IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO. FSD 9 OF 2018 (IKJ)

IN THE MATTER OF THE COMPANIES LAW (2016 REVISION) (AS AMENDED)

AND

IN THE MATTER OF LEYOU, INC.

IN CHAMBERS

Appearances:

Mr Stephen Atherton QC and Mr Jan Golaszewski of Carey Olsen for CDB-CITIC ("**the Applicant**")

Mr James Eldridge and Mr Malachi Sweetman of Maples and Calder on behalf of Leyou, Inc ("**the Company**")

Mr Chris Keefe of Walkers on behalf of Carlyle Asia Growth Partners IV, L.P. and CAGP IV Co-Investment L.P. ("**the Petitioners**")

Before: The Hon. Justice Kawaley

Heard: 29 May 2018

Date of Decision: 30 May 2018

Draft Reasons circulated : 23 July 2018

Reasons delivered: 25 July 2018

HEADNOTE

Winding-up petition-original petitioners compromising debt as part of merger-substitution application-standing of applicant as member despite making redemption request and being

offered payment in full-construction of Articles- effect of late payment-whether redeemer entitled to rescind redemption request

REASONS FOR DISMISSING SUBSTITUTION APPLICATION AND RULING ON STANDING

Introductory

1. The Petition was first heard on February 28, 2018 and adjourned to May 29, 2018 to enable the Applicant, the sole redeemer not to have compromised its claim, to pursue a substitution application. That application was made by Summons dated May 15, 2018, which was listed for hearing on May 29, 2018. On May 30, 2018, in a Summary Ruling, I refused the substitution application. I now give reasons for that decision which incorporate my determination of the Applicant's standing.

2. The Applicant contends that it is either a preference shareholder or a redemption creditor. Although it served a redemption request which the Company belatedly honoured paying in full the amount the Applicant now accepts is due, the Applicant asserts that it lawfully withdrew its redemption request before it was honoured and that the monies tendered on behalf of the Company by its subsidiary could not lawfully have been paid by the Company. The Applicant declined to accept the payment and returned the monies wired to it. Its draft Petition essentially complained about the Company's conduct in responding to its redemption request, in particular in refusing to acknowledge it was still a shareholder and depriving it of its rights to dissent to the Merger.

Reasons for refusing substitution application

Factual background

3. The critical facts were not disputed and can be stated briefly. The original Petition was presented by a redemption creditor with a $60 million claim on the grounds of insolvency. Total redemption claims amounted to some $150 million. The Company's response to its financial conundrum was to enter into a Merger Agreement dated April 23, 2018, which is expected to return the Company to solvency. All preference shareholders save for the Applicant elected to receive less than 100% of their redemption claims.

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4. The Applicant's redemption debt of approximately US$1.34 million fell due for payment on February 28, 2018. Having reached a negotiated settlement with all other redeeming shareholders save for the Applicant, on April 16, 2018, the Applicant purported to withdraw its redemption request. The following day, the Company's Board resolved to tender the full amount of the Applicant's redemption debt which sum was wired to the Applicant on April 18, 2018. The Applicant returned the monies and instead applied to be substituted for the Petitioner.

5. The draft Amended Petition primarily relies on the standing of the Applicant as a shareholder and the just and equitable ground for winding-up (Companies Law, section 92(e)). The central underpinnings of the loss of confidence and want of probity of which the Applicant complained of as justifying a winding-up were described as follows:

- the Company had not validly redeemed the Applicant's shares and wrongly sought to amend the register of members;
- the Company had excluded the Applicant from discussions about the Proposed Merger;
- the Company had improperly paid the Applicant redemption monies while the Petition was before the Court without seeking a Validation Order;
- the Company had improperly deprived the Applicant of its rights to dissent from the Proposed Merger.

6. In the alternative to a winding-up order, the Applicant sought rectification of the register and a declaration that it was entitled to exercise its rights as a dissenting shareholder in respect of the Proposed Merger. To the extent that the Applicant was not a shareholder, a winding-up order was sought as an unpaid redemption creditor.

