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IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2011-404-5315
[2012] NZHC 13

BETWEEN	SEA MANAGEMENT SINGAPORE PTE LIMITED Plaintiff
AND	PROFESSIONAL SERVICE BROKERS LIMITED First Defendant
AND	NATIONAL EQUITY LIMITED Second Defendant
AND	NIGEL GEOFFREY LEDGARD BURTON, MICHAEL MURRAY BENJAMIN AND MICHAEL WALTER DANIEL Third Defendants
AND	ALLAN BROOKE MITCHELL AND FLEUR NINA MITCHELL AS TRUSTEES OF THE REMUERA TRUST Fourth Defendants
AND	JOHN NOBLE COZENS, SUELLEN RUTH WILKINS AND JOHN PHILLIPS WILKINS AS TRUSTEES OF THE PANDANUS TRUST Fifth Defendants

Hearing: 14, 15 16 and 22 November 2011

Appearances: D J Cooper and T B Fitzgerald for Plaintiff
M A Gilbert SC and M C Harris for Second to Fifth Defendants

Judgment: 25 January 2012 at 4:00 PM

RESERVED JUDGMENT OF ASSOCIATE JUDGE BELL

This judgment was delivered by me on 25 January 2012 at 4:00pm
pursuant to Rule 11.5 of the High Court Rules

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Registrar/Deputy Registrar

Solicitors:
Bell Gully, Auckland, for Plaintiff
Gilbert Walker, Auckland, for 2nd-5th Defendants

Introduction

[1] This is an application under s 241(4)(d) of the Companies Act 1993 that Professional Service Brokers Ltd (PSB) be put into liquidation on the just and equitable ground. The plaintiff, SEA Management Singapore Pte Ltd (SEA), is a 50 per cent shareholder of PSB. The second to fifth defendants are the other shareholders. They form one bloc – the NEO shareholders. SEA's ground for seeking a liquidation order is that there is an irreconcilable deadlock at board and shareholder levels, so that strategies favoured by either bloc cannot be executed, potential business opportunities will be missed and there will be a loss of value. The NEO shareholders oppose, saying that SEA can have no justifiable lack of trust and confidence in the NEO directors. SEA has created the deadlock so as to bring about a forced sale of a subsidiary, and there are adequate alternatives to liquidation, which is a remedy of last resort.

Legal principles

[2] Under s 241(4)(d) the court may appoint a liquidator if it is satisfied that it is just and equitable that the company be put into liquidation. In *Re Bleriot Manufacturing Aircraft Company Ltd* Neville J said:[1]

> The words "just and equitable" are words of the widest significance and do not limit the jurisdiction of the Court to any case. It is a question of fact and each case must depend on its circumstances.

Many cases since have confirmed that approach including *Loch v John Blackwood Ltd*,[2] *Ebrahimi v Westbourne Gallery Ltd*[3] and *Jenkins v Superscaf Ltd*.[4]

[3] Because there is no limit to the kinds of cases where it may be just and equitable to order a liquidation, categorisation has been deprecated.[5] However, where common patterns recur, the courts have developed consistent approaches. One

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1 *Re Bleriot Manufacturing Aircraft Company Ltd* (1916) 32 TLR 253, 255.
2 *Loch v John Blackwood Ltd* [1924] AC 783 (PC) 791.
3 *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL) 379.
4 *Jenkins v Supscaf Ltd* [2006] 3 NZLR 264 (HC) [93] – [99], [109] –[114].
5 *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL) 374.

recurring kind is deadlock by decision-makers, at board or shareholder level, that paralyses the business of the company. Deadlock may arise when there is equality of voting power between competing factions, although deadlock cases are not confined to companies where control is shared equally.[6] The deadlock must be so serious as to impede the continued operation of the company. The essential basis for the court to give relief is frustration by internal discord. The court may order liquidation in its discretion if it is satisfied that there is no other way out of the impasse. New Zealand examples include *Re Upper Hutt Town Hall Ltd*,[7] *Re Mataia Ltd*,[8] *Vujnovich v Vujnovich*,[9] *Re Rongo-ma-tane Farms Ltd*[10] and *Strachan v Denbigh Property Ltd*.[11]

[4] The task of the court is to find out whether there is a deadlock, its causes and its effects. In *Re F Hall and Sons Ltd* the Court of Appeal said:[12]

> As to whether there was a deadlock is a question of fact and, if there was, the question as to whether it was sufficient to justify a winding-up order depends upon the manner in which it arose and its effect upon the various parties interested. It is necessary therefore to examine the circumstances leading up to the alleged deadlock and the petition for winding-up.

It is not for the court to adjudicate on the merits of differences between the parties on business issues, as Lord Cairns explained in *Re Suburban Hotel Co*:[13]

> But what I am prepared to hold is this, that this Court, and the winding-up process of the Court, cannot be used and ought not to be used, as the means of evoking a judicial decision as to the probable success or non-success of a company as a commercial speculation.

But if the court finds that the plaintiff is solely responsible for the deadlock, it may dismiss the application in its discretion,[14] as the Court of Appeal did in *Re F Hall and Sons Ltd*. On a finding of a sufficiently serious deadlock to stymie the operation of the company, a liquidation order is not made automatically. As the court needs to

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6 *Re Deep Sea Trawlers Ltd; Re Overland Investment Co Ltd* (1984) 2 NZCLC 99,137.
7 *In re Upper Hutt Town Hall Ltd* [1920] NZLR 125.
8 *In re Mataia Ltd* [1921] NZLR 807.
9 *Vujnovich v Vujnovich* [1988] 2 NZLR 129 (HC and CA), [1989] 3 NZLR 513 (PC).
10 *Re Rongo-ma-tane Farms Ltd* (1987) 3 NZCLC 100,145.
11 *Strachan v Denbigh Property Ltd* (2011) 10 NZCLC 264, 813.
12 *Re F Hall and Sons Ltd* [1939] NZLR 408 (CA) 418.
13 *Re Suburban Hotel Co* (1867) LR 2 Ch 737, 750.
14 *Vujnovich v Vujnovich* [1989] 3 NZLR 513 (PC) 518.

be satisfied that there is no other way out of the impasse, alternatives are always relevant. *Charles Forte Investments Ltd v Amanda*,[15] not a deadlock case, shows that the availability of alternative remedies is a relevant consideration in all applications under the just and equitable ground, in part to ensure that the remedy is not misused. As a decision to order liquidation under s 241(4)(d) involves the exercise of an equitable discretion, other factors going to justice and equity may influence the decision.

[5] One of the NEO shareholders' defences is that SEA cannot have a justifiable lack of confidence in the NEO directors. They rely on this passage from the advice of the Privy Council in *Loch v John Blackwood Ltd*:[16]

> It is undoubtedly true that at the foundation of applications for winding up, on the 'just and equitable' rule, there must lie a justifiable lack of confidence in the conduct and management of the company's affairs. But this lack of confidence must be grounded on conduct of the directors, not in regard to their private life or affairs, but in regard to the company's business. Furthermore the lack of confidence must spring not from dissatisfaction at being outvoted on the business affairs or on what is called the domestic policy of the company. On the other hand, wherever the lack of confidence is rested on a lack of probity in the conduct of a company's affairs, then the former is justified by the latter, and it is under the statute just and equitable that the company be wound up.

[6] On its face that suggests that any application for a liquidation order on the just and equitable ground must show a justifiable lack of confidence in the conduct and management of a company's affairs. But that is to read this passage out of context. That case did involve a claim of justifiable lack of confidence, but the Privy Council was not intending to exclude cases which did not raise that claim. That is apparent from its rejection of the ejusdem generis interpretation, so as to leave the grounds unconfined, and its recital of passages from the Scottish case, *Symington v Symington's Quarries Ltd*,[17] a deadlock case. In *Ebrahimi v Westbourne Galleries Ltd* Lord Cross said:[18]

> But it is not a condition precedent to the making of an order under the subsection that the conduct of those who oppose its making should have been unjust and inequitable.

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15 *Charles Forte Investments Ltd v Amanda* [1964] Ch 240 (CA).
16 *Loch v John Blackwood Ltd* [1924] AC 783 (PC) 788.
17 *Symington v Symington's Quarries Ltd* (1905) 8 F 121.
18 *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL) 383.

