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Doctrine of Just and Equitable Winding Up as Minority Shareholders' Remedy in Pakistan

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Abstract: *This article examines the doctrine of just and equitable winding as a minority shareholders' remedy in Pakistan. This is a residual remedy and developed with the passage of time for the protection of minority shareholders in the UK. The courts in the UK have established different views regarding circumstances in which remedy may be sought. In some cases, the court held that the jurisdiction of winding up is not different from unfair prejudice. Therefore, this article will further discuss the possibility of seeking remedy viz a viz other minority shareholders' protection mechanism such as remedy against unfair prejudice. This article is based on qualitative research. The doctrinal and comparative research methods have been applied in the research. This article concludes that the remedy of winding up on just and equitable grounds may be effective only when the grounds for seeking remedy are wider than the unfair prejudice remedy.*

Key Words: Corporate Governance, Just & Equitable, Minority Shareholders, Oppression, Pakistan, Unfair Prejudice, Winding Up

Introduction

The power of decision making and management is with shareholders who are the owners. These powers are vested based on voting shares. The minority shareholders, having fewer voting powers, are mostly at the losing end as compared to majority shareholders. Some remedies are developed in common law and equity to protect the minority shareholders. One important remedy amongst them is winding up on just and equitable grounds. This remedy was developed by courts for partnerships. In partnerships, when mutual trust and confidence were broken between the investors, the courts used to order winding up. The reason was that when the basis on which partnership was formed was finished, then there was no need to stick to such relations, which are at a deadlock.

Similarly, there are a number of small private companies that are formed and operate based on mutual trust and confidence. These companies are like partnerships. Therefore, they may also be named as quasi partnership companies. These quasi-partnership companies are structured like a partnership. Therefore, the courts started ordering winding up on the same basis on which the partnerships were liquidated. However, some decisions of courts have limited the scope of the remedy. Since winding up is a residual remedy; therefore, courts direct the petitioner to go for an unfair prejudice remedy. Sometimes it is difficult to establish unfairness in those cases where the company was in fact formed based on mutual trust and confidence. In this situation, the petitioner may lose his right to wind up on just and equitable grounds. This article will discuss the development of a remedy of just and equitable winding up in the UK. This paper will also compare the remedy with the unfair prejudice remedy. In the last, the paper will discuss the effectiveness of the remedy as to a minority shareholder protection mechanism in Pakistan.

Nature and Scope of the Remedy

The doctrine of Just and Equitable winding up remedy is developed with the passage of time. According to S. 125 (2) (b) the Insolvency Act 1986 (the UK), it is a residual remedy. It means one may pursue the remedy when there is no alternate available. In other words, if the alternative remedy is available, then courts may

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not allow pursuing winding up. The most common alternative remedy for just and equitable winding for companies is unfair prejudice. The Unfair prejudice remedy may be sought by shareholders where their membership or personal rights are infringed by majority or controlling shareholders. This remedy is specifically designed for minority shareholders. Both these remedies are interrelated to each other and often used as an alternative to each other. The just and equitable winding-up has been developed as an alternative to unfair prejudice, and unfair prejudice is sought as an alternative to just and equitable winding up. The principles upon which these remedies are sought are the same. For example, the common law principles such as good faith and bond of trust established for just and equitable winding up of partnerships are often considered and applied to the unfair prejudice remedy sought in companies (Pettet, Lowry, & Reisberg, 2009).

The remedy of winding up on just and equitable grounds was established for partnerships. The scope of the just and equitable winding up for partnerships has been established by the courts with the passage of time. The principles upon which the partners may pursue winding up of partnerships were a breach of a bond of trust, co-operation, and good faith. Once these principles were established, the courts used to apply these principles in companies, especially those companies that were quasi-partnership companies (*Ebrahimi v Westbourne Galleries Ltd,* 1973). There are a number of small private limited companies in the corporate sector of every jurisdiction that operate as partnerships. These are the companies where the ownership and the management are vested in the same persons. In these quasi-partnership companies, the relations between the investors are not limited to articles of association that define internal management as per company law but may also be based on other things such as legitimate expectations and equitable considerations (Jeffrey G. MacIntosh, 1989). This phenomenon can be explained through the following hypothetical example for a small private company. Suppose there is a small private company formed by four investors. Further, suppose each member contributes 25% investment. Further, suppose it is agreed between them that every investor will be a director with a specific amount of remuneration as a director, and there will be no profit-sharing in the form of a dividend. In these circumstances, there may be two worse possible situations when there is a lack of trust between the investors. Firstly, if they are divided into two equal groups with two members in each group. This may create a deadlock in management due to a lack of trust and cooperation (*Re Yenidje Tobacco Company*, 1916). This may create difficulty in running the company smoothly. Secondly, when one is dismissed as a director by the other three members from the directorship. In this case, the dismissed director will lose getting remuneration as a director and therefore no profit for his investment. Now, the capital of such a removed director will be locked. There will be a difficulty for such an investor in exiting from such a small private company. The reason is that the shares of private companies are not traded in the market, so selling shares to a third party on market value is not feasible. The other difficulty may be that some jurisdictions, such as Pakistan that restrict the selling of shares in private companies without the consent of the board of directors. The other difficulty is that if such an investor receives the consent of the board of directors for selling shares, then it is quite possible that he will not get the true price for his investment as there is no defined mechanism for valuation of share price for private companies. In these circumstances, the investor has no alternative except to go for winding up of companies under the principle of just and equitable winding up.

