Offshore Cases

British Virgin Islands

Privy Council

From the Privy Council of the Eastern Caribbean Supreme Court (British Virgin Islands) Chu (Respondent) v Lau (Appellant) (British Virgin Islands) Judgment given on 12 October 2020

Winding up on just and equitable grounds – Deadlock – Exclusion from Management in Quasi-Partnerships

Chu Kong ("**Mr Chu**"), the Appellant in these proceedings, sought to reinstate the winding up order made against Ocean Sino Ltd ("**OSL**") on 28 July 2017 by the BVI Commercial Court Judge, Wallbank J (the "**Judge**").

The winding up application (the "**Application**") before the BVI Commercial Court was brought by Lau Wing Yan ("**Mr Lau"),** one of the two shareholders of OSL. The grounds of the Application were that (i) there was an irretrievable breakdown of trust and confidence between Messrs. Lau and Chu and (ii) there was functional deadlock in the management of OSL both at board and shareholder level.

Messrs. Chu and Lau were the only two directors of OSL and were both known to be business colleagues and friends who invested in a number of jointly owned commercial enterprises mainly in shipping and logistics.

OSL is the holding company of a Hong Kong entity named PBM Asset Management Limited ("**PBM**"). PBM owns a 49% share interest in another Hong Kong entity named Beibu Gulf Ocean Shipping (Group) Limited ("**Beibu Gulf**"). The remaining shares in Beibu Gulf are owned by the People's Republic of China through its company ("**PRC Holdco**"). Mr Chu and Mr Lau were at one point both executive directors of Beibu Gulf, but most of Beibu Gulf's directors were appointed by PRC Holdco.

First Instance Decision

The Judge found there to be irretrievable deadlock at board and shareholder level of OSL and by extension PBM and that all trust and confidence between Mr Lau and Mr Chu had been lost as a result of matters which took place prior to the filing of the petition and as at the date of the hearing.

Court of Appeal Decision

On 17 January 2020 the Eastern Caribbean Court of Appeal unanimously reversed the winding up order made by the Judge on the basis that the Judge had (i) wrongly taken into account the dissension between Mr. Lau and Mr. Chu occurring at the Beibu Gulf level, (ii) failed to consider whether OSL was deadlocked at the date of the filing of the petition rather than at the time of the hearing, (iii) failed to take into account the possibility of Mr. Lau and Mr. Chu selling their shares in OSL to avoid deadlock and (iv) failed to consider alternative remedies to winding up including a buy-out of Mr Lau.

Assessing Deadlock

In assessing deadlock, the Privy Council highlighted the Judge's finding that OSL was a corporate quasi-partnership. The Board also distinguished between functional deadlock where the members are unable to co-operate in the management of the company and which ultimately leads to the inability of the company to function at board and shareholder level and breakdown of trust and confidence where the company is a quasi-partnership. The distinction was important in the the Board's analysis that functional deadlock could result in a winding up order being made irrespective of whether there is a corporate quasi-partnership, but if the company is a quasi-partnership then a breakdown in trust and confidence between the members would justify a winding up order, even where there is no complete functional deadlock. The Board considered that breakdown in trust and confidence may well be the reason for functional deadlock, as in the present case.

Applying the guidance set out by Lord Wilberforce in *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, the Board agreed with the Judge's finding that OSL was a corporate quasi-partnership and by implication the strict legal rights of the members would be subject to equitable considerations.

Also significant is the Board's determination that there is no requirement that evidence in support of a winding up application must reflect the position as at the date of filing. Reference was made to section 162(1)(b) of the Insolvency Act, 2003 (the "**Insolvency Act**"), which requires the Judge to consider at the time of the hearing, whether it is just and equitable that a liquidator be appointed. The Board took the view that in the absence of any express provision in the Insolvency Act or in the Insolvency Rules, 2005 that required the Judge to ignore relevant evidence (which there is none), the Judge was entitled to consider all relevant matters as at the date of the hearing when exercising his discretion.