[7] If SEA had based its application on a claim of lack of justifiable confidence in the NEO directors, the defence would be relevant. But SEA claims on the basis of deadlock. It is conceivable that in a deadlock case the probity of those opposing might be part of a defence to show that the plaintiff is solely responsible for the impasse, but it is not a defence by itself. It is necessary to keep in mind that deadlock may arise without fault on either side.

[8] SEA cited decisions of New York[19] and Delaware[20] courts to show how deadlock is addressed in those jurisdictions. The New York decisions show that in that state there is no inquiry as to fault but only whether a deadlock exists, precluding successful conduct of the corporation's affairs. The just and equitable ground allows a more nuanced approach. The Delaware decisions are under that state's limited liability company[21] (LLC) statute, which provides for judicial dissolution when it is not reasonably practicable to carry on the business in accordance with the limited liability company agreement. In both cases the Court of Chancery declined to require plaintiffs to use remedies available under the LLC agreement in the particular circumstances of those cases. In *Haley v Talcott* Vice Chancellor Strine said:[22]

> The Delaware LLC Act is grounded on principles of freedom of contract. For that reason, the presence of a reasonable exit mechanism bears on the propriety of ordering dissolution under 6 Del. C. §18-802. When the agreement itself provides a fair opportunity for the dissenting member who disfavours the inertial status quo to exit and receive the fair market value of her interest, it is at least arguable that the limited liability company may still proceed to operate practicably under its contractual charter because the charter itself provides an equitable way to break the impasse.

That is not very far away from the approach under the just and equitable ground under our Companies Act.

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19 *Matter of Goodman v Lovett* 200 A D 2d 670 (NYAD 2 Dept 1994), *In the Matter of Dream Weaver Realty Inc* 70 A D 3d 941 (NYAD 2 Dept 2010).

20 *Haley v Talcott* 864 A 2d 86 (Del Ch 2004); *Fisk Ventures LLC v Segal* CA No 3017-CC (Del Ch 2009), aff'd 984 A 2d 124.

21 In the United States a limited liability company is neither a corporation nor a partnership but has limited liability and has features of a partnership.

22 *Haley v Talcott* 864 A 2d 86 (Del Ch 2004) 96.

Background

[9] PSB is a holding company. The important subsidiaries[23] are GSB Supplycorp Ltd (GSB) and Conexa Ltd. There is no significant external debt. Combined there are about sixty staff. They have offices in Auckland and Wellington.

[10] GSB, a wholly owned subsidiary, is a procurement services provider. Before it was privatised in 1991 it was the state-owned enterprise that took over the Government Stores Board. Its business is focussed on New Zealand and Australia. It has throughout traded profitably. It is said to be New Zealand's largest commodities brokerage with members transacting business worth $700 million per annum.

[11] Conexa is a start-up e-commerce and procurement software developer and supplier. It provides collaborative trading networks for businesses of all sizes, delivering online selling, billing and procurement technology products and services. Its products include "Commerce One" and "eNabler." It obtained a licence for "Commerce One" from its American developer. This software system allows large organisations to trade electronically with their suppliers – it is buyer-centric. Conexa separately developed "eNabler" to allow large organisations to transact business electronically with their customers internationally – it is seller-centric. Conexa has customers in Europe, Australia and America. The value of business conducted annually using Conexa's systems is said to be over US$30 billion. Over 80 per cent of its income is from overseas. Conexa has started to grow in recent years. While it has not been profitable until very recently, it may become very profitable. The dispute has its source in the parties' responses to the growth of Conexa.

[12] Conexa is a wholly-owned subsidiary but PSB holds 20 per cent of the shares on trust for Conexa's CEO, Mr Rajab, who in turn holds shares on trust for members of the management team. Mr Rajab and his beneficiaries do not have the right to appoint directors. Mr Rajab was a director of Conexa until October 2010.

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[23] PSB has other non-operating subsidiaries that are irrelevant for this case. GSB has two operating subsidiaries and other non-operating subsidiaries.

[13] PSB has six directors, three appointed by SEA: Mr Donald Fletcher, Mr Jesse Lu and Mr Lambert Lu, and three appointed by NEO: Mr Charles Brown, Mr Keith Gosling and Mr Michael Daniel. It is not necessary to refer to the constitution of PSB as relations between the parties are largely governed by a shareholders' agreement of October 2010.

[14] PSB was originally a wholly-owned subsidiary of National Equity Ltd, the second defendant, which is owned by trusts associated with Mr Brown and Mr Gosling. Minority interests were sold to trusts associated with Mr Phil Wilkins, Mr Daniel, Mr Brooke Mitchell and Mr Peter Crickett.

[15] In 2000 PSB's shareholders sold 24.99 per cent of the company to the SEA Group for $14,667,441. SEA Group[24] is a multi-national investment group with substantial interests in Asia and Australia. SEA Holdings Ltd, the ultimate holding company, is a Bermuda-registered company listed in Hong Kong. Its shareholders' equity is said to be about NZ$1.5 billion. Revenue is derived from property investment, property development and hotels. The executive chairman is Mr Jesse Lu. He is responsible for the group's investment strategies and development directions. Other directors include Mr Lu's sons and a cousin. SEA, the plaintiff, is a subsidiary of the SEA Group. Following its initial investment, SEA appointed its personnel to management and board positions. Mr Donald Fletcher was one of three SEA personnel appointed as a director. Mr Fletcher has remained a director of PSB throughout and gave evidence for SEA. Later in 2000, the SEA Group made a further investment of $11 million in PSB bringing its shareholding up to 50 per cent. That investment allowed PSB to buy the "Commerce One" licence.

[16] In December 2001, PSB, as licensor, entered into an exclusive master licence agreement with SEA Group subsidiaries, Superior Site Ltd as licensee and South East Asian Investment and Management Services BV as covenantor, under which it granted an exclusive, perpetual, royalty-free licence to exploit the "PSB Concept" in 19 Asian territories, effectively all of East and South-East Asia. The "PSB Concept"

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[24] I use SEA Group to refer to SEA Holdings Ltd and its subsidiaries, without identifying particular subsidiaries.

is PSB's business concepts including its intellectual property rights. Clause 15.3 of the agreement provides:

> The Licensee shall, within the confines of market conditions and outlooks and availability and prudent allocation of financial, human and other resources, use reasonable endeavours to enhance and grow the PSB Concept in the Territories.

[17] Consideration was given for the licence. The circumstances in which the licence was given are not relevant for this case.

[18] Until 2010, matters proceeded without friction. GSB traded profitably. Conexa was still developing its technology and was not making profits. Profits from GSB were applied to fund Conexa. The SEA and NEO directors worked together professionally and in harmony. In his affidavits, Mr Fletcher criticised PSB's performance during this period. According to him, SEA was extremely disappointed with PSB's alleged failure to perform. SEA considered that the negligible growth in net profit was because the NEO directors caused Conexa to pursue an organic, low growth, New Zealand-focussed strategy, contrary to the representations at the time of investment that Conexa would be a fast-growing international IT business. That criticism did not survive Mr Fletcher's cross-examination. SEA's initial investment was made at the time of the "dotcom" bubble. But once that bubble burst, PSB could not pursue the expansion that SEA had hoped for. Instead, PSB continued to develop its technology with the support of the whole board. Business plans and budgets approved by the board provided for international expansion beyond Australasia. Conexa was a finalist for an export award in 2006. Mr Fletcher withdrew his claim that the NEO directors caused Conexa to pursue an inappropriate strategy. The claim was not repeated in SEA's closing.

[19] Mr Brown and Mr Gosling were joint managing directors. Mr Brown chaired board meetings. PSB paid National Equity Ltd, the first defendant, a monthly consulting fee for additional work by Mr Brown and Mr Gosling in managing the business beyond their work as directors. That did not come under criticism until 2010.

The licence renegotiation

[20] In Mr Fletcher's words, during 2008/09 SEA got "quite excited" and "got very serious." The cause was the progress Conexa had made. Its products were proving to be robust and marketable. There was increased acceptance in the market. In 2009 Conexa's revenue increased by 30 per cent and was above budget. Large multinationals were showing strong interest. An important customer was the aviation division of BP. Mr Brown and Mr Rajab travelled to the United Kingdom in late 2008 to try to win a new contract with the Brakes Group, a major company in the food industry. Mr Fletcher arranged for Mr Rajab to travel to Shanghai with him for a weekend conference arranged by SEA. The purpose was, in Mr Fletcher's words, "to test Mr Rajab to see whether he was the real deal and understood exactly what he had produced and whether it was sustainable". As well as senior management of the SEA Group there was a "team of probably 10 of some of the best software developers and executives in Asia." SEA thought that Mr Rajab was the real deal: later plans by SEA for Conexa's expansion overseas provided for Mr Rajab to work in Hong Kong. In February 2009, SEA appointed Mr Jesse Lu's son, Lambert, to the boards of the PSB companies. The PSB board continued to oversee and support Conexa's international expansion plans in 2009. At board level there was no disagreement about the company's strategic direction. Hopes were high that the company would succeed internationally.

