IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO. FSD 161 OF 2018 (NSJ)

IN THE MATTER OF THE COMPANIES ACT (2018 REVISION)
AND IN THE MATTER OF CHINA SHANSHUI CEMENT GROUP LIMITED

BETWEEN

TIANRUI (INTERNATIONAL) HOLDING COMPANY LIMITED
PETITIONER

AND

CHINA SHANSHUI CEMENT GROUP LIMITED
FIRST RESPONDENT

ASIA CEMENT CORPORATION
SECOND RESPONDENT

CHINA NATIONAL BUILDING MATERIAL CO. LTD
THIRD RESPONDENT

JUDGMENT ON THE COMPANY'S VALIDATION APPLICATIONS

Before: **The Hon. Mr Justice Segal**

Appearances: **Mr Tom Smith KC instructed by Carey Olsen for the First Respondent**
Mr Tom Lowe KC instructed by Ogier for the Petitioner

Heard: **24 February 2023**

Draft judgment Distributed: **24 March 2023**

Judgment Delivered: **31 March 2023**

Introduction

1. China Shanshui Cement Group Limited (the ***Company***) has applied, pursuant to its summons (the ***Summons***) dated 28 November 2022, for:

   (a). an order pursuant to section 99 (***Section 99***) of the Companies Act (2023 Revision) (the ***Act***) validating the payment of the final dividend to shareholders (the ***Dividend***) declared at the Company's Annual General Meeting (the ***AGM***) held on 27 May 2022 (the ***Dividend Validation Application***); and

   (b). a variation of certain terms of the validation order (the ***Validation Order***) made by Justice Mangatal in these proceedings and dated 11 October 2018 (the ***Variation Application***). The Validation Order was largely made by consent of the parties: see [7] of Mangatal J's judgment dealing with a previous application by the Company to vary the Validation Order, handed down on 12 September 2019 (the ***Mangatal Judgment***).

2. The Petitioner has applied, as a contributory, for a winding up order on the just and equitable ground. The petition (the ***Petition***) was originally presented on 30 August 2018 (or 4 September 2018) but has subsequently been amended.

3. The Dividend Validation Application seeks an order permitting the Company to pay the Dividend to all shareholders. The Variation Application seeks to vary the Validation Order by deleting part of paragraph 1 of the Validation Order (which imposes a spending cap) and deleting paragraph 6 of the Validation Order in its entirety (which imposes a reporting obligation on the Company). The Dividend Validation Application and the Variation Application are supported by the Sixth

Affirmation (***Wu 6***) of Ms Wu Ling-Ling (also known as Doris Wu) (***Ms Wu***) (Ms Wu is an executive director of the Company), the First Affirmation (***Li 1***) of Li Huibao (***Mr Li***) (Mr Li is a director and chairman of the board of the Company) and the First Affirmation (***Charlton-Stevens 1***) of Ms Julia Frances Charlton-Stevens (Ms Charlton-Stevens is a Hong Kong qualified solicitor and the principal of Charltons, a law firm based in Hong Kong). The last two affirmations were filed and served in reply (on 10 February).

4. Paragraph 1 of the Validation Order states that (with the words which the Company seeks to have deleted in bold):

> *"Subject to paragraph 4 hereof, notwithstanding the presentation of the Petition, unless otherwise ordered by the Court, any payment or other disposition of property made on or after the date of the presentation of the Petition in the ordinary course of the business of the Company* ***provided the total of such payments or dispositions do not exceed US2 million in each calendar month*** *shall not be void by virtue of section 99 of [the Act].*"

5. Paragraph 6 of the Validation Order states that:

> *"The Company shall provide to the Petitioner within five (5) clear working days of the end of October 2018 a schedule recording each payment in excess of HK$500,000 made in the ordinary course of its business and validated pursuant hereto from 31 August 2018 to September 2018 and for each calendar month thereafter five (5) clear working days from the end of the calendar month (Schedule)."*

6. Paragraph 4 of the Validation Order, which is referred to in paragraph 1, states as follows:

> *"The Orders made at paragraphs 1-3 above shall not apply to any payment or disposition made:*
>
> *(a) out of the proceeds received by the Company as a result of the issue of convertible bonds pursuant to the purported subscription agreement dated 30 August 2018 referred to on the announcement made by the Company on the website of the Stock Exchange of Hong Kong Limited dated 31 August 2018, which was purportedly completed on 3 September 2018 (the* ***Disputed Subscription Agreement****); or*
>
> *(b). in respect of any fees, expenses commissions or other payments arising out of or in relation to the Disputed Subscription Agreement."*

7. The Petitioner consents to the Dividend Validation Application on certain conditions (explained below) but objects to the removal of the spending cap and the reporting obligation. It relies on the evidence of Li Xuanqi (an authorised representative of the Petitioner) contained in his Tenth Affirmation.

8. My conclusions and decision can be summarised as follows:

(a). the Dividend Validation Application should be dismissed:

(i). applying the principles governing an application for validation under section 99 as explained, and adopting the cautious approach mandated, by the Court of Appeal in *Tianrui (International) Holding Company Ltd v China Shanshui Cement Group Ltd* [2020 (1) CILR 417] (the ***CICA Judgment***), and balancing the various competing factors, I do not consider that payment of the Dividend to the Convertible Bondholders would "[*assist] in preserving the status quo and .. not frustrate the purpose of section 99*" (see the CICA Judgment at [23]). Therefore a validation order should not be made which permitted such a payment. It follows that the Court should not make a validation order that permitted the Company to pay the Dividend to all shareholders.

(ii). it would not be appropriate to make a validation order that permitted the Company to pay the Dividend to all other shareholders provided that it had first opened, settled the terms of and funded an escrow account into which the Convertible Bondholders' share of the Dividend was paid. Such an order would not override company law prohibitions which prevent the Company by a shareholders' resolution deciding to pay a duly declared dividend to some shareholders only (or declaring a dividend in favour of only some shareholders) and is likely only to result in the Company being unable to pay a Dividend to any shareholders. It would also give rise to various difficulties and issues which are likely only to complicate matters and be prejudicial to the Company.

(iii). I have considered and taken into account all the relevant circumstances, in particular the prejudice to the other shareholders, who will regrettably be deprived of a Dividend to which they are clearly otherwise entitled, and the prejudice to the Convertible Bondholders who are not currently before the Court. I have also given particular weight to the Court of Appeal's reasoning and decision on the facts in the CICA Judgment which seem to me strongly to point against a validation of the payment of the Dividend to the Convertible Bondholders.

(iv). I have refused to make the validation order sought by the Company on the Dividend Validation Application. In those circumstances, even though I have also declined to make the conditional order which the Petitioner sought, the Dividend Validation Application is to be treated as dismissed.

(b). the Variation Application should be dismissed. It seems to me, in light of the findings and reasoning of Justice Mangatal in the Mangatal Judgment, that the reporting obligation and the spending cap were agreed and incorporated into the Validation Order in order to give the Petitioner certain protections as part of a bargain entered into by the Petitioner and the Company in which the Petitioner gave up the chance to proceed with (or at least where the bargain was struck against the backdrop of there being possible further) applications and claims for relief that would provide similar protections. The Petitioner having given up or having decided to take no further action based and in reliance on the Validation Order, it would be wrong to remove the benefits and protections for which it bargained in the absence of changes in circumstances which undermined or affected the basis of that bargain. I do not consider that the removal of the qualified audit opinions and the fact that previous financial irregularities no longer have an impact on the Company's financial position or financial statements do so or are otherwise sufficient to justify the removal of the reporting obligations or the spending cap. Of course, it remains open to the Company to propose and to seek to agree with the Petitioner a revision to the amount and terms of the spending cap.

The 2019 Validation Application

9. The Company has, as I have already noted, previously applied for variations to the Validation Order and failed to obtain an order to remove the spending cap and the reporting obligation.

10. By a summons dated 29 March 2019 (the ***2019 Validation Application***), the Company sought to vary the Validation Order to, inter alia (a) remove the spending cap in paragraph 1 and the reporting obligation in paragraph 6 of the Validation Order and (b) validate the transfer by certain shareholders of their legal title in certain shares in the Company to the Hong Kong Securities Clearing Company Limited so that such shares could be deposited into, and traded through, the Hong Kong Stock Exchange's (***HKSE***) Central Clearing and Settlement System Depository (the ***CCASS Transaction***).

11. Mangatal J (in the Mangatal Judgment) dismissed the 2019 Validation Application with respect to the relief set out in (a) above but granted the application with respect to the relief set out in (b). However, the Petitioner successfully appealed Mangatal J's judgment in relation to the CCASS Transaction. The Court of Appeal's reasons for allowing the appeal are set out in the CICA Judgment. Moses JA's judgment sets out the decision of the Court of Appeal and contains an extensive review of the main authorities relating to, and an analysis of the principles to be applied by the Court when dealing with a validation application under, section 99.

The Dividend Validation Application

The AGM and the Dividend

12. On 22 April 2022, the Company, by order of the board of directors, issued a notice (the ***Notice***) convening an AGM on 27 May 2022. The purpose of the AGM was to seek shareholders' approval for *inter alia* the following resolutions:

(a). "*To receive and adopt the audited consolidated financial statements of the Company and its subsidiaries and the reports of the directors and auditors for the year ended 31 December 2021*."

(b). "*To declare a final dividend of RMB0.256 per share for the year ended 31 December 2021*" (the ***Dividend Resolution***).

13. After setting out the purposes for which the AGM was to be held and the resolutions to be proposed at the AGM, the Notice contained nine "*Notes*." Note (i) (***Note (i)***) stated that "*The final dividend of RMB 0.256 per share is subject to all necessary order [sic] and approval from the Grand Court of the Cayman Islands ("Grand Court") given the outstanding winding-up petition against the Company. For determining the entitlement to the proposed final dividend (subject to the order and approval from the Grand Court), the last registration date and the book closure period will be announced by the Company in due course separately*."

14. The AGM was duly held on 27 May 2022 and all the proposed resolutions were passed as ordinary resolutions. The Dividend Resolution was passed with a majority of 94.56% of the votes of those shareholders present and voting. The Petitioner voted all of its 340,000,000 shares (representing 7.8% of the issued share capital of the Company) in favour of this resolution.

The Escrow Requirement

15. As I have noted, the Summons was issued on 28 November last year. Subsequently, on 20 December 2022, the Petitioner's Cayman Islands attorneys, Ogier, wrote to the Company's Cayman Islands attorneys, Carey Olsen, stating that the Petitioner agreed to the validation of payments to be made for the purpose of paying the Dividend on the condition that the payments that would be made to certain shareholders be held in escrow. These are the shareholders (the ***Convertible Bondholders***) whose shares (the ***CB Shares***) had been issued pursuant to the exercise of conversion rights of various issues of convertible bonds (the ***Convertible Bonds***), as referred to in Wu 6, in circumstances challenged in the Petition. The Petitioner argued that the payments in respect of the share of the Dividend otherwise payable to the Convertible

Bondholders be held in escrow or on trust by the Company (the ***Escrow Requirement***) pending the resolution of the proceedings commenced by the Petition (and the Petitioner's related writ proceedings). The Petitioner has taken the same position on the Dividend Validation Application.

The Company's submissions

16. The Company submitted that there could be no proper basis for objecting to the validation of the payment of the Dividend. The Dividend Resolution had been voted for by the overwhelming majority of the Company's members, including the Petitioner (albeit that in view of Note (i), the effect of the Dividend Resolution had only been to create a contingent debt, the contingency being full validation of the proposed Dividend payment by the Court) and declaring and paying a dividend was plainly part of the ordinary business of the Company, which on the evidence was clearly solvent. As Ms Wu had confirmed in Wu 6, the Company's independent auditors, Moore Stephens CPA Limited, had provided an unqualified opinion that the Company's consolidated financial statements for each of the years ended 31 December 2020 and 31 December 2021 gave a true and fair view of the consolidated financial position of the Company and its subsidiaries. Moore Stephens had also confirmed that they no longer had "*significant doubts regarding the group's ability to continue as a going concern*" as had previously been the case for the financial statements in respect of the years ended 31 December 2018 and 31 December 2019.

17. The Company argued that validating the payment of the Dividend would be in accordance with the approach and principles established by the Court of Appeal in the CICA Judgment, which the Company submitted was the leading Cayman Islands authority on section 99. The Company said that the Court of Appeal had described the object of section 99 as "*conservational*" as it sought to preserve the status quo between presentation of the winding up petition and the making of a winding up order (CICA Judgment at [14]). The power to grant a validation order must not be exercised in a way that undermined the objective of section 99 and any relief granted under a validation order should not "*run the risk of impeding or obstructing the unwinding effects of section 99*" (CICA Judgment at [72]). The Company submitted that this requirement was to be understood as a threshold or gateway test, and if it was met the Court then had a discretion to

grant or refuse validation. The threshold test was satisfied in relation to the payment of the Dividend and the Court should exercise its discretion to make a validation order.

