IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS
ON APPEAL FROM THE GRAND COURT OF THE CAYMAN ISLANDS FINANCIAL SERVICES DIVISION

CICA (Civil) Appeal No 31 of 2019
(Formerly FSD 161 of 2018 (IMJ))

BETWEEN:

TIANRUI (INTERNATIONAL) HOLDING COMPANY LIMITED

Appellant

AND

CHINA SHANSHUI CEMENT GROUP LIMITED

Respondents

BEFORE:

THE RT. HON. SIR BERNARD RIX
THE RT. HON SIR RICHARD FIELD
THE RT. HON SIR ALAN MOSES

Appearances:	**Mr. Tom Lowe QC instructed by Ms. Gemma Lardner of Ogier for the Appellant** **Mr. Vernon Flynn QC instructed by Mr. James Eldridge and Mr. Adrian Davey of Maples for the Respondent.**
Heard:	**11 November 2019**
Draft Judgment circulated:	**4 February 2020**
Judgment delivered:	**18 February 2020**

JUDGMENT

Moses JA

Background

1. This is an appeal against a Validation Order made by the Honourable Justice Mangatal dated 12 September 2019 in which she ordered, *inter alia*, that any transfers of the shares

in China Shanshui Cement Group Limited (the Company/Respondent) to HKSCC Nominees Limited (HKSCC) should not be avoided by the provisions of Section 99 of the Companies Law (2018 Revision) in the event of an order being made on a Petition by Tianrui International Holding Company Limited (Tianrui) for the winding up of the Company.

2. The Company is a holding company whose subsidiary is amongst the largest of the cement producers in the People's Republic of China. Its major shareholders, Tianrui, Asia Cement Corporation (ACC) and China National Building Material Holding Company (CNBM) have been involved in what Tianrui describes as a bitter take-over battle for the Company. Tianrui alleges in its Petition, brought on the just and equitable ground, that ACC has been acting improperly in concert with CNBM to dilute Tianrui's shareholding and squeeze it out of the Company.

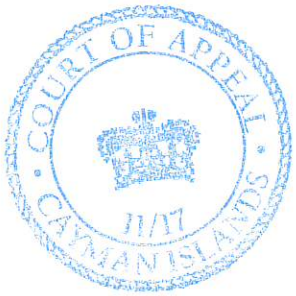
3. The Petition has already been fully analysed and explained in the decision, ("the CICA Decision") of this court (CICA (Civil) 26 of 2018 (the Hon John Martin, The Hon Sir George Newman, the Rt. Hon Sir Alan Moses JA, (16 January 2019, reasons given 5 April 2019)) in which it overturned a decision of the Grand Court to strike out the Petition.

4. The relevant part of the Validation Order concerns share issues which the Appellant Tianrui seeks to impugn as part of the conspiracy to dilute Tianrui's own shareholding.

5. It is alleged that this dilution was achieved by an improper exercise by the directors of their powers to issue securities, through successive issues of bonds in August and September 2018 to bond holders with whom ACC and CNBM were associated or connected. The convertible bonds were subsequently converted into shares. This is described more fully in the CICA Decision:

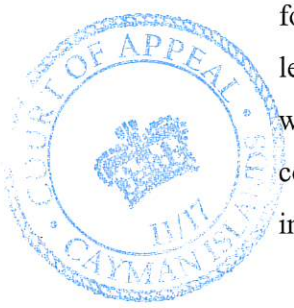
> In August and September 2018, …when CNBM and ACC were in control of the board, the Company made two issues of convertible bonds. The first issue, made on 8 August 2018, was in consideration of a payment of US $210,900,000 at an interest rate of 20%; and on conversion the bondholders would receive shares in the Company, resulting in the dilution of the shareholdings of all the then current shareholders. In Tianrui's case, the effect of conversion would be that its percentage of shares would drop from 28.16% to 26.13%. The second issue of convertible bonds was made on 3

> September 2018, in consideration of payments totalling US $320,700,000, again at an interest rate of 20%; and the effect of conversion into shares in the Company would be that the percentage of shares held by Tianrui would fall from 26.13% to 23.56%.
>
> On 7 October 2018, after presentation of the petition on 4 September 2018, the Company announced that it had agreed with some of the bondholders to vary the terms so that conversion would occur immediately at a lower price in return for more shares. The effect of conversion into shares would be that Tianrui's shareholding would fall to 21.40%.
>
> On 30 October 2018 an EGM of the Company was held at which the shareholders voted by a majority to authorise the issue of new shares to the bondholders on conversion. … The shares were issued on the same day. The issue of the shares allowed the Company to represent to the Hong Kong stock exchange that there were enough public investors to satisfy the listing requirements, with the result that the suspension of the Company's listing (on 16 April 2015, after the public float fell below the required 25%) (my parenthesis) was revoked and trading in its shares resumed on 31 October 2018.



6. These successive steps taken, as Tianrui asserts, to dilute its shareholding were the latest stage in an alleged conspiracy to cause it damage (CICA Decision [33]). Both by means of its Petition, and by a separate action to reverse the convertible bond and share issues, Tianrui is seeking to unwind the allegedly improper steps taken to achieve this dilution of its shareholding. The shares into which the bonds were converted were the subject-matter of the Validation Order. Tianrui contends that the application for the Validation Order was part of the means by which ACC and CNBM, through the Company, sought to safeguard the impugned share issues and baulk any future restoration of the status quo, should the Petition be successful.