[21] Conexa adopted a three-year business plan in February 2010. While it recorded opportunities for expansion internationally, in particular Australia, United Kingdom and the United States, it noted that access was restricted in Asia. The restriction was due to the exclusive licence to the SEA Group. The issue was raised at a board meeting on 14 February 2010. Mr Fletcher agreed to raise the issue with the SEA Group with a view to renegotiating the licence agreement.

[22] The response was a letter from Mr Lambert Lu on 12 April 2010 suggesting that the marketing of Conexa's products might be in breach of the licensee's rights under the licence agreement. In fact the SEA Group had done nothing about marketing or selling the PSB Concept within the territories under its licence. The only interest it had shown in doing so was to arrange the Shanghai conference.

When Mr Jesse Lu later asserted that he had a legal opinion to support his position, he did not provide a copy when requested. SEA Group alleged that the refuelling of an aircraft with BP product at Hong Kong airport was a breach of the licence. The BP contract had been in effect since 2006 and the SEA Group had not raised the issue until then. PSB's position was that the licence did not prevent companies outside the territories under the licence from trading by internet with companies inside the territories. It referred to relevant provisions of the licence addressing the issue. The accusation of breach of contract was simply an opening gambit in negotiation. The SEA Group was trying to develop some leverage. There was nothing in the accusation, and during the hearing SEA did not try to suggest that there was. While the parties may not have recognised it at the time, it was the start of a rift.

[23] On 26 April 2010, there was a meeting in Hong Kong between Mr Jesse Lu, Mr Lambert Lu and Mr Fletcher for the SEA Group and Mr Brown, Mr Gosling and Mr Rajab for Conexa and PSB. The surrender of the licence was discussed. Both sides agreed that it would be desirable for Conexa to be able to trade within the licensed territories without restriction and in return the SEA Group should be compensated by payments calculated on a percentage of Conexa's worldwide revenue. PSB proposed a price. Mr Jesse Lu rejected it as too low and countered with a price double what had been offered. That was not accepted. By closing submissions and notwithstanding Mr Fletcher's evidence to the contrary, it was common ground that no agreement as to price was reached at the meeting. Instead it was agreed that PSB would come back with a further proposal by 26 July 2010. The dispute as to the alleged breach of the licence would be put on hold in the meantime. Mr Lambert Lu offered to gather information and supply it to PSB. PSB wanted that information so that it could see that there was a proper business case for Conexa to consider operating in the licensed territories and from there assess what to offer for the surrender of the licence. It looked to SEA Group as having relevant experience in the territories to give the information.

[24] Mr Fletcher says that the understanding reached in the meeting was marked by a handshake and that SEA believed that there was agreement in principle to the surrender of the licence subject only to reaching agreement on the revenue split. Mr

Jesse Lu believed that he had agreement as to the minimum price for the licence, the amount PSB had offered.

[25] PSB followed up with requests for information. Mr Lambert Lu declined, saying that until agreement on a new arrangement was reached, the business expansion into Asia was an internal matter of SEA. PSB tried to explain its purpose to SEA but without effect. The SEA Group had decided that PSB should do its own research without its help, although it did not communicate this to PSB very well. It did not provide any information.

[26] By 26 July 2010 PSB had not presented any proposal to SEA. It says that it had not been provided with information with which it could assess the viability of Conexa expanding into Asia. According to Mr Fletcher, Mr Jesse Lu was "to say the least, furious." Mr Lu had allegedly lost all trust with the NEO shareholders over the inability to settle the master licence one way or another. On 27 July 2010, he wrote letters to PSB alleging a breach of the agreement to come up with a proposal by 26 July and advising that steps would be taken to enforce SEA's rights under the licence. A meeting was requested, failing which the dispute would be submitted to mediation, then to court.

[27] Mr Brown replied, setting out the PSB position, proposing a date and place for a meeting. His email ends with comments that an adversarial approach would not be constructive and that shareholder disputes should be avoided at all costs. Mr Fletcher said that he felt that that part of the response was somewhat orchestrated.

[28] A meeting of Mr Fletcher, Mr Gosling and Mr Brown took place on 4 August 2010. Mr Gosling and Mr Brown persuaded Mr Fletcher to give more time for PSB to make a proposal. Mr Gosling sent a proposal on 12 August 2010. It offered less than PSB's offer in Hong Kong on 26 April. Mr Fletcher indicated that the offer was not acceptable. Mr Gosling claims that the offer was realistic given PSB's state of knowledge of the Asian markets.

[29] Mr Fletcher set out SEA's perception of PSB in the second half of 2010. According to him, in board meetings and discussions with management, SEA found it difficult to get commitment to international expansion of Conexa. SEA saw the opportunity. While allowing that others also saw the opportunity, he says that there was a difference as to timing. If a large company overseas were to be created, time, effort and money had to go in. It had to be done quickly. His view was that the sense of urgency was not shared. He criticised Mr Brown and Mr Gosling as managing directors for spending too much time overseas, and not enough time on company affairs. He criticised managers of Conexa for their inexperience, saying that this showed up in management reports, in not making budget and in contract negotiations with customers. He says that he was frustrated by delays in responses from the managing directors. He was concerned that a window of opportunity would be lost.

[30] This perception went to the sale of the licence. The concern of the SEA Group was that it was to sell its Asian rights to a company which in its view did not have the competence to make a success of its IT developments. If Conexa failed without acquiring the rights, the SEA Group would still have the rights to exploit the PSB Concept in the territories.

Board meeting of 7 October 2010 and shareholders' agreement

[31] There was a board meeting of PSB on 7 October 2010. SEA pleads that at that meeting, the directors of PSB could not pass any resolutions owing to fundamental differences of opinion about Conexa's strategic direction and a lack of trust and confidence between the directors. It is necessary to set out relevant parts of the meeting. Mr Fletcher proposed three matters:

(a) That Conexa should be separated from PSB and run as an international IT software provider and procurement provider. There would be an in specie distribution of PSB's shares in Conexa to the shareholders of PSB. There would be a shareholder agreement that would set out clearly the company's aspirations, business plan, method for execution and management structure;

(b) That SEA was to have more involvement in management especially Conexa; and

(c) That Conexa buy the master licence and there be an agreement as to price.

[32] There was constructive discussion of the first issue. The NEO shareholders were not opposed to the suggestion, but were willing to look into the proposal further. Mr Fletcher summed up the discussion:

> I think everyone is very generous and genuinely kept an open mind and summed up the points in regard to that. And we will try and move forward.

[33] The minutes record a resolution that the board recognised the merits of SEA's proposal and that in order to expand globally more rapidly Conexa Ltd should be managed separately from PSB/GSB, and it welcomed SEA's offer to submit for its consideration a draft shareholder's agreement covering the company's aspirations, strategies, business plans and funding.

[34] Mr Brown began the discussion of the second matter by explaining some aspects of his management that had been criticised (an allegation that information from GSB and Conexa had been kept from SEA) and by offering to bring his managing directorship to an end. He was conscious of what appeared to be a shareholder standoff developing because of a perception of how he had performed and was keen to avoid that for the sake of the company. Mr Gosling endorsed what Mr Brown said, and also offered to resign. On this aspect, Mr Brown and Mr Gosling already knew that Mr Fletcher was looking for their resignations. They also made it clear that they were expecting that, notwithstanding their resignations, the company's ability to go forward would not be frustrated by inability to get decisions expeditiously as required. In particular, they hoped that the meeting would approve contracts which required board approval, in particular one with the Ministry of Economic Development. At this point Mr Lambert Lu and Mr Fletcher made it clear that unless all three issues were resolved as one package then there would be no movement forward. They claimed to have taken advice. According to them, they could not, as directors, approve a contract if the company was not going to be around

to honour the contract. They would be obliged to vote against any motion to enter into a contract because of uncertainty surrounding the company's future and because there was a shareholders' dispute. The advice they claimed to have received was not put in evidence and there were no submissions supporting it. Mr Fletcher was well aware of the effect of the stance the SEA directors were taking. He acknowledged that the NEO directors felt that they might have a gun to their head, but went on to assert that the SEA directors were working in the interests of the company. Later, the meeting deteriorated. A symptom of the deterioration was that procedural wrangles developed.

