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IN THE GRAND COURT OF THE CAYMAN ISLANDS (Civil)
HOLDEN AT GEORGE TOWN, GRAND CAYMAN

CAUSE NO. 356/04

IN THE MATTER OF FORTUNA DEVELOPMENT CORPORATION

AND

IN THE MATTER OF SECTION 94 OF THE COMPANIES LAW (2004 REVISION)

Appearances: **Mr. Andrew Jones QC with Mr. Mac Imrie of Maples & Calder for the Petitioner**
Mr. William Trower QC instructed by Mr. Nicholas Joseph of Appleby Spurling for the Company

Before: **Hon. Justice Henderson**

Heard: **August 25, 2005**

GRAND COURT CAYMAN ISLANDS

RULING

There are two applications before me. The company seeks a validation order under section 156 of the Companies Law validating the giving of certain security on a refinancing of its current debt and that of its subsidiaries. In addition, the petitioner seeks an adjournment on the ground that the present state of the evidence is insufficient.

The company is solvent. This is a contributory's petition. There is no provisional liquidator in place.

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Applications for a validation order in these precise circumstances are not common. A similar application was made to Mr. Justice Slade in *Re Burton & Deakin Limited, [1977]* 1 All E.R. 631.

At page 636, his Lordship noted that where a validation application is made following the presentation of a petition based on the alleged insolvency of the company:

> "It seems to me natural and right to conduct a careful Scrutiny of the disposition or proposed disposition in Question before granting relief under the section."

At page 637, he contrasted that with the position of an admittedly solvent company, and Used these words to describe the appropriate approach:

> "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 s 227 [the analogous English section] 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 2 210 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 on 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

> s 227 and such a discretion will of course be exercised in every instance having regard to the particular circumstances of the particular case."

That judgment was cited and agreed with by Mr. Justice Brightman in *Re JN2 Ltd. [1977]* 3 All E.R. 1104 and mentioned with approval by the Court of Appeal in *Alipour v. Ary and Another [1977]* 1 W.L.R. 534 (C.A.).

In my view the passage summarises accurately the state of the law in the Cayman Islands.

Thus, there are four elements which must be established before an applicant shall be 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. Second, 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. Third, 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. Fourth, the reasons for the disposition must be shown to be ones which an intelligent and honest director could reasonably hold.

The argument of the petitioner here addresses item four. The petitioner says the evidence is simply too sparse and conclusory to permit the court to decide this question today.

What sort of evidence should a court expect before it can say with conviction:

"this disposition is one which an intelligent and honest director acting reasonably might consider to be in the best interests of the company?" Specifically, what sort of evidence should the court expect on a validation application concerning a major refinancing?

The petitioner has provided in argument a shopping list of documents, not in evidence, Which it says are necessary. These include financial statements, cash flow projections, documents evidencing the amounts outstanding on the present facilities, and all of the loan documentation and correspondence leading up to the agreement or agreements for the proposed new facility.

The primary reasons advanced by this company in its affidavit evidence for the refinancing are as follows.

It says that the principal of the petitioner, Mr. Chen, has wanted to be relieved of his personal guaranteed obligations for some time and this will accomplish that. He has written to some of the lenders alleging acts of default under the security instrument. The Lenders have become understandably nervous. That feeling has only been heightened by the present litigation. The lenders have asked that the facility be renegotiated. In any event, Mr. Chen needs to be relieved of his personal guarantee if one party to this litigation is to buy out the other, as is proposed.

In this setting I must be concerned with two questions: First, is the decision to arrange a refinancing within the realm of reasonableness? Is it necessary to refinance to release Dr. Chen, or should the debt (or some part of it) just be paid off?

Second, are the terms of the proposed refinancing also within the realm of reasonableness?

The test the applicant must satisfy is not high. Nevertheless, there must be a body of evidence which, viewed objectively, establishes that the decision is one which a reasonable director, having only the best interests of the company in mind, might endorse.

The evidence of Ms. Tsien and Mr. Driscoll is too conclusory and abbreviated to permit such a finding. I think the applicant must produce and file the following documents in support of its application: first, the consolidated financial statements, which I gather have been prepared (albeit in draft form and without the notes); second, the cash flow projection or projections done in support of the proposed refinancing; third, particulars of the amounts owing under the present facility (as there appears to be some ambiguity in the affidavit of Ms. Tsien on that point); fourth, a description of any approaches made by the company to the existing lenders for continuation of the present agreement, and the answers received; fifth, details of the proposed refinancing, including interest rates, repayment dates, proposed security0-taking, commitment fees, arrangement fees and estimated legal costs.

That is far from the list requested by the petitioner. Much of the balance which I am not directing be produced goes beyond what a court might reasonably expect in an application of this sort, given the limited nature of the question placed before me.

I will adjourn this application for a short period of time to enable the company to make immediate disclosure of these documents. The company will have to file a brief supplementary affidavit to address some of the points I have mentioned.

Dated 25th day of August, 2005

Henderson, J.

Henderson, J.
Judge of the Grand Court