Substitution governing principles

7. I was satisfied that the Applicant, assuming it was still a shareholder, could seek to be substituted as petitioner for the Petitioner even though the Petition was presented as a

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creditor's Petition. It was common ground that the Companies Winding Up Rules (rule 3) are silent on this point. However, the Applicant relied on, most significantly, two decisions and one statutory power. Firstly, reliance was placed on this Court's decision in *Hannoun-v-R Limited* [2009] CILR 124 where Henderson J stated (at paragraph 7):

> "*…If, for some reason, the petitioner can no longer maintain the action, the court is at liberty to substitute the name of another creditor or contributory as petitioner. These considerations serve to illustrate the distinct nature of winding-up proceedings which, although brought in the name of the petitioner, are really being advanced in the interests of the creditors or contributories as a whole.*"

8. This *dictum* supported the Applicant's jurisdictional right to seek to be substituted while at the same time demonstrating why its application lacked substantive merit. Far from seeking to advance the interests of "*contributories as a whole*", the Applicant appeared to be seeking to be substituted to achieve a windfall for itself through blocking the Merger which all other unpaid redeeming shareholders were hoping would succeed.

9. Secondly, Mr Atherton QC for the Applicant relied on Segal J's more recent decision in *Re Natural Dairy (NZ) Holdings Limited* [2017 (1) CILR Note 3]:

> "*(3) The Grand Court had an inherent power to order the substitution of a contributory in the case of a contributory's petition. It would not be inconsistent with the scheme or requirements of the Companies Winding Up Rules 2008. While the Rules did not make provision for such substitution, there was no basis for concluding that the omission was the result of a decision to preclude substitution. The power to substitute a new petitioner was within the scope of the court's inherent power to regulate its own procedures and was a necessary and useful power, in appropriate circumstances, to facilitate efficient and cost-effective management of proceedings.*"

10. I fully endorse both of these two decisions. However, I also accept the Applicant's further submission that the jurisdiction to substitute a contributory in the absence of

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authority expressly conferred by the Rules has a very clear statutory foundation. Section 95(1) of the Companies Law provides that on the hearing of a petition, the Court may:

> *"(a) dismiss the petition;*
>
> *(b) adjourn the hearing conditionally or unconditionally;*
>
> *(c) make a provisional order; or*
>
> *(d) any other order that it thinks fit*..." [emphasis added]

11. Mr Eldridge most importantly attacked the merits of the substitution application, rightly contending that it made no sense to permit the Applicant to present a Petition which was (a) liable to be struck out, and (b) inconsistent with the interests of the majority of shareholders. In the Company's Written Submissions it was argued:

> "*6.4...The Merger agreement is intended to preserve and maximise value, for the benefit of all the Company's shareholders, including all the redeeming Preference Shareholders (each of whom has signed-up to the Merger Agreement). The Merger agreement cannot complete while these proceedings remain on-foot. CDB-CITIC ought not to be permitted to potentially derail the Merger, contrary to the wishes and best interests of the Company's real stakeholders, in order to advance a plainly meritless case.*"

12. I ultimately accepted this irresistible submission.

Did the Draft Petition disclose an arguable case for winding-up on the just and equitable ground and/or on the grounds of insolvency?

13. The Draft Petition did not in my judgment disclose an arguable case for winding-up on the just and equitable ground (on the assumption that the Applicant was still a shareholder) nor on the grounds of insolvency (on the assumption that the Applicant was an unpaid redemption creditor). It was alleged that the Company had acted improperly by seeking belatedly to comply with the Applicant's redemption request

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without seeking a validation order. In circumstances where all other shareholders had been willing to accept less than 100% of their redemption claims, this was an obviously hopeless plea in terms of supporting an arguable case for a just and equitable winding-up. There was no need for a validation order as the original Petitioner had already compromised its claim when the Board approved the redemption request. Accordingly, there was no prospect of a winding-up order. It was plain and obvious that it was reasonable that the Company, having compromised the vast majority of the redemption claims, chose to pursue the Merger Agreement with a view to:

(a) meeting the redemption claims (as compromised); and

(b) enabling the Company to emerge from cash-flow insolvency.