18. The Company submitted that the Court should make an unconditional validation order and not impose the Escrow Requirement as a condition. The Company made three main points. First, there was no justification for preventing the Convertible Bondholders from being paid their share of the Dividend. Secondly, the imposition by the Court of the Escrow Requirement was both unnecessary and would result in serious breaches by the Company of its obligations under the HKSE Listing Rules and the Company's constitution. Thirdly, if the Court was of the view that payment of the Dividend could only be validated if the Escrow Requirement was imposed, then the right approach was for the Court to make no order on the Dividend Validation Application. To make a validation order subject to the Escrow Requirement would, in practical terms, be equivalent to dismissing the Dividend Validation Application. This was because, as I have already noted, the Company claimed that the Dividend Resolution had created a contingent debt (by reason of the effect of Note (i)), the contingency being full validation of the proposed Dividend payment by the Court. If the Court were to grant validation subject to the Escrow Requirement, that contingency would not be met, so that the Dividend would never become payable (to the Convertible Bondholders or to any other members of the Company).

19. The Company argued that the Court should not, as the Petitioner argued, refuse to validate the payment to the Convertible Bondholders of their share of the Dividend and impose the Escrow Requirement on the ground that the issue of the CB Shares was the subject of complaint in the Petition and might subsequently be set aside. Even if the complaints were justified and made out, the issue of the CB Shares would not be set aside and the CB Shares would not be cancelled *immediately upon and by reason of the making of the winding up order*. The Convertible Bondholders' were presently shareholders and entitled to be paid their share of the Dividend. Furthermore, their rights as shareholders would continue after and be unaffected by the winding up order. The Company submitted that when deciding whether to make a validation order, both in the case of a contributory's and a creditor's petition, the Court had to consider whether doing so would prevent a liquidator from recovering payments (or other dispositions) which had been made after the presentation of the petition and which would be avoided pursuant to section 99. A

validation order must not be made where it would frustrate a liquidator's power to avoid a payment (or disposition) in reliance on section 99. Thus, in the case of a creditor's petition in respect of an insolvent company, where the Court was asked to validate a payment to a pre-petition unsecured creditor in circumstances where the effect of doing so would be to reduce the value of the company's assets and the dividend payable to other unsecured creditors upon the making of the winding up order, the Court should refuse to make a validation order. Validating the payment would frustrate the liquidator's ability to recover the prejudicial payment.

20. But the Court was not entitled to refuse to make a validation order in respect of a payment in the ordinary course of business to a payee pursuant to an obligation incurred prior to the presentation of the petition merely because a subsequently appointed liquidator might (or even would) be entitled after the winding up order had been made to commence proceedings to set aside the transaction or act (in this case the issue of the CB Shares) pursuant to which the Company's obligation arose. In the present case, even though the CB Shares were issued after the Petition, the issue of shares was not prohibited or affected by section 99 (as the Petitioner accepted) and a liquidator would be unable to challenge the issue of the CB Shares in reliance on section 99. Even though a liquidator might be able to bring proceedings to set aside the issue of the CB Shares on other grounds, so that if successful the Convertible Bondholders would have their CB Shares cancelled and lose their right to the Dividend, section 99 was not intended to protect the prospective rights of action of liquidators in this way or the liquidation estate to that extent.

21. The Company said that this approach and construction of section 99 was in accordance with the judgment of Moses JA in the CICA Judgment. The Company argued that Moses JA had repeatedly focussed on the need, when considering whether to make a validation order, to maintain the status quo (see [14] and [41]) to protect the avoidance function of section 99. Accordingly, at [45] of the CICA Judgment, Moses JA had said that (underlining added):

> *"In every case, those seeking a validation order must be able to satisfy the court that what is proposed will not undermine the avoidance function of s.99, that it will not impede or frustrate the unwinding of transactions after the presentation of the petition but will maintain the status quo. This is so whether the company is solvent or insolvent, and whether the proposal is made in the ordinary course of business or not. Where the proposal*

> *is made for the purposes of the ordinary course of business, the court will more readily take the view that there is no unacceptable risk to the maintenance of the status quo."*

22. The Company submitted that Moses JA was to be understood, when explaining the purpose for which a validation order was to be made, as referring to the need to protect the unwinding of transactions that were themselves subject to and avoided by section 99. The extract below from [45] of Moses JA's judgment was to be read as if the words in bold were added: those seeking a validation order must be able to satisfy the court that what is proposed will not "*impede or frustrate the unwinding of transactions* ***that took place between*** *the presentation of the petition* ***and the making of the order*** *but will maintain the status quo*." The same point had been made in [68] when the learned Justice of Appeal had referred to the need to avoid "*frustrating the avoidance provision on [sic] s.99*."

23. The Court of Appeal's application of these principles and its decision had been set out at [61] of the CICA Judgment as follows (underlining added).

> *"The deposit of shares to CCASS was alleged by the appellant to be an important further stage in the process of diluting its shareholding and the conspiracy to cause it damage. It should never have been forgotten that the proposed transactions in respect of which validation was sought were themselves the subject matter of the petition. Validation would have the effect of preventing the successive conversion of the bonds into shares, which took place after presentation of the petition, being unwound. It would make it impossible to reverse the issue of shares and, as Tianrui put it, "risk stymying what a Court, the liquidator or the appellant might legitimately do."*

24. The Company argued (a) that it was important to Moses JA's reasoning that the proposed validation order related to and would prevent a subsequent challenge to action taken after the presentation of the petition (the conversion of the bonds into and the issue of the CB Shares) and (b) that when he had said that the validation order would "*make it impossible to reverse the issue of shares and, as Tianrui put it, "risk stymying what a Court, the liquidator or the appellant might legitimately do"* he was only referring to action which a liquidator could take in reliance on section 99. The Company acknowledged that the interpretation of these *dicta* was to some extent unclear since Moses JA had not explained how, on the facts, there could subsequently be a challenge based on section 99 since the action that he had said could be challenged, namely the

issue of the CB Shares, was not the type of action that was invalidated by or subject to section 99. The Company submitted that Moses JA should be understood as not having addressed the question of whether the issue of the CB Shares would be reversed upon a winding up order being made as a result of the operation of section 99 but had simply proceeded on the assumption that this was so. The Company noted that this assumption might have been made on the basis that at the time of the appeal the Petitioner had been simultaneously pursuing in its separate writ action an order that the bond conversion and issue of the CB Shares be declared void and set aside (however the Petitioner had since amended the writ and abandoned its claim to that relief).

25. The Company also submitted that it would in any event be wrong for section 99 to be used as a means of providing *de facto* injunctive relief against third parties (other than the Company) in support of future proceedings by a liquidator. The point had been well made by Hoffmann J (as he then was) in *Re a Company, ex parte Schwarcz* [1989] BCLC 424 (***Schwarcz***).

26. In that case, Hoffmann J had been asked to grant relief under section 127 of the English Insolvency Act 1986 in the context of a dispute between shareholders. A validation order was sought by the company to pay its debts in the ordinary course of business. The petitioners argued that it should be subject to provisos that the validation should not include (1) any of the costs of defending the petition or prosecuting the company's motion to strike out, or (2) any of the costs and expenses of the company or anyone else relating to a proposed management buy-out (which was complained of and the subject of the dispute). Hoffmann J pointed out (at 426a –c) that these provisos were tantamount to an interim injunction (underlining added):

> *"It does not seem to me right that that jurisdiction should be used in a case where there is no question about the company being able in the end to pay all its lawful debts and therefore no such protection is required. What I am being asked to do is to use jurisdiction in order to give the petitioners what would amount to an interlocutory injunction restraining the company's board from dealing with its assets in a certain way on the ground that that would be a breach of their fiduciary duty. If an application for such an injunction were made, the basis upon which the court would go into the matter would be rather different from the way in which it has been put to me now. It would be concerned with the balance of convenience as between the parties and it would also of course be necessary for the petitioners to give a cross-undertaking in damages."*

27. The Company said that the Escrow Requirement amounted, in substance, to an interim injunction affecting only the holders of the CB Shares since it would in effect freeze their entitlement to receive the Dividend pending the determination of the Petition. However, this was objectionable as none of the usual requirements for the grant of such relief had been observed by the Petitioner:

(a). the Petitioner had not demonstrated the existence of a cause of action to recover the Dividend from the holders of CB Shares.

(b). the Petitioner had not offered a cross-undertaking in damages with, if necessary, appropriate fortification.

(c). the Petitioner had not explained why the test in *American Cyanamid Co v Ethicon Ltd* [1975] AC 396 would justify the granting of an injunction.

(d). the Convertible Bondholders were not before the Court, nor had they even been notified by the Petitioner of the attempt to impose the Escrow Requirement.

28. In addition, if the Escrow Requirement was imposed as a condition to a validation order the Company's directors would be placed in the invidious position of being unable to make use of the validation order without breaching their fiduciary duties and breaching important regulatory rules in Hong Kong.

29. The Escrow Requirement would, the Company said, lead to a material difference in the treatment of the Convertible Bondholders and the other shareholders. Article 24 of the Company's Amended and Restated Memorandum and Articles of Association dated 30 May 2019 (the ***Articles***) governed the payment of dividends by the Company and it was clear that the Articles did not provide any authorisation for the Company to treat shareholders of the same class differently in respect of dividend payments.

30. The Company also relied on a memorandum of advice (the ***Memorandum***) prepared by Ms Charlton-Stevens which had been exhibited to Charlton-Stevens 1. In the Memorandum, Ms

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Charlton provided her view on whether, as a matter of Hong Kong law, giving effect to the Escrow Requirement would contravene (and cause the Company to be in breach of) the HKSE Listing Rules and whether there were any regulatory consequences for the Company (and its directors) if it failed to pay the Convertible Bondholders their share of the Dividend. Ms Charlton-Stevens concluded, based on the facts presented to her, that giving effect to the Escrow Requirement (a) would result in the Company being in breach of the HKSE Listing Rules because doing so would constitute a breach of the fundamental principle that shareholders are to be treated equally (HKSE Listing Rule 2.03(4) states that "*all holders of listed securities are treated fairly and equally*" and Rule 13.75 states that "*An issuer shall ensure equality of treatment for all holders of securities of the same class who are in the same position…*") and (b) could result in the HKSE issuing directions to, and imposing sanctions on, the Company and its directors (and the Securities and Future Commission of Hong Kong (the ***SFC***) could also take action to suspend dealings in the Company's shares and to sanction the Company's directors).

31. Furthermore, the Company said, there was no justification for refusing to allow the Dividend to be paid to the Convertible Bondholders since, even if it could be said that the Petition (or the Petitioner's writ) might lead to the setting aside of the issue of the CB Shares following the making of a winding up order, the payment of the Dividend would not adversely affect or interfere with the liquidator's claim.

32. The Company noted that the Petitioner had contended that payment of the Dividend would be impossible to claw back from the Convertible Bondholders if a winding up order was made and that this would interfere with a liquidator's claim to set aside the issue of the CB Shares. However, this concern was misplaced. Even if it was right that the issue of the CB Shares might be unwound as a result of a winding up order, the Convertible Bondholders would at that point be entitled to receive back from the Company the Convertible Bonds which had been discharged in consideration for the issue of the CB Shares. The principal owing under the Convertible Bonds was US$456,600,000 and these bonds had matured in 2021. The conversion price was HK$4.20 per share. Therefore the Convertible Bondholders would have an unsecured claim in respect of the sums that would be owing under the reinstated Convertible Bonds. Even after accounting for

the Dividend, the Convertible Bondholders would still be net creditors of and owed substantial sums by the Company.

33. If a winding up order were to be made and if section 99 had the effect of avoiding both the issuance of the CB Shares and the payment of the Dividend, insolvency set-off (pursuant to section 140 of the Act) would net the amounts dollar-for-dollar leaving the Convertible Bondholders net creditors of the Company (in the amount of at least HK$3.90 per voided CB Share). Given that the Company is solvent, this set-off would not result in any windfall to or preferential treatment of the holders of the CB Shares. The effect of the set-off would simply be to avoid the need to litigate cross-claims. Further, even if for some reason insolvency set-off under section 140 did not apply, there was no reason why equitable set-off would not be applicable.

34. The Company submitted that if despite these submissions the Court concluded that it was necessary to condition any permission to pay the Dividend by reference to the Escrow Requirement, the Court should make no order on the Dividend Validation Application. To make a validation order subject to such a condition would be inconsistent with the core requirement (as confirmed by Henderson J in *Re Fortuna Development Corporation* [2004-2005 CILR 533] at [5], which was applied by the Court of Appeal in *Re Torchlight Fund LP* [2018 1 CILR 290]) that the Court should only validate a disposition that was within the powers of the directors (here the payment of the Dividend only to some shareholders would not be); where the directors believed it to be necessary or expedient in the interests of the Company (they do not believe that payment of the Dividend only to some shareholders would be in the interests of the Company) and where the directors' decision had been taken in good faith and was one which an intelligent and honest director could reasonably hold (a decision to pay the Dividend only to some shareholders would not be such a decision).

The Petitioner's submissions

35. The Petitioner's position was that dividends should not be paid to shareholders who had received the CB Shares as part of the share allotment which was the main subject of the dispute in the

Petition (and the separate proceedings against the Company commenced by writ), in circumstances where such payment was likely to or could adversely affect the ability of a liquidator to set aside the issue of those shares and recover the dividend. In the event that the complaints in the Petition were upheld (or the Petitioner succeeded in its writ proceedings) the issue of the CB Shares would be challenged by a liquidator and was likely to be (or at least it was arguable on the Petitioner's case that it would be) set aside. The holders of the CB Shares should not be paid their share of the Dividend until after the Petition had been dismissed (or the writ action had failed). They should wait to receive their share of the Dividend until after the challenge to their right to retain the CB Shares and the claim that they were parties to the oppressive conduct on which the Petition was based had been resolved. The Court should preserve the status quo pending resolution of the Petition proceeding and the writ proceeding.

