have duties, why should shareholders be able to exercise such powers without corresponding duties? In the UK, responsibilities between corporate constituents are fixed (only directors owe duties). If responsibilities are fixed, and the link between powers and responsibilities should be fixed, it is unclear why powers should be variable.

The New Zealand Law Commission called the UK regime ‘entirely unsatisfactory’, and ‘an anachronism which is misleading.’ It therefore called for the default rules to become a statutory presumption, noting:

The greater the role for the general meeting in management of the company, the greater the need to develop a concept of a fiduciary duty owed by the majority to the minority. This is a developing area of law which, carried too far, may undermine the concept of the share as property and may make company decision-making and enforcement of obligation procedurally complex.

Such a switch was adopted, which makes sense if there is a switch in powers between directors and shareholders. However, it risks lacunae: if directors follow instruction from (or hint from, or to appease) majority shareholders – who then owes the minority duties? The majority have not undertaken the action; directors may not have controlled it and will not benefit. Shareholder ability to usurp powers must relate to corresponding duties. Even then, there is a space for a gap between the two, to the detriment of the minority.

In conclusion, the default division of powers happened by accident under UK law, and fails to protect the minority despite courts’ strident claims. More than this, for so long as director powers are set by shareholders in the UK, the majority can triangulate residual loss (and so agency costs), and indirectly manifest them through the directors. In other words, this power exists for no valid reason, but causes harm to the minority. Strengthening the powers of directors in UK private companies would resolve such harm.

B. Ability to Remove Directors

The second ground for majority capture in the UK regime is shareholders’ ability to remove directors. Again, this risks indirect manifestations of agency costs: directors may act to please the majority to avoid removal, including to the detriment or neglect of the minority. This power was used

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168 S 251 Companies Act 2006. This is easily avoided by a controlling shareholder – see Davies, n. 24 above, 380.
170 ibid, para. 156.
to remove Maurice Saatchi as a director of Saatchi & Saatchi, but it is cumbersome. Special notice is required, any such resolution cannot be passed by written resolution, and the director can protest her removal. Worse, a removed director retains her right to compensation for termination. This could be a significant amount, even though any such payments or long term contracts need to be approved in advance.

Early UK company law reports noted lifetime appointment of directors can cause ills within the company. As a result, the UK 1844 Act mandated triennial retirement for directors, which continued in the 1845 Act. This also moved to the articles in the 1856 Act. The UK Companies Act 1900, introduced a statutory requirement that a director failing to comply with any shareholding requirement in the company’s articles within prescribed periods automatically vacates her office.

The triggers for automatic vacation of office under the default UK articles of association were expanded in 1929: including making profit from the company where not approved by shareholders; the director entering bankruptcy, being declared a lunatic; resigning; or being conflicted. The UK Companies Act 1948 made several provisions regarding the removal of directors mandatory. It introduced a mandatory retirement age of 70, together with an age disclosure requirement. In addition, the 1948 Act introduced this second cause of majority capture: a statutory right for shareholders to remove a director by ordinary resolution. A version of special notice regime was required. This new regime aimed to provide shareholders with ‘greater powers to remove directors with whom they are dissatisfied’. There is, therefore, a valid reason for this power to exist: it helps shareholders act to resolve director/shareholder agency costs.

The ambit of this new UK shareholder power was discussed in Bushell v. Faith, where a company had three shareholders, two of whom were directors. Each shareholder held one third of the shares. Article nine of the company’s articles of association provided that on any removal resolution, that

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174 *ibid*, 674.
175 S 168 (2) Companies Act 2006.
176 *ibid*, s 288 (2).
177 *ibid*, s. 69.
178 *ibid*, s 168 (5) (a).
179 Keay, n. 173 above, 673; Davies and Worthington, n. 28 above, paras 14-54 and 14-55.
180 S 188 Companies Act 2006.
182 S 88 Companies Clauses Consolidation Act 1845.
183 Arts 48 and 49, Table B, Joint Stock Companies Act 1856.
184 S 11 Companies Act 1900 - a rare move from statute to articles.
185 Art 72, Table A, Sch 1, Companies Act 1929.
186 S 185 Companies Act 1948.
187 *ibid*, s 186.
188 *ibid*, s 184.
189 *ibid*, s 184 (2) - 184 (3).
director’s shares each had three votes. Accordingly, each director could veto her removal. A resolution was introduced to remove a director – the challenged director voted against whereas the other two shareholders voted in favour.