14. I considered the hypothesis that the Applicant was right and the Company had (for technical legal reasons) lost the right to redeem and was therefore wrongly depriving the Applicant of its continuing status as a shareholder entitled to dissent to the Merger. Such a technical legal error, on points of construction upon which this Court was required to reserve judgment, could never constitute grounds for a just and equitable winding-up. The appropriate remedies for this legal complaint lay without, rather than within, the winding-up jurisdiction of this Court. The alternative remedies contemplated by section 95(3) of the Companies Law presuppose that a *prima facie* case for winding-up has been made out. It is not possible to save a just and equitable petition which does not disclose an arguable case for winding-up from being struck-out by reference to:

(a) a prayer for alternative relief; and

(b) legal complaints which could potentially be advanced independently of winding-up proceedings.

15. It was plain and obvious that the alternative prayers for rectification of the register and recognition of its rights to dissent to the merger could and should be pursued through the statutory proceedings designed for that purpose, namely:

(a) Companies Law, section 46 ("*REMEDY FOR IMPROPER ENTRY OR OMISSION OF ENTRY FROM REGISTER*");

(b) Companies Law, section 238 ("*RIGHTS OF DISSENTERS*").

16. The Company rightly submitted that it was an abuse of process to pursue winding-up proceedings where more suitable alternative remedies exist: *Camulous-v-Kathrein* [2010(1) CILR 303] (Cayman Islands Court of Appeal).

Summary: reasons for refusing substitution application

17. In summary, the substitution application was refused because the Draft Amended Petition was liable to be struck out and the application was an abuse of process because there were more suitable alternative remedies for the arguable complaints which were advanced. However, because the standing of the Applicant as a shareholder was fully argued, it was agreed that I should decide that issue in the present proceedings. I set out my decision on that issue below.

Findings on the Petitioner's standing

Overview

18. The main standing controversy at the hearing was whether or not the Applicant's shares had effectively been redeemed or whether the Applicant was still a member of Company. This was a question of construction of the Memorandum and Articles of Association ("M&AA"). The scenario appeared to me to be a bizarre one. The Company insisted that the Applicant had been effectively redeemed and was willing to pay the full redemption amount. The Applicant was unwilling to accept full payment (as calculated by the Company). The Applicant wished to recover a larger amount as a dissenting shareholder in respect of the pending merger on the basis that the fair value of the shares was greater than the contractually agreed redemption entitlement. All this against the background of all other Preference Shareholders having agreed to receive discounted redemption payments.

19. The Applicant sent back the monies wired in settlement of what was essentially agreed to be the full redemption payment due. It argued that once the time for redemption had expired, and the redeemer had signified it wished to withdraw its redemption request, it was not possible for the Company to complete the redemption process.

Submissions

20. The Applicant's submissions set out at paragraph 40 of its Skeleton Argument may be summarised as follows:

(a) The parties were free to contract redemption terms as they saw fit: *Pearson-v-Primeo Fund* [2017] UKPC 19 at [15]-[16];

(b) Article 33(e), which required the Applicant to surrender its share certificate when it sent its Notice of Redemption, was not complied with by the Applicant. As the Company did not waive compliance with this requirement, the redemption process was not validly commenced;

(c) the Company failed to comply with Article 33(e)'s requirement that the redemption proceeds be paid "*as soon as practicable following the date of redemption (but in any event within 30 days after the date of redemption)*";

(d) an unpaid member must have the implicit power to withdraw a redemption request if payment is not effected by the 30 day cut-off date;

(e) the monies tendered were not paid by the Company (but by Leyou HK) and could not lawfully be paid by the Company because it was admittedly insolvent;

(f) the monies purportedly paid were advanced post-Petition without a validation order. The M&AA did not envisage payment by means of a contingently void transaction.