36. The status quo in this context meant the circumstances existing upon and since the filing of the Petition in which the Company has been unable to make payments out of its own assets to the Convertible Bondholders in circumstances where the validity of their allotted shares has been directly challenged in two proceedings and any dividends paid in respect of those shares may later need to be unwound. The Petitioner submitted that if the Convertible Bondholders' share of the Dividend was not preserved in escrow or on trust but distributed to them, the status quo would be irretrievably altered. If the issue of the CB Shares was set aside, the Dividend paid to the Convertible Bondholders would have to be repaid and it was unclear how the funds paid to the Convertible Bondholders would ever be recovered (particularly where the Company and the Respondents had refused to provide evidence of the identities of the ultimate beneficial owners of the CB Shares). In addition, there was a risk that difficulties in recovering the Dividend could also prejudice the ability of a liquidator to set aside the issue of the CB Shares in the first place.

37. The Petitioner argued that the issue of the CB Shares was central to the dispute on which the Petition was based and that the facts averred in the Petition (together with the writ) showed that the Convertible Bondholders were parties to the oppressive and improper conduct complained of and that on a winding up order being made it was likely that a liquidator would be successful in setting aside the issue of the CB Shares.

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38. The chronology of the events surrounding the issue of the Convertible Bonds, their conversion and the issue of the CB Shares was, in outline, as follows. There were two issues of Convertible Bonds, the first being on or about 8 August 2018 and the second being on or about 3 September 2018. On or about 6 October 2018, the Company agreed with the holders of the Convertible Bonds to convert 531,600,000 of the Convertible Bonds into 888,980,352 new shares in the Company (the ***Conversion Agreements***) and announced the allotment and issue of further 85,845,636 shares in the Company (the ***New Shares***). On 30 October 2018, the Company's board purported to allot and issue a total of 1,067,830,759 shares comprising the New Shares and 93,004,771 shares, representing shares relating to the Convertible Bonds held by persons who had not agreed to convert them under a Conversion Agreement (the ***New Share Issue***).

39. The Petitioner had also commenced the writ proceedings seeking, inter alia, declarations that the New Share Issue was not a valid exercise of the directors' power to issue and allot shares. The Company had applied to strike out the writ. I dismissed that application but the Court of Appeal allowed the Company's appeal against my decision but has granted leave to appeal to the Judicial Committee of the Privy Council.

40. Although the Petitioner did not now, as a result of amendments to the writ, seek relief invalidating the New Share Issue (as the Convertible Bondholders have not been joined to that proceeding), it had sought declarations that the New Share Issue was not a valid exercise by the Company's board of the power to issue shares so that if the Petitioner was successful, the practical effect of such a declaration, the Petitioner argued, would be that the CB Shares would either be invalid or voidable. Those Convertible Bondholders who had at the relevant time been on notice of the improper exercise of the directors powers were unlikely to have any answer to a consequential claim by a liquidator to set aside the New Share Issue.

41. The Petitioner submitted that the Company's interpretation of the CICA Judgment was unduly narrow and not sustainable. Moses JA's approach required, particularly but not exclusively in the case of a contributory's petition, an assessment by the Court of the objective and purpose of the winding up sought by the petitioner and of whether the payment or disposition to be validated would be damaging to the winding up by prejudicing the liquidator's ability, or making it more

difficult for the liquidator, to conduct the winding up so as to achieve that objective or purpose. The Court was given a wide discretion under section 99 to preserve the status quo as at the date of the petition, in the sense of being able to ensure that when the winding up order was eventually made, the liquidator would be in the same position (as regards matters relevant to the conduct of the winding up) as if the winding up order had been made at the date of the petition (so as to ensure that contributories were properly protected).

42. The Petitioner noted that at [46] Moses JA had adopted Mr Lowe KC's wide formulation of the matters relevant to the exercise by the Court of its discretion to make or refuse a validation order (underlining added):

> "*For these reasons I adopt the submission of Mr. Lowe, Q.C. in his written argument:*
>
> > *"Just as in the case of a creditors' petition validation will not be allowed to undermine the purpose of a winding up (i.e. pari passu distribution), in a just and equitable petition a validation order should not undermine the objective of stopping or reversing oppressive conduct."*

43. Moses JA had also made it clear that the decision whether or not to make a validation order required the Court to consider and take into account what was needed to protect contributories, as parties interested in the conduct and outcome of the winding up. At [47] he had said that:

> *"Careful scrutiny is needed not just to protect creditors in an insolvency petition but also contributories at a stage when no one can say whether the petition in respect of a solvent company will succeed or not. Validation orders should only be made if they are consistent with the purposes of s.99 and of the power to make such orders."*

44. The Petitioner also submitted that the Court of Appeal's decision on the facts and its application of the principles discussed by Moses JA to the facts of the case was consistent with the Petitioner's wider interpretation of the Court's approach to the exercise of the discretion to make a validation order. The Court of Appeal had relied on (see [61] of the CICA Judgment) the allegation made by the Petitioner that the proposed deposit of shares to CCASS was an important further stage in the process of diluting its shareholding and the conspiracy to cause it damage; that "*the proposed transactions in respect of which validation was sought were themselves the*

subject matter of the petition" and that validation would make it impossible to reverse the issue of the CB Shares and "*risk stymying what a court, liquidator or the appellant might legitimately do*." It was clear that Moses JA was taking a broad view of the purpose of the proposed winding up, the damaging effect that permitting the proposed deposit of shares would have on the actions which a liquidator might take to remedy and deal with the alleged improper conduct of the board and the improper share issue, and focussing on what was needed to protect the interests of the Petitioner and other contributories by ensuring that there was no post-petition share transfer (which was the act caught by section 99) which would make it more difficult for the liquidator to unwind the CB Share issue. In circumstances where there appeared to be no reasonable explanation other than that proffered by the Petitioner, namely that the deposit was intended to prevent the unwinding of the issue of the CB Shares (and the related issue and conversion of the Convertible Bonds) in the event that the Petition was successful, the Court of Appeal concluded that it should refuse to make a validation order.

45. As regards the Company's objections to the Escrow Requirement, the Petitioner submitted that these were unfounded. The section 99 jurisdiction was wide and unqualified and the Court could impose conditions on its grant of relief and validation of a payment.

46. Pursuant to the Escrow Requirement, the amounts otherwise payable to the Convertible Bondholders would be held by the Company in an escrow account on trust for them pending the outcome of the Petition and the writ. The Petitioner argued that this approach was no different from that applied to shareholders who, by operation of law, are prevented (temporarily or otherwise) from receiving dividends, for example sanctioned entities. If the Petitioner was unsuccessful, the sums in the escrow account would be payable immediately to the Convertible Bondholders. If the Petitioner was successful, those amounts would be payable to other shareholders *pro rata* in proportion to their readjusted shareholding or to the Company for working capital or to be paid into a share premium account. The Petitioner submitted that this was a perfectly fair and equitable way to deal with the Convertible Bondholders in the circumstances.

47. The Petitioner argued that the Company was wrong to claim that the Escrow Requirement would result in a breach of the Company's constitution. The Escrow Requirement was being imposed by the Court pursuant to a Court order and not by the Company (for this reason, the judgment of Sheriff Kelbie in the Sheriff Court of Grampian, in *Doherty v Jaymarke Developments (Prospecthill) Ltd* [2001] SLT (Sh Ct) 6 (***Doherty***) on which the Company relied, was distinguishable). Furthermore, shareholders were being treated equally and in accordance with the Articles. The Convertible Bondholders' rights would be respected and protected by the Escrow Requirement because they would receive their share of the Dividend, plus interest, if they were entitled to it once the dispute regarding and challenge to the issue of the CB Shares had been disposed of.

48. The Petitioner argued that if a validation order was made with a direction that the Escrow Requirement be satisfied the Company would be bound to pay the Dividend to the shareholders not affected by the escrow arrangements. It was at least arguable, and for the purpose of the Dividend Validation Application the Court should assume, that the Escrow Requirement would not prevent the Dividend Resolution from being fully effective and binding (or result in a breach of the Articles). The Company had asserted that there was a risk that the shareholders were unaware when voting on the Dividend Resolution that the Dividend might not be immediately paid to the Convertible Bondholders so that it would be wrong to impose the Escrow Requirement because this would be inconsistent with the wishes or expectations of the shareholders who voted at the AGM. However, the Petitioner said, there was insufficient evidence before the Court as to what was discussed or available to shareholders at the AGM (or what they should be taken to be aware of) and the Court could therefore not properly conclude that the Escrow Requirement would be inconsistent with shareholders' reasonable expectations or wishes. In any event, the risk of such inconsistency was at most a factor relevant to the exercise of the Court's discretion and should not prevent the Court imposing the Escrow Requirement.

49. The Petitioner submitted that the Court could and should conclude that the Company's shareholders knew from the Notice that an application for a validation order would and needed to be made and must be taken to have known that the Court had the power and might refuse to validate the payment of the Dividend to the Convertible Bondholders (it was clear that the Court

had a discretion as to what order to make on an application under section 99). The Convertible Bondholders certainly knew that their rights as shareholders were the subject of complaint and challenge and must have understood that there would be an issue as to whether they should be allowed to receive a dividend before the challenge had been adjudicated. The Court was entitled to make an order giving effect to the Escrow Requirement even though it resulted in some difference of treatment between the Convertible Bondholders and other shareholders in a case such as this where the Convertible Bondholders were alleged to have been parties to the wrongdoing on which the Petition was founded.

50. The Petitioner objected to the Company's reliance on the Memorandum and the opinion of Ms Charlton-Stevens. First, the Memorandum purported to be expert evidence on Hong Kong law for which the Court's permission had neither been sought or granted. Secondly, the Memorandum had only been filed in the Company's reply evidence and the Petitioner had not been given advance notice of the Company's intention to file expert evidence or an opportunity to respond. Accordingly, the Court did not have the benefit of a responsive expert report from the Petitioner (who was not given sufficient time to brief an expert on Hong Kong law either to provide their own expert report or to comment upon Ms Charlton-Stevens' evidence). Thirdly, Ms Charlton-Stevens had gone way beyond the permissible subject matter of an expert's report. She had sought to apply the Hong Kong law she had opined on to the facts of this case and reach a conclusion on how this Court should decide the Company's application. The Petitioner submitted that in these circumstances Ms Charlton-Stevens' evidence should be disregarded and the Company should not be entitled to rely on it.

51. The Petitioner argued, without prejudice to that submission, that even if Ms Charlton-Stevens' evidence was taken into account it did not demonstrate that imposing the Escrow Requirement *would* result in a breach of the HKSE Listing Rules and Hong Kong law, merely that it *might* do so. The evidence failed to appreciate that the Convertible Bondholders would, under the Petitioner's proposal for an escrow account and trust, be granted a beneficial interest in the Dividend paid into that account in respect of the CB Shares. Taking this beneficial interest into account, there was no unfair or unequal treatment. Furthermore, the proposed treatment of the Convertible Bondholders was not unfair. The Petitioner alleged that they had been part of a

clandestine group formed improperly by ACC and CNBM to take over the Company and their entitlement to the CB Shares had been challenged. The Convertible Bondholders were in a different position from the other shareholders whose rights as shareholders were unchallenged. It could hardly be unfair and unequal treatment to withhold payment of the Dividend until the proceedings in which the challenge to the issue of the CB Shares had been made were concluded. The Petitioner also said that the Company's Cayman legal advisers had been wrong to tell Ms Charlton-Stevens that a validation order under section 99 would not result in the Company being compelled to pay the Convertible Bondholders' share of the Dividend into escrow. Given the broad discretion and flexibility of the Court's power under section 99, a validation order can compel the Company to do so.

52. The Petitioner also argued that the Company's reliance on insolvency or equitable set-off was unfounded or at least not at this stage established. The Petitioner alleged that it was likely that the funds advanced to the Company pursuant to the Convertible Bonds had come from ACC and CNBM. They would be the parties entitled to the sums due under the Convertible Bonds if the Convertible Bonds were reinstated. The parties liable to repay the Dividend however were likely to be the parties to whom the CB Shares had been issued, i.e. the Convertible Bondholders. There would therefore be, or at least it was arguable that there would be, no mutuality for the purpose of insolvency or equitable set-off, so that the set off on which the Company relied would not be, or cannot safely be assumed to be, available.

53. Finally, the Petitioner submitted that the Company was wrong to characterise the Petitioner's application with respect to the Escrow Requirement as being in substance an application for an interim or interlocutory injunction against (or at least affecting) the Convertible Bondholders as third parties. The Company had previously raised this objection in connection with the 2019 Validation Application when it said that the refusal to validate the proposed share transfers by the Convertible Bondholders amounted to the imposition of an injunction against them. But this objection had been rejected by the Court of Appeal. The prohibition on the payment of a Dividend to the Convertible Bondholders arose by reason of section 99 and the claim to a validation order permitting such a payment had to be considered by reference to the principles governing applications under section 99. At [70] Moses JA had said this:

> *"Nor do I accept the company's repeated complaint that Tianrui is seeking to impose an injunction on the deposit without fulfilling the stringent requirements that would be necessary for such an application, particularly a cross-undertaking in damages. Section 99 and the power to make a validation order have the purpose and effect I have identified. Tianrui had the right to oppose the making of the order and s.99 requires the respondent to make its application good. Tianrui had no obligation or need to seek an injunction, when the merits of the application were to be considered under s.99."*

Decision and analysis – the CICA Judgment and the principles governing the exercise of the Court's discretion

54. It is first necessary to consider the Court of Appeal's reasoning in the CICA Judgment. It seems to me that the following propositions and principles can be derived from Moses JA's judgment (I make reference below to the main paragraphs in the CICA Judgment which are relevant to particular propositions but they are not to be understood as the only relevant paragraphs which can be cited to support the particular proposition):

    (a). Justice Mangatal's main error had been to treat the purpose of section 99, when share transfers were at issue, as being to prevent members holding partly paid shares from avoiding liability in relation to calls, so that the "*rationale of section 99*" was not engaged where there was an application to validate transfers of fully paid shares (see [21]).