The House of Lords upheld article nine. Lord Reid with ‘some reluctance’ agreed, despite this meaning shareholders could not remove directors.\footnote{ibid, 1105.} Lord Upton identified irremovable directors as the relevant mischief.\footnote{ibid, 1108E-F.} Nonetheless, he upheld article nine. Prentice and Lord Upton each identified the mischief as obstructive director removal mechanics, which the case result allowed. Lord Upton asked:

what about shares which had no voting rights under the articles? Should not Parliament give them a vote when considering this completely artificial form of ordinary resolution? ... I only raise this purely hypothetical case to show the great difficulty of trying to do justice by legislation in a matter which has always been left to the corporators themselves to decide.\footnote{ibid, 1109E-H.}

This does not clarify matters. If the evil was difficulty in removing directors, then surely fettering a UK company’s rights freely to choose this matter is precisely what Parliament wanted. Lord Donovan took a different approach, tacitly repudiating Upton’s reasoning by stating that the UK Parliament’s intention could only be ascertained through the words used.\footnote{ibid, 1110A.} He stated UK Parliamentarians must have known:

that unless some special provision were made, the mere direction that an ordinary resolution would do in order to remove a director would leave the section at risk of being made inoperative in the way that has been done here. Yet no such provision was made, and in this Parliament followed its practice of leaving to companies and their shareholders liberty to allocate voting rights as they pleased. When, therefore, it is said that a decision in favour of the respondent in this case would defeat the purpose of the section and make a mockery of it, it is being assumed that Parliament intended to cover every possible case and block up every loophole. I see no warrant for any such assumption. A very large part of the relevant field is in fact covered and covered effectively.\footnote{ibid, 1110F–1111A.}

Lord Donovan’s reasoning raises further questions. If the UK Parliament has identified and resolved a genuine evil (per Lord Upton), it is not clear why, without clarification or explanation, they would have left such large loopholes. Prentice is highly critical of the decision, stating that it reduced the protection to ‘an empty rhetorical gesture’.\footnote{Prentice, n. 190 above, 696.} The most coherently reasoned speech was that of Lord Morris of Borth-y-Gest objecting. He argued the UK Act referred to an ‘ordinary’ resolution and overrode any provision to the contrary in the articles. Accordingly, any article of association purporting...
to require a special resolution would violate the 1948 Act. Article nine’s ‘unconcealed effect is to make a director irremovable ... The learned judge thought that to sanction this would be to make a mockery of the law. I think so also.’

Lord Morris’s formulation would undoubtedly resolve the mischief identified by easing director removal. By rejecting this analysis, the House of Lords neutralised the value of the statutory regime in protecting against director/shareholder agency costs in the UK, as managers can use weighted voting and small shareholdings to perpetuate this mischief. Nevertheless, the statutory regime exists as a theoretical stick for the majority to deploy against a director of a UK company. This is more likely to result in majority capture of directors. A systemic flaw with this type of right is that it is often unworkable in practice, but can give the majority power to threaten a director. Worse, the strength of the protection depends on the constitution of the relevant UK company – which will be proposed by the dominant constituency. Accordingly, this protection is likely to be neutered where it is needed most (where there is strong separation of ownership and control, causing director/shareholder agency costs), but cause a harm to the minority in situations where it is not needed. This regime, therefore, does not adequately protect against director/shareholder agency costs – and, in addition, actively exacerbates majority/minority agency costs. It therefore not only fails to provide the intended benefit; it is actively harmful.

Since Bushell v. Faith, there have been two major restatements of UK company law. Each failed to overturn Bushell v. Faith. Accordingly, policy makers have twice rejected the option to reformulate the statutory provision to meet the policy aims highlighted.

5. INADEQUATE REMEDIES

Whilst director/shareholder agency cost are mitigated by law, majority/minority agency costs are not. Worse, two features exacerbate the issue. This is irrelevant if law otherwise mitigates these agency

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200 Berle and Means, n. 5 above, 187-195; Easterbrook and Fischel, n. 62 above, 1420. The UK doctrinal framework follows the same precepts – companies can change their articles by special resolution (s 21 Companies Act 2006), the whole text of which must be circulated at the same time as the meeting is announced (s 283 Companies Act 2006). Members can summon a meeting only if they represent five per cent of the share capital (s 303 Companies Act 2006), and members of private companies can request written resolutions only if they represent five per cent of the share capital (s 292 Companies Act 2006). As a result, a shareholder can only propose a resolution to amend the constitution if they hold more than five per cent of shares. Directors can summon meetings or written resolutions at will (ss 302 and 291 Companies Act 2006 respectively), but the vote on the result is taken by shareholders: who are rationally apathetic where there is a large separation of ownership and control, and not if they are dominant (all sources cited at n. 14 above). As a result, in situations where directors are dominant (and thus may create agency costs), they control the constitution; in situations where the majority are dominant (and thus may create agency costs), they control the constitution.
costs, or any components thereof. There are two areas which could do so: first if directors’ duties require them to act independently from a dominant majority. Second, if the minority have adequate remedies. Unfortunately, neither mitigates the foregoing.

A. Director Duties

If directors of UK companies can ignore the majority, they can avoid majority capture, and so mitigate indirect manifestations of majority/minority agency costs. Duties owed by directors of UK companies have been codified in the Companies Act 2006, but with the caveat that they be interpreted with reference to existing UK case law.

It has long been UK law that the recipient of the duties of directors of a UK company is the company itself, rather than any shareholder. This is now provided by statutory formulation. If ‘the company’ is interpreted in a manner which protects the minority, their plight could be mitigated. Historically, the ‘interests of the company’ in the UK have been those of the shareholders, present and future, with actions of directors only being valid if they purported to advance the long-term shareholder value of the company. The current UK formulation is enshrined in statute as enlightened shareholder value: the success of the UK company is considered to be the success for its members as a whole, having regard to certain third parties (such as employees and suppliers) and the need to act fairly as between members of the company. Reference to ‘have regard to’ means the non-shareholder considerations are just a sub-set of benefitting the members as a whole – merely means to create shareholder value rather than distinct, independent objectives in their own right. Stakeholders have no rights under this formulation; there is merely a duty on the directors to consider these interests. If directors fail to consider these stakeholders’ interests only the other directors (on behalf of the company) or the members (by way of derivative action) have recourse. The former are

202 Ss 170 – 226 Companies Act 2006; Hood, n. 17 above.
204 E.g. Percival v. Wright [1902] 2 Ch 421. This is the case even if one shareholder holds all the shares in the company (Bell v. Lever Brothers, Limited [1932] AC 161), and outside of insolvency, no duties are owed by directors to creditors (Yukong Line Ltd v. Rendsburgh Investments Corporate (No 2) [1998] 1 WLR 294).
206 Hutton v. West Cork Railway Co (1883) 23 Ch D 654; Parke v. Daily News (No 2) [1962] Ch 927.
210 ibid, 605. This can be contrasted to South Africa, where stakeholders ostensibly hold no rights, but have remedies if certain internal procedures are not followed – see Irene-marie Esser and Piet Delpout, The protection of stakeholders: the South African social and ethics committee and the United Kingdom’s enlightened shareholder value approach: Part 2 17 De Jure 221 (2017).
211 Keay, n. 209 above, 608.
unlikely to pursue one of their own. As such, directors are incentivised to ensure that shareholders are satisfied to avoid litigation.212

The minority is ostensibly included in the UK formulation. Only shareholders can ratify breaches of director duty (by ordinary resolution),213 and the affected director cannot vote.214 This mitigates director/shareholder agency costs: directors cannot vote as shareholders to ratify their own wrongs of any component of agency costs. However, it worsens majority/minority agency costs: majority shareholders in whose interests’ directors have acted can vote. Accordingly, not only is the minority not protected against triangulation, the majority may be able to use a requirement (or an alleged requirement) to ratify against a director to require their interests to be furthered. As a result, directors’ duties are liable to majority capture: exacerbating minority/majority agency costs triangulated through the directors.

Worse, the substance of duties owed by directors of UK companies does not protect the minority. There are five key duties owed by directors of UK companies to the company.215 First, directors have longstanding duties under UK law to ensure that the company acts within its powers.216 In addition, directors of UK companies have a duty to use their powers for a proper purpose.217 The definition of ‘proper purpose’ is wide,218 such that issuing shares to dilute a majority was not improper.219 Under the current, codified UK formulation directors have to act within the company’s constitution,220 and exercise their powers only for the purposes for which they are conferred under the company’s constitution.221 Generally, what constitutes an improper purpose is tested against the articles of association.222 This causes problems for the minority. If the majority mandate certain action,223 directors risk of breach of this duty for ignoring the majority (which could, in turn, only be ratified by the majority). Rather than helping the minority, directors’ duty to act within the company’s constitution binds directors to act within the constitution, which is majority controlled, thus also exacerbating minority/majority agency costs triangulated through the directors.

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212 Keay, n. 209 above, 609.
213 S 239 Companies Act 2006; Morse et al, n. 76 above, paras 8.3412–8.3424.
215 See generally Davies and Worthington, n. 28 above, ch 16; Morse et al, n. 76 above, ch 8; Hood, n. 17 above.
216 Re Land Allotment Co [1894] 1 Ch 616 CA. Consequently, directors of a UK company who paid dividends when not able to do so under the company’s articles were held to have breached their duty to the company and were found personally liable to the company for the value of such dividends. Re Oxford Benefit Building and Investment Society (1886) 35 Ch D 502.
218 Davies and Worthington, n. 28 above, para. 16–26.
220 S 171 (a) Companies Act 2006.
221 ibid, s.171 (b).
222 Re Smith and Fawcett Ltd [1942] Ch 304 CA.
223 Per the default formulation – Art 4 (1), Sch 1, The Companies (Model Articles) Regulations 2008 (SI 2008/3229).
Second, directors of UK companies have a duty to act in the best interests of that company\textsuperscript{224}: which has been called ‘the most basic’ and ‘core duty’ owed by directors.\textsuperscript{225} The UK court is not keen to interfere in decisions of directors – Green MR stated the duty was for directors to act ‘bona fide in what they consider – not what a court may consider – is in the interests of the company.’\textsuperscript{226} Accordingly UK courts are unlikely to interfere where directors satisfy the majority, and if any such action were ever to be threatened, the majority would be able to ratify the breach (rendering commencing any action pointless). Once again, majority rule enables unfettered conflation between the shareholders and the majority, harming the minority by exposing them to residual loss.

Third, each director of a UK company must exercise her independent judgement.\textsuperscript{227} This provides potential minority protection as it must include independence from the majority. However, the duty cannot be infringed by a director acting in a way authorised under the company’s constitution.\textsuperscript{228} So should the majority change the constitution to mandate that the company does something, the director doing so will not breach this duty.\textsuperscript{229} Accordingly ‘the articles may authorise restrictions on the exercise of independent judgement, which might be a useful facility in private companies’.\textsuperscript{230} This utility has a cost: it provides ex ante majority power to mandate action, in addition to their ex post ratification right. Once more, providing no mitigation for majority/minority agency costs, and further exposing them to residual loss.

Fourth, each director of a UK company has to exercise reasonable care, skill, and diligence,\textsuperscript{231} set at the higher of the skill a reasonable director should have,\textsuperscript{232} and the skill that such director actually has.\textsuperscript{233} This is designed to increase professionalism among directors.\textsuperscript{234} However, the risks reviewed do not arise because of carelessness, but from deliberate action. In addition, any breach can be ratified by the majority pre-insolvency.\textsuperscript{235}

Fifth, duties on directors of UK companies to avoid conflicts of interests also have a long pedigree under UK law,\textsuperscript{236} and are considered fundamental to ensure directors are not ‘swayed by interest rather
than driven by duty'.  There are two statutory aspects under the current UK regime. Firstly, a duty to avoid situations in which the director may have a conflict of interest. This excludes transactions with the company. The other directors can approve a director's conflict in a private company if the articles do not prohibit it. This lets shareholders prevent directors authorising situational conflicts, helping mitigate manifestations of director/shareholder agency costs by way of rent seeking. However, it does not help majority/minority residual loss: the exacerbation does not arise because directors are conflicted, but rather they may, as directors, act to appease the majority to the detriment of the minority. Such triangulation is not mitigated by limiting situational conflicts of directors under the current regime.

Secondly, a duty on the director of the UK company to avoid transactional conflicts. This framework obliges directors to disclose their interests in proposed or current transactions. Once again, this disclosure provides no protection for the minority against the majority. In fact, as breach of this duty can again only be cured by ratification by ordinary resolution (i.e., by the majority), the operation of such duties could be seen to further worsen the plight of the minority as it could cause breach by directors requiring majority ratification, making the directors further captive to the majority.

Directors of UK companies owe fiduciary duties to the company, which effectively protect shareholders against shirking and rent seeking from the directors. The regime governing these duties could offer minority protection against the majority. However, the current regime of directors' duties does not. Certain duties themselves defer to the company’s constitution, which the majority control. Accordingly, these duties are subject to majority capture. Even those that do not fail to protect the minority. Even if they did, the duties are owed to the company. Any breach of these duties can be ratified by the majority. As a result, whilst directors are obliged to act in a fiduciary manner, the formulation of their duties leaves them either captive to the majority, or otherwise of no help to the minority. Accordingly, directors' duties offer no protection for the minority against majority oppression: they still risk suffering residual loss from the majority.

**B. Minority Remedies**

UK Courts tend to emphasise two specific remedies available to minority shareholders of UK companies when denying them other remedies. However, neither the statutory derivative claim nor

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237 Breitenfeld UK Ltd v. Harrison [2015] EWHC 399 (Ch), [68].
238 S 175 Companies Act 2006.
239 ibid, s 175 (3).
241 S 177 Companies Act 2006.
242 ibid, s 182.
243 For example, when denying claims for reflective loss (Prudential Insurance Co Limited v. Newman Industries (No 2) [1982] Ch 204) - see Sevilleja v. Marex Financial Ltd [2020] UKSC 31, [81].
remedy of unfair prejudice provide adequate mitigation to the minority. These are less relevant in a listed company, where a minority could always sell their shares at the fungible price.

Directors may not been keen to pursue action against a miscreant director, so shareholders have attempted to litigate themselves.\textsuperscript{244} Judicial reticence\textsuperscript{245} prevented an individual shareholder litigating on behalf of the UK company outside limited circumstances. Shareholders in UK companies now have a statutory right to do so – they can commence action on behalf of the company (a derivative claim) against a director\textsuperscript{246} in certain, limited circumstances. The derivative claim has been called an ‘outmoded superfluousness’.\textsuperscript{247} It does not protect the minority against agency costs from the majority. First, claims must be against a director qua director\textsuperscript{248}; so cannot be made against the majority. Second, a claim must be refused if it relates to something which was approved or ratified\textsuperscript{249} – so subject to majority capture. Third, the company receives any damages\textsuperscript{250}; there is therefore little incentive for the minority to undertake action which, even if successful, would secure them only an indirect proportional benefit. The derivative claim, therefore, does not adequately protect the minority against the majority imposing agency costs.

Protections against unfair prejudice also exist under UK law\textsuperscript{251} to protect the minority’s ‘expectations and not just rights’.\textsuperscript{252} Under this regime, a shareholder of a UK company may petition the UK court for relief on the grounds that the company’s affairs are being (or have been) conducted in a manner which is ‘unfairly prejudicial’ to the interests of the members generally (or a subset thereof, or just that shareholder), or a specific or proposed act would be prejudicial.\textsuperscript{253} Thus, UK public law terminology has been borrowed so that a breach of the minority shareholder’s ‘legitimate expectation’ will trigger the unfair prejudice regime.\textsuperscript{254} Unfair prejudice ‘arises out of a fundamental understanding between the shareholders which formed the basis of their association but was not put into contractual form.’\textsuperscript{255} This understanding can occur on formation or subsequently.\textsuperscript{256} UK courts will assume that a

\textsuperscript{244} Davies & Worthington, n. 28 above, ch. 17. Scots law equivalents are provided in ss 265 – 269 Companies Act 2006. For discussion, see David Cabrelli, Statutory derivative proceedings: the view from the Inner House 14 Edinburgh Law Review 116 (2010).

\textsuperscript{245} Foss v. Harbottle (1843) 2 Hare 461.


\textsuperscript{248} S 260 (1) Companies Act 2006.

\textsuperscript{249} ibid, s 263 (2) (c).

\textsuperscript{250} ibid, s 260 (1) (b).

\textsuperscript{251} ibid, s 994. See discussion of a previous regime in Prentice, n. 56 above, and discussion of the line between unfair prejudice and derivative claims in Brenda Hannigan, Drawing boundaries between derivative claims and unfairly prejudicial petitions Journal of Business Law 606 (2009).

\textsuperscript{252} Davies and Worthington, n. 28 above, para. 20-6.


\textsuperscript{254} Re Saul D Harrison & Sons plc [1995] 1 BCLC 14, 19.

\textsuperscript{255} ibid.

\textsuperscript{256} Strahan v. Wilcock [2006] 2 BCLC 555 CA.
UK company’s articles of association contain all relevant understandings.257 ‘Legitimate expectations’ has evolved to ‘equitable considerations’,258 This lets the UK court explore any equitable requirement to constrain the majority's rights based on the bargain between majority and minority.259 This includes non-contractual understandings260 but must result from the minority’s understanding. As such, the remedy is normally only available in quasi-partnerships.261 When faced with a quasi-partnership, courts are keen to maintain the distinction between companies and partnerships, but consider certain partnership-style remedies.262 Not all duties inherent within partnership are imbued upon members of a quasi-partnership,263 and it has been argued that law should act to expand this.264

Whilst this may help Rock & Wachter’s example of the sacked minority shareholder if the minority’s right to employment in the company was at any time formally expressed,265 it does not provide more general structural protection for the minority. This example may be enough to prevent certain rent seeking by the majority, but does nothing to protect against the loss arising from shirking.266 This is because an unfair prejudice remedy is not available in the UK merely when the interests of the minority are ignored: which is the very definition of shirking. Instead, to obtain such a remedy it must be equitable for the UK court to uphold an informal agreement which is breached. This will only help the minority in respect of breaches of pre-agreed protections against residual loss, rather than protecting the minority generally against components of agency costs. This protection does not arise in the absence of such pre-existing informal agreement,267 which must be verifiable and certain to a sufficient degree.268 Courts have thus stated that to evidence this agreement there must be

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259 ibid, 10–11.
261 Peter Breakey, Quasi-partnerships, acquiescence, excessive remuneration and discounts and buyouts: case law developments in the law relating to s 994 40 The Company Lawyer 375 (2019); David Milman, Legal characterisation of commercial relationships in the UK: the quasi-partnership example 40 The Company Lawyer 312 (2019).
262 Re Westbourne Galleries [1973] A.C. 360, 380 per Lord Wilberforce; Hollington (n. 100 above) para 7-39. This is important because partners owe each other a full suite of fiduciary duties – as Vice Chancellor Bacon stated ‘I cannot conceive a stronger case of fiduciary relation than that which exists between partners’ - Helmore v. Smith (1886) 35 Ch. D. 436, 444. See also Roderick I’Anson Banks, Lindley & Banks on Partnership, paras 16.06 – 16.08 (London: Sweet & Maxwell, 20th edn 2017).
263 Re Corin Ltd [2012] EWHC 2343 (Ch).
265 Rock & Wachter, n. 58 above.
266 They also do not protect against other types of rent seeking – see Ernestine Ndzi, Shareholders’ dilemma regarding excessive directors’ pay and unfair prejudicial conduct 36 The Company Lawyer 3 (2016).
267 For discussion of the contractual basis of unfair prejudice, see Harry McVea, Section 994 of the Companies Act and the primacy of contract 75 Modern Law Review 1123 (2012). Prentice states in passing that it may be only available where usual tenets of majority rule are disappplied – Prentice, n. 56 above, relying on Ebrahimi v. Westbourne Galleries Ltd [1973] AC 360, 379. The remedy’s reliance on enforcing an agreement is subpar as legal rules are usually required in addition to such agreements – see Holger Fleischer, Comparative Corporate Governance in Closely Held Corporations, in Jeffrey N. Gordon and Wolf-George Ringe (eds) Oxford Handbook of Corporate Law and Governance, 707 (Oxford: Oxford University Press, 2018).
a ‘settled and accepted course of conduct between the parties’. Indeed, the court has gone further and stated:

It must, surely, be necessary to identify conduct referable to the contract contended for, or, at the very least, conduct inconsistent with there being no contract made between the parties to the effect contended for. Put another way, I think it must be fatal to the implication of a contract if the parties would or might have acted exactly as they did in the absence of a contract.

Part of this is likely to be the degree of mutuality within the purported agreement – did all parties have benefits and burdens in respect of the alleged agreement? If not, this lack of mutuality is likely to be fatal.

This means that the minority are protected if they have evidence of negotiated, mutual agreements that are treated by all as if they were binding contracts. This remedy therefore does not generally protect the minority – it protects against the removal of a pre-agreed positive, rather than against negatives for minority shareholders generally. Ultimately, this protects only where a putative wrongdoer has agreed in advance to not do so. To return to the language of agency costs – the minority is only protected from ex post residual loss if they obtain protections in advance: if they incur ex ante bonding costs. As such, the minority only obtain protection from one component of agency costs by incurring another component of agency costs. This remedy cannot, therefore, be said to universally reduce majority/minority agency costs in UK companies: to save one component, the minority must incur agency costs in another component.

Some categories of the UK’s unfair prejudice remedy do not rely on ‘legitimate expectations’/‘equitable considerations’. The UK courts have granted the remedy when faced with breaches of analogous but inapplicable standards or guides – for example, the Takeover Code (which only applies to public companies) to the sale of a private company; and the model articles to establish reasonable timescales for meetings where they not adopted. If there is no equivalent provision, and no prior agreement, there is nothing to breach. Gower’s Modern Company Law states:

Then the court may have to face the task of developing its own criteria of fairness. For example, the company may have adopted a policy of paying only low dividends, although financial able to do better and even though the controllers have been able to obtain an income from the company by way of directors’ fees. Is that unfairly prejudicial to the interests of the non-director?

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269 Re Fildes Bros [1970] 1 WLR 592 Ch D.
270 The Aranui [1989] 1 Lloyd’s Rep 213 CA (Civ Div), 224, per Bingham LJ; Hollington, (n. 100 above), para 7-44.
271 Re Edwardian Group Ltd [2018] EWHC 1715 (Ch); Hollington, (n. 100 above), para 7-38.
shareholders, even in the absence of any informal understanding as to the level of dividend pay-outs or as to the participation of the petitioner in the management of the company as a directors (and thus entitling him to fees)275

This is unknown. Unfair prejudice under the UK regime always requires unfairness in addition to prejudice.276 This is simply a reformulation of a requirement for the minority’s understanding.277 Certainly, minority consent278 or acquiescence279 precludes a claim, as will blame being ascribed to the minority.280

Accordingly, the remedy offers little protection for the minority in a UK private company, other than protecting express and verifiable agreements that the majority would not inflict residual loss on the minority (in other words, to obtain protection from rent seeking under this arrangement, ex ante bonding costs need to be incurred by the minority). Existing authority on ‘equitable considerations’ requires some breach of agreement, formal or informal. Without such a breach, there is no remedy. Other potential unfair prejudice options are undeveloped, and even then, could be defeated if in any way the conduct was consented or acquiesced to.

6. SCHOLARSHIP IMPLICATIONS

Minorities in UK private companies face quite a plight caused by lack of exit, ease of majority formation and no protection from the majority without incurring ex ante bonding costs – themselves a component of agency costs. Majority rule causes the issue, and the majority in a UK company face limited constraint on their voting. The minority have limited legal protections against rent seeking from the majority, and no protections against shirking, and therefore have inadequate protection against residual loss inflicted upon them by the majority. Incurring the cost to provide contractual protections is, itself, a component of agency costs. The risk of majority capture of the board of directors makes matters worse due to two features of UK company law. The regime on the division of powers between directors and shareholders makes little conceptual sense, and the power of shareholders to remove directors has been neutered by case law where it is needed, but acts as a further risk of majority capture of directors where it is not needed. Director duties and ostensible minority protections do not resolve these issues. Doctrinally, the minority in UK private companies are exposed to agency costs imposed upon them by the majority – particularly residual loss. This juxtaposes clearly to the protections against each component of agency costs provided for the paradigmatic agency cost in the UK, as outlined in Part 1.

275 Davies & Worthington, n. 28 above, para. 20-12.
276 There must, as a pre-requisite, be prejudice: Re Corvin Ltd [2012] EWHC 2343 (Ch).
277 Davies & Worthington, n. 28 above, para. 20-13.
279 Re R/A Noble & Sons (Clothing) Ltd [1983] BCLC 273; Re Hardy Estates Ltd [2014] EWHC 4001 (Ch).
Legal analysis states that both shareholder/director and majority/minority issues are agency costs, but UK law treats them differently. If all agency costs are considered equal, then the same legal responses should apply equally to the same components of agency costs. This is currently not the case in the UK. This means that either components of agency costs require different legal protections depending on the context and so need to be unpacked more than in current literature, or UK law should be amended to treat them all the same by further constraining the majority.\(^{281}\) Either way, UK company law needs to either highlight differences between the natures of different agency cost components in different situations or align legal responses. Indeed, if only one agency cost should be subject of academic attention, it should be majority/minority agency costs rather than director/shareholder agency costs. UK law already provides protections for the cost-sufferer of the latter against all components of agency costs, whereas the former remains mostly unmitigated (the only exception being certain, specific prohibitions on rent seeking). A neat proposal would be to follow the implication of the dicta of UK courts and the solution adopted in New Zealand, and place fiduciary duties upon majority shareholders.\(^{282}\) Delaware offers a potential model, whereby controlling shareholders owe fiduciary duties to the minority,\(^{283}\) and shareholders assume duties of directors if they exercise the powers of the company.\(^{284}\) By aligning the interests of the majority to the minority, such duties would help mitigate the cost to the minority of shirking (as such fiduciary duty would act to align the interests of the majority to the minority, in the same way as director fiduciary duties do for director/shareholder agency costs) and rent seeking. However, this would create broad implications for company law – it would change the nature of being a shareholder in the UK, as current shareholder liability is highly limited.\(^{285}\) Given the UK doctrinal approach to the nature of shares and voting, outlined above, this would be a dramatic change which would have various knock-on implications for doctrinal and theoretical aspects of UK company law.\(^{286}\) The advantages of such a reform may outweigh these implications, or may not: only further research can tell. This article also demonstrates that more

\(^{281}\) The former, of course, could render the theoretical framework applied in this article as invalid. However, this framework is the dominant framework applied across all types of agency cost (e.g. Kraakman et al, n. 1 above, ch. 2), meaning that if this is the case then a replacement paradigm is required to explain majority/minority agency costs.


\(^{284}\) §351, Title 8, Delaware General Corporation Law (1899 as amended).

\(^{285}\) Currently normally limited to the amount unpaid on their shares – see s 3 Companies Act 2006 and s 74 Insolvency Act 1986.

\(^{286}\) Large amounts of UK company law theory is predicated upon the proprietary nature of share. (e.g. see Pennington, n. 83 above); Ross Grantham, *The Doctrinal Basis of the Rights of Company Shareholders* 57 Cambridge Law Journal 554 (1998); Richard C. Nolan, *Shareholder Rights in Britain* 7 European Business Organization Law Review 549 (2006); Michael J. Whincop, *Painting the Corporate Cathedral: The Protection of Entitlements in Corporate Law* 19 Oxford Journal of Legal Studies 19 (1999)). Making changes to this proprietary nature is likely to require adjustments of this analysis, and thus have a number of implications for theoretical company law, in addition to the immediate effects on shareholders and majorities.
attention needs to be paid to private companies, especially in the UK. Protections have, correctly, been provided where needed in listed companies due to a separation between ownership and control. Similar attention to the incentives and manifestations of components of agency costs, and legal mitigations, needs to be paid to private companies where the issue is likely to be even starker.

7. **CONCLUSION**

We have seen that UK law responds strongly to the paradigmatic ‘vertical’ agency cost in listed companies. When we start to explore components of agency costs between majorities and minorities, we see a different picture – private company minority shareholders need legal protections the most, yet have fewest under UK law. A minority shareholder in a UK private company has no protection against shirking and limited protection against rent seeking by the majority. This means that their legal protection against agency costs is lower than exists for the paradigmatic agency cost in a listed company. Either we need to identify analytical differences between agency costs, or change UK law.

One thing, though, is indisputable. Components of majority/minority agency costs in UK private companies do not receive the same legal mitigations as director/shareholder agency costs do in public companies. Until this is resolved or adequately explained, the UK private company minority shareholder will continue to face quite the plight.