[35] Two contracts were put up for board approval. The first was with the Ministry of Economic Development. It was for the operation of a whole-of-government e-marketplace for two years with three one-year rights of renewal. Conexa had won the contract against strong competition from around the world. Having the contract would boost Conexa's ability to promote its products. The SEA directors criticised it for being too favourable to the government. The contract provided that PSB guaranteed Conexa's performance. The SEA directors voted against the motion to enter into the contract. I am satisfied that their reason for voting against was not so much any concern with the merits of the contract as their wish not to allow the company to go forward until the matters proposed by Mr Fletcher had been resolved to their satisfaction. The second contract was with Brakes Group in the United Kingdom, a major company. There is no evidence that it operates in any of the licensed territories. According to Mr Rajab, the contract would be very profitable. The SEA directors voted against entering into the contract, not because of any concern as to its merits, but out of their alleged concern whether the company would stay in existence. The NEO directors voted in favour of both contracts. The motions for both contracts failed because there was not a majority in favour.

[36] During the meeting Mr Fletcher put the NEO directors on notice that SEA was seriously considering applying to court to liquidate the company. The context does not suggest that he said this in the heat of argument. He gave as his reasons that SEA had genuine concerns over the last six months over many occasions that the company had got to the stage where there was an impasse as to its ability to go

forward and do business. Mr Fletcher had deadlock on his mind as early as that meeting, and made it known.

[37] There was no discussion as to the price to be paid for the surrender of the licence agreement, other than Mr Brown saying that they would continue to negotiate with SEA. The meeting was adjourned.

[38] The approval of the MED and Brakes contracts ought not to have been a contentious matter. In its closing SEA did not try to justify the refusal to approve the contracts on the merits of the contracts or otherwise. Clearly these contracts were in Conexa's interests. They were in keeping with the expansion of the company which both parties were intent on. The approval of the contracts would not have affected the matters that SEA was proposing in the meeting. The NEO directors had responded positively to the first two of SEA's proposals. The SEA directors claimed doubts as to the continued existence of the company – but the only apparent threats to its continued existence were their refusal to allow Conexa to do business and their threat to apply for liquidation. Their stated reason does not stand up. SEA relies on the meeting as an example of deadlock, but it is clear that in the meeting the SEA directors used their voting power to stop the company entering into important contracts, unless they got their way on their proposals. The SEA directors are solely responsible for the limited business done at that meeting.

[39] SEA pleads that after the meeting there was an ongoing deadlock. It says that the dispute about Conexa's strategic direction continued. But that is not what happened. After the meeting, SEA instructed its lawyers to draft a shareholders' agreement. The NEO shareholders instructed their own lawyers to represent their interests in negotiating the agreement. The agreement was signed on 26 October 2010. This was on the eve of the deadline the Ministry of Economic Development had set for its contract to be signed. In cross-examination, Mr Brown protested against the tight timeframe and SEA's alleged inflexibility in negotiation. However, he conceded that amendments had been made in negotiations. The NEO shareholders have consistently accepted that the agreement is valid and binding.

[40] The agreement includes these provisions:

(a) PSB is the holding company for the PSB Group (clause 3 (a));

(b) Conexa is a fast growing company which is a software service provider urgently focussed on global expansion (clause 3(c));

(c) If SEA holds exactly 50 per cent of the PSB shares, then it is entitled to appoint three directors to PSB, Conexa and GSB (clauses 4.1(a) and 4.2(c));

(d) If the NEO shareholders hold exactly 50 per cent of the PSB shares, then they are entitled to appoint three directors to PSB, Conexa and GSB (clauses 4.1(a) and 4.2(c));

(e) The chairmanship of the board rotates every twelve months between a SEA director and a NEO director, with Mr Fletcher to be the first chairman (clause 4.4(d);

(f) The chairman does not have a casting vote (clause 4.9(b));

(g) For as long as there are both three SEA appointees and three NEO appointees on the board, a board resolution must not be passed unless at least one SEA appointee and one NEO appointee vote in favour (clause 4.10);

(h) The board must use all reasonable endeavours to agree each draft annual budget before the beginning of the financial year to which it relates and failing agreement the budget for the previous year will apply (clause 5.3(b) and (c));

(i) For the current financial year (ending 30 June 2011) and the next three financial years, PSB will provide Conexa's annual funding requirement (as fixed in Conexa's budgets) up to a maximum amount equal to PSB's consolidated net profit after tax for the year before (clause 6.2);

(j) If PSB is not able to provide Conexa's funding requirements, Conexa may obtain funding from other sources, including by pro rata contributions from PSB shareholders (clauses 6.3 and 6.4);

(k) Share pre-emption in fairly standard terms for notice to be given by any shareholder wishing to sell, the board to offer the shares to existing shareholders, acceptance notices by any shareholder wishing to buy, price to be determined an independent chartered accountant if not agreed, and right to sell to third parties if no acceptances. Any sale to a third party in the five years after the date of the agreement requires board approval (clauses 8 and 9);

(l) For disputes between the parties and deadlock at board level, there must be reasonable endeavours to resolve the dispute within 20 business days (Clause 12.1). If there is no resolution, the matter will be referred to a representative nominated by each party to the dispute (clause 12.2);

(m) The agreement prevails over any provision in the constitution of any company (clause 15.1); and

(n) The management fee will no longer be paid to National Equity Ltd (clause 18).

[41] Schedule 4 to the agreement is a deed (the SSL deed) under which the master licence of December 2001 is surrendered. In consideration, Conexa undertook to pay 3.5 per cent of its gross annual revenue and 15 per cent of its adjusted net profit before tax, regardless of any sales in Asia. The consideration was what SEA had demanded. There was no negotiation on that point. There was a termination provision (clause 6) if Conexa was sold or transferred to third parties by some other defined form of major transaction. The SSL deed and the right to receive payments would be terminated on sale, subject to SEA receiving fair value as defined for the termination. The fair value was to compensate SEA for loss of future payments.

[42] The shareholders' agreement preserves the equality of voting power and control between the NEO directors and shareholders and SEA.

[43] SEA had now resolved the master licence issue by surrendering the licence so that Conexa could have a free hand to expand world-wide without concerns as to breaching the licence in its territories. That was a commitment to making Conexa work.

[44] The shareholders' agreement does not provide for Conexa or PSB or any other company in the group to change domicile to another jurisdiction.

[45] The shareholders' agreement resolved the deadlock in the meeting of 7 October 2010. There was no dispute as to the strategic direction of Conexa. Apart from the insertion of "urgently" into clause 3(c) of the agreement, there was no departure from what had already been agreed in business plans approved by the board. The contract with the Ministry of Economic Development was signed with unanimous board approval.

[46] Mr Fletcher took over as chairman. There was a change of practice. Until then, decisions for all three companies had been dealt with in one meeting. Now the business of each company was addressed in separate meetings. Board meetings were held on 16 December 2010 and 25 January 2011. They were productive and harmonious.

Proposed redomiciling of Conexa

[47] Mr Fletcher worked with the management team on budgets and business plans for Conexa and GSB and price modelling for Conexa. He also arranged for the signing of the contract with the Brakes Group to be deferred and for negotiations to be started afresh. With the approval of the board he also started investigations and preliminary planning for Conexa to move overseas, specifically for its head office and senior executive team to relocate to Hong Kong. He asked KordaMentha, accountants, to value Conexa – that could be required for tax purposes if Conexa were to be sold to any overseas entity. The tax issue was not relevant for SEA but

any recovery for depreciation would affect NEO shareholders as New Zealand tax residents. He also asked PricewaterhouseCoopers Hong Kong to give a report on the tax efficiency of moving Conexa offshore. Mr Fletcher was concerned that it was tax inefficient for Conexa's international profits to be channelled through New Zealand, when they could be channelled through a jurisdiction with lower corporate tax rates.

[48] The PricewaterhouseCoopers Hong Kong report of 24 February 2010 recommended two options:

(a) A new holding company (HoldCo) is incorporated (potentially in Bermuda, British Virgin Islands or the Cayman Islands) to hold a Hong Kong subsidiary (HKCo). HKCo then acquires Conexa. Intellectual property is split between Conexa (licensing rights for customers in US, Australia and New Zealand) and HKCo (for all other international customers). The split was proposed to take advantage of New Zealand double tax agreements.