    (b). this was an unjustifiably narrow view of the purpose of section 99, which could not be so confined (see [22]).

    (c). section 99's purpose is "*to preserve the status quo; it has … a "conservational" function. The retrospective effect of s.99 derives from the legislative scheme for insolvency which treats the commencement of a winding up as the date when the winding up was initiated, normally the date when the petition was presented, rather than the date when a winding-up order is made and the real winding up begins*" (see [14]).

    (d). where section 99 is engaged because there has been or is to be a post-petition disposition of the company's property, a transfer of shares or an alteration to the status of members, the Court must only validate the relevant disposition, transfer or alteration "*in*

circumstances which assisted in preserving the status quo and which did not frustrate the purpose of section 99" (see [23]).

(e). the reference to the status quo refers to the position of the relevant company and of those interested in any future winding up as at the date of the presentation of the petition. The Act provides (in section 100(2)) for the making of a winding up order to have retrospective effect (so that if an order is made, the winding up is to be treated as having been started on the date on which the petition was presented). Section 99 is part of the machinery for giving effect to that statutory rule. The Court has to consider whether any proposed change to the company's position as at the date of the petition (arising from a post-petition disposition of the company's property, a transfer of shares or an alteration to the status of members) would adversely affect the company and the interests of those interested parties having regard to the position in the event a winding up order is subsequently made (see [40], [41], [45] and [46]).

(f). the Court must therefore assess how the post-petition disposition of the company's property, transfer of shares or alteration to the status of members on the company will affect the position of the company and the interested parties in the event that a winding up order is made. The Court must look at what the company's position will be if an order is made and if the relevant action for which a validation order is sought is permitted and taken (see [54], [56] and[59]).

(g). the Court must consider whether upon a winding up order being made the company (and the liquidator appointed to conduct the winding up for the benefit of those interested in the liquidation), and those interested parties, are likely to be worse off than if the relevant action was not taken. If they are likely to be worse off the status quo will not have been preserved (see the previously mentioned paragraphs and [72]).

(h). in assessing the position of the company and the interests of the parties interested in the winding up at the time when a winding up order is made the Court is entitled to have regard to the action which a liquidator is likely to have to take to protect the position of the

company and the interested parties and for the purpose of the proper conduct of the winding up, in particular what action the liquidator is likely to have to take to unwind or set aside transactions which a liquidator would wish, for any proper reasons, to challenge (in light of the allegations made in the petition) (see [61]).

(i). in considering the impact of the proposed disposition (or share transfer or change in status) on the company and the interested parties, the Court should also have regard to the reasons given by the company justifying and for making the disposition (or by the shareholders justifying the proposed transfers or change in status). It will obviously assist the application for validation if the company has (or shareholders have) put forward a reasoned and reasonable case which demonstrates that the company (and interested parties) will benefit (or at least not be prejudiced) by the proposed disposition (or share transfer or status change) and that it is being done for *bona fide* ordinary business reasons (see [59] and [61]-68]).

(j). there is no distinction in principle between solvent and insolvent companies and the Court has a responsibility carefully to scrutinise and adopt a cautious approach before validating dispositions, share transfers and changes in the status of members even where the company is solvent (see [44] and [47]).

(k). on the facts of the case under appeal, the deposit of shares into CCASS would have had an adverse impact on the position of the company and its liquidator as at the date of the winding up order (as compared with the company's position as at the date of the presentation of the Petition) and was not justifiable. That deposit was alleged, and in the absence of a satisfactory explanation to the contrary, was assumed to be for the purpose of facilitating the process of diluting the Petitioner's shareholding and the conspiracy to cause it damage. It was an important further stage in the oppression and improper conduct of the Company and the board alleged and relied on by the Petitioner in the Petition. The effect of the deposit would have been to make it impossible to reverse the issue of the CB Shares and would have prevented action to reverse that share issue by a liquidator (see [56], [61], [66] and [72]).

55. I do not consider that the Company is right to say that the Court should approach a validation application under section 99 in two stages: first, by considering whether the threshold or gateway test had been satisfied (would the granting of a validation order undermine the objective of section 99?) and second, if that test was satisfied, by applying a residual discretion. Such an approach seems to me to be inconsistent with the language of the section, inconsistent with the approach of Moses JA and unnecessarily rigid. The Court has to consider the disposition, share transfer or change of status of the company's shareholders proposed and assess whether in all the circumstances granting a validation order would promote, and not undermine, the objective of ensuring that the position of the company (and those interested in the winding up) will be preserved and protected (by being improved or at least not made worse) in the event that a winding up order is subsequently made, having regard to the likely effect of the disposition (or other action). The Court has to compare the position of the company at the date of the presentation of the petition and on the making of the winding up order, having regard in a real-world and practical context to whether the effect of the disposition (or other action) will be adversely to impact the conduct of the winding up by the liquidator and prejudice those interested in the winding up. It seems to me that the Court is entitled to have regard, based on the evidence adduced, to what is likely to happen in the winding up. In the case of a creditor's petition in respect of an insolvent company, the primary (but not exclusive) concern will be whether the general body of creditors will be prejudiced because the disposition will reduce the dividends payable to creditors if a winding up order is made. In the case of contributory's petition in respect of a clearly solvent company, the interested parties will be the contributories including the petitioning contributory and the Court will be concerned as to whether the distribution will reduce the value of the contributories' interest in the company without a proper basis for doing so.

56. But the Court is also entitled to look more generally at the likely impact of the disposition (or share transfer or change to a shareholder's status) on the conduct of the winding up to see whether it would adversely impact on the steps that a liquidator could take in the winding up, bearing in mind the nature of the dispute as alleged in the petition. Where a contributory's petition on the just and equitable ground is based, as is usually the case and is the position in these proceedings, on a dispute between shareholders, the Court is also entitled to have regard to whether the

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proposed disposition (or share transfer or change to a shareholder's status) would be for the benefit of the alleged wrongdoers such that they would benefit in a manner that is likely to be difficult to reverse in the event of a winding up. Because a contributory's petition on the just and equitable ground has many of the characteristics of an *inter partes* dispute between shareholders (and may be treated for case management purposes, as in this case, as an *inter partes* proceeding between shareholders pursuant to Order 3, rule 12 of the Companies Winding Up Rules (2023 Consolidation) (***CWR***)) it seems to me that the Court is entitled to have regard to the impact of the proposed disposition on the position of the petitioning contributory (and other contributories not alleged to be parties to the conduct complained of in the petition in the event of a winding up. This is the import and effect of Moses JA's adoption of Mr Lowe KC's submission as set out at [46] of the CICA Judgment.

57. I also do not consider that the Company is right to say that Moses JA decided or considered that the Court could only refuse to validate a disposition (or share transfer or change of status) if it was made pursuant to a transaction (or obligation) which itself would be avoided by reason of section 99 on the making of a winding up order. The Company argued that section 99 was not intended to prevent the payment of sums properly due and payable by the Company by reason of a binding obligation (in this case the declaration of the Dividend) merely because there might subsequently be a challenge to that obligation after a winding up order had been made and because a liquidator, if appointed, may bring proceedings to avoid or set aside the obligation. It was unclear whether the Company was making a point concerning the Court's jurisdiction (that section 99 did not cover dispositions or payments of that kind) or only the exercise of its discretion (the Court should never exercise its discretion under section 99 to refuse to validate such a disposition). Either way, I do not accept that argument. The Company's approach was inconsistent with Moses JA's reasoning and with the Court of Appeal's decision on the appeal.

58. It seems to me that the Court is given a wide discretion, to be exercised for the purpose and in the manner described by Moses JA, which permits it to have regard to the position of the company (and of the contributories) in the event a winding up order is made and the impact on the company and those contributories, and on the conduct of the winding up, of validating the proposed disposition or share transfer. Section 99 is intended to protect the estate (and contributories) and

avoid prejudicing the conduct of the winding up if a winding up order is made. It does this by ensuring that any dispositions or changes at the shareholder level that take place after the presentation of the petition (which in principle could be damaging to the estate or contributories and the conduct of the winding up) are avoided unless they can be shown not to be so damaging.

59. The Company was driven by its analysis to argue that Moses JA had (wrongly) assumed that the issue of the CB Shares was capable of being reversed pursuant to section 99 upon a winding up order being made. But I do not consider that he did so. He did not treat as critical to his refusal to validate the deposit of the shares into CCASS the fact that the issue of the CB Shares took place after the presentation of the Petition. What was critical was that a validation order would facilitate a further step in the improper conduct complained of in the Petition by prejudicing the position of the Company and its liquidator following the making of a winding up order. The learned Justice of Appeal did not need to consider or decide the issue of whether the CB Shares could or would be avoided pursuant to section 99.

60. I also reject the Company's submission that a refusal to validate the payment of the Dividend to the Convertible Bondholders would be an improper exercise of the Court's discretion because it would in substance involve making an interlocutory injunction against them without the conditions for the granting of such an injunction being satisfied. I accept the Petitioner's submissions on this point. [70] of the CICA Judgment seems to me to require the rejection of the Company's argument on this point. The prohibition on the payment of the Dividend arises by reason of section 99 and is directed to the Company. The Court must decide whether to grant a validation order by reference to the approach and principles applicable to an application for a validation order made under that section. The Court can, and in my view should, have regard to the position and the impact of its order on third parties (for example, payees to whom a payment is to be made) but the Court must focus on and give priority to the interests of the Company and those who will have an interest in it upon a winding up order being made, since that is the statutory mandate established by section 99.

61. I do not consider that Hoffmann J's decision in *Schwarcz* requires me to validate, or justifies a refusal to decline to validate, the payment of the Dividend to the Convertible Bondholders.

Hoffmann J (in what appears to have been a brief *ex tempore* judgment) refused to allow the English equivalent of section 99 to be used to prevent the company's directors from spending the company's funds on its defence of the petition (where doing so was alleged to be a breach of their fiduciary duties because a contributory's just and equitable petition is to be treated as in substance a dispute between the relevant shareholders and the company's funds should not be spent on such a dispute) or on a proposed management buy-out that the petitioning contributory said should not go ahead (of course, in this jurisdiction the issue of the extent to which the company is permitted to participate in the petition proceedings and spend its own money is dealt with, at least on an interlocutory basis, when directions are given by the Court at the outset of the proceedings pursuant, as noted above, to Order 3, rule 12 of the CWR). He considered that the proper process for making such a challenge was an action alleging that the directors were or would be acting in breach of duty and an application for an interlocutory injunction in that action. These facts are different from the present case. They relate to an objection to the management of the company by its directors and the company's conduct of its defence to the petition in advance of the hearing of the petition. The present case is focussed on the impact of paying the Dividend on a future winding up and on the ability of a liquidator to avoid defined transactions and acts which have been challenged in the petition (and to recover the payments sought to be validated if the liquidator is successful). Furthermore, it appears that Hoffmann J went on to consider whether the limitations which the petitioner sought to impose were justified in the circumstances and concluded that the petitioner would suffer no prejudice if such limitations were not imposed and consideration of its challenge to the directors' actions was deferred until after the strike out motions filed by the respondent shareholders and the company had been heard – which motions were listed to be heard within a short time (see pages 425 b-c and 426c-d). In any event, it seems to me that Moses JA's judgment in [70] of the CICA Judgment makes it clear that the Court is entitled in an appropriate case to decline to validate payments to third parties even though in doing so the third parties are prevented from receiving what is due to them or from exercising their rights.

62. Section 99 does not operate so as to turn the Petition into an injunction prohibiting all and any further oppressive conduct of the kind complained of in the Petition. But it does in my view prevent dispositions which may be part of such conduct in certain circumstances. The

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presentation of the petition will (by virtue of section 99) prohibit, and the Court will generally not validate, actions (to the extent they are within the activities covered by section 99) which are likely to prejudice the conduct of the winding up and prejudice the interests of contributories if a winding up order is made. Accordingly, where the winding up will (or is likely to) involve a review of conduct and transactions complained of in the petition and the liquidator may well wish to challenge that conduct and set aside those transactions, and the disposition or change at the shareholder level will (or is likely to) interfere with (and make more difficult) the action which the liquidator may wish to take, the Court may decide not to, and I would say will usually not, validate it. There is, of course, no absolute rule and the Court must consider all the facts of the case. But if the disposition to be validated may be seen as another step in the pattern of oppressive and improper conduct complained of in the petition, which the petitioner seeks to end, reverse and seek recompense for by the making of a winding up order then the Court may refuse to validate it where the effect of the disposition is likely to be that a liquidator's actions to reverse such conduct will be prejudiced or, if a liquidator may seek to reverse and recover sums paid pursuant to the disposition itself, there is evidence that there may be material difficulties in his/her doing so, such that the effects of the disposition may never be reversed.