7. The Company sought validation of a proposed transfer of shares in the Company, held by eighteen shareholders known as the Definitive shareholders (defined by the Company as those who held their shares by direct entry on the register of members). It was proposed that the shares should be transferred to the Hong Kong Securities Clearing Company Nominees Limited (HKSCC) to facilitate the trading of those shares through the Central Clearing and Settlement System (CCASS). CCASS is an electronic book-entry clearing and settlement system for the public stock market in Hong Kong. In order to trade using CCASS, shareholders must transfer their legal title to HKSCC, acting as common nominee



for shares held in CCASS, prior to depositing their shares into CCASS. The transfer of legal title would involve the Company issuing the necessary share certificates for deposit with CCASS, delivering the certificates to CCASS on behalf of the shareholders and confirming that henceforth legal title in the shares was held by HKSCC rather than the individual shareholders to whom the share certificates had been issued.

8. CCASS had indicated that, before it would accept the deposit of shares, it required that the Cayman Court should validate the transfer of legal title to HKSCC (see the exchange of emails referred to by Mangatal J in her Judgment [47]). The eighteen Definitive shareholders had informed the Company that they wished to have their physical shares, representing 43.96% of the Company's issued share capital, deposited into CCASS.

9. A validation order made in respect of the transfer of legal title in the shares to HKSCC and their subsequent deposit into CCASS would have the effect that those transactions could not be unwound under Section 99, in the event of the Petition being successful.

10. The judge accepted the Company's case for validation: that it was a response to CCASS's request and that it wished to reduce the illiquidity of its shares. She was sedulous in her application of what she concluded, at the invitation of the Company, to be the applicable test to be found in *Burton v Deakin Ltd.* [1977] 1 WLR 390: the postulated reasons were those which an intelligent and honest director could reasonably hold in good faith and had a clear commercial basis.

11. Further, she accepted the Company's argument that the transfer of legal title in the shares did "not run afoul of the rationale of Section 99". That rationale was said by the Company to be to prevent the shareholders of partly paid shares to evade liability by transferring their shares to men of straw after the commencement of the winding up. The Company's entire share capital was fully paid up.

12. This appeal is focussed on Tianrui's contention that the judge misunderstood the purpose of section 99 and failed to identify the correct approach to validation under that section. Had she considered the application in a manner consistent with the purpose of section 99 she would have appreciated that the consequences of validation of the proposed

transactions was, by virtue of sections 45 and 54 of the Hong Kong Securities and Futures Ordinance, to make it impossible to unwind those transactions should the Petition be successful.

Section 99

13. Section 99 of the Companies Law (2018 Revision), which, for relevant purposes, replicates section 127 of the UK Insolvency Act 1986, provides:

> When a winding up order has been made, any disposition of the company's property and any transfer of shares or alteration in the status of the company's members made after the commencement of the winding up is, unless the Court otherwise orders, void.

14. It is fundamental to this appeal to identify the purpose of this section. Its purpose is to preserve the status quo; it has what Palmer describes as a "conservational" function (Vol 4 15.526 Palmer's Company Law). The retrospective effect of section 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 Section 100(2) Companies Law (2018 Revision) which provides that the winding up "shall be deemed to commence at the time of the presentation of the petition for the winding-up").

15. Accordingly, once a petition has been presented, during the "twilight period" between presentation of the petition and its resolution, any transaction such as the proposed transfer of shares to HKSCC or alteration in the status of the company's members will be avoided, if the winding up order is made, unless the court, exercises its discretionary power under Section 99 to validate the transaction. The avoidance effect of Section 99 enables the liquidator to unwind any transactions which may have taken place during this twilight period and return the assets and circumstances of the company and its contributors to those which were in place at the time the winding up commenced.

16. However, during this twilight period, it is important that the deleterious effect of the very fact of the presentation of the petition, possibly long before its merits are determined, may be ameliorated by the process of validation. Validation may prevent the risk of paralysis,

once a petition is presented. All companies are vulnerable to the damaging effect the presentation of a petition may have; the ability to validate transactions during the period between presentation and the hearing of the petition enables companies to continue to operate in the ordinary course of their business prior to the hearing. As the editors of Palmer put it:

> A company is not by law required to cease trading merely because a winding-up petition is presented against it. Pending the determination of the petition it is permissible for the company to continue to trade, provided that it does so in a bona fide and regular manner and with necessary regard to the implications for all interested parties (including the potential liability of the directors) if a winding up order is made by the court when the petition is heard. (op.cit 15.527).

17. The purpose and importance of validation may most clearly be seen in relation to trading companies. They are not prevented from continuing to trade once a winding up petition is presented; a validation order provides commercial certainty for those trading with the company, and for the company, that their transactions will not be avoided.

18. The rationale for validation of transactions by a trading company in the ordinary course of business was explained by Lord Cairns in *re Wiltshire Iron Co.(*1868) 3 Ch. App 443 at 446 in relation to a predecessor of Section 127, Section 153 of the Companies Act 1862:

> The 153rd section no doubt provides that all dispositions of the property and effects of the company made between the commencement of the winding up (that is the presentation of the petition) and the order for winding up, shall, unless the court otherwise orders, be void. This is a wholesome and necessary provision, to prevent, during the period which must elapse before a petition can be heard, the improper alienation and dissipation of the property of a company in extremis. But where a company actually trading, which it is the interest of everyone to preserve, and ultimately to sell, as a going concern, is made the object of a winding-up petition, which may fail or may succeed, if it were to be supposed that transactions in the ordinary course of its current trade, bona fide entered into and completed, would be avoided, and would not, in the discretion given to the court, be maintained, the result would be that the presentation of a petition, groundless or well-founded, would, ipso facto, paralyse the trade of the company, and great injury, without any counter-balance of advantage, would be done to those interested in the assets of the company.

See also Romer J in *Re Park Ward* [1926] Ch 828.