(b) HoldCo is incorporated in a tax haven as in (a) to hold HKCo. HKCo acquires Conexa. HoldCo incorporates a new tax haven company to hold the international intellectual property (IPCo). Intellectual property is split between Conexa (licensing rights for customers in US, Australia and New Zealand) and IPCo (for all other international customers).

[49] The report contains an important note:

> HoldCo and HKCo need to ensure that their centre of management is not in New Zealand and its directors do not exercise control of HoldCo and HKCo in New Zealand. This will require key executives/management running the group to move from New Zealand and make decisions outside New Zealand. The overall management and control of HoldCo and HKCo should not be from New Zealand otherwise HoldCo may be regarded as tax residents of New Zealand and be subject to New Zealand tax. To ensure that this does not happen decisions in relation to HoldCo's and HKCo's operations should not be made in New Zealand and the majority of HoldCo's and HKCo's directors should not reside in New Zealand.

[50] The NEO shareholders generally supported the proposed move to Hong Kong. Mr Gosling sent an email to the other directors on 8 March 2011 saying that the NEO directors approved the 2011 budget, the NEO shareholders were prepared to contribute their share of $500,000 for a further funding requirement and they approved the latest business plan (the Conexa International Staffing Plan, which provided for the relocation of staff overseas). He also added that they supported the relocation and tax structure plan so long as it did not affect the 50/50 control through the board directors and the tax position was neutral for New Zealand shareholders for tax and capital gain purposes.

[51] The NEO directors took advice from an accountant on the tax issues. Her opinion raised a number of queries including as to residency (Mr Rajab would continue to be a New Zealand tax resident because his family would stay here, even though he would be overseas about 50 per cent of the time), how directors resident in New Zealand could exercise control outside New Zealand, whether HoldCo and HKCo would be controlled foreign corporations for New Zealand tax purposes. She sounded a warning that the restructure could be viewed as tax avoidance. While her opinion was put in evidence, she did not give evidence and I have no basis on which to gauge her expertise in cross-border tax issues. Mr Gosling sent the opinion to Mr Fletcher on 17 March. Earlier on the same day he also emailed Mr Fletcher noting that the proposed restructure was extremely complex, needed careful consideration and review. He said that the relocation of staff outside New Zealand should proceed but that it was not necessarily tied to a relocation for tax purposes. Following discussions with NEO directors, Mr Fletcher circulated a paper on 20 March setting out the commercial case for relocation.

[52] There was a meeting of the board of Conexa on 8 April 2011. There was discussion of the proposal to change Conexa's domicile. Mr Gosling set out the NEO shareholders' position:

> I think our position has been covered in a number of ways by email and basically what we're saying is that we feel at this juncture the timing is not right in terms of a number of issues – commercial reality, control, taxation, establishment that we have a sound business case and a profitable ongoing business. We're saying we don't think the timing is now. We're not against the principle. In fact, if the company is successful then it is very logical that it moves offshore but we're saying at this present time we think it's too early.

[53] After discussion, a motion was proposed that the board approve the recommendations contained in the PricewaterhouseCoopers tax and domicile report, and authorise management to prepare the necessary resolutions and auxiliary documentation for execution by the board and shareholders. That was the redomiciling motion. The SEA directors voted for it and the NEO directors voted against it. The motion failed. For the SEA directors, Mr Fletcher said that they regarded the resolution as integral to the business of the company going forward. Mr Gosling repeated the NEO directors' position.

[54] Mr Fletcher then put the motion for approval and adoption of the Conexa 2011 budget. The NEO directors voted for it, the SEA directors against. The motion failed. This was the budget that Mr Fletcher had worked on with the management team. It had already been circulated for the directors to consider. By the time of the meeting, none of them had any concerns with the substance of the budget. The only reason why the SEA directors voted against the budget was the failure of the motion to redomicile Conexa. Other business on the agenda also failed following the failure of the budget motion. On a motion that Conexa request funding from PSB for 2011, all voted against. On a motion to approve the 2011 business strategy, the SEA directors voted against and the NEO directors abstained. On a motion to approve and adopt the strategy paper for negotiation with Brakes,[25] the SEA directors voted against and the NEO directors abstained. On a motion to approve KPI and management report templates, the NEO directors voted for and the SEA directors against. The SEA directors' consistent opposition was because the redomiciling motion had failed, not because of the merits of the particular motions. The NEO directors voted or abstained on the merits. Other matters discussed at the meeting are not relevant for this case.

[55] On the merits of the redomiciling motion, the SEA directors' position was that moving Conexa offshore was consistent with the strategy for Conexa in clause 3(c) of the shareholders' agreement. The growth of the company would come from offshore. It was sound to locate the business offshore to win clients and revenue and to have access to better capital markets. It was beneficial for Conexa to own its

[25] Signing had been held over. If the PwC report were adopted, an offshore Conexa company would sign the agreement, not Conexa NZ.

intellectual property offshore. The move should not be delayed. Implementation might take six months in any event. The motion did not have to address all the legal and accounting details as they could be dealt with later. It was to get approval in principle to the move. The PricewaterhouseCoopers report showed the tax efficiencies that could be achieved. The NEO directors did not have good reason to be concerned about tax issues: according to Mr Fletcher cross-border taxation is not rocket science and their concern was "absolute nonsense." In any event, from a tax point of view it would make better sense to move Conexa offshore before it had become a proven performer. I am satisfied that in promoting the redomiciling the SEA directors were not intending to wrest control of Conexa or to assert dominance over the NEO interests. They were acting in what they considered to be the best interests of the company.

[56] The position of the NEO directors was that they did not oppose the expansion overseas, but had always supported it. They did not oppose establishing offices overseas and relocating staff offshore. While they saw the merits of the proposal, they believed that the move was too early. There were risks in selling Conexa's intellectual property, perhaps for little or no consideration, to a company based in a tax haven. In their eyes, Conexa should first establish itself as a success before it moved offshore. The tax issues affected their control of the company. For them, the risks might be that if they were held to be in control of an offshore Conexa on the application of New Zealand's foreign investment fund rules they would be taxed not only on distributions they received from the offshore Conexa, but also on undistributed profits retained in the company. The price of avoiding that might be to cede control to SEA. Tax and legal issues had not been resolved and should be. The value of Conexa and its intellectual property had not been established satisfactorily. Sale price and other critical terms had not been formulated. I find that in voting against the motion, they were not acting selfishly in their own interests and were not intending to depart from the shareholders' agreement. They also were acting in what they considered to be the best interests of the company.

[57] The result was that the directors disagreed on the timing of redomiciling, each side acting in good faith. It goes without saying that on this disagreement on a business issue, I should not express any view as to the merits, if I had one.

[58] The next matter is the SEA directors' linking of the failure of the redomiciling motion to their refusal to approve the 2011 budget and other motions. The NEO shareholders have consistently maintained that the only real difference was as to the timing of the redomiciling and there was no justification for the SEA directors to use that disagreement to paralyse the board's decision-making. Mr Fletcher's evidence was that the redomiciling was fundamental as a building block, a cornerstone, to growing the company internationally. In his words, they were not going off half-cocked to spend money in other parts of the world if the cornerstone was not in place. Without approval for the redomiciling there was no point in proceeding further. In the meeting he made it clear that the issue was a fundamental one. I accept that Mr Fletcher was accurately stating the position of the SEA directors. They did not oppose the later motions as a way to put pressure on the NEO directors to come round to their viewpoint. There was no ulterior motive. Nor were they irrationally inflexible. They may have been dogmatic (and that is not for me to say) but in linking the motions they were making a purely commercial decision. Again, the SEA directors' decision was on a business issue on which I should not express any view as to the merits.

Attempts to resolve deadlock

[59] On 19 April 2011, Mr Fletcher as director of SEA wrote to the NEO shareholders starting procedures under clause 12 of the shareholders' agreement because of the deadlock in the meeting on 8 April. He proposed a further meeting of directors of PSB and Conexa to seek to resolve matters. Mr Brown replied on 26 April. He restated the NEO position, criticised the SEA linkage of the motions and said that the only substantive issue on which the parties were not agreed was the timing of the redomiciling proposal. Mr Fletcher called a board meeting to try to resolve the issue under clause 12.1 of the shareholders' agreement. He replied to Mr Brown's letter, affirming SEA's position.