Decision and analysis - would validating payment of the Dividend to the Convertible Bondholders undermine or frustrate the maintenance of the status quo pending resolution of the Petition?

63. With these general principles and propositions in mind, and following the approach set out in the CICA Judgment, I must turn to consider whether to permit the Company to pay to the Convertible Bondholders their share of the Dividend and whether, if I conclude that such payment should not be permitted, to permit the Company to pay all other shareholders provided that the Convertible Bondholders' share of the Dividend is paid into an escrow account on suitable terms and for a suitable period pending the disposal of the Petition (and/or the writ).

64. My starting point, adopting the cautious approach mandated by the Court of Appeal, is that it would be wrong, having regard to the purpose of section 99 and the principles to be applied on an application for a validation order, to validate the unconditional payment of the Dividend to the Convertible Bondholders. It appears that there is a serious risk that paying the Convertible Bondholders their share of the Dividend will (a) adversely impact the ability of a liquidator to

take action to set aside and reverse the issue of the CB Shares (and the Convertible Bonds) and (b) if the liquidator is able to establish that the CB Shares (and the Convertible Bonds) should be set aside, worsen the Company's position in the winding up since the funds paid out to the Convertible Bondholders by way of the Dividend are likely to be difficult to recover. Accordingly, allowing the Convertible Bondholders to receive unconditionally their share of the Dividend would be prejudicial to the position of the Petitioner and other shareholders in the event a winding up order is made, as compared with the position (and therefore the status quo) as at the date of the presentation of the Petition.

65. The Convertible Bondholders' entitlement to their share of the Dividend is dependent, obviously, on their being shareholders. They currently hold the CB Shares but both parties accept that if the Dividend is now paid to the Convertible Bondholders and the issue of the CB Shares is subsequently set aside, they will be required to repay the sums so paid. The Company's evidence is that there are likely to be significant difficulties in recovering the Dividend if paid out (although the Company does not explain what those difficulties are and the extent to which they relate to the Convertible Bondholders) and it is accepted by both parties that if such difficulties would exist, they are likely to complicate and adversely affect a liquidator's claim to set aside the issue of the CB Shares or be prejudicial because a liquidator will be unable to recover the funds which have been paid to the Convertible Bondholders and which they need to repay.

66. Ms Wu said, at [34] of Wu 6, that (underlining added):

> "*... the Company wishes to ensure that there is sufficient clarity as to the status of the dividend in the event of a winding-up order. Given there likely will be significant difficulties in trying to recover any dividends that are paid out, the Company also wishes to ensure that a validation order is granted before making any payment.*"

67. The Company did not explain the precise nature of the difficulties or the shareholders affected. Ms Wu refers to difficulties with respect to *any* dividends paid out. In the absence of a qualification that made it clear that the anticipated difficulties did not apply to the Convertible Bondholders I can only assume that the concern expressed by Ms Wu applies also to them.

68. There are two ways, as I understand it, in which the liquidation estate and contributories may be prejudiced if the Dividend is paid unconditionally to the Convertible Bondholders.

69. The first problem is that the ability of a liquidator to obtain an order setting aside the issue of the CB Shares will be adversely affected if the Convertible Bondholders are unable to restore and repay the Dividend they have received. The Petitioner claims in the writ (at [61]) that the issue of the Convertible Bonds and the issue of the CB Shares was "*invalid as the Board exercised its powers for the Improper Purpose*". The Improper Purpose was "*to dilute the Petitioner's interest or voting power and/or thereby enable ACC and/or CNBM to ensure the passing of special resolutions which prior to the Convertible Bond Issues the Petitioner would have been able to block*" (see [60] and 61] of the writ. The Petitioner then seeks declarations that "*the exercise by the directors of the power*" to issue the Convertible Bonds, to convert the bonds and to issue the CB Shares was "*not a valid exercise of the .. power.*" In the Petition, the Petitioner relies on what it describes as the "*Improper Share Issue*" and avers that the Convertible Bonds and the CB Shares were issued for an improper purpose, namely to dilute the Petitioner's shareholding for the benefit of ACC and CNBM (see [36]). The Petitioner is therefore claiming that the directors acted for an improper purpose and if correct it would follow that the steps taken purportedly on behalf of the Company, including the issue of CB Shares, would be *prima facie* voidable at the election of the Company or its liquidator. However, the remedy of rescission will be barred where *restitutio in integrum* is impossible. It is, as I understand it, being said that because there will be difficulties in obtaining repayment of the sums paid to the Convertible Bondholders (because they may have spent the funds received) a liquidator's claim for rescission may be prejudiced and barred.

70. The second related problem is that, since the identity and location of the Convertible Bondholders remains unknown, it cannot safely be concluded that they will be good for the money if they are subsequently sued and there may just be real problems in enforcing repayment of the Dividend from them. Accordingly, if the unconditional payment of the Dividend to the Convertible Bondholders is validated now, even if the relief (and remedies) which a liquidator can be expected to seek will not be compromised, the position of the Petitioner and the other shareholders in the event of a winding up will be worsened because sums paid out now will not then be recoverable.

71. These grounds for a challenge to the issue of the CB Shares, while formulated in general terms and only particularised to a limited extent, adequately set out the basis of a claim that a liquidator could make to avoid and set aside the issue of the CB Shares and are in my view at least reasonably arguable. The evidence indicates that there is a material risk that recovery from the Convertible Bondholders of the Dividend will be difficult and would be in doubt. Together, these factors constitute strong reasons for refusing to validate the unconditional payment at this stage of any Dividend to the Convertible Bondholders.

72. The Company argued that these concerns were of no weight because there will be no difficulties in recovering the Dividend paid to the Convertible Bondholders and no real risk of prejudice to a liquidator since there will be no need to require the Convertible Bondholders to repay the Dividend. The Company argued that if the issue of the CB Shares is set aside and those shares are cancelled, the Convertible Bondholders obligation to repay the Dividend they received will be discharged by set-off (insolvency or equitable) since the Company will then be under an obligation under the Convertible Bonds which would be reinstated. However, I am not satisfied, at this stage, that I can safely assume that a set-off will be available. There are insufficient facts in evidence which allow a proper analysis of the effect of setting aside the CB Shares and who will hold (and be entitled to) the claims and cross-claims that are likely to result. The Petitioner has raised one doubt, that there may be a lack of mutuality between the claims for recovery of the Dividend and for principal and interest under the reinstated Convertible Bonds. In a case such as this, and just looking at the allegations in the Petition (see [36]-[51]), where there are multiple parties, some of whom were acting in a representative capacity, and the identity of all the parties and the beneficial owners of the Convertible Bonds is not clear, I am not satisfied that I can dismiss the Petitioner's challenge to the existence of the right of set-off or that I can safely conclude that a set-off will be available so as to avoid the need for the Convertible Bondholders to repay the Dividend.

73. It seems to me that there is a material overlap in this case with the concerns that caused the Court of Appeal to refuse to grant the application to validate the CCASS Transaction. The Court of Appeal considered that it would be wrong to validate a transaction (the deposit of shares) where doing so would prejudice the Company, the Petitioner and other contributories by making it more

difficult for a liquidator, if subsequently appointed, to take action to remedy and reverse improper and oppressive conduct. It is true that the payment of the Dividend to the Convertible Bondholders will not make it impossible (as a practical matter) to establish the identity of the Convertible Bondholders and therefore impossible to bring claims against them, as was the case with the deposit of shares into CCASS, but, as I have explained, it is likely to prejudice and make more difficult the process for unwinding the allegedly improper conduct and thereby inhibit (and disincentivise) a liquidator from doing so.

Decision and analysis – would payment of the Dividend to the Convertible Bondholders give rise to a waiver of the Company's rights to set aside the issue of the CB Shares?

74. I would add that it appears to me that there may be a further reason for not validating (or at least for being cautious before validating) the unconditional payment of the Dividend to the Convertible Bondholders, although this was not a point raised by the Petitioner. It must be arguable that payment of the Dividend (at least at this stage when the challenge to the basis on which the CB Shares were issued has been made) would constitute an acknowledgement by the Company that the CB Shares had been validly issued and a waiver of claims to challenge and set aside the issue of the CB Shares. I do not give this any weight in my analysis since, as I say, the point was not raised by the parties and submissions were not made with respect to it (and the related evidence has not been filed or at least referred to on this application). The whole issue of the extent to which the Company's conduct to date (including the previous payment of a dividend) might have waived or as a matter of law could constitute a waiver of its right to avoid the issue of the CB Shares has not been canvassed. It may well be that in a case such as this, where there is an allegation that the Convertible Bondholders have been parties to and aware of the alleged improper conduct (with and involving those in control of the Company) and had notice of the directors' invalid or improper exercise of their powers, that nothing that the Company (operating under the control of those parties) could or would constitute or give rise to such an acknowledgement or waiver or an estoppel. In addition, claims which a liquidator may be able to bring may be unaffected by the Company's pre-liquidation conduct. But these points have not yet been raised let alone properly developed in argument.

Decision and analysis – is the Petitioner precluded from opposing an order validating payment to all shareholders?

75. The Company did address the impact of the Petitioner's conduct and argued that the Petitioner's conduct (in particular its vote at the AGM in favour of the Dividend Resolution) precluded it from objecting to a validation order being made which permits the Convertible Bondholders to be paid their share of the Dividend. However, I am not persuaded.

76. There is a distinction to be drawn between approval *qua* shareholder of the Company's proposal that a Dividend be paid and taking the position *qua* petitioning contributory, after such approval has been given, that payment of the Dividend should not be made to some shareholders (because those shareholders' claim to the Dividend is based on holding shares which the Petition alleges were issued improperly pursuant to an invalid exercise of the directors' powers). It was clear that the implementation of the Dividend Resolution, if passed, would be subject to a validation order and it seems to me that it was open to the Petitioner to exercise its vote at the AGM to approve the Company assuming an obligation to pay the Dividend but then argue on the subsequent hearing of the Dividend Validation Application and as petitioning contributory, that, having regard to the principles applicable to a validation application under section 99, some shareholders should not be paid unconditionally their share of the Dividend. I also reject the Company's submission that by voting in favour of the Dividend Resolution the Petitioner was to be treated as having accepted the Convertible Bondholders' entitlement to be paid their share of the Dividend and that the issue to them of the CB Shares had been valid and effective. Voting on the Dividend Resolution cannot in my view be treated as conduct which expresses or evidences a view as to the status of and validity of the issue of shares to *other* shareholders. The Petitioner's vote was based only on and only evidenced its own claim to be a shareholder with the right to vote on the Dividend Resolution. I do not even see how it could credibly be argued that the Petitioner should *qua* shareholder have lodged with the chair of the AGM an objection to the Convertible Bondholders' vote on the Dividend Resolution. The Convertible Bondholders are at present and for the time being shareholders of the Company with the right to vote. The Petitioner's objection to their unconditionally receiving the Dividend is made in the different context of the Dividend Validation Application (which views the proposed payment of the

Dividend to the Convertible Bondholders through the section 99 lens) and the application of the principles for determining applications for validation derived from section 99.

77. The Company has not claimed that the Petitioner is estopped from arguing, or not entitled as a matter of law to argue, for the Escrow Requirement. As I understand it, the Company submits that the Court should have regard when exercising its discretion on the Dividend Validation Application to the Petitioner's failure to make its position known and clear before the passing of the Dividend Resolution. The Company argues that this was unfair and prejudicial since, had it known about the Petitioner's objections and concerns, it could have considered and if appropriate proposed a different resolution or an amendment to the Dividend Resolution and put the objections and an amended resolution to the shareholders for a vote. It seems to me that the Company is right that the Court should take into account the Petitioner's conduct when exercising its discretion and I have some sympathy with the Company's argument that the Petitioner should, at least as a matter of best practice and good conduct, have made its position known before the AGM. However, the Company's position on the Dividend Validation Application (and in these proceedings generally) strongly suggests that even if the Petitioner had informed the Company that it objected to the Convertible Bondholders receiving their share of Dividend, the Company's attitude and approach would not have changed. It does not seem to me that the Company was misled in any material respect. It was fully aware of the Petitioner's attitude and challenge to the issue of the Convertible Bonds and the CB Shares (as manifested in the Petition and writ proceedings to date) such that the Petitioner's position on the Dividend Validation Application should not have come as a great surprise. The Company is advised by experienced and expert advisers and can be expected to have taken account of the Petitioner's likely response to the Dividend Validation Application and advice on how best to protect its position.

Decision and analysis – the choice between validating the payment of the Dividend to shareholders conditional upon the setting up and funding of an escrow account for the Convertible Bondholders and declining to validate the payment of the Dividend to any shareholders

78. In circumstances where I consider that it would be wrong to permit the Convertible Bondholders to be paid their share of the Dividend unconditionally the question arises whether I should make the conditional validation order for which the Petitioner contends or decline to make any

validation order on the Dividend Validation Application. I have concluded that, on balance, I should decline to validate the payment of the Dividend to any shareholders.

79. There are various difficulties that would flow from making a validation order (a ***Conditional Order***) that permitted the Company to pay the Dividend to all other shareholders provided that it had first opened, settled the terms of and funded an escrow account into which the Convertible Bondholders' share of the Dividend was paid.

80. First, a question would arise as to the effect of a Conditional Order on the Company's obligation to pay the Dividend. If the proper construction of the Dividend Resolution and the shareholders' vote on it is that no Dividend is payable unless the Court makes a validation order permitting the Company to pay the Dividend to all shareholders, then there would be no obligation to pay the Dividend to any shareholders after the making of a Conditional Order. If however the effect of the Dividend Resolution and the shareholders' vote on it is that the Company is under an obligation to pay the Dividend if and to the extent that the Court permits (and makes a validation order permitting) a Dividend to be paid, even if some shareholders are to be paid unconditionally while others are subject to the proposed escrow arrangements, a Conditional Order could trigger an obligation on the Company to pay the Dividend.

81. The Company argued for the former construction. It said that the Dividend Resolution created a contingent debt, the contingency being full validation of the proposed Dividend payment by the Court, so that if the Court were to grant validation subject to the imposition of the Escrow Requirement, the contingency would not be met and the Dividend would never become payable to any shareholder. The Petitioner, as I understood it, argued (in its written submissions and in oral argument) for the latter construction.

82. I am not in a position to form a final view on the construction and effect of the Dividend Resolution, Note (i) and the shareholder vote at the AGM. Nor is this application the proper forum for doing so. Other shareholders would need to be given an opportunity to appear, further evidence would probably need to be adduced and further submissions made. But for the purpose of the Dividend Validation Application, I am prepared to accept that it is strongly arguable that

if a Conditional Order was made the Company would not have a liability to pay the Dividend to any shareholders. It is strongly arguable that Note (i) was intended to ensure that the Dividend was only payable if the Court made a validation order permitting it to be paid and that what was contemplated was that the Court would only permit, or refuse to permit, the Dividend to be paid to all shareholders. Note (i) can be read as meaning that payment of the Dividend – the whole Dividend to all shareholders - would only be made if this Court permitted it ("*[Payment of] [t]he .. [D]ividend is subject to …. approval [by] the Grand Court]*"). There was no mention of the possibility of a Conditional Order because such an order was never contemplated. The Company would not be seeking such an order and no-one else had indicated that a Conditional Order should be made. Note (i) did not state in terms that implementation of the Dividend Resolution was *conditional* on a validation order but that is what it appears to have meant. The Dividend Resolution was not drafted as being subject to such a condition, no doubt because the Company considered that it had to be clear that the Dividend Resolution was to be treated as having been passed when voted on (and not at a later date when the condition of a Court order was made, which would probably be impermissible). So the analysis would be, based on this approach, that the shareholders passed a resolution, declaring a dividend, and thereby creating a debt owed to the shareholders but the resolution was only to take and be given effect if the Court made a validation order permitting the Dividend to be paid in full, so that, as the Company argued, the debt was subject to that condition and therefore contingent.

83. But I can see that there may be counterarguments and that the conclusion of any dispute as to the effect of the Dividend Resolution may depend on further evidence and legal submissions. For the purpose of the Dividend Validation Application, I take into account my provisional view of the effect of a Conditional Order, namely that it is likely that it will result in the Company having no obligation to pay the Dividend but that there is some residual uncertainty and room for dispute.

84. Secondly, the Conditional Order would require further discussions to take place in order to establish the full terms of the escrow arrangements.

85. The precise terms proposed for the escrow account have yet to be finalised. The Petitioner has proposed the Escrow Requirement but has not set out the full terms for such an arrangement. The

interest rate payable on the account has not been considered and the conditions (the ***Release Conditions***) that would need to be satisfied and therefore the time at which the funds held in escrow would be released have yet to be defined. The Petitioner has (see Ogier's letter dated 20 December 2020 to Carey Olsen and the Petitioner's skeleton argument for the Dividend Validation Application at [20]) referred to the Convertible Bondholders' share of the Dividend being "*held in escrow or on trust by the Company pending resolution of the Proceedings*." The reference to proceedings covers both the Petition and the writ, so that, assuming the reference to "*resolution*" of the proceedings means a final judgment, the Petitioner's proposal is that the Release Conditions would only be satisfied after a final judgment has been obtained in both the Petition and the writ proceedings and upon the last final judgment to be handed down. It seems to me that further consideration needs to be given to these terms before the Court can be asked to approve a form of Conditional Order. I do not see that it would be justifiable to condition the Convertible Bondholders' right to be paid their share of the Dividend by reference to the writ proceeding, which although related to the winding up by articulating the basis of a claim to set aside the issue of the CB Shares which is likely to be made by a liquidator if a winding up order is made, is separate from it. The section 99 objective of maintaining the status quo pending the making of a winding up order can be achieved by maintaining the escrow until the earlier of the final dismissal of the Petition or the expiry of a short period (say one month) after the making of the winding up order during which the liquidator would have the opportunity to consider the position and decide whether to commence proceedings to set aside the issue of the Convertible Bonds and the CB Shares and to seek further relief. Further consideration would need to be given as to whether the funds would remain in escrow if the liquidator did issue proceedings or whether the funds should be released subject to the liquidator obtaining at that state a freezing order or other relief to prevent the Convertible Bondholders having access to the Dividend.

86. Third, a Conditional Order would not be capable of being given effect by the Company without the Company giving further consideration to the impact of the HKSE Listing Rules and in particular having discussions with the HKSE to ascertain its position and whether it considers that there would, on the facts of this case, and once the escrow terms had been fully settled, be a breach of the HKSE Listing Rules if the escrow arrangements were to be agreed and put into effect (or whether the HKSE could and would be prepared to issue a waiver in this case).

87. The Company asserts that if it were to put in place the proposed escrow terms and sought to satisfy the condition set out in the Conditional Order, so that it paid the other shareholders their Dividend but only paid the Convertible Bondholders' share of the Dividend into the proposed escrow account, the Company and the directors would be in breach of the HKSE Listing Rules (or Hong Kong law) and face the real risk of serious sanctions as a result. The Company accepts that a Conditional Order would not of itself have that effect but argues that if it cannot give effect to the Escrow Requirement it would be wrong for the Court to include it, or at least there would be no point in the Court doing so.

88. As regards Ms Charlton-Stevens' evidence as to Hong Kong law, I agree with the Petitioner that it would be unfair to it for the Court to rely on Ms Charlton-Stevens' evidence and treat it as giving an accurate statement of Hong Kong law when the Petitioner has not had an opportunity to file response evidence. However, while not treating Ms Charlton-Stevens' evidence as definitive and establishing the applicable Hong Kong law, it does seem to me to make clear two relevant propositions. First, that a Conditional Order would not give rise to a breach of the HKSE Listing Rules (or Hong Kong law), on the assumption that the Conditional Order did not include a direction to the Company to establish the relevant escrow arrangements (I would not wish to make an order that was likely to give rise to such a breach). Secondly, it is not clear how the proposed escrow arrangements resulting from an order of this Court on a section 99 application would be characterised for the purpose of and treated under the HKSE Listing Rules. Ms Charlton-Stevens did not cite any similar case and it appears to me that the interpretation and application of the HKSE Listing Rules would at least need to be discussed with the HKSE before a view could be taken as to whether giving effect to a Conditional Order would breach the HKSE Listing Rules.

89. I can see, and must take into account the fact, that making a Conditional Order would have some practical benefits since it would give the Company an opportunity to have these discussions (including discussions with the Convertible Bondholders to see whether they would be prepared to agree the terms of such an arrangement in order to allow the Company to pay the Dividend) and to review further the Hong Kong law position in light of those discussions. However, these

potential benefits are outweighed by the prejudice caused by the difficulties associated with a Conditional Order.

90. Fourth, if the effect of a Conditional Resolution was to trigger the Company's obligation to pay the Dividend to all shareholders other than the Convertible Bondholders, the validity of the Dividend Resolution would be called into question and the directors might be unable to pay the Dividend to such shareholders without being in breach of duty.

91. If, in accordance with my provisional view, the proper construction of the Dividend Resolution and the shareholders' vote on it is that no Dividend is payable unless the Court makes a validation order permitting the Company to pay the Dividend to all shareholders, then, as I have noted, a Conditional Order will simply result in no Dividend being due or paid to anyone. The Company would have to decide whether to abandon the decision to pay the Dividend or whether to negotiate with and seek the agreement of the Convertible Bondholders to the proposed escrow arrangements.

92. But if my provisional view is wrong, and the proper construction of the Dividend Resolution and the shareholders' vote on it is that upon a Conditional Order being made the Company became liable (pursuant to the Dividend Resolution rather than the Conditional Order) to pay the Dividend to the other shareholders (since such a payment had been validated by the Court), there would then be a risk that the Dividend Resolution could be challenged as a breach of the Articles and the directors, if they permitted such a payment to be made, might be acting in breach of duty. A shareholder resolution that, as properly construed, declared a dividend in favour of only some shareholders or declared a dividend but only permitted payment to some shareholders would be invalid. But one only has to state these consequences to see why such a construction of the Dividend Resolution and the shareholders' vote on it is so unattractive and likely to be ultimately unsustainable.

93. There are two points of law that are relevant. First, the rule that once a dividend has been declared, a debt is owed by the Company to its shareholders. Secondly, the rule that a company cannot pass a resolution declaring a dividend that fails to apportion the dividend pro-rata between all the

shareholders of the same class or which defers the time at which the dividend is to be paid to some shareholders or qualifies a shareholder's right to payment.

94. If the effect of the Dividend Resolution and a validation order was that the Company was to be treated as having declared and become liable to pay a dividend, I do not see how a payment into escrow on the terms proposed by the Petitioner would discharge that debt owed to the Convertible Bondholders or prevent them insisting on full, immediate and unconditional payment.

95. If the Dividend Resolution was to be interpreted as approving a dividend to be paid only to the other shareholders, it would be invalid.

96. It therefore seems to me that the Company's submissions on this issue are broadly right.

97. The Company relied on Palmer's Company Law (at [9.715]) ("*Once a dividend has been declared, it is ultra vires to resolve that payment should be postponed*") and *Doherty* (cited in Palmer's Company Law).

98. In *Doherty* the company on 30 March 1998 declared an interim dividend but failed to pay two shareholders their share. It appears that the company relied in its defence to the shareholders' claim for payment *inter alia* on a subsequent resolution (probably a shareholders' resolution) that stated that the dividend payable to these two shareholders was not payable until 31 December 1999. Sheriff Kelbie unsurprisingly held that the second resolution was invalid and of no effect. He said this (at [8B]) (underlining added):

> "*It is clear from [the authorities cited to him including Aramayo Franke Mines Ltd v Public Trustee [1922] AC 406] that once a company declares a dividend a debt immediately becomes payable for which shareholders can sue. The company, as it seems to me, has no power to make any difference as to methods or times of payment as between different shareholders, unless there is a difference between the types of shares or the terms of their holding. The Company does have a power to say when the dividend becomes payable but when the dividend becomes payable all shareholders entitled to that dividend are entitled to payment*."

99. Sheriff Kelbie in *Doherty* found the decision of the House of Lords in *Aramayo Franke Mines Ltd v Public Trustee* [1922] AC 406 particularly apposite and helpful. In *Aramayo* the shares in a company were held by enemy aliens and had, pursuant to the Enemy Trading Amendment Act 1914, been vested in a custodian of enemy property appointed pursuant to the Act (the Act was designed to prevent the payment by debtors in the UK of money to any enemy subject). The company declared an interim dividend but attached to that declaration certain conditions. Those conditions referred to the method by which the dividend was to be paid. The first provided that it was to be paid on 1 February 1915 and the second and the third provided that as regards the members of the company who were resident in Germany, Austria and Turkey the dividend was to be payable only out of the assets of the company in Germany, and that as regards other members the dividends were to be payable out of the assets in the UK. The House of Lords held that the resolutions, in so far as they provided for payment of the dividend only out of the Company's assets in Germany were void as against the custodian and that the company was liable out of any assets. Lord Buckmaster said that (at 409-401) (underlining added):

> *"It is contended on behalf of the appellants that there is no right whatever in the custodian trustee to any part of either of these sums of money, because either the conditions that were attached to the resolutions for payment were good and they were at liberty to permit the enemy shareholders to satisfy the debt owing by the English company out of the foreign assets, or, if they were bad, the whole declaration of dividend was bad throughout, there consequently was never any declaration of dividend, and no debt is due from the company to the custodian trustee. I will not pause to consider what the ultimate effect might be upon the directors of the company if the latter branch of this argument found favour in your Lordships' minds, because I think it is founded upon a mistaken view of these resolutions. <u>In truth, the company did in plain terms declare a dividend, and it was that, and that only, that was within the competence either of the directors or of the company. The conditions which were attached, except the one as to the date of payment, are conditions which there was no power whatever to make effective, but, although they have purported to make these conditions of the declaration of dividend, their addition has not affected the fact that the dividend was declared. It has merely attempted to impose upon the method by which the liability thereby created was to be discharged conditions on which it is impossible for the company to rely. It is therefore my clear opinion that all these dividends were actually declared, and it results that from their declaration at their various respective dates there were debts that arose from the company to the various shareholders, including those who may be referred to as the enemy shareholders.</u>*

100. *Aramayo* dealt with conditions attached to a resolution which sought to modify the rights of the shareholders resident in Germany, Austria and Turkey by limiting the assets of the company out of which they were entitled to be paid.

101. It seems to me that *Doherty* and *Aramayo* do support the propositions that (a) in fixing (in the relevant shareholders' resolution) the date of (and other terms relating to) payment of a dividend the company cannot differentiate between and treat differently shareholders in the same class and (b) a company cannot attach conditions to a resolution declaring a dividend that would qualify and limit the right of shareholders to be paid the dividend.