19. Thus validation itself may be seen as preserving the status quo by permitting a company to conduct its business in a manner which enables it to survive notwithstanding the depressing effects which flow from the presentation of a petition. It enables the company to keep "ticking over".

20. It ought hardly to need emphasis that the power of the court to make a validation order must not be exercised in a way which undermines the essential purpose of section 99, namely to preserve the status quo pending resolution of the petition. Any assessment of an application for a validation order must always have, at the forefront of consideration, the need not to impede, undermine or preclude fulfilment of that purpose.

21. The judge was led by the Company to take a far more limited view of the purpose of section 99. It had submitted that the purpose of section 99 was to prevent shareholders from evading liability by transferring their shares to a man of straw after winding up has commenced. The judge appeared to accept that submission. The Company has persisted in that submission in this appeal. The judge said:

> I also accept the Company's submission that the transfer of legal title from a shareholder to HKSCC is as nominee and does not run afoul of the rationale of section 99, since the shares of the Definitive Shareholders are fully paid-up. [Judgment 129]

22. Undoubtedly, there is authority that section 99 did have that purpose in relation to calls on a shareholder in respect of partly paid up shares (see e.g. *Rudge v Bowman* (1868) LR 3 QB 689). But the days of partly paid up shares are long gone. The purpose of Section 99 cannot be so confined. The statutory analogue in the United Kingdom has been re-enacted many times, (in 1908, 1929, 1984 and 1985), into a period long after the days of partly paid up shares. Moreover, the section has application to all kinds of compulsory winding up whether on the grounds of insolvency or on just and equitable grounds, and, accordingly, whether the company is solvent or not.

23. The judge was led into a fundamental error in relation to the purpose of section 99. The transfer of legal title from a shareholder to HKSCC fell squarely within section 99; a Court ought only to have made a Validation Order in respect of such a transaction, in circumstances which assisted in preserving the status quo and which did not frustrate the

purpose of section 99. The question then arises as to the principles the judge ought to have applied, consistent with that purpose.

The principles applicable to a validation order

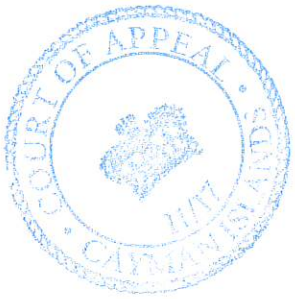
24. The principles which apply were disputed by the parties to the instant appeal. The judge based her decision on what Slade J himself called "broad guidelines" in *In Re Burton & Deakin Ltd.* [1977] 1 WLR 390. In that case, the company was trading in the business of buying and selling new and second hand cars. Faced with the reluctance of its finance company to continue to finance the supply of new cars, the company sought an alternative source of borrowing and to obtain a validation order to protect itself from the operation of section 227 in respect of a proposed deed of assignment in favour of the new finance company and the discharge of the remaining indebtedness to the former finance company. It asserted that the payments were to be made in the ordinary course of business [393A-394D]. To this proposal objection was made on the basis that it was a radical change in the company's course of business which would have a deleterious effect [395E]. The precise reasons for this challenge need not detain us, but it led to an argument relating to the burden of proof in circumstances where Slade J thought the evidence was such that he could not decide the case "firmly" either way [395H].

25. Slade J accepted that where a company was insolvent, in order to protect the creditors, careful scrutiny of the proposed disposition was needed [396 G-H], following the approach of Buckley J *In re A. I. Levy (Holdings) Ltd.* [1964] Ch.19, 24. But he drew a significant distinction between an insolvent and a solvent company. Where the company was solvent, he said there was no onus on the directors to justify the proposed transactions; on the contrary, the onus was on those who opposed validation: a court would normally sanction the disposition unless "compelling evidence" was adduced by the contributory who opposed the proposal. Mangatal J relied on the following passage:

> As Mr. Stubbs pointed out, the responsibility of managing the business of the company is entrusted in its articles of association to its directors. At least so long as a winding up petition has not been presented, the court will not generally, save in the case of proven bad faith or other exceptional circumstances, interfere with the exercise of the discretion conferred on the directors by a company's articles of association at the instance of a shareholder. Thus, if before the presentation of a petition a shareholder were to come to the court in an attempt to restrain a particular disposition of the

company's property contemplated by the board of directors and falling within their powers, he would not generally succeed, unless he could prove bad faith or other exceptional circumstances. He would not be able, merely by adducing prima facie grounds for criticizing the wisdom or beneficial nature of a particular transaction, to place upon the company or its board of directors the onus of justifying the proposed disposition by detailed evidence.

I can see no good reason why the rights of interference by a shareholder vis-à-vis the company or its directors should, in this kind of situation, for practical purposes be drastically improved during the interim period, merely because he happens to have presented a winding up petition which is not demurrable and which has not yet been heard. The interim period may be quite a long one. In the present case, from what I have been told, it looks like between three and six months. In a case such as the present, the court, at the time when the application under section 227 comes before it generally has not sufficient evidential material to enable it properly to form even a prima facie view as to whether the petition itself is ultimately likely to succeed or fail. It must therefore necessarily assume that the petition is at least as likely to fail as it is to succeed. Indeed, in the case of many contributories' petitions-of which this is one - the primary relief sought by the petitioners is an order under section 210 that other persons be ordered to purchase their shares at a stated price, a winding up order being sought only as a second alternative - so that, if the primary relief were granted, the petitioner would in any event have had no interest in the intended dispositions at all.