21. Mr Atherton QC's typically robust oral submissions gave these arguments, which at first blush appeared unimpressive on paper, a lustre which they did not ultimately deserve. Mr Eldridge poured scorn on these submissions and contended that the construction of the M&AA the Applicant contended for was uncommercial. I agree that it is important to remember that the redemption regime is generally understood as being designed to create important rights for the benefit of redeemers. It is ordinarily of commercial import for members to be able to obtain the return of their investment when they wish and to limit the wriggle room companies have to escape from their payment obligations.

22. On the failure to return the share certificate point, the Company submitted firstly that the share certificate had no great legal significance. Although a certificate was *prima facie* evidence of the Applicant's title (Companies Law, section43), the register was *prima facie* of a party's shareholding (Companies Law, section 48). Furthermore, the Applicant should not be permitted to resile from the position it initially adopted in the Redemption Notice itself:

> "*We cannot return our shares* [sic] *certificate to the registered office of the Company or any transfer agent since we cannot locate the original. However, this shall not affect our right to redeem all our Series B Preference Shares, which are duly recorded in the Register of Members of the Company…*"

23. As to the consequences of late payment, the Company argued that the effects were clearly spelt out in the following provisions of Article 38(g):

> "*…the balance of any Preference Shares subject to redemption hereunder with respect to which the Company has become obligated to pay the redemption payment but which it has not paid in full shall not be redeemed until the Company has paid in full the redemption payment required with respect to the redemption of such Preference Shares, and prior to such payment and redemption, such shares shall continue to have all powers, designations, preferences…which such shares had prior to such date. Nothing in this*

subsection...shall be deemed to limit in any way the obligation of the Company to effect the redemption of any Preference Shares, or to make any payment required, pursuant to Article 3."

24. As Mr Eldridge persuasively argued in his oral submissions, the M&AA expressly provided that non-compliance with the time-limit prescribed for payment did not terminate the redemption process. The payment obligation was expressly preserved while the redemption creditor was compensated by being able to exercise shareholder rights until fully paid.

25. Could a member withdraw its election? Mr Eldridge submitted that it was important to remember that redemption was a collective right and that it was financially important for there to be clarity as to where a company stood in terms of the overall redemption obligation picture. Further, the implied right to withdraw a redemption request failed to meet the requirements for the implication of a term which were explained in *BP Refinery (Westernport)Pty Ltd-v-Shire of Hastings* (1977) 180 CLR 266; *Attorney-General of Belize-v-Belize Telecom* [2009] UKPC 10. In the latter case, Lord Hoffman opined as follows:

> "*26. In BP Refinery (Westernport) Pty Ltd v Shire of Hastings (1977) 180 CLR 266, 282-283 Lord Simon of Glaisdale, giving the advice of the majority of the Board, said that it was "not ... necessary to review exhaustively the authorities on the implication of a term in a contract" but that the following conditions ("which may overlap") must be satisfied:*
>
> > *"(1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract".*
>
> *27. The Board considers that this list is best regarded, not as series of independent tests which must each be surmounted, but rather as a collection of different ways in which judges have tried to express the central idea that the proposed implied term must spell out what the contract actually means, or in which they have explained why they did not think that it did so. The Board has already discussed the significance of 'necessary to give business efficacy' and 'goes without saying'. As for the other formulations, the fact that the proposed implied term would be inequitable or unreasonable, or contradict what the parties have expressly said, or is incapable of clear expression, are all good*

reasons for saying that a reasonable man would not have understood that to be what the instrument meant."