102. The prohibition on unequal or discriminatory treatment is confirmed by the Company's Articles, in particular Article 24.14, which imposes a requirement of *pro rata* apportionment and payment of dividends. It states as follows (underlining added):

> *"Unless and to the extent that the rights attached to any shares or the terms of issue thereof otherwise provide, all dividends shall … be apportioned and paid pro rata according to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid."*

103. It follows that in this case the Dividend Resolution could not authorise the Company to pay the Convertible Bondholders their share of the Dividend at a different time from other shareholders of the same class or impose a condition that if not satisfied would result in the Convertible Bondholders not being paid (while other shareholders were paid).

104. As I have said, it seems to me that the Dividend Resolution cannot be understood as having done either of these things. But the Company would be unable, if a Conditional Order was made, to propose a further resolution which did so (to give effect to such an order).

105. The Petitioner argued that the Company could put in place the proposed escrow arrangements for the Convertible Bondholders and pay other shareholders unconditionally and in full without breaching the Articles. The Petitioner submitted that the proposed escrow arrangements would adequately protect the Convertible Bondholders and thereby avoid unequal or discriminatory treatment. The Petitioner relied on the cases in which the Court has held that there is no unfair

discrimination where the consideration payable or to be distributed under a scheme of arrangement or pursuant to a takeover offer to shareholders who under applicable law may not at that time receive payment or securities is paid or transferred to a trustee under a holding trust. The Petitioner referred to my judgment in *Re E-House (China) Enterprise Holdings Limited* (Unreported, 17 November 2022) in which I sanctioned a shareholders' scheme of arrangement of a listed company which provided for the payment of amounts owing to shareholders affected by Russian sanctions into a holding trust. However, these cases are distinguishable. The rights of shareholders (or creditors) to the scheme or takeover consideration under such a holding trust is *as against the relevant company* unconditional. The holding trustee holds that consideration for their benefit subject only to the relevant prohibition being lifted or the scheme or takeover consideration being converted into a form which can be paid or delivered to the shareholder (or creditor). Their right to receive the scheme or takeover consideration is unaffected; it is only the enjoyment of those rights that are temporarily suspended and which is generally considered to be fair and justifiable in the circumstances (see the judgment of Mr Justice Marcus Smith in *Re Haya Holco 2 plc* [2022] EWHC 1079 (Ch) at [72(3)], cited at [67(a)] in *Re E-House*). But, in the present case, the proposed escrow arrangements would not give the Convertible Bondholders the unconditional right (as against the Company) to the funds paid into escrow (their share of the Dividend). Their right to the funds would only be conditional. Not only would the payment into escrow not discharge the Company's debt to the Convertible Bondholders, it would involve unlawful discriminatory treatment. I do not see how the challenge to the rights of the Convertible Bondholders and a likely future claim to avoid the issue of the CB Shares can, as a matter of corporate law, currently affect the Convertible Bondholders' rights to a declared dividend or equal treatment under the Articles.

106. Of course, if proceedings were commenced by or on behalf of the Company against the Convertible Bondholders seeking an order setting aside and rescinding the allotment of the CB Shares, then an order could, in appropriate circumstances, be sought in those proceedings which prevented the Convertible Bondholders demanding payment of the Dividend or, after the Dividend had been paid, from disposing of the funds so paid pending the outcome of proceedings. The restriction or limitation on the Convertible Bondholders' right to be paid the Dividend would then derive from the Court's order and not a shareholder resolution or the actions of the Company.

I appreciate that the Petitioner has invited the Court to decide the Dividend Validation Application having regard to the likelihood that a liquidator will following the making of a winding up order commence such proceedings, and I have accepted that I should do so, but it does not follow that it can be assumed for the purpose of the Dividend Validation Application that the Company's corporate law obligations and the Convertible Bondholders' rights as current shareholders are subject to the relief that could be granted in such proceedings.

107. In these circumstances, on balance, it seems to me that the preferable and more appropriate course is to decline to make any validation order on the Dividend Validation Application.

108. Such an approach will prejudice the other shareholders because they will be kept out of the Dividend to which they are clearly entitled. Refusing to allow the Company to pay a dividend to shareholders whose rights are unchallenged is not a step taken lightly by the Court. But it seems to me to be a necessary (but regrettable) consequence of the need to prevent the Company taking a step which would interfere with the status quo and frustrate the purpose of section 99 pending the disposal of the Petition. I accept that as a general rule solvent companies subject to a contributory's winding up petition on the just and equitable ground should be permitted to pay a dividend in the ordinary course if doing so will not adversely impact on a future winding up and that the Court should be slow to prevent this. But for the reasons I have already given the circumstances in the present case justify the Court refusing to validate dividend payments to some of the shareholders with the consequence that dividend payments cannot be made to any of the shareholders (without the agreement of those shareholders who will not be paid). The refusal to permit the payment of the Dividend to the Convertible Bondholders will benefit the other shareholders if there is a winding up order and the issue of the CB shares is set aside, since they would then become entitled to a greater share of the Dividend. Their interests are, at least in the medium term, being protected. It will be a matter for the Company to explore whether arrangements can be made with the Convertible Bondholders that would allow the Dividend to be paid to the other shareholders.

109. I also note the concerns of (often expressed as complaints by) the Company as to the time it has taken to advance the Petition (and writ) proceedings. But, as the Petitioner says, the Company is

at least as responsible as the Petitioner is for this. This case has taken a very considerable time to progress because of the large number of interlocutory applications and appeals both in relation to the Petition and the writ. However, as a general matter, I do not criticise the parties for that. They must bring such applications and appeals as they consider to be justified and necessary to protect their position.

The Company's evidence regarding the effect of the payment of the Dividend on the ability of a liquidator to challenge the issue of the Convertible Bonds and the CB Shares

110. I would add that there is another reason which supports the conclusion that a refusal to validate the payment of any Dividend is the proper result. This relates to the Company's evidence regarding the effect of the payment of the Dividend on the ability of a liquidator to challenge the issue of the Convertible Bonds and the CB Shares. This reason was not advanced by the Petitioner in opposition to the Dividend Validation Application – because the Petitioner wishes to receive its share of the Dividend – or by the Company in opposition to the Petitioner's position, so that I give it no weight. But it does seem to be worthy of note.

111. The Company's evidence was that the payment of the Dividend to all shareholders will adversely affect the ability of a liquidator to unwind the issue of the Convertible Bonds and the CB Shares. Ms Wu accepted that the payment of the Dividend to all shareholders, which would result in a significant reduction of the Company's reserves, would do so. At [40(c)] of Wu 6 she said that (underlining added):

> *"... <u>such a significant reduction in the Company's reserves to pay the dividend would make it more difficult for the Company to repay the bondholders and unwind the issuance of the First Bond Issue, Second Bond Issue, or the Share Conversion in the event it was ever ordered to do so (as previously sought by the Petitioner)</u>. If such an order is sought against the Company in the future, the Company reserves its right to rely on the Petitioner's actions, and on the payment of the dividend, as a material fact to resist that application."*

112. This evidence raises in my mind the question of whether the Dividend really is a normal dividend paid in ordinary course and unaffected by the dispute with the Petitioner. It is unclear to me why the Company would wish to diminish its reserves to such a significant extent and how this could

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be justified. However, the evidence did not address this issue, nor did the parties, so that I do not rely on the concern or draw any adverse inferences regarding the Company's purpose in proposing the Dividend in reaching my decision. But I do note that the order I propose to make will avoid what appears to be a result inconsistent with the preservation of the status quo pending the disposal of the Petition.

The Variation Application

The Company's submissions

113. The Company noted that both parties accepted that it was necessary to show good grounds in order to justify a variation of the Validation Order, being an order made by consent. This required a significant change of circumstances or the possession of evidence which the applicant could not reasonably have had on the earlier occasion (see *Chanel Ltd v FW Woolworth & Co. Ltd* [1981] 1 WLR 485 (***Chanel***) and *John Richardson Computers Ltd v Flanders and Anor* [1992] Ch D 391 (***Richardson***)).

114. The Company argued that there had been significant changes in relevant circumstances since the Mangatal Judgment and therefore good grounds for amending the spending cap and reporting obligation in the Validation Order and that, when the position was considered afresh now, there was no (or an insufficient) justification for retaining the spending cap and the reporting obligations.

115. The Company submitted that there had been two material changes in circumstances since the Mangatal Judgment that justified the Court reviewing afresh the justification for the spending cap and reporting obligation. First, and most significantly, the Company had obtained unqualified audit reports from its auditors for each of the financial years ended 2020 and 2021 and the Petitioner no longer asserted that the Company's solvency and financial standing were in doubt. The Petition had been amended on 17 March 2021 to remove such allegations. Secondly, the nature of the Petition proceedings had fundamentally changed since the parties first agreed to the Validation Order in 2018, more than four years ago. At that time, the Company was the sole

respondent. The Petitioner had since then joined ACC and CNBM as respondents to the Petition which had moreover been characterised as an *inter partes* proceeding between the Petitioner on the one hand, and ACC/CNBM on the other. Accordingly, the Company was now no more than a nominal party in a dispute between shareholders.

116. The Company submitted that Mangatal J's finding that there were serious questions as to the financial situation of the Company was central to her reasoning when deciding to dismiss the 2019 Variation Application as it related to the spending cap and reporting obligation. These serious questions were said to have arisen because the Company's auditors had only been able to provide a qualified audit opinion for the financial year ended 31 December 2018 (Mangatal Judgment at [76]). Notwithstanding that the Company was solvent, the auditors had commented that they held "*significant doubts regarding the group's ability to continue as a going concern*". The Petitioner had also relied on these alleged financial irregularities to justify its claim that the reporting obligation and the spending cap were warranted (Mangatal Judgment at [76] and [79]). In these circumstances, Mangatal J was persuaded to "*take the view that there would be merit in maintaining the Spending Cap*" given the auditors' analysis and comment (Mangatal Judgment at [119]), and that there were insufficiently significant circumstances or good grounds to support the removal of the reporting obligation, that had been agreed to between the parties, when regard was had to all of the circumstances and in particular the reason for agreeing to the condition, i.e. to assuage the concerns of the Petitioner (Mangatal Judgment at [116]).

117. The Company noted that, as explained in Wu 6 at [29], the qualified opinion arose from historical financial irregularities which occurred prior to December 2017 (at a time when the Petitioner was in control of the Company's board) which led to the auditors being unable to verify the opening balance (i.e. as at 1 January 2018) and necessitated a qualification for financial statements in respect of the year ended 31 December 2018 and, in turn, for the year ended 31 December 2019 (as the prior year was reproduced for comparison).

118. However, as Ms Wu had confirmed in her evidence (in Wu 6), the issues relating to the Company's financial position no longer subsisted. The Company's independent auditors had provided an unqualified opinion in respect of the consolidated financial statements for each of

the years ended 31 December 2020 and 31 December 2021 and no longer held "*significant doubts regarding the group's ability to continue as a going concern*." As a result, a central factor in the decision not to remove the spending cap and reporting obligation had now been satisfactorily resolved.

119. The Company argued that looking at the matter afresh in light of the present position, there was no basis for the imposition of either the spending cap or the reporting obligation.

120. As regards the spending cap, the longstanding practice in the case of a contributory's petition in respect of a solvent company was to validate payments and dispositions made in the ordinary course of a company's business, without any cap being imposed. This was described by Hoffmann J (as he then was) as "*the common formula*" in *Schwarcz* at 425d–e). The Petitioner had not shown why the Court should depart from this practice other than to say that the Company originally agreed to the spending cap at the time of the Validation Order. However, as noted above, there has been a material change of circumstance since then, and the original reasons for agreeing to the spending cap (i.e. the Petitioner's concerns regarding supposed financial irregularities) had fallen away. The Petitioner had complained that the Company had not provided evidence that the existing cap was insufficient or onerous but it was for the Petitioner to show, where the Company was clearly solvent, why the spending cap was required or justified. A bare assertion was not enough. The Company is a holding company with expenses which are largely administrative in nature. The Petitioner's claim that the removal of the spending cap would allow unlimited spending which could prejudice the Petitioner and other shareholders was also without foundation and purely speculative. Any spending was subject to the directors' duties including their duty to act in the best interests of the Company. As confirmed in the Company's evidence, the Company's board had no reason to, and will not, engage in wasteful unlimited spending. In addition, as a listed entity, the Company is subject to various restrictions including but not limited to the need for seeking shareholder approvals for, *inter alia*, major transactions.

121. As regards the reporting obligation, there was also no justification for its continuation. Nothing in section 99 contemplated imposing such an obligation on any company, let alone a solvent company that was the subject of a contributory's petition. Moreover, the reporting obligation was

inconsistent with the rationale behind section 99. The jurisdiction to refuse to validate a disposition (or to refuse a validation absent conditions such as the reporting obligation) was designed to protect creditors and interested parties, including contributories, in the event of an insolvent liquidation. No such protection was required where, as in the present case, the company will be able to pay all its debts in full in any winding up (as Hoffmann J had said in *Schwarcz* at 426a–c).

122. The Company also argued that it was important to take into account the fact that the Validation Order had only been intended as an interim measure to permit numerous pressing or overdue payments to be made from the Company's Hong Kong bank accounts which at the time had been frozen as a result of the presentation of the Petition. As Ms Wu's evidence demonstrated (see Wu 6 at [11]-13] and [14]-[18]), in order to secure this interim validation, the Company had consented to the spending cap and the reporting obligation proposed by the Petitioner but had expressly reserved its right to apply to the Court to vary or remove these restrictions in the future once the initial urgency had subsided pursuant to the liberty to apply provision contained in the Validation Order.

The Petitioner's submissions

123. The Petitioner argued that the significant change of circumstances test required the Court to consider the circumstances in and the evident purpose for which the Validation Order had been made. The apparent clean bill of health now provided by the Company's auditors would have been irrelevant to the Validation Order because (a) there was no evidence that the Company's financial irregularities had anything to do with the Company and the Petitioner's agreement to the spending cap and reporting obligation and were not known to the Petitioner at the time of the negotiations over the Validation Order in September-October 2018, and (b) concerns about the Company's financial position were not referred to in any of the relevant correspondence leading up to the finalisation of the Validation Order. As Mangatal J had recognised (see [106] and [107] of the Mangatal Judgment in which the letter dated 13 September 2018 from Herbert Smith Freehills, the Company's solicitors, was quoted, which letter referred to *Re Emagist* [2012] 5

HKLRD 703 at [7]), the concerns which the Petitioner had at the time of the negotiations were related to the Company's entry into the transactions related to the Convertible Bonds which had been concluded after presentation of the Petition. The Company's agreement to the spending cap and the reporting obligation had been a sensible safeguard that was intended to provide the Petitioner with confidence that the Company would refrain in future from entering into collusive transactions with the Convertible Bondholders.

124. Furthermore, the Company's financial irregularities had not been the basis for Mangatal J's decision. Although the Petitioner accepted that it had relied on the Company's financial irregularities at the hearing before Mangatal J, this was no more than an additional factor which the learned Judge had borne in mind in reaching her conclusions. In her reasoning explaining her decision to retain the spending cap, she said (underlining added) that Company's financial irregularities did "*persuade me to take the view that there would be merit in maintaining the Spending Cap, separate from the fact that good grounds for removing it have not been demonstrated*." Mangatal J had found that the Company's financial irregularities were an additional but alternative factor which supported retention of the spending cap. Her ultimate decision to maintain the spending cap was wholly related to the Company's failure to show good grounds as per the tests in *Chanel* and *John Richardson*.

125. Mangatal J had also recorded the Petitioner's argument that the Company's financial irregularities supported retention of the reporting obligation but the Company's financial irregularities did not appear to have been part of her reasoning justifying its retention.

126. The Petitioner argued that in any event the Company had failed to show good grounds to remove the spending cap and the reporting obligation. Many of the Company's complaints had been before Mangatal J at the hearing of the 2019 Validation Application and there had been no relevant change in circumstances since then. The spending cap and the reporting obligation remained justifiable and needed to remain in place to protect the Petitioner and all other contributories. The Company's conduct before and during the Petition proceeding gave the Petitioner no confidence that the Company will act in the interests of all shareholders.

127. In addition, the Company had failed to file any evidence of prejudice that would flow from continuing the reporting obligation and the spending cap. The parties had agreed to impose the spending cap and the reporting obligation as minor safeguards to allow the Petitioner to monitor the conduct of the Company. There was no evidence that either obligation has caused prejudice to the Company's day-to-day business operations or would do so in the future and as such, there was no reason to vary or justification for varying the existing regime. The spending cap was designed to and did allow the Company to operate normally. It only ensured that the Company was unable without Court approval to consummate very large transactions with the Convertible Bondholders after the Petition had been presented. In view of the history of the dispute and the Company's track record, this was unobjectionable.

128. The Company was also wrong to say that the Court's order dated 5 August 2021 regarding the proper characterisation of and the proper parties to the proceeding and the extent to which the Company may participate in the Petition constituted a relevant and significant change in circumstances. It did not affect the continued need for and justification of the Validation Order. Even in a case where the petition was treated as an *inter partes* proceeding between members, when it was unclear (as here) that the management was independent and trustworthy, section 99 was still needed to confine validation in a way that maintained the status quo and ensured that management did not stymie the winding up through improper expenditure or unjustifiable transactions. In the present case, the supposedly independent board had approved the disputed transactions and implemented them even after presentation of the Petition. The Petitioner did not accept that the Board was independent or trustworthy.

129. The Petitioner rejected the Company's allegations (made in Ms Wu's evidence) that the Petition proceeding had taken a much longer time and had been delayed by the Petitioner's mistakes and conduct (such that the understanding or assumption made at the time of the Validation Order regarding the likely duration of the spending cap and reporting obligations had now been shown to be wrong or in need of revision and this was at least one reason for concluding that there had been a significant change of circumstances). The Petitioner said that this was a disingenuous argument in circumstances where it was clear that the Petition proceeding had been delayed principally due to the conduct of the Company.

Discussion and decision

130. In my view the Variation Application should be dismissed. The Company has not established that there has been a significant change of circumstances such that, having regard to the reasons why they were agreed and included in the Validation Order, the reporting obligations and spending cap can no longer be justified.

131. It seems to me that the following points can be taken from the Mangatal Judgment:

(a). the Validation Order was to be treated as recording an agreement between the Company and the Petitioner ([114]).

(b). in making the 2019 Validation Application the Company "*was exercising a right reserved under the contract represented by the [Validation Order] where liberty to apply was agreed*" ([114]) (following *Chanel* and *Richardson*).

(c). to justify a variation the Company (also following *Chanel* and *Richardson*) would need to show good grounds ([114] and [116]). There would be good grounds if there had been some significant change of circumstances or the party [had] become aware of facts which he could not reasonably have known or found out in time for the first encounter ([116]).

(d). regard should be had to all the circumstances affecting the making of the Validation Order "*including the apparent reasons for [the Company] agreeing to*" the reporting obligation (and the spending cap) ([116]).

(e). it was also relevant to consider the rationale for the reporting obligations and the spending cap and whether they had any utility in the relevant circumstances ([103].

(f). as regards the reporting obligations:

(i). the Company had submitted that the reporting obligations were inconsistent with the rationale behind section 99, gave the Petitioner an unfair advantage, would obstruct the Company's conduct of its business in the ordinary course and would result in the Company being required to disclose to the market the information given to the Petitioner pursuant to the reporting obligations ([15], [22], [23]-[32]). The Company also said that the Petitioner had argued that the reporting obligation should be retained because the Company's auditors had qualified their audit opinion for the financial year ended 31 December 2018 (in view of its status as a creditor as well as a contributory), but that section 99 was not intended to afford a petitioner oversight of the company's finances before the hearing of the Petition and the qualified opinion had represented a significant improvement from previous years ([17]-[21]).

(ii). Mangatal J recorded the Petitioner as having argued that (A) the serious questions concerning the Company's financial situation (due to ongoing financial irregularities) had warranted the reporting obligations in the first place ([76]) and had still not been resolved to the satisfaction of the auditors and (B) that the Company's grounds for removing the reporting obligations, in particular the failure to appreciate that while reporting obligations were common in Hong Kong they were not in Cayman, were insufficient where the Company had agreed to them, had not shown that the reporting obligations restricted its ability to operate and where as a Hong Kong listed company, following Hong Kong practice was appropriate and would be consistent with the expectation of the company's shareholders ([75]-[78]).

(iii). Mangatal J concluded that there had not been a significant change of circumstances justifying removal of the reporting obligations.

(iv). Mangatal J noted that one apparent reason why the Company had agreed to include such obligations in the Validation Order was that it had accepted that it needed to do so in order to alleviate the Petitioner's concerns and ensure that the Petitioner adopted a less adversarial approach ([106]). The reporting obligations had been agreed in the context of the Petitioner's failed application for the appointment of

provisional liquidators in this jurisdiction ([32]). The existence of the petition filed in Hong Kong and the Petitioner's impending application for the appointment of provisional liquidators in Hong Kong "*loomed large in relation to the agreement to include the Reporting Obligations and the Spending Cap*." ([104])

(v). the subsequent discontinuance of the Hong Kong petition was not a significant change of circumstances particularly when it was appreciated that the reporting obligation had been agreed to by the Company in order to accommodate the Petitioner and to avoid, at the time of the Validation Order, the Petitioner seeking further or more onerous orders and relief (116]).

(vi). the Company and the Petitioner appear to have thought that reporting obligations were generally imposed on solvent companies subject to a winding up petition in Hong Kong ([104]) but the fact that the Company had "*miscalculated the practical effects of the Validation Order" was insufficient justification for the removal of the reporting obligations*" ([117]).

(g). as regards the spending cap:

(i). the Company had argued that the spending cap was an arbitrary limit on the validation of its payments and dispositions in the ordinary course of its business and its removal would not prejudice shareholders ([33]); that a spending cap was not ordinarily included in validation orders for solvent companies ([34]) and its continuation would cause injury to the Company because as the ultimate holding company in the group it had to raise capital on short notice and was inhibited from doing so by the spending cap and because its flexibility to operate its business was damaged ([35]-[36]).

(ii). the Petitioner argued that in view of the concerns and irregularities regarding the conduct of the Company's affairs it would not be rational to allow unlimited spending ([79]). The Company had accepted that the spending cap was a reasonable

safeguard for shareholders and there was no justification for removing it ([81]) although an increase in the cap may well be justified if the Company justified by evidence a revised cap, which it had failed to do.

(iii). good grounds for removing the spending cap had not been demonstrated ([119]).

(iv). separately, the opinion of the auditors (that they held significant doubts as to the group's ability to continue as a going concern) established that there was a justification for (merit in) maintaining the spending cap ([119])

132. It seems to me that I should follow Mangatal J's test for deciding whether to grant an application made pursuant to the liberty to apply paragraph in the Validation Order. It also seems to me that the learned Judge's characterisation of the Validation Order and her approach, following *Chanel* and *Richardson* was right. The Company needs to show a significant change of circumstances such that the reporting obligations and spending cap can no longer be justified (in the absence of new facts existing at the time of the Validation Order of which the Company was not and could not reasonably have been aware at the time). I do not consider that the Company has done so. While there has been a change in circumstances, resulting from the issuing of the unqualified financial statements in the recent periods and there being no repetition of the financial irregularities and problems in previous periods which had caused the auditors to qualify their audit opinions, they are not in my view sufficient to justify the removal of the reporting obligations or the spending cap.

133. As can be seen from my summary above, it appears that Mangatal J regarded it as of particular importance that the reporting obligations and spending cap had been agreed as part of an arrangement to accommodate the Petitioner by giving it certain protections and thereby to avoid it pressing for and taking further action to remove or restrict the management powers of the Company's directors (including pressing for the appointment of a provisional liquidator in Hong Kong or by proceeding with its appeal of the dismissal of its application for the appointment of a provisional liquidator in this jurisdiction). The reporting obligations and spending cap were a *quid pro quo* for the Petitioner adopting a less adversarial (or hostile) approach.

134. It seems to me that this factor does need to be given particular weight on the Company's further Variation Application. An accommodation and deal was done with the Petitioner and the Petitioner gave up certain further options for relief to restrict management's powers to make payments or dispositions and by agreeing to the Validation Order adopted a different and less adversarial approach. It seems to me that it would be wrong to deprive the Petitioner of those negotiated protections save where, by reason of changed circumstances, the Company would suffer substantial prejudice by their retention. There is no (or insufficient) evidence of such prejudice.

135. Mangatal J's judgment makes it clear that the transactions with the Convertible Bondholders were under discussion between the Company and the Petitioner at the time as is shown by the letter dated 13 September 2018 from Herbert Smith Freehills quoted at [107] of the Mangatal Judgment. It seems reasonable to infer that this (and the risk of further such transactions and payments) was one of the reasons why the Petitioner was pressing for restrictions on the Company's powers to make payments and dispositions. The fact that the parties had in mind the impact of the issue of and the challenge to the Convertible Bonds, and the need to preserve the position by restricting payments and dispositions by the Company pending the hearing of the Petition, is demonstrated by [4] of the Validation Order. This stated that the validation of payments and dispositions below the cap (as set out in [1]-[3] of the Validation Order) did not apply to payments out of proceeds received on the issue of the Convertible Bonds and the payment of fees, expenses, commissions and other payments arising out of or in relation to the subscription for and issue of the Convertible Bonds in September 2018.

136. It appears that the Petitioner did also rely on the financial irregularities evidenced by the qualified audit opinions as justifying the retention of the reporting obligations and the spending cap. This particular justification no longer arises. But even though the problems which resulted in those qualified audit opinions being issued have now been resolved, that does not in my view mean that the basis for including the reporting obligations and the spending cap has disappeared or been substantially undermined where these terms were also needed to persuade the Petitioner not to press for and to give up the chance of obtaining other relief that would achieve similar protections.

137. I accept that had this issue arisen without there having been a previous consent order which incorporated the agreement I have described pursuant to which the Petitioner irretrievably gave up avenues of further recourse and the chance to apply for further relief in order to obtain the protections which are provided by the reporting obligations and spending cap (which cannot now be resuscitated if the reporting obligations and spending cap are now removed), I would have been inclined to take a different view of the Variation Application. I can see the strength of the argument (which is expressed clearly by Mr Justice Harris in Hong Kong in *Re Emagist*) that in the ordinary case of a clearly solvent company, the company should not be required to obtain the consent of the petitioning contributory for payments and dispositions in the ordinary course of business.

Mr Justice Segal
Judge of the Grand Court, Cayman Islands
31 March 2023

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