Taking all these considerations into account and in the absence of any authority demonstrating the contrary, I thus reach these conclusions on the question of principle raised by the present application. If on an application under section 227 relating to a solvent company, (a) evidence is placed before the court showing that the directors consider that a particular disposition, falling within their powers under the company's constitution, is necessary or expedient in the interests of the company, and (b) the reasons given for this opinion are reasons which the court considers that an intelligent and honest man could reasonably hold, it will in the exercise of its discretion normally sanction the disposition, notwithstanding the opposition of a contributory, unless the contributory adduces compelling evidence proving that the disposition is in fact likely to injure the company. *A fortiori* in my judgment the court will be inclined to exercise its discretion in this manner in a case such as the present, where the primary relief sought by the petition is an order under section 210 that the other shareholders be ordered to purchase the shares at a stated price.

While I have attempted to formulate these statements of principle so as to explain the basis upon which I decide this particular case, I should nevertheless make it clear that they are intended merely as broad guidelines. No limits are placed by the sections on the court's discretion to grant or refuse an application under section 227, and such a discretion will of course

be exercised in every instance having regard to the particular circumstances of the case.

26. Mangatal J [Judgment 123] and [124], then invoked the decision of Henderson J, in the Grand Court in *In the Matter of Fortuna Development Corporation* [2004-5 CILR 533], which followed *In re Burton*. In that case the Company sought a validation order permitting it to engage in a major refinancing to relieve its principal of his obligations under a personal guarantee. Henderson J, at the first hearing, adopted Slade J's distinction between an insolvent and solvent company [3] and stated that the passage cited above accurately stated the law in the Cayman Islands [4]. Henderson J continued, in passages cited by Mangatal J:

> 5. Thus, there are four elements which must be established before an applicant is entitled to a validation order. First, the proposed disposition must appear to be within the powers of the directors. There is no dispute about that here. Secondly, the evidence must show that the directors believe the disposition is necessary or expedient in the interests of the company. There is no dispute here that the directors do have that belief. Thirdly, it must appear that in reaching the decision the directors have acted in good faith. The burden of establishing bad faith is on the party opposing the application. Fourthly, the reasons for the disposition must be shown to be the ones which an intelligent and honest director could reasonably hold.

After considering further evidence at a later hearing Henderson J continued:

> 16. I am not called upon here to answer the question "Is this in the best interests of the company?" or even "Is this a reasonable decision?" The question is a narrow one. Might an intelligent and honest director acting reasonably come to such a conclusion? I find for the reasons given in Ms. Tsien's affidavit that he or she might. The decision has been demonstrated to fall within the realm of reasonableness. The applicant will therefore be granted a validation order.

27. In two further passages Mangatal J emphasised the approach she adopted in reliance on those two cases:

> One of the principles that I derive from the decision in *Fortuna* is that the type of solid evidence that the Court needs to see must depend upon the nature and type of transaction in respect of which validation is sought. As *Burton and Deakin* reminds, the articles of association of a company entrust the management of the business of a company to its directors. Thus, upon a winding up petition being filed in relation to a solvent company, "it is not only normal but necessary for a company to obtain a validation order and

> that it would only be if the shareholder has specific concerns which he can support by credible evidence that he should actively contest any part of the application." - see the statement of Harris J in the Emagist HK decision referred to in paragraph 107 above. [126].....

She continued later:

> As *Burton v Deakin* reminds, in the case of a solvent company, a shareholder should not merely because he happens to have presented a winding up petition which is not demurrable and which has not yet been heard, get some greatly improved position from which to attack the decisions taken by the directors of the company which they say are taken in good faith and in the best interests of the Company. The consideration discussed in *Cybervest* does not arise here, or at least at this stage since the Court is not in a position at this stage to say and has not sufficient evidential material to enable it properly to form even a prima facie view as to whether the petition itself is ultimately likely to succeed or fail. I must therefore necessarily assume that the petition is at least as likely to fail as it is to succeed – *Burton v Deakin*. In C*ybervest*, the facts were, in my view, distinguishable – see paragraphs 32 – 34 of the judgment. In the instant case, I am not, on the state of the evidence before me, able to say that irregularities in the conduct of the Company have been "shown".[130]
>
> Also as contemplated in Burton v Deakin, the interim period may be quite a long one. Between the different interlocutory applications that are pending in the Financial Services Division and the pending application to the Privy Council for special leave, this Petition is likely to take a long time to come on for hearing".[131]

28. The judge's reference to *Re Cybervest Fund* [2006] CILR 80 was to observations made by Smellie CJ in a case where a winding up had been sought on just and equitable grounds because there was alleged to have been convoluted dealings with the assets of the fund about which the manager had failed to consult the shareholders. The Chief Justice refused to validate management fees said to be paid in the ordinary course of business [32]. After citing Henderson J in *Fortuna* at [5], he continued:

> There is another consideration to add to the list, in light of the concerns raised in this matter, although arguably it is subsumed within the third and fourth elements. This would be whether irregularities in the affairs of the company can be shown, even if the company is solvent as alleged here.[30]

29. The Chief Justice then referred to *Re a Company (No.007130 of 1998*) [1987] 3 BCC 57 in support of the proposition that even in the case of a solvent company the conduct of the company's business should not be at the expense of its members [31]. But his approach

was strongly influenced by Henderson J's fourth principle. He did not consider that "the directors could properly hold" that the opposed payment of fees was "necessary or expedient in the interests of the company at that time" and rejected the Validation Order [33]

30. *Re a Company (No.007130 of 1998)* provides, as you would expect, an important explanation of the approach adopted by Slade J in *Burton* but also sounds a significant note of caution in cases where the opposed transactions were not in the ordinary course of business. Mervyn Davies J drew attention to Buckley J's identification in *Re A. I. Levy (Holdings) Ltd* [1964] Ch 19 at 24 of the purpose of Validation Orders, founded on Lord Cairns' judgment in *In re Wiltshire*:

> (they are) designed to preserve the value of the assets of a company for the people interested in the assets notwithstanding the pendency of winding up proceedings in order that the company might not be unduly hampered in carrying out transactions which might be for the benefit of those interested in the value of its assets. [p.59]

31. Mervyn Davies J pointed out that in the case of solvent companies, when both petitioner and respondent are anxious to preserve the worth of their shares the application for a validation order is usually unopposed [59]. He cited Slade J in *Re Burton* and continued:

> As I see it, that case brings out the point that on a sec.522 application of that kind, great weight is to be attached to the wishes of the directors of the company since the mere presentation of a petition should not have the effect of allowing a shareholder to interfere with the directors' management of the company's business. But beyond that I do not see that the Burton case affords much guidance here. I say that because in Burton (i) there was no objection to an order validating transactions in the ordinary course of business; (ii) the application (as opposed) concerned specific transactions and (iii) the company was plainly solvent ….None of those three features appears in the case before me. [p.60]

32. Mervyn Davies J then commented that "s.522 consents are in all cases to be given with some caution" and concluded that continued trading would not be for the benefit of the shareholders and might well work to their detriment [p.61].

33. *Re a Company* is of importance in the instant appeal in three respects. First, in the distinction drawn between cases where it is plain that the proposed dispositions sought to

be validated are in the ordinary course of business. It was beyond question that *Burton* concerned a disposition proposed for the purposes of the ordinary course of business of that motor trader. No other justification had been advanced. That the proposal was to enable the company to continue in business during the twilight period was not disputed by the opposition.

34. The second significant feature of Mervyn Davies J's judgment lies in his reminder that the beliefs and wishes of the directors, even if advanced in good faith and without improper motives, and even if the proposal is made for the purposes of the ordinary course of business, although to be given great weight are not dispositive.

35. Third, all applications need to be approached with some caution, whether in the ordinary course of business or not and whether the company is solvent or not.

36. Slade J's guidelines in *Burton* paraphrase the test adopted, in the alternative, by Pennycuick J in *Charterbridge Corpn Ltd v Lloyds Bank* [1970] 1 Ch 63 in which it was alleged that a legal charge had been created for purposes outside the scope of the Company's business, and was *ultra vires*. The state of mind of the directors was, so Pennycuick J held, irrelevant on the issue of *ultra vires* [74B]. But he took an alternative approach in case he was wrong in his view of the law:

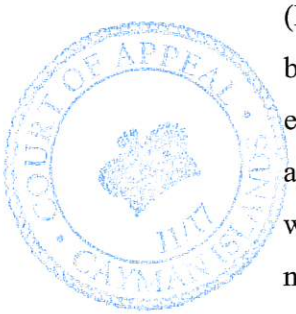
> The proper test, I think, in the absence of actual separate consideration, must be whether an intelligent and honest man in the position of a director of the company concerned could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company. [74F]

37. That Pennycuick J was not wrong as to the irrelevance of the directors' state of mind, where a transaction is said to be *ultra vires,* is confirmed by Lord Wilberforce in *Howard Smith Ltd v Ampol Petroleum* [1974] 1 AC 821 (PC). A shareholder company challenged the issue of shares to a rival in a takeover battle on the basis that the issue was to reduce the proportion of its shareholding. The directors contended they were acting in good faith for the purposes of raising capital in the target company. The Board decided that it was unconstitutional for directors to use their fiduciary powers over the shares in a company purely for the purpose of destroying an existing majority, or creating a new majority which did not exist [837 G]. Lord Wilberforce continued:

> That this is the position in law was in effect recognised by the majority directors themselves when they attempted to justify the issue as made primarily in order to obtain much needed capital for the company. And once this primary purpose was rejected, as it was by Street J, there is nothing legitimate left as a basis for their action, except honest behaviour. That is, in itself, not enough [838 B].

38. Both *Charterbridge* and *Howard Smith* in admittedly different contexts, although the latter may subsequently be relevant to issues in the Petition, provide an important reminder that there will be cases where the honest belief of the directors is irrelevant to the propriety of a transaction. In an application for a Validation Order, where the purpose of the proposed transaction is impugned, the motive of the directors is far from determinative. If the proposed transaction undermines the purposes of section 99 and of the power to make Validation Orders, then the directors' belief or good faith may be irrelevant.

39. Before analysing the principles which may be drawn from these authorities, I should mention one further Cayman Island authority to which attention was drawn: *In the matter of Torchlight Fund LP* [2018] (1) CILR 290. In that case a validation order was sought in respect of payments in the ordinary course of the business of a partnership. This Court (Martin, Newman and Morrison JJA) adopted *Burton, Fortuna* and *Cyberfest* [16]-[22], but there was no dispute as to the test [16] either in this court or below and the judge's exercise of his discretion to make the order was not challenged on the basis that he had applied the incorrect legal test [68]. The opposition was not on the basis that the payments were outside the ordinary course of business but that they were inadequately explained or not legally due [70].



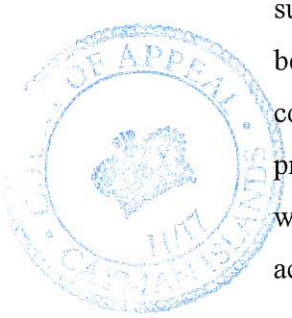
Principles to be drawn from the Authorities

40. The starting point for the identification of the principles a court should apply in considering whether to exercise its power to make a validation order must be the legal source of that power, section 99. Two features are fundamental. First, that the power to make such an order is contained within that section itself. It is, therefore, part and parcel of the means by which the purpose of the section is to be achieved. That purpose is, as I have already identified, the maintenance of the status quo between presentation and resolution of the winding up petition, so as to render effective the section's retrospective avoidance function. Second, the section applies to all companies, the subject of a compulsory winding up,

whether the company is solvent or not, whether it is a trading company or undertakes some other business, and whether the winding up is on the grounds of insolvency or on just and equitable grounds.