Wang Zhongyong v Union Zone Management Ltd distinguished

The Court of Appeal overturned the winding up order partly on the basis that the Judge was wrong to take into account matters related to Beibu Gulf in assessing deadlock. Their reasoning was that such disputes could not have affected OSL at the director and shareholder level. The Court of Appeal relied on its previous decision in *Wang Zhongyong v Union Zone Management Ltd* (BVIHCMAP 2013/0024 delivered 12 January 2015) which ruled that exclusion of the applicant from the management of a company, which was not a subsidiary of the subject company, could not constitute unfairly prejudicial conduct of the subject company.

Union Zone was neither a deadlock case nor was the company in question a corporate quasi-partnership. The Board also distinguished Union Zone from the present case on the basis that where the subject company is a corporate quasi-partnership, the relationship between the quasi-partners is of utmost importance and by implication all aspects of their business relationship would be relevant in assessing deadlock. On that basis, the Board took the view that the Judge was entitled to rely on all matters which occurred between Mr. Lau and Mr. Chu at the Beibu Gulf level as relevant to assessing the relationship of trust and confidence between the parties.

Irretrievable breakdown in trust and confidence

One of the main disagreements between Mr. Chu and Mr. Lau was whether the funding for the purchase of the Beibu Gulf fleet which had been made by PBM was by way of on demand lending, which PBM could recover summarily (as alleged by Mr. Lau), or by way of capital injection (as alleged by Mr. Chu).

There were also attempts by the parties to separate their business affairs by way of asset division in which Mr. Chu would take Mr. Lau's half interest in OSL, while Mr Lau would take Mr. Chu's half interest in another jointly owned company. Unfortunately for Mr. Lau, the valuation of OSL required the financial information about the business of Beibu Gulf in which Mr. Chu was the managing director and in relation to which it was alleged that Mr. Chu refused to provide such information to Mr. Lau.

There was also PRC Holdco's sale of its interest in Beibu Gulf to Bright Good (Asia) Limited ("**BGAL**") and Polyrise Team Ltd ("**Polyrise**"); both being companies connected to Mr. Chu, which eventually resulted in the removal of Mr. Lau as director of Beibu Gulf. The Judge ruled that the acquisition of Beibu Gulf by BGAL and Polyrise, without Mr. Chu disclosing his interest, arguably amounted to a breach by Mr Chu of his fiduciary duty to PBM and OSL.

Winding up on the just and equitable ground

Having considered the relationship between the parties at the time of the filing of the Application and considering post-commencement events, the Board agreed with the Judge's findings that there was deadlock in OSL and PBM and there was no basis for the Court of Appeal to overturn that finding.

The Board also disagreed with the Court of Appeal's finding that there could be no deadlock in OSL where Mr. Lau had the opportunity to sell his shares in OSL to a third party. This was because a sale to a third party would be an appropriate solution to resolve a purely functional deadlock situation. However, the present appeal was not such a case and a prospective buyer would be faced with some of the same challenges faced by Mr. Lau, especially where such a buyer would have no right to appoint a director to the board of OSL. The acrimonious background between Mr. Lau and Mr. Chu may also result in a discounted price from any prospective buyer.

Further, the Board held that the Court of Appeal misdirected itself on the law in finding that the onus was on Mr. Lau to demonstrate that there was no alternative remedy available to him. Rather, section 167(3) of the Insolvency Act places the onus on the respondent to show that the applicant is being unreasonable in failing to pursue some other attractive and available remedy.

Even more instructive for the purposes of future winding up applications in the BVI is the Board's rejection of the Court of Appeal's finding that had a case for winding up been established it had the discretion to order a buyout of Mr Lau's shares. The Board rejected this approach as being wrong in law and concluded that the BVI court had no such discretion to order a buyout as alternative relief on a winding up application under the Insolvency Act. Such relief would only be available in unfair prejudice proceedings and on the present case the Judge was entitled to find that a buy-out order was not the most appropriate remedy.

Takeaways

While it is a well-known principle that a winding up order on the just and equitable ground is a remedy of last resort and is generally considered a 'draconian remedy', the Privy Council has made it clear that in an unequivocal quasi-partnership case where there is a complete breakdown of trust and confidence resulting in deadlock, a winding up order is usually the most appropriate remedy. More importantly, the applicant will be under no obligation *to prove* that there is no alternative remedy available to him.