Implications and Grounds for just & equitable winding up in the United Kingdom

Financial Implications for Remedy

There are financial implications if a company is wound up as compared to unfair prejudice remedy. In unfair prejudice, the minority shareholder may approach the court for a remedy for mismanagement, oppression, or violation of personal or corporate rights. The court may award damages to the petitioner, and the company's business remained unaffected. This will not damage much to the company. However, in winding up, the business of the company is closed, and only the assets of the company are left. Consequently, in winding up, both parties, petitioner and respondent, may suffer. Firstly, after winding up, the shares of companies do not represent the exact proportion of the assets of the company. Therefore, it is quite possible that one may not get gets due compensation for their shares and investment in the company. Secondly, the investors may lose continuous profit in the form of a dividend. Thirdly, if a small private company is formed on the understanding that every investor will be a director and will get remuneration as a director. In this case, one may lose continuous profits in remuneration as a director if the company is not liquidated. Fourthly, suppose the business of the company is based on profits from personal relations and contacts of the investors, then winding up may not be an attractive remedy, and everyone will suffer after

liquidation (Pettet *et al.*, 2009). Therefore, winding up on just and equitable grounds is not an attractive remedy as compared to unfair prejudice. Nevertheless, there are advantages of winding up on just and equitable grounds as far as minority shareholders are concerned. It provides a bargaining chip to minority shareholders to control the corporate powers of the controlling shareholders, which can otherwise be destructive for the minority shareholders (Kershaw, 2009).

Scope of Grounds for Remedy Under just and Equitable Winding Up

As far as grounds upon which minority shareholders may seek remedy on just and equitable winding up is concerned, the scope of the remedy is wide. The courts have shown wide discretion in granting remedy of just and equitable winding up. The courts have shown reluctance in enlisting the grounds for winding up on just and equitable grounds. Lord Wilberforce said in a leading case that it was neither feasible nor desirable to define the circumstances in which one may seek remedy on just and equitable grounds (*Ebrahimi v Westbourne Galleries Ltd,* 1973). He further said that this depends upon the circumstances of each case. However, he has discussed some of the grounds upon which remedy may be sought in the *Ebrahimi* case. In this case, three investors formed a private company. There was a mutual understanding between the members that they would all be directors. It was further agreed that there would be no distribution of profit except remuneration as profit being director of the company. After some time, two members, who were father and son, removed the third member from the directorship. Therefore, he lost his directorship as well as remuneration as a director and, consequently, received nothing against his investment. He approached the court for winding up on just and equitable grounds. This was an interesting case. Lord Wilberforce said that a company that was formed and operated like a partnership would be dealt with like a partnership. He explained if a company was formed based on mutual confidence and relationship. Further, if it was agreed that everyone would be a director and would participate in the management and impose restrictions on the transfer of interest was like a partnership. Therefore, the principles of partnership such as 'mutual confidence', 'probity', 'good faith' would apply. Therefore, such a company will be considered as a quasi partnership company. He further explained that though removal as director was their legal right. However, the equity consideration went beyond legal rights. Lord Wilberforce held that there were, therefore, valid grounds for just and equitable winding up.

Unfairness in just and Equitable Winding up Remedy

There is disagreement about the requirement of unfairness on the part of the defendant for claiming remedy of winding up under just and equitable grounds. The courts have shown the different points of view in different cases. For example, in the Re Guideline case, the honorable judge denied the remedy of winding up on just and equitable grounds on the basis that the act of majority shareholders was not unfairly prejudiced (*Re Guidezone,* 2000). On the other hands, it is said that when a company is formed and operate based on mutual trust and confidence, and when this mutual trust and confidence is broken, then it is enough to wind up the company, and there is no need to prove unfairness on the part of the defendant for ordering winding up. For example, in the Ebrahimi case, the honorable judge ordered the winding up based on a breakdown of mutual trust and confidence. This decision is made because it is not possible to show unfairness every time. Therefore, it is enough to show to the courts that the mutual trust and confidence have broken, which was the basis of the formation of the company. When there is no trust and confidence amongst the members in quasi partnership companies, then lingering on with these companies will yield nothing except to increase the quantum of mismanagement and destruction of business and assets of the company. So, providing a remedy of winding up on just and equitable grounds without showing unfairness on the part of the defendant provides wide discretion to the courts (Stephen, 2001).

Requirements of Clean Hands in just and Equitable Winding Up

As far as claiming remedy of winding up upon just and equitable grounds is concerned, the question arises whether the petitioner needs to come with clean hands? Though just and equitable winding and unfair prejudice remedies are considered as an alternative to each other, but they are different from each other based on legal rights and equitable rights. The unfair prejudice remedy is a common law remedy, whereas just and equitable remedy is provided by equity. In other words, unfair prejudice remedy can be claimed in infringement of legal rights and even can be claimed in contributory harms. Therefore, there is no need to come with clean hands while pursuing unfair prejudice remedies. On the other hand, just and equitable winding-up can be claimed in infringement of equitable rights, and it can be claimed in cases when there is a breach of mutual trust and confidence. However, since it is an equitable remedy, therefore, it is necessary for the

petitioner to come with clean hands (*Re London School of Electronics Ltd,* 1986).

Just and Equitable Winding up vs. Unfair Prejudice Remedy

The just and equitable winding up is a residual remedy. Unfair prejudice is alternative to winding up and *vice versa*. Winding up is not an attractive remedy and is costly as well due to several factors. Therefore, an alternative was provided by law in the form of an unfair prejudice remedy. The insolvency laws provide that winding up can be pursued when there is no alternative remedy available. Therefore, courts direct petitioners to go for alternative remedies instead of asking for winding up. Since winding up is, in fact death sentence for a company, therefore, courts direct to go for winding up on just and equitable grounds as a last resort. Consider a hypothetical example where the petitioner asks for winding up on just and equitable grounds, and the court directs to go first for unfair prejudice, which is an alternative remedy for winding up. Suppose he fails to establish unfairness even though mutual trust and confidence had broken. The court will not provide relief to the petitioner, and he will have to face a problem in getting relief from winding up.

In a leading UK case, the petitioner filed a petition for unfair prejudice remedy and failed to establish. He then requested the court to convert the petition to wind up under just and equitable grounds. The court rejected the application on the grounds that when he failed to establish unfairness on the part of the defendant, then he could not get a case for winding up under just and equitable grounds. The learned judge held that the jurisdiction of winding up under just and equitable grounds is no wider than jurisdiction for a petition under unfair prejudice remedy (*Re Guideline Ltd*, 2000). The impact of this decision was that the petitioner could not demand a remedy for winding up. If he goes for winding up remedy, then the court will direct to go for unfair prejudice remedy. If he fails in unfair prejudice remedy, then he will not get a remedy for winding up. Technically, the court shut the doors for winding up under just and equitable grounds.

However, in another leading UK case, the learned judge observed and held in Re Neath Rugby case that there are doubts on the correctness of the judgment of Parker J in *Re Guidezone* case (*Frederick Geraint Hawkes v Simone Francesca Cuddy, Micheal Cuddy, Neath Rugby Limited, Neath-Swansea Ospreys Limited,* 2009). In this case, the learned judge observed that the jurisdiction of winding up on just and equitable grounds is wider than unfair prejudice remedy (Boyle, 2004). The reason is that there are possibilities that the parties lost mutual trust and confidence, but still, there is difficulty to establish unfairness. Small private companies which are established by relationships such as by close friends and relatives based on mutual trust and confidence. These companies are no different than partnerships, and therefore, their functioning and even liquidation will be like partnership. So, these should have been wound up on the same basis on which partnerships are liquidated.

Therefore, it may be concluded that the scope of a remedy under just and equitable winding up is wider than the unfair prejudice remedy. It can be further concluded that unfair prejudice is a legal remedy, whereas winding up on just and equitable grounds is an equitable remedy. In short, the jurisdiction of both remedies can be concluded in this way that petitioner can claim damages for infringement of legal rights under unfair prejudice remedy and can also claim winding up if there is a breach of mutual trust and confidence (Stephen, 2001). In other words, a petitioner may be allowed to pursue winding up on just and equitable grounds in addition to or in lieu of unfair prejudice. If winding up on just and equitable grounds is annexed with unfair prejudice, then the purpose of winding up on just and equitable grounds may fail.

Just and Equitable Winding up in Pakistan

The remedy of winding up on just and equitable grounds is provided in the Companies Act 2017 in Pakistan. This remedy was also provided in previous company law i.e., the Companies Ordinance 1984. The law provides that the court will not proceed with winding up on just and equitable grounds if other remedies are available. This means this remedy is also recognized in Pakistan as an alternative remedy {S. 308 (2) of the Companies Act 2017 (PK)}.

In Pakistani corporate culture, there is a dominance of private companies which are operated by the families and close friends. These types of companies are formed and operate like partnerships. The basis of these companies is mutual trust and confidence between the members. Since these types of companies are formed and operate like partnerships, therefore, their dissolution can be made on the same basis on which partnerships are dissolved (*Messrs Nangina Films Ltd v Usman Hussain and Others,* 1987(Pakistan).

The remedy of winding up on just and equitable grounds was developed for partnerships. The partnerships were dissolved by the courts in cases when mutual trust and confidence were broken. For instance, when there is a deadlock in running a business or lack of confidence in managerial affairs between the

partners, and exclusion of investors from the business. These grounds may also be applied in the dissolution of small private companies, which are quasi partnership companies. The reasons are that small private companies are formed and operate like partnerships; therefore, these may be dissolved like partnerships. The courts have enumerated different grounds for dissolution of such types of companies, but there is no exhaustive list (*Ladli Prasad Jaiswal v The Karnal Distillery,* 1965). This will depend on case-to-case basis. It is not possible to enumerate the list on which winding up on just and equitable grounds may be made {*Re: Kruddson limited*, 1972 (Pakistan)}. The important thing is to see whether the companies can be operated on the basis on which the company was formed and that there is no other remedy available. Therefore, the remedy of just and equitable winding is an effective remedy of dissolution of companies that are quasi partnership companies.

Winding up on just and Equitable Grounds v Oppressive Remedy in Pakistan

It was established through different decisions of the courts that the remedy of unfair prejudice and winding up on just and equitable grounds are alternative as well as independent to each other. However, this principle has not yet matured as the courts, in some cases, took a different view in Pakistan. The honorable judge of the High Court in *ABIL v EBM* held that there is not much difference between jurisdiction of a remedy under oppressive conduct and winding up on just and equitable grounds. The court further held that one might pursue a remedy of mismanagement or oppressive conduct if the company's affairs are conducted in such manger that the company may be wound up but winding up will unfairly prejudice the members {*Associated Biscuits International Ltd v English Biscuits Manufacturers (Pvt) Ltd,* 2003 (Pakistan)}. This may be problematic for petitioners because this will limit the scope of remedy of winding up on just and equitable grounds. Because, when a party goes for winding up, the court may direct to go for alternative remedy of mismanagement and oppressive conduct. If a petitioner fails in securing remedy under mismanagement or oppressive conduct, this may debar from obtaining a remedy under winding up on just and equitable remedy. The remedy of winding up on just and equitable grounds may be effective only when its scope is wider than the remedy under oppressive conduct. A party who fails to secure remedy under oppressive conduct may be allowed to pursue a remedy for just and equitable winding up alternatively as a last resort.

There is another aspect of winding up on just and equitable grounds that the remedy of oppressive conduct is too demanding in Pakistan, and it may not be feasible for most of the time for the minority shareholders to pursue this remedy. Therefore, the petitioner may be left with no other option except to ask for winding up on just and equitable grounds. Winding up is not considered an attractive remedy as both parties may suffer. It is, therefore, necessary to make the remedy of oppressive conduct feasible for minority shareholders, so that the remedy of winding up on just and equitable grounds may be pursued as a last resort.

Conclusion

The just and equitable winding up is a residual remedy. The courts have applied this doctrine in those companies which are formed and operate like partnerships. These companies are formed and operate based on mutual trust and confidence. Once that trust and confidence are broken, the courts used to order winding up on just and equitable grounds. However, there is a problem with this remedy. The remedy is a residual remedy; therefore, the courts order petitioner to seek an unfair prejudice remedy first, and once he fails, the court denies the winding remedy. The reason is that courts have held in different decisions that the jurisdiction of both remedies is not different from each other. This may limit the scope of equitable remedy. Therefore, there is a need to enhance the scope of equitable remedy.

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