41. It follows, in my view, that as a matter of principle, a court, in every case, must satisfy itself that any order it makes does not undermine or frustrate the maintenance of the status quo pending resolution of the petition, and that, on the contrary the order should be made in furtherance of that objective. This principle should not alter according to the particular circumstance of the case. Of course, its application will vary from case to case.

42. I stress what might be called this underlying principle because there was considerable debate as to whether the approach identified in cases such as *Burton* and *Fortuna* was, as submitted by the Appellant, to be confined to cases where the proposals were advanced as being to maintain the ordinary course of the company's business. The Respondent contended they were not to be so limited. I suggest it is better to regard the underlying principle as applicable to all cases. But, the court's assessment as to whether the proposal will advance or undermine the purpose for which the power is conferred will vary according to whether it is sought in relation to the ordinary course of business or not.



43. Thus in cases, such as *Burton*, *Fortuna* and *Torchlight* where there can have been no doubt that the proposals were to further the ordinary course of business, the court might need little persuasion that they assisted in maintaining the business pending resolution of the winding up, provided the interests of those concerned with the assets of the company were considered. Such proposals were consistent with section 99. But that is not to recognise a distinction in principle between solvent and insolvent companies. It is, rather, that the application of the underlying principle I have sought to identify will vary according to the relevant circumstances of the company and the nature of its proposed transactions, as Slade J himself seems to have acknowledged.

44. It is dangerous to assume that a court may be relieved of the responsibility of careful scrutiny and caution merely because the company is solvent. It may be disputed whether what is proposed is in the ordinary course of business or is in the best interests of the company during the period between presentation and resolution of the petition. It may be contended that the directors themselves are making the proposals out of dishonest or

improper motives or that the proposals themselves will run the risk of undermining or frustrating the purpose of the section. In such cases, a court can make no assumptions as to the propriety of the proposals and will need to be satisfied that they are consistent with the purposes of the section and for the benefit of the company and those interested in the value of its assets.

45. The real danger I detect in the approach in *Burton* and *Fortuna* is that it focusses on the burden of proof and creates a presumption in favour of the belief of the directors as to the propriety of their proposals. Cases will rarely turn on the burden of proof; there is no presumption. 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 section 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. In such a case the views of the directors as to whether the proposals are for the benefit of the company will plainly be relevant even though not dispositive.

46. For these reasons I adopt the submission of Mr Lowe QC 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.

47. 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 section 99 and of the power to make such orders.

The judge's approach

48. Paragraphs [127]-[129] are the foundation of the judge's conclusion:

> In my judgment, it is quite important that it is the SEHK that has sought for the Company to make this application. This is one of the reasons that the

Company advanced for making this application, along with requests from the Definitive Shareholders regarding the deposit of their physical shares in CCASS. The Company just as recently as 31 October 2018 was able to have trading in its shares resumed on the SEHK, which both the Company and Tianrui consider a positive development. The Company also advanced that the illiquidity of the Company's shares has had a significant adverse effect on the Company. This is because the illiquidity affects the Company's share price adversely. In addition, it maintains that the illiquidity will make it difficult for the Company to raise significant capital from the equity markets in the future. [127]

In my judgment there is an abundance of evidence and reasons (paragraph 127 above) that the Company has provided, which, viewed objectively, indicate that the Directors consider that it is necessary and expedient to seek the validation order. In my judgment the reasons are reasons which an intelligent and honest director could reasonably hold in good faith and obviously have a clear commercial basis. It is rational as well as reasonable that the Company would wish to bring down the illiquidity of its shares, and the Company being a holding Company, would have good reasons in wanting to reduce difficulties, such as illiquidity, lying in the way of its raising required capital in the equity markets in the future. In my view, it is not possible or necessary for the Court at this stage to delve deeper into what are complicated questions as to precisely what are the causes of this illiquidity; the fact of the matter is that the directors have approached the Court to validate a type of transaction which in my view clears the bar and ought to be validated. [128]

The evidence of Tianrui including Mr. Birkett is as to the facility with which changes in beneficial ownership of the shares can be effected and the anonymity of the new shareholders and "the cloak which CCASS Validation would give to future collusive dealings in the shares". However, it is common ground by the experts on both sides that CCASS is a computerized system, which handles the process of matching buyers and sellers, and the Definitive Shareholders cannot choose who their shares are sold to. It is also common ground that section 99 does not affect the ability of shareholders to deal with the beneficial interest in their shares. The shareholders could therefore deal with the beneficial interest off market. As a matter of law, shareholders who have not deposited their shares in CCASS may still sell the beneficial interest in their shares off market. I also accept the Company's submission that the transfer of legal title from a shareholder to HKSCC is as nominee and does not run afoul of the rationale of section 99, since the shares of the Definitive Shareholders are fully paid-up. The burden is on Tianrui to demonstrate and unless it adduces "compelling evidence proving that the disposition is in fact likely to injure the company" (Burton v Deakin), the Court will be inclined to exercise its discretion provided the evidence from the Company fulfils the requirements (the bar not being a high one). Tianrui has not discharged the burden. Its allegations about being unable to trace beneficial ownership relate to its alleged claim, which of course at this point, remains a matter of assertions. In my judgment, Tianrui has not provided any compelling evidence that the

transfers to allow for trading on CCASS is detrimental to the Company as a whole. [129]

49. In reliance on *Burton* and *Fortuna*, the judge was led to regard herself as free from any requirement to subject the application to close scrutiny, whilst imposing the burden on the Appellant to adduce compelling evidence. This approach dictated her view of the evidence and arguments advanced by the Appellants and led to her adopting, rather than questioning, the case advanced by the Respondent. In addition, by virtue of her incorrect identification of the purpose of section 99, she never even considered whether the proposal to deposit shares with the HKSCC would impede or undermine the purposes of the section.

