Cassels

From Deadlock to Liquidation – A Cautionary Tale

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Petersen v. Hawley[1] serves as a stark reminder that "shareholders of closely-held companies who go into business together without providing for the resolution of future conflicts in a written agreement are courting disaster – even if (and perhaps especially if) they are related by blood."[2] In Reasons released May 18, 2022, the British Columbia Court of Appeal upheld a decision by the Chambers Judge that it was "just and equitable" to order liquidation of a deadlocked company due to an ongoing and bitter conflict between identical twin brothers, each holding 50% of shares of the family company.

Background

Petersen and Hawley are identical twin brothers who equally own shares of a BC company, Value Equity Ltd. (Value). Value holds the real assets of the family company, "The Mega Group of Companies." The most valuable asset in Value's portfolio is a property in Surrey, BC that Value rents to an operating company held by the brothers. The ongoing litigation centres on Mr. Hawley's position that he is a 90% shareholder of the operating company while Mr. Petersen is a 10% shareholder.

Initially, Mr. Petersen as Petitioner sought a declaration that Value's affairs were being carried on in an oppressive manner,[3] as well as an appointment of a receiver/manager of its assets and undertakings.[4] Chief Justice Hinkson dismissed Mr. Petersen's application, as he was unable to find on the evidence "a strong *prima facie* case" for oppression on the basis of the law in *RJR Mcdonald*, even though Mr. Petersen's pleading may have disclosed a serious question to be tried.

Subsequently, Mr. Petersen sought a finding that the parties were "irreconcilably deadlocked" and that he was therefore entitled to equitable relief under s. 324 of the British Columbia *Business Corporations Act*: the forced liquidation and dissolution of a company, Value, where the Court determines it would be "just and equitable" to so order. In response, Mr. Hawley applied for an Order that the Petersen Petition be converted to an Action and sent to the Trial list pursuant to Rule 22-1(7).

Mr. Justice Branch found that there was a deadlock between the brothers that was preventing the proper operation of Value and it was just and equitable to order the liquidation and dissolution of Value. The circumstances illustrating the deadlock include: no meeting of directors or shareholders since the conflicts commenced; physical altercations; Mr. Hawley preventing Mr. Petersen from accessing Value's office, and allegations of each brother improperly using company funds.

The Appeal

Mr. Hawley, as Appellant, submitted that the Chambers Judge erred in two ways. First, Mr. Hawley took the position that his brother 'deliberately manufactured' the deadlock, giving rise to a triable issue. In response, the BCCA acknowledged that a party's conduct may well be relevant to the granting of an order under s. 324, but held nonetheless that the Chambers Judge correctly declined to refer Mr. Petersen's Petition to the trial list. Given that Mr. Petersen was proceeding under s. 324, he needed only to show that it would be "just and equitable" to wind up the company.

The appellate court shared the Chambers Judge's view that a full trial would be unlikely to bring the disagreement to an end; however, liquidation would disentangle the two shareholders and resolve the deadlock. The fact that both parties were accused of having 'unclean hands' was largely irrelevant to the resolution of the parties' disagreement.

Second, Mr. Hawley argued that the Chambers Judge erred in failing to consider the parties' reasonable expectations and failing to consider whether a "marginally different alternative" he proposed would be a fair but less drastic means of achieving the same result consistent with the parties' expectations.[5]

However, the Panel held that the Chambers Judge properly considered and construed the parties' expectations; the focus should not be only on the "actual" expectations of a particular shareholder, but on what the parties would reasonably have expected. In a 50/50 split, where there is no shareholders' agreement, it is reasonable to assume that had they been asked at the outset what should happen in the event of a deadlock, the brothers would have responded that the company's assets would be sold and that the company would then be wound-up.

Lastly, Mr. Hawley asserted that the Chambers Judge did not make the least drastic order possible and should have required that Value's Surrey property not be sold until the other assets had been sold. Mr. Hawley suggested that the proceeds from an early partial sale may put himself, or one of his companies, in a position to purchase the remaining properties of Value. However, the BCCA found no error in the Chambers Judge's reasoning that he did not have sufficient evidence to determine the most appropriate sales sequence that would "yield the best outcome." The BCCA preferred to rely on the liquidator's duty to keep an even hand, rather than modify the order of the Chamber's Judge on the basis of a factual assumption he felt was unsafe to make.

Looking Forward

The decision of the BCCA provides helpful commentary and insights regarding deadlock and when liquidation will be "just and equitable," including:

1. relative blameworthiness is not a basis for denying relief sought on a deadlock application. The Court noted that there is fault to be shared in this case;[6] and
2. where a liquidator is appointed, issues regarding disposition of property are best left to the discretion of the liquidator as an officer of the court is in the best position to address the issues.

The BCCA left open the issue as to whether an appellate court will intervene where the remedy is not the "least intrusive" as one of the factors from *Wilson v. Alharayeri*, 2017 SCC 39. Going forward, when litigating a claim in which deadlock is asserted, parties should be aware that liquidation may be the appropriate remedy, not withstanding its heavy-handed result.

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[1] *Petersen v. Hawley*, 2022 BCCA 169

[2] *Petersen v. Hawley*, 2022 BCCA 169 at para 1.

[3] Within the meaning of s. 227(2) of the *British Columbia Business Corporations Act*, S.B.C. 2002, c. 57.

[4] Pursuant to s. 39 of the *Law and Equity Act*, R.S.B.C. 1996, s. 253.

[5] In Value's early years, the parties' expectations were that Value would be a "nominal passive landlord" for the operations company.

[6] *Petersen v. Hawley*, 2021 BCSC 2348 at para 75.