26. Reliance was secondly placed on the following legal language in the M&AA:

> "*33(a) Subject to the provisions of the Statute and these M&AA, a majority of the holders of the Series B Preference Shares may elect to redeem all (but not some) of the Series B Preference Shares...provided that the holders of Series B Preference Shares making such election shall provide the Company and the other holders of Preference Shares with written notice of such election…*"

27. Reliance was thirdly placed on the following passage in the judgment of Martin JA in *Re Weavering Macro Fixed Income Funds Limited* (unreported), Cayman Islands Court of Appeal, judgment dated November 18, 2016:

> " *29...It is essential to the operation of an investment vehicle such as the Company that permits investment through the acquisition and redemption of shares that there should be certainty on a day-to day basis as to the price at which shares are to be purchased or redeemed…*"

28. Mr Atherton QC replied that this case was dealing with a different issue. Mr Eldridge was really, in my judgment, simply relying on the quoted passage as very general support for a broader commercial proposition in aid of the construction of the M&AA which he contended for. Namely, that companies would not know where they financially stood if redemption requests once made could be withdrawn depending on the circumstances.

29. The related questions of (a) whether it was permissible for a third party to meet the Company's debt and (b) whether any payment made directly or indirectly by the Company was invalid without a validation order, effectively merge into one. Can a company which is a respondent to a petition and is admittedly insolvent, without Court approval, incur inter-company debt to pay off a 'hold-out' redemption creditor, in

circumstances where it has compromised claims with all other redemption creditors? The Company submitted that:

(a) it was normal practice for expenses of one member of a corporate group to be met by another. The tendered payment was clearly made on behalf of the Company; and

(b) a validation order was only strictly required (as regards a payment made while a petition is pending) if a winding-up order was eventually made. Mr Eldridge argued that it was a matter of judgment for the respondent to a petition to decide whether or not it felt a validation order was required.

Findings: effect of failure to return lost share certificate

30. I accept the Company's submissions on this issue. The redemption process was not invalidated by the fact that the Applicant was unable to return its share certificate with the Redemption Notice. Any contrary finding would achieve a wholly uncommercial result.

Findings: effect of late payment

31. I accept the submissions of the Company on this issue. The Company could validly tender payment more than 30 days after the Redemption Request was received. This was a target deadline, but a target which was subject to an ongoing obligation on the Company's part to pay all redeemers either in full or on such less favourable terms as might be agreed. As pointed out in the Company's Written Submissions:

> *"4.8 CDB-CITIC's case is also obviously inconsistent with commercial common sense. It would render the redemption right meaningless if all the Company had to do to avoid it was not to pay on time…"*

Findings: right to withdraw redemption request

32. For the reasons urged by the Company, I find that the M&AA do not confer an implied right to withdraw a redemption request in favour of a member which has served a valid redemption request. In my judgment, to use Lord Hoffman's words in the *Belize Telecom* case, "*a reasonable man would not have understood that to be what the instrument meant.*" The right to withdraw a redemption request is the sort of matter which reasonable parties would expect to be dealt with by carefully crafted express language rather than left to the vagaries of implication.

Findings: ability of Company to validly use third-party funding to redeem the Applicant without a validation order

33. There may well be a myriad of circumstances in which it would be inappropriate for a redemption creditor which has petitioned to wind up a company to accept a payment from a third party on behalf of the respondent without a validation order. At the heart of the matter would be the question of whether there is a discernible risk that a winding-up order will be made and the payment set aside and recovered by a liquidator. In the distinctive circumstances of the present case, the Applicant was unable to effectively undermine the Company's two crucial assertions that:

    (1) it has compromised all other redemption claims; and

    (2) it wishes to implement a merger agreement which will return it to solvency.

34. In these circumstances I am bound to reject the Applicant's submission that (the redemption amount now being agreed) the Company was not able to tender full payment of the relevant redemption claim without first obtaining a validation order.

Summary on standing

35. It follows that, the Company validly discharged the Applicant's redemption claim in full with the result that the Applicant ceased to have standing to pursue the present petition as member of the Company (and, upon its redemption proceeds being returned to it, would also cease to be a creditor). It follows that the Applicant will also be unable to pursue dissenting member rights under section 238 of the Companies Law.

36. I shall hear counsel as to costs at the adjourned hearing of the Petition, which has now been re-listed for the afternoon of July 26, 2018.

HON. JUSTICE IAN RC KAWALEY
JUDGE OF THE GRAND COURT