Tianrui's challenge to Validation: the effect of Section 45 of the Hong Kong Securities and Futures Ordinance

50. As I have previously indicated, the Respondent's case for validation was that the share transfers to HKSCC, as nominees, for depositing into CCASS was to remedy the illiquidity of its shares. The eighteen Definitive shareholders had informed the Company that they wished to do so to counter the adverse effects of illiquidity (see the Company's argument recorded at [48] to [57] of the Judgment and [127] and [128] cited above). The argument as to the ill effects on illiquidity was based on the evidence of an expert, Philippe Espinasse. He described the average daily trading volume in proportion to the Company's market capitalisation as unreasonably illiquid; this had an adverse effect on share price and made it difficult for the Company to raise significant capital.

51. The application was supported by an affirmation from Wu Ling-Ling (Ms Wu) (the 4th affirmation). She asserts that the Definitive Shareholders are at a disadvantage to those who have deposited their shares prior to the presentation of the petition because they cannot trade through the Exchange [93], and are left with dealing in the beneficial interests in their shares off-market [95]. She records that the Company announced on the Hong Kong Exchange that they were applying for a validation order to sanction the deposit of share certificates into CCASS and invited applications from shareholders [102]. In the six days following, the eighteen Definitive Shareholders informed the Company they wished to do so, and, for that purpose to transfer the legal title to HKSCC Nominees Ltd. Their shares

represent 1,870,323,160 shares being 42.69% of the Company's share capital [104]. She identifies those shareholders and their holdings in Schedule 1.

52. As is apparent from the passages in the judgment I have cited above, the judge thought it was reasonable for the Company to wish to reduce the illiquidity of its shares should they wish to raise capital in the future [128]. She took the view that it was neither possible nor necessary to delve deeper into the causes of illiquidity. In short, she accepted the evidence of Ms Wu without any critical analysis, in the absence of compelling evidence from Tianrui.

53. By adopting that approach, it seems to me that the judge wrongly overlooked one of the essential features of Tianrui's opposition. The opposition was based on two distinct arguments. One of the arguments was that validation would enable the CNBM and ACC and their related parties to play a "shell game" with beneficial ownership of their shares and cloak future collusive dealings, an argument recorded at [94]. The judge answered that argument by concluding that under the CCASS system the Definitive shareholders could not choose to whom the shares were sold and, in any event, they could deal with the beneficial interest in their shares off market [129]. Tianrui contends that investigation of the true beneficial ownership of the shares will be impeded, but that is not material to the nub of this appeal. For the purposes of this appeal, it is unnecessary to consider this aspect of the dispute. The argument relating to the shell game was by no means the only argument.

54. This appeal is concerned with the distinct argument relating to section 99. As the judge herself had earlier recorded, Tianrui contended that the transfer of shares to the CCASS system would cause "serious and irreversible consequences" and would prejudice the outcome of the petition because it would be impossible to unwind the "improper and dilutive share issue if the Petition is upheld" [85] to [86]. This argument had been based, as the judge recorded, on the evidence of an expert, Mr Birkett, adduced on behalf of Tianrui and set out in the judgment [93]. Section 45 of the Securities and Futures Ordinance provides:

> 45. Proceedings of recognized clearing house take precedence over law of insolvency:

(1) None of the following shall be regarded as to any extent invalid at law on the ground of inconsistency with the law relating to distribution of the assets of a person on insolvency, bankruptcy or winding up, or on the appointment of a receiver over any assets of a person-

(a) a market contract;

(b) the rules of a recognized clearing house relating to the settlement of a market contract;

(c) Any proceedings or other action taken under the rules of a recognized clearing house relating to the settlement of a market contract;

(d) A market change;

(e) the provision of market capital;

(f) the default rules of a recognized clearing house, or

(g) any default proceedings.

(2) The powers of a relevant office-holder in his capacity as such, and the powers of a court acting under the law of insolvency, shall not be exercised in such a way as to prevent or interfere with-

(a) the settlement in accordance with the rules of a recognized clearing house of a market contract; or

(b) any default proceedings.

(3) Subsection (2) shall not operate to prevent a relevant office-holder from recovering an amount under section 51 after the completion of a matter referred to in paragraph (a) or (b) of that subsection.

55. Mr Birkett took the view that this section, through the operation of section 54 of the SFO, removed the proposed transactions from the scope of section 99 of the Cayman Companies

Law and would place the proposed deposits into CCASS outside the power of a liquidator. Mr Birkett was of the opinion that the effect of section 45 was to override the Hong Kong law of winding up and insolvency in relation to certain transactions on a recognised clearing house such as HKSCC and by virtue of Section 54 of the Ordinance this applied to non-Hong Kong winding up and insolvency statutes (see his evidence recorded at Judgment [93]). He concluded:

> 51. "There are strong statutory finality protections in place for settlement of trades in CCASS. This structure has been established to provide certainty and reduce risk for market participants, and is based on the fungibility of an issuer's securities of the same class, and the interposition of a central counterparty in the clearing mechanics. Together, these elements do appear to be effective in preventing a Participant or issuer, or a liquidator or either of them, from reopening or reversing a sale or purchase of the issuer's shares through CCASS once it has been settled."

