CJ/LIB

IN CHAMBERS

IN THE GRAND COURT OF THE CAYMAN ISLANDS

22-08-03

CAUSE NO. 424/2003

IN THE MATTER OF SIIC MEDICAL SCIENCE AND TECHNOLOGY (GROUP LTD.)
AND
IN THE MATTER OF THE COMPANIES LAW (2003 REVISION)

BEFORE: MADAM JUSTICE LEVