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Chu v Lau: The Privy Council weighs in on shareholder deadlock

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The Judicial Committee of the Privy Council (the **Privy Council**) has recently had to consider when a company can and should be wound up on a just and equitable basis.

In Chu v Lau [2020] UKPC 24, the Privy Council considered the matter in the context of an appeal from the Court of Appeal of the Eastern Caribbean Supreme Court regarding a BVI company. However, like the BVI, Jersey's company law (as well as that of certain other offshore jurisdictions, such as Cayman and Guernsey) is similar to that in England (for example, Jersey's primary companies legislation, the Companies (Jersey) Law 1991 (**CJL**) is based on the United Kingdom Companies Act 1985) and English authorities are generally persuasive in Jersey in matters of company law, where there is no express Jersey authority or legislation regarding the point at issue. In particular, under the CJL, there is a similar discretion available to the Jersey courts to wind up a company on the same basis as that in Chu v Lau, i.e. where it is "*just and equitable*" to do so.

Read our guide which looks at the key things you need to know about winding up a Jersey company on just and equitable grounds here.

Background

Mr Lau and Mr Chu were business partners. They each owned 50% of the shares in a BVI company, Ocean Sino Limited (**OSL**). OSL had a wholly owned subsidiary, Asset Management Limited (**PBM**). OSL and PBM were Mr Lau's and Mr Chu's corporate vehicles for a joint venture with a state-owned entity of the People's Republic of China (**PRC**). The joint venture company was Beibu Gulf Ocean Shipping (Group) Ltd (**Beibu Gulf**), in which PBM held 49% of the shares. The remaining, and controlling, 51% of Beibu Gulf was held by a PRC corporate vehicle.

The relationship between Mr Lau and Mr Chu significantly deteriorated. Unsuccessful attempts were made to sever their many business relationships which led to numerous legal claims being made between them before the courts of Hong Kong.

In May 2015, Mr Lau applied to the BVI High Court (the **BVI Court**) for a just and equitable winding up of OSL, alleging:

- an irretrievable breakdown of trust and confidence between him and Mr Chu; and
- a functional deadlock in the management of OSL (and therefore PBM) at both board and shareholder level.

After a six-day trial in May and June 2017, the first-instance trial judge granted the winding-up order sought by Mr Lau and concluded that there was an irretrievable deadlock at board and shareholder level and that all of

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the trust and confidence between Mr Lau and Mr Chu had gone.

In January 2020, Mr Chu appealed the decision and the Eastern Caribbean Court of Appeal (the **COA**) unanimously reversed the winding-up order, holding that the first-instance trial judge had made the following four errors:

- he had wrongly considered issues between Mr Lau and Mr Chu at the Beibu Gulf which ought not to be taken into account when assessing deadlock in OSL;
- he had failed to concentrate on the question as to whether OSL was deadlocked at the date of the filing of the application rather than at the time of the hearing, and thereby failed to take into account evidence that Mr Lau and Mr Chu were able to negotiate and agree matters after May 2015, so that their breakdown in co-operation was not then irretrievable;
- he had not considered the freedom for either party to sell their shares in OSL; and
- he had failed to consider alternative remedies reasonably available to Mr Lau, such as a buy-out of shares, before ordering a winding up as a last resort.

Mr Lau appeal to the Privy Council and requested that the winding-up order be reinstated. The Privy Council restored the decision of the first-instance trial judgment and held that OSL was deadlocked and that there had been an irretrievable breakdown of trust and confidence between Mr Lau and Mr Chu.

In doing so, the Privy Council helpfully clarified a number of considerations underpinning the just and equitable winding-up regime by analysing the four errors mistakenly identified by the COA.

The relevance of Beibu Gulf when assessing deadlock

The Privy Council held that a winding up may be ordered where the company's members have fallen out in two related but distinct situations (which may or may not overlap).

1. Where there is a functional deadlock, where the inability of members to co-operate paralyses the company from functioning.
2. Where the company is a corporate quasi-partnership, and there has been an irretrievable breakdown in trust and confidence between the participating members.

The Privy Council relied upon and upheld the leading English case on whether a company is quasi-partnership, Ebrahimi v Westbourne Galleries Ltd (In re Westbourne Galleries Ltd) [1973] AC 360. In *Ebrahimi* (which has been cited with approval by the Jersey courts), it was noted that it would be impossible, and wholly undesirable, to try and define the circumstances when a corporate quasi-partnership might arise. However, a corporate quasi-partnership is likely to include one or more of the following:

1. an association formed or continued on the basis of a personal relationship, involving mutual confidence;
2. an agreement, or understanding, that all, or some of the shareholders shall participate in the conduct of the business; and/or

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3. a restriction upon the transfer of the members' interest in the company – that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

The first-instance judge had held that OSL was a quasi-partnership. The Privy Council agreed with this assessment. This had the legal effect of importing additional equitable considerations beyond strict legal right. The Privy Council took the position that when considering whether there had been an irretrievable breakdown in trust and confidence between the participating members, it can consider any relevant evidence of the broader relationship between the parties. Therefore, the conduct of Mr Lau and Mr Chu outside of OSL (i.e. that pertaining to Beibu Gulf) was a relevant consideration.

Assessing the position at the date of trial

The Privy Council did not agree with the COA that the application to wind up OSL had to be determined by reference to the position as at the date of filing the application. It held that a court should assess the facts at the time of trial. In any event, the first-instance judge held that there was both deadlock and an irretrievable breakdown of trust and confidence by the time the application was filed.

Freedom to sell shares

It was argued on behalf of Mr Chu that the lack of restriction upon Mr Lau selling his shares was relevant to whether:

1. OSL was a quasi-partnership;
2. there was a functional deadlock in the affairs of OSL; and
3. it was unreasonable for Mr Lau to seek a winding-up order instead of attempting to sell his shares.

As set out above, one of the *Ebrahimi* considerations for whether a quasi-partnership exists is a restriction on the ability to deal with the shares of the company. OSL did not have such a restriction. However, none of *Ebrahimi* considerations were held to be mandatory, in that the lack of one would not be fatal to the application. OSL therefore remained a quasi-partnership.

The Privy Council held that the lack of restrictions on the sale of shares may only be relevant if the petitioner could be expected to sell his or her shares on fair terms. In this case, any incoming third-party purchaser of Mr Lau's shareholding would have faced a number of disincentives from paying full value, such as having to deal with Mr Chu and having no right to appoint himself or a nominee to the board of OSL.

On the basis that the Privy Council considered the sale of Mr Lau's shares of OSL to be *"purely theoretical"* and the inability to obtain a fair value, Mr Lau could not be criticised for not pursuing this avenue.

Alternative remedies

It is generally considered that a winding up is a shareholder's remedy of last resort. Indeed, in the BVI (unlike in Jersey), there is an express statutory requirement in the BVI Insolvency Act that there be no alternative remedy which is reasonable for the shareholder to pursue instead of winding up.

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The Privy Council held that the respondent (in this case, Chu) has the legal burden to establish that the petitioner (i.e. Lau) has acted unreasonably in not pursuing an alternative remedy. However, just pointing to an alternative remedy is not enough. The respondent must demonstrate that the alternative remedy is sufficiently attractive as an alternative to make it unreasonable to continue to seek a winding-up. The suggestion that Mr Lau's shares could be sold, for example, did not meet this threshold. In relation to this, and contrary to the COA's finding, a court ordered purchase of Mr Lau's shares was not an option in the absence of an unfair prejudice application (a different type of action), which had not been made.

Conclusion

This case is an important one. It clarifies several important aspects of when a BVI company might be wound up on just and equitable grounds.

Given the similarities between the principles at issue in this case, the findings of the Privy Council, being also the highest court in matters of Jersey law, are likely to be of particular interest in Jersey and abroad and one can expect that the lower Jersey courts may consider these principles to apply in Jersey in the context of shareholder disputes and alternative remedies to derivative actions and unfair prejudice claims. You can find more about this topic here.

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