56. On the basis of this evidence Tianrui contended that the CCASS share deposits would be irreversible; the transactions would be beyond the reach of the liquidators, in the event of a winding-up (arguments recorded in the Judgment at [88] and [89]).

57. The Company disputes that interpretation of the Hong Kong Ordinance but produced no expert evidence to the contrary. Although the judge, in her "Discussion and Analysis", referred to the "shell game" argument and to Mr Birkett's evidence in relation to changes in beneficial ownership, she made no reference to this second argument at all. The Respondent contended that it was a new argument. But it is plain from both written and oral arguments before the judge and the argument recorded by the judge that that is not so. It was a crucial argument in relation to the compatibility of the Respondent's application for validation with the purposes of section 99. The consequence of her mistaken view of the purposes of section 99, was that this vital argument received no consideration by the judge.

58. Further, led as she was to the view that the bar which the Respondent had to clear "was not a high one" [128] and [129], and that it was for Tianrui to provide compelling evidence, she neither questioned nor scrutinised the Respondent's case for validation.

59. Yet that case required careful analysis as to the reason why the Respondent was seeking to deposit the Definitive Shareholders shares into CCASS and, above all, consideration as to whether validating such a transaction would impede or frustrate the purpose of section 99, as Tianrui contended.

Examination of the Company's proposal

60. Since the judge was deflected from the necessity to scrutinise the Company's proposal, this court should undertake that task. The judge did not have the good fortune of The Hon John Martin JA's appraisal of the Petition and the nature of case advanced by Tianrui, to which I have referred above.

61. The deposit of shares to CCASS was alleged, by the Appellants, 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".

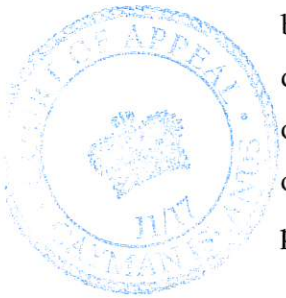
62. Faced with that opposition, the obvious question which arises is as to why the Company sought, for its benefit, to deposit the Definitive Shareholders' shares identified by Ms Wu. Ms Wu's Schedule identifies four shareholders who had been holders of the Convertible Bonds. The shares had been issued following an EGM on 30 October 2018 (CICA Decision [7]). The names of eleven others on the list speak of a relationship with ACC. No explanation has been given as to why any of those shareholders wanted to deposit their shares into CCASS. It seems unlikely they would wish to sell those shares, the acquisition of which was an integral part of the process whereby Tianrui's percentage was diminished and ACC and CNBM sought to gain control, and of the alleged conspiracy.

63. Moreover, Ms Wu is not only Director of the Company but Executive Vice President and Chief Financial Officer of ACC. She would have been in a position to explain the reason why those shareholders on her list which bore names suggesting association with ACC

were concerned with illiquidity at that time when, as I have said, it seems so unlikely that they would want to divest themselves of the shares.

64. Nor does the suggestion that illiquidity would cause problems, should the Company wish to raise capital, bear examination. There was no evidence as to why the Company which is a holding company, the parent of operating subsidiaries, wanted to raise finance. In any event raising finance would itself need validation to avoid the risk of being unwound.

65. Further, the timing of the request appears of significance. Before the suspension of listing most of the Company's shares had not been deposited on CCASS. ACC and CNBM, who became shareholders before the listing was suspended, had not, at that time, sought to deposit all their shares. They could have done so during the period after Mangatal J struck out the Petition on 19 October 2018 and before the Court of Appeal's decision was given on 16 January 2019 restoring the Petition. Their asserted concerns as to illiquidity did not prompt them to do so.



66. In the absence of any response, I am driven to the conclusion that there was no reasonable explanation other than that proffered by Tianrui, namely that the deposit was intended to have the effect described by Mr Birkett and to baulk the unwinding of those transactions should the Petition be successful.

67. The fact that prior to deposit CCASS required validation of the transfer of legal title to HKSCC, was regarded by the judge as "quite important" and a reason for making the application. On the contrary, it does not seem to me to provide any explanation for the shareholders' wish to deposit the shares. If there was a reasonable explanation for such deposits then it was true that validation was needed, but that has no bearing on examination of the logically prior question as to why the deposit was requested or needed.

68. There was a dispute between the parties as to whether the deposit was in the ordinary course of the Company's business. Whether it was or was not, did not preclude the need for acceptable answers to the obvious questions I have posed nor as to why the transactions should be validated notwithstanding the effect they would have in frustrating the avoidance provision on Section 99.

69. I should, however, record my view that, though it does not appear to have been argued to the contrary below, as the judge noted when giving leave to appeal, the transactions proposed were not made in the ordinary course of business: the Company's business is in holding interests in subsidiaries, it is not in the business of trading in its own shares.

70. 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 Section 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 section 99.

71. For those reasons, I conclude that the judge made material errors of law leading her to a failure to consider relevant evidence and to make necessary assessments of that evidence. Accordingly, her exercise of evaluative judgment cannot stand (see e.g. *Henderson v Foxworth Investments Ltd and another* [2014] 1 WLR 2600 [67]).

72. At the end of yet another stage in this bitterly fought dispute, there remains the fact that no answer has been advanced as to why the Court, in response to the application, should make an Order which runs the risk of impeding or obstructing the unwinding effect of section 99, in relation to transactions which are the subject-matter of the Petition. In those circumstances I would reverse the Order made by the Judge and refuse to make a Validation Order in respect of the proposed CCASS deposit.

Field JA

I agree.

Rix JA

I also agree.