[60] A board meeting was held on 17 May 2011. The deadlock issue was discussed at some length. Neither side moved from the position it had already taken. Mr Jesse Lu proposed that PSB go into voluntary liquidation. The NEO directors opposed that. The SEA directors rejected a suggestion that SEA dispose of its shares

under the share transfer provision of the shareholders' agreement. A motion to approve and adopt the Conexa budget failed for opposition by the SEA directors. The meeting did not result in a resolution of the differences at the meeting on 8 April. It is also interesting that Mr Rajab reported that for Conexa, customers were currently happy, things were moving forward, opportunities were coming from multiple places, the company and the staff were in good shape and he expected the company to turn a profit.

[61] There have not been any more board meetings since then. The three companies are operating without direction or governance from their boards. Conexa is operating under the budget for the year before under clause 5.3(c) of the shareholders' agreement.

[62] Mr Fletcher then moved to the next stage of the deadlock resolution procedure under clause 12.2 of the shareholders' agreement. SEA appointed Mr Fletcher and NEO appointed Mr Daniel. They met on 7 June 2011. The outcome was a proposal to investigate a sale of GSB and Conexa. Both parties were prepared to follow that up. An investment bank would be appointed to conduct the sales. Grant Samuel & Associates Ltd was chosen. Mr Lorimer of that company dealt with the matter.

[63] During July 2011, SEA circulated various versions of a proposed agreement in relation to sale process. The parties were SEA, SEA Holdings NZ Ltd, its immediate holding company, the NEO shareholders, PSB and Conexa. I need to consider the last version only. The agreement provided for the sale of GSB and Conexa to be conducted by Grant Samuel. A timetable was set. The agreements for the sale of each company were not to contain any warranty or indemnity other than standard warranties as to title to the Conexa and GSB shares. The consideration must be cash only. Either 25 per cent of the purchase price was to be paid to SEA Holdings as fair value under the SSL deed, or a complicated provision would operate, allowing SEA to decide whether to terminate the deed of surrender based on final bids. In such an event, bids would state whether they were made subject to accepting the payment obligations under the surrender deed or not, with SEA able to decide to take a higher differential. The successful bidder was to be the highest

bidder who did not make any alterations to the agreement for sale and purchase. Any shareholder of PSB would be entitled to bid. The shareholders of PSB must pass a special resolution for the voluntary liquidation of the company if no agreements for sale and purchase had been entered into on 20 October 2011 or immediately after settlement of any agreements.

[64] Mr Lorimer was asked to comment on an earlier version of the proposed agreement. He also gave evidence. He considers that GSB and Conexa would both attract a reasonable level of interest as they are good businesses. They could be sold for their fair value given appropriate time and commitment from the vendor. He would expect them to command an eight-figure purchase price, with Conexa getting substantially more than GSB. GSB is more likely to attract a local buyer and Conexa a buyer from overseas.

[65] Mr Lorimer had three major concerns with SEA's sale terms: the refusal to include standard warranties, the refusal to accept any changes to the sale agreement and the requirement for immediate liquidation of PSB after completion. He explained these concerns to SEA's representative, Mr Kenward. SEA remained unmoved. According to Mr Lorimer, the minimum warranties given by the vendors should be for title to shares, title to intellectual property, taxation and litigation. Warranties are the subject of negotiation in any sale. Limitations as to duration and amount may be negotiated. In cross-examination, he set out why a due diligence process would not be enough to satisfy a prudent purchaser. He regarded SEA's insistence that only bids which did not incorporate any amendments to the draft agreement as unrealistic, given that in transactions of this sort buyers and sellers do negotiate terms. The immediate liquidation of PSB would make any warranty worthless. SEA's position on these three concerns was so unusual that any potential bidder would have to be told at the outset of the sale process. In his view, these matters would effectively scuttle a sale to a serious third party purchaser. Only the current shareholders of PSB could be expected to bid. I accept that Mr Lorimer's concerns are valid.

[66] SEA says that as a matter of policy SEA Holdings Ltd, as a listed company, does not give warranties to buyers in these cases. Mr Lorimer's evidence is that that

is contrary to his experience. Public companies as much as private companies give warranties as to the business as a way of securing a good price. SEA did not try to justify its policy in its closing.

[67] Because SEA insisted that any sales process had to be on its terms and NEO regarded those terms as uncommercial, the parties did not agree. Mr Fletcher took that as completing the process under clause 12.2 of the shareholders' agreement.

[68] There have been other proposals to see if the parties can resolve their differences, but without success. NEO proposed that SEA take a majority position in Conexa and that NEO take a majority position in GSB, but SEA rejected the proposal. NEO proposed that SEA take Conexa entirely and NEO take GSB entirely, but SEA again rejected. SEA proposed that NEO give it control of PSB for no consideration, or it would apply to liquidate. NEO was prepared to consider allowing SEA control, so long as its minority position was protected, but SEA rejected this. Other than to note that SEA believes that GSB is currently worth more than Conexa, it is not necessary for me to comment on the reasons given by the parties. So far, neither party has initiated the share transfer process under clause 8 of the shareholders' agreement. SEA began this proceeding in August 2011.

[69] No-one has yet carried out an expert valuation of GSB or of PSB. GSB has an established record of trading profitably at a steady rate, so carrying out a valuation should not be a challenge for an experienced accountant. KordaMentha provided a valuation of Conexa early in 2011. That valuation supports SEA's views that Conexa is worth less than GSB. KordaMentha's report was not put in evidence. Mr Graham, who worked on the report, said that it was not in final form and that it was heavily qualified. He applied a discounted cash flow approach, but in the absence of company forecasts of future performance he had to make his own projections. Anyone now trying to value Conexa would face the same uncertainty. While the company now seems to be turning profitable, it will be difficult for anyone to forecast future profits as its growth prospects are still uncertain. However, existing shareholders are more likely to have a more informed appreciation of the potential of the company.

Assessment of state of deadlock

[70] This case shows that there are various forms of deadlock. There may be deadlock on a single issue or set of issues. In those cases the parties may be able to put those deadlocked issues to one side while continuing to run the business. That sort of deadlock does not call for the liquidation of the company. In another sort of deadlock, one party links the failure to agree to one issue to co-operation on other issues. The deadlock on other issues may impede the operation of the company in a way that the deadlock on the initial issue does not. The linkage escalates the deadlock. In these cases the question will arise whether it was legitimate to escalate the deadlock. If a party has improperly escalated the deadlock, they may be held to have created the deadlock, which may count against them in a liquidation application. The NEO shareholders say that this is a single-issue deadlock case that SEA has improperly escalated. I accept that SEA's linkage was not improperly motivated but was a commercial decision. If I had held otherwise, I would dismiss SEA's application for being the sole cause of the deadlock. As it is, neither side is solely responsible for the impasse.

[71] If only the motions that were not passed at the meeting of 8 April are considered, then the deadlock appears to affect only the operations of Conexa. It is still able to carry on business in some fashion, but has a board that is deadlocked on moving forward. GSB continues to carry on business successfully and none of the failed motions affect it, except as to the application of its profits to Conexa. GSB currently earns more than Conexa. Business is continuing. However, a wider consideration is required. The deadlock has affected relations between the blocs of directors and shareholders. SEA has lost patience with the NEO shareholders. It believes it has put a lot of time and effort and money into PSB. It made a significant commitment with the surrender of the master licence and it is frustrated that in its view the NEO shareholders did not have the common sense to follow its plans for international expansion of Conexa. In its eyes, the NEO shareholders have not recognised the urgency required, despite clause 3(c) of the shareholders' agreement. It is suspicious that the NEO shareholders do not really share its vision for the international growth of Conexa. It feels a sense of betrayal. It is no longer interested in staying in the same company as the NEO shareholders. It wants out.

[72] For their part, the NEO shareholders could not understand the linkage SEA made between the redomiciling motion and other routine motions that would always have been passed in the ordinary course. They had good reasons to be cautious about the redomiciling and that issue did not stand in the way of other steps for Conexa's international expansion. In their eyes, SEA had used strong-arm tactics in the October meeting to get its way. The April meeting also seemed to them a case of SEA using strong-arm tactics to get its way. They would be suspicious that SEA would use similar tactics again to get its way and if they gave way again, that would be a de facto surrender of control.

[73] Only one witness believed that it would be possible for the parties to resume normal working relations. That was Mr Brown. His position is consistent with his appreciation from the outset that internal differences are destructive and should be avoided, his willingness at times to seek compromise in the interests of the company and his desire to sustain the company with which he had been associated for so long and into which he had invested so much. I do not have Mr Brown's optimism. The sad fact is that relations between the parties have deteriorated to such an extent that it is not realistic to expect the parties to work again in harmony. There is evidence of incidents that show the breakdown in relations between the parties. It is unnecessary to detail them, but one is significant – the deadlock has cost Mr Brown and Mr Fletcher their friendship. The breakdown in relations means that SEA and NEO cannot be counted on to work together at director and shareholder levels to advance PSB and its subsidiaries. There will be a lack of strategic direction at board level that will prevent PSB operating effectively. The state of deadlock has existed at least since the board meeting of 8 April 2011. It has continued since. The parties' attempts to resolve the impasse so far have been unsuccessful. There is such a deadlock at board and shareholder levels that the Court can consider whether to make a liquidation order.

Liquidation and an alternative way out of the impasse

[74] SEA says that on that finding an order for liquidation should follow. Its case is that liquidation is a just and equitable resolution of the deadlock. As PSB is a holding company, its subsidiaries can be sold as going concerns, without the

disruption that normally goes with liquidation of an operating company. Liquidation will provide an orderly separation of the parties' interests under the conduct of independent professionals – insolvency practitioners. They will set the terms of sale independently of the parties, avoiding the need for the parties to agree on the process. They will sell GSB and Conexa for the best available price, although the parties will have the opportunity to bid. There is no reason to believe that the sales will not achieve full value. The difficulties as to warranties identified by Mr Lorimer can be addressed. A separation of the parties' interests is inevitable and will lead to liquidation. The only difference between the parties is the order in which steps were taken – liquidation-sale-distribution or sale-liquidation-distribution. There is no other way of breaking the deadlock.

[75] Mr Graham, an experienced insolvency practitioner, gave evidence in support. In his opinion, the fact that the holding company was in liquidation should not adversely affect the sales of the subsidiaries. As PSB had guaranteed Conexa's contract with the Ministry of Economic Development, Conexa would need to address that with the Ministry before it was sold, but that issue would arise on any sale of Conexa and was not peculiar to a liquidation. Sales of shares in GSB and Conexa by the liquidators were more likely than sales of assets by directors of the subsidiaries. The fact that existing shareholders might be potential purchasers was not problematic, so long as a proper process was followed to ensure that the sales were at the best price reasonably obtainable. An investment bank or recognised industry agent could be engaged to assist in the sale of a technology company such as Conexa. As to warranties on sales of shares in the subsidiaries, he acknowledged the objections made by Mr Lorimer. A warranty given by PSB would be of limited value to a purchaser because the company has little substance outside Conexa and GSB, so the issue would arise whether PSB was in liquidation or not. If warranties were a significant concern to a purchaser, the issue could be addressed in several ways: shareholders in PSB could give warranties directly to the purchaser, but he noted that shareholders resist giving such personal guarantees; a share sale agreement could provide for warranties to have real effect by the liquidator retaining funds on a specified basis as to value, duration and procedures for claims, and delaying the time of distribution to shareholders; a warranty and indemnity insurance policy could be obtained; and it may not be necessary to give warranties, in

particular if the purchaser is familiar with the businesses, such as one of the existing shareholders. He did not address the effects of the termination provision in the SSL deed.

[76] In support of there being no reasonable alternative, SEA submitted that the share pre-emption clauses in the shareholders' agreement are a restriction on the normal rights of sale. They are not a remedy for deadlock, but simply give a non-selling shareholder protection in the form of a right of first refusal. It referred to evidence of Mr Lorimer that a sale by one bloc of the shareholders in PSB would be very unlikely to have a successful outcome other than a very low price. As to alternatives proposed by NEO, they generally involved arrangements for the parties to separate their interests, which required co-operation, something the parties had shown was not a realistic prospect; were commercially unrealistic; or involved ceding control, which was contrary to the shareholders' agreement.

[77] Mr Lorimer's evidence is that on an international sale of Conexa, the liquidation of PSB would have a significant adverse effect. In his opinion, the majority of international purchasers would not even put an indicative bid in. Liquidation would raise a red flag to any potential purchaser that something was wrong and the filtering process would stop the matter going further. Given Mr Graham's evidence that an investment bank could be engaged to conduct a sale of a technology company, I find that Mr Lorimer, an investment banker, has more relevant experience and I prefer his evidence on this aspect where it conflicts with Mr Graham's.

[78] As to warranties, it is clear that SEA has no interest in giving any warranty except as to ownership of shares. That is unlikely to encourage the NEO shareholders to expose themselves to the risk of potential liability for other warranties not shared by SEA. Retaining part of the sale proceeds on specified terms is possible but may not suit the shareholders. Mr Jesse Lu seems intent on SEA realising its investment as fast as possible. Warranty insurance is only a theoretical possibility. Mr Graham and Mr Lorimer were both aware of it, but neither had practical experience with it. Mr Graham's last point on warranties is that an existing shareholder would not require warranties, being familiar with the company already.

On Mr Lorimer's evidence, while other potential purchasers would carry out due diligence, they would still demand warranties and would be less willing to buy to the extent that they could not be satisfied on warranty issues. Existing shareholders would not be so constrained. Existing shareholders are likely to be more willing bidders than third parties.

[79] The effects of the termination provision of the SSL deed are relevant. Clause 6.3 defines a major transaction, which triggers the requirement to pay fair value to the SEA Group:

> For the purposes of this clause 6, a Major Transaction involving Conexa is one under which all or substantial portion of PSB (including Conexa) or Conexa is, with the agreement of PSB Shareholders, sold or transferred to third parties whether by way of a share sale, business sale, issue of securities or stock exchange listing.

[80] Clause 6.1 also relevantly provides:

> If the shareholders in PSB agree to implement a Major Transaction (as described in clause 6.3)...

[81] A sale by a liquidator in the exercise of his powers under Schedule 6 of the Companies Act is not a sale by agreement of the shareholders if the liquidator has been appointed under a contested liquidation application. Such a liquidator is not exercising his powers with the shareholders' consent, but by virtue of the court order appointing him. In those circumstances, a sale by a liquidator will not trigger the obligation to pay fair value under clause 6.1. That consequence could only be avoided by the liquidator separately obtaining the consent of the shareholders. Accordingly, any third party buying the shares of Conexa would take Conexa subject to its obligation under clause 3.1 of the SSL deed to make annual payments to the SEA Group. Due diligence should bring this to light and I would expect that a liquidator or a responsible agent promoting the sale, such as Mr Lorimer, would draw this to the attention of potential purchasers at the outset. It raises the kind of warranty issues he was concerned about. A third party purchaser, who has not otherwise been put off, will discount what it would otherwise have offered on account of the payment obligation under clause 3.1. A purchase of Conexa by the NEO shareholders is not within the definition of a major transaction as they are not third parties and would not trigger the obligation to pay fair value. They would also

discount what they would otherwise offer on account of the annual payment obligation. On the other hand, SEA will not be so constrained. If it buys Conexa, the annual payment obligation under the SSL deed will only involve internal adjustments within the SEA Group, if it were to persist with the SSL deed. SEA will not need to discount its offer in the same way that other potential purchasers will. SEA is in a preferred position as a potential purchaser of Conexa on a sale by a liquidator, as it can afford to outbid others.

[82] A liquidator wishing to make Conexa attractive to sell so as to maximise price may try to remove the effect of the SSL deed for purchasers.[26] He or she could only do so with the consent of the SEA Group. The SEA Group is in a position where it could effectively negotiate for an arrangement the same as or close to the fair value payment requirement under clause 6.1 of the SSL deed. Its stipulation for 25 per cent of the purchase price (or more under the complicated differential bid provision) in the drafts of the agreement in relation to sale process gives a good idea of its view of fair value. For the sake of argument, I assume that the liquidator might be able to negotiate some adjustment to that, but there would still be some arrangement under which the SEA Group would receive a not insignificant part of the sale price as compensation for giving up its right to the annual payments under clause 3.1 of the SSL deed from a purchaser of Conexa. That would still put it in a preferred position as a potential purchaser, as it could afford to offer more than others by up to an amount close to the compensation payment.

[83] Similarly, if I am wrong in holding that a sale of Conexa by a liquidator does not trigger the fair value payment requirement under clause 6.1 of the SSL deed, the adjustment to the distribution of the sale proceeds will have the same effect as in the last paragraph.

[84] Against that background, SEA's submission of no reasonable alternative can be considered. The aspect of greatest concern is its refusal to use the share pre-emption provisions of the shareholders' agreement. The normal remedy for a shareholder disenchanted with his investment is to sell his shares. In this case that

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[26] A liquidator could ensure Conexa's co-operation. With control of PSB's shares in Conexa, he could requisition shareholders' meetings and secure the appointment of directors.

right is subject to the pre-emption provisions. Their effect is to give the NEO shareholders a right of first refusal, a common arrangement in a closely-held company. But they still provide a means for SEA to depart from the company without liquidation. I do not accept that they are not a remedy for deadlock.

[85] It is useful to remember the basis for the courts' reluctance to order liquidation when alternative remedies have not been exhausted. Shareholders in dispute should be encouraged to resolve their disputes themselves without the court's assistance. A strong vein running through the Companies Act is to limit court intervention in company affairs, except in defined cases. That is consistent with the establishment of companies as self-governing entities. Even in cases of strong deep-seated disagreement between blocs of shareholders, it is better in the long run that they resolve their differences without court intervention. Constitutions and shareholders' agreements are standard mechanisms for the government of a company and for regulating relations among shareholders. A shareholder seeking relief from the court in its just and equitable jurisdiction has an onus to satisfy the court why it is equitable that it should not be held to remedies under the constitution or under shareholders' agreements.

[86] It is also useful to bear in mind the practical effect of share pre-emption provisions. They draw disputing shareholders into an arms-length negotiation. While they may follow the steps, it is very common to find the parties exchanging offers and exploring settlement outside those formal provisions. Share pre-emption provisions enable orderly negotiated disengagements by shareholders in dispute.

[87] If SEA were to start the share pre-emption steps, both parties are likely to take good accounting and legal advice. Both sides have very experienced businessmen. There is no evidence that they have unequal knowledge of the businesses of PSB and its subsidiaries. Any uncertainties as to value will be shared. Because they are 50/50 shareholding blocs, they will be able to test the reasonableness of any asking price by offering to reverse the position, that is, to sell their own shares at that price. If the NEO interests were to buy out SEA they would take Conexa subject to the obligations under the SSL deed, but that can offer other options for a negotiated resolution either at the time of purchase of the shares or

later. The share pre-emption provisions of the shareholders' agreement offer the parties a real opportunity to resolve their disengagement without the assistance of the court and without the costs or effects of liquidation.

[88] There is one minor reservation on the terms of the share pre-emption clauses in the shareholders' agreement – the requirement for board approval of any sale to a third party. A refusal of approval to thwart a genuine disposal of shares on exiting the company could trigger an application under s 174 of the Companies Act. However, I am confident that the parties are able to take and heed advice, so that there is not an appreciable risk that the directors' power not to approve a sale to a third party will be misused.

[89] SEA's stated objections to using the share pre-emption clauses in the shareholders' agreement are that it would not receive a reasonable price and that the NEO shareholders have not initiated the share pre-emption steps. On the second point, there is no onus on the NEO shareholders to start the process as they are not the ones seeking to withdraw and seeking a liquidation. As to the first, that is a risk SEA assumed when it entered into the shareholders' agreement. It instigated the agreement. It had clauses 8 and 9 inserted in the agreement. At the time of agreement it appreciated the prospects of deadlock and liquidation because Mr Fletcher had raised them in the board meeting of 7 October 2010. SEA's stated objections do not make it equitable to relieve it from the agreement it insisted on entering into.

[90] In *O'Neill v Phillips* Lord Hoffmann explained how in company law relief may be given against being held to rules under a constitution or terms of a shareholders' agreement:[27]

> Although fairness is a notion which can be applied to all kinds of activities its content will depend upon the context in which it is being used. Conduct which is perfectly fair between competing businessmen may not be fair between members of a family. In some sports it may require, at best, observance of the rules, in others ("it's not cricket") it may be unfair in some circumstances to take advantage of them. All is said to be fair in love and war. So the context and background are very important.

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[27] *O'Neill v Phillips* [1999] 1 WLR 1092 (HL) 1098-1099.

> In the case of section 459, the background has the following two features. First, a company is an association of persons for an economic purpose, usually entered into with legal advice and some degree of formality. The terms of the association are contained in the articles of association and sometimes in collateral agreements between the shareholders. Thus the manner in which the affairs of the company may be conducted is closely regulated by rules to which the shareholders have agreed. Secondly, company law has developed seamlessly from the law of partnership, which was treated by equity, like the Roman societas, as a contract of good faith. One of the traditional roles of equity, as a separate jurisdiction, was to restrain the exercise of strict legal rights in certain relationships in which it considered that this would be contrary to good faith. These principles have, with appropriate modification, been carried over into company law.
>
> The first of these two features leads to the conclusion that a member of a company will not ordinarily be entitled to complain of unfairness unless there has been some breach of the terms on which he agreed that the affairs of the company should be conducted. But the second leads to the conclusion that there will be cases in which equitable considerations make it unfair for those conducting the affairs of the company to rely upon their strict legal powers. Thus unfairness may consist in a breach of the rules or in using the rules in a manner which equity would regard as contrary to good faith.

That case was under an English provision similar to s 174 of the Companies Act, but the passage is equally applicable to winding up applications on the just and equitable ground. Lord Hoffmann made this clear by his reference to Lord Wilberforce's speech in *Ebrahimi v Westbourne Galleries Ltd*.[28] Under Lord Hoffmann's approach, there is nothing inequitable in holding SEA to the exit mechanism which it freely agreed to.

[91] SEA's unstated objection to using the share pre-emption provisions is that it will lose the opportunity to buy Conexa for itself or that it will also have to buy out NEO's interest in GSB, a company in which it has no long-term interest. The evidence that it is intent on buying Conexa is:

(a) Mr Fletcher's evidence that SEA would be keen to buy Conexa at the lowest possible price;

(b) Its insistence on uncommercial terms for the sale of Conexa in the drafts of the agreement in relation to sale process, so as to reduce the attractions of the company to third parties;

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[28] *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360 (HL) at 379.

(c) Its provision in those drafts for shareholders to be entitled to bid;

(d) Its arranging for Mr Rajab to visit Mr Lu in Hong Kong on 17 September 2011 and 10 October 2011, while this proceeding was pending;

(e) Its evidence that a liquidation would allow existing shareholders to bid for Conexa and GSB and that it intends to bid for Conexa in the liquidation; and

(f) Its superior bargaining position as a potential purchaser of Conexa by virtue of the red flag effect of liquidation of PSB, its ability to deter other purchasers by not co-operating on warranties and the effects of the SSL deed.

[92] If SEA had applied for liquidation of PSB on the grounds that it was just and equitable that it should be allowed to buy Conexa from a liquidator in conditions that gave it a superior bargaining position, it would be dismissed out of hand. It does not have such an entitlement in equity and it did not argue that it had. If that cannot be a good ground for seeking a liquidation order, it cannot be a good ground for bypassing reasonable alternatives to a liquidation order. I called this an unstated objection because SEA did not argue for it, but it is clear that the prospect of buying Conexa in forced sale circumstances where it will be in a far more favourable position than any other potential purchaser has largely driven SEA in applying for a liquidation order.

Disposition

[93] Having reached a state of deadlock with the NEO interests, SEA is entitled to disengage and withdraw its investment in PSB. It can do so through the share pre-emption provisions of the shareholders' agreement. So far it has not taken that available remedy and it has not shown that it is either impracticable or inequitable. As there is another way out of the impasse and as liquidation is a matter of last resort, SEA's application must fail.

[94] I make these orders:

(a) SEA's application for a liquidation order is dismissed;

(b) SEA must pay the NEO shareholders costs on the application. If the parties cannot agree costs, I will hear submissions on *17 February 2012 at 11.45 am*. The NEO shareholders should file and serve their submissions by *13 February 2012* and SEA by *15 February 2012*; and

(c) The parties may circulate this judgment among all the defendants, among the SEA Group's directors and management teams, to their professional advisers, to the management teams of GSB and Conexa and to PSB's lawyers (who have taken no part in this proceeding). In all other respects Associate Judge Doogue's order of 9 September 2011 restraining advertising and other information relating to the proceeding will remain in force pending further order. On *17 February 2012* I will hear submissions whether the order should be discharged or further amended.

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Associate Judge R M Bell