VOISIN LAW

Just and Equitable Winding Up – a pragmatic solution to an unusual situation | 1

In the recent case of Monarch Investments Limited [2023] JRC024, the Royal Court was faced with a Jersey company which had become 'paralysed' as a result of a breakdown of relations between its two shareholders.

Background

The case concerned Monarch Investments Limited (the "Company"), which was a Jersey company incorporated in April 1971 and which held, as its principal assets, two properties in the heart of St. Helier.

The two shareholders of the Company were Robert Gibbons ("Robert") and Kenneth Gibbons ("Kenneth"), who were brothers and Robert was also the sole director of the Company.

Kenneth was a minority shareholder of the Company and held 35% of the shares, with the balance of the shares being held by Robert.

The dispute between the two brothers had been ongoing for many years, with proceedings brought before the Royal Court in 2015. In that hearing, the Royal Court was not asked to consider ordering the just and equitable winding up of the Company, but rather was simply asked for a declaration that the substratum of the Company (broadly the objects for which the Company had originally been incorporated) had been lost, which the Royal Court declined to give.

Turning now to the present case, the Court noted that matters had further deteriorated since the last court hearing and that:
"No matter who is to blame for these difficulties, it seems clear that the relationship between Kenneth and Robert has effectively broken down and Monarch has not been run in a way which either benefits it or ultimately its shareholders..... the company is currently dysfunctional in its operation and has not been administered and run appropriately and in its interests."

In particular, the Royal Court noted that the relationship between the brothers had broken down to such an extent that the brothers have only met twice in recent years, despite many efforts by Kenneth to make contact. The affairs of the Company were also in complete disarray, with the Company being in arrears in respect of its tax liabilities, parish rates for the properties having not been paid, annual accounts having not been prepared and one of the properties being left empty and in need of repair.

The Royal Court further noted that matters were not helped by the age of the shareholders, with the Court noting in particular that Robert (who failed to respond to correspondence relating to the proceedings and did not attend the hearing) may have been suffering from poor health and had encountered significant financial problems recently.

The inability of Robert, as majority shareholder and sole director, to manage the Company had in turn led to a considerable burden being placed on Kenneth, which he had difficulty discharging as he was not a director. Kenneth was also unable to change the composition of the board as he was also a minority shareholder.

As a result of the aforementioned issues, Kenneth had sought an order that the Company be wound up on a just and equitable basis, on the footing that the properties should be sold and the assets of the Company distributed between the shareholders, with the process being overseen by an independent liquidator.

Winding up on just and equitable grounds pursuant to Article 155 of the Companies Law

Pursuant to Article 155 of the Companies (Jersey) Law 1991 (the "Companies Law"), the Royal Court may grant a winding up order on the grounds that it is just and equitable to do so, and such an order can be granted in relation to a solvent or insolvent company.

Importantly, an Article 155 application can be made by the company, a director, a shareholder, the Chief Minister, the Minister for Treasury and Resources or the Jersey Financial Services Commission.

Although the Royal Court will have regard to English case law in assisting their interpretation of "just and equitable," Jersey case law has seen a wide approach to the application of the Court's discretion in interpreting this concept, which has led to the widening of circumstances in which such an order has been granted in Jersey. The Court has the power to direct the manner in which the winding-up is to be conducted and to make such orders as it sees fit to ensure that the winding-up is conducted in an orderly manner.

In the case of Financial Technology Ventures and Others v ETFS Capital Limited and Graham Tuckwell [2021] JRC 025, the Royal Court provided examples where it may be just and equitable to wind up a company and stated:

"It is not possible exhaustively to define all of the circumstances when it may be just and equitable to order the winding up of a company. The Court has a wide discretion and each case must be assessed on its own merits. Common examples of where just and equitable winding up has been ordered by the court include (i) where the substratum of a company has gone; (ii) where a company is insolvent and its affairs need to be investigated; (iii) where there is a deadlock between the members and / or directors preventing decision making on matters central to the company's prospects and; (iv) where, if the company is a quasi-partnership, there has been a breakdown of relations between the participants such that they are unable to cooperate in the conduct of the company's affairs."

In Representation of Abdallah [2021] JRC 249, the Royal Court provided further examples of where the Court may be satisfied that a winding up order is "just and equitable order" including:

1. a justifiable loss of confidence in the probity and a lack of impartiality in relation to the management of a company, particularly where the controlling director treats the business as his own; or

2. in cases where there is conduct deliberately calculated to 'freeze out' a minority shareholder, driving him to sell his shares at an undervalue,

with the Court noting that such orders would always be "context specific."

In examining the relevant case law, the Royal Court also noted that a winding up order on just and equitable grounds was certainly unusual in the case of a solvent company, and in the Australian case of Peter Exton v Extons Pty Ltd [2017] VSC 14 it was "accepted that the winding up of a solvent and flourishing company should be a last resort".

In this present case, the Royal Court however held that this was a case of "last resort" as the Company had now become "paralysed" due to the breakdown of relations between the two shareholders.

The Royal Court's Decision

The Royal Court noted that In Representation of Abdallah, that there were 3 questions that the court needed to ask itself when considering whether to order the winding up of the company on just and equitable grounds which were: (i) is there a lost confidence in the probity or impartiality of the director to manage the Company; (ii) is that loss of confidence justified; and, if so (iii) is it sufficient to prompt a just and equitable winding up of the Company?

Applying these 3 questions to the present case, the Royal Court held that:

1. that there had been a loss of confidence in the probity or impartiality of Robert to manage the Company, as Kenneth had offered to assume the directorship of the Company and to assist Robert in managing the Company and such offers had been rejected;

2. Kenneth's loss of confidence had been objectively justified, owing to his brother's conduct in running the Company over the last few years and that Robert's own wish to continue to control the Company and to exclude Kenneth from assisting had prejudiced the interests of the Company and Kenneth as the minority shareholder; and

3. the circumstances of the case were sufficient to prompt a just and equitable winding up of the Company, as it was an unusual case and there were no other options readily available to the Court – somebody needed "to be in control of the Company", given that it was diminishing in value as a consequence of Robert's neglect.

The Court therefore ordered that the Company should be wound up on the just and equitable basis under Article 155 of the Companies Law and a liquidator be appointed to carry out the winding up process.

Conclusion

As the Royal Court rightly noted, this was an "unusual case," with the breakdown of the relationship between the two shareholders being described as "total", which had led to the Company diminishing in

value and being neglected. However, the case is of great importance in highlighting the flexible and broad interpretation which the Court will adopt to the phrase “just and equitable” in considering whether to grant an order under Article 155 of the Companies Law.

Indeed, as the Jersey insolvency regime does not yet include procedures like administration under the UK Insolvency Act 1986, the Royal Court’s broad interpretation of when it is just and equitable to wind up a Jersey company has also enabled the Royal Court to issue bespoke orders in insolvency scenarios in order to enable the company to realise a better return for its creditors by, for example, permitting it to trade for a further period or enter into a pre-pack sale of its assets.

This case also highlights the importance of putting in place a good shareholders agreement, in circumstances where a company has multiple shareholders. For example, a robust shareholders agreement should help protect the rights of minority shareholders who otherwise might have little power over the running of the business and have mechanisms in place to assist in avoiding disputes between shareholders escalating. Normally a shareholders agreement would also set out a process to follow when a shareholder wants to sell their shares or dies, which in many cases will enable the parties to avoid expensive court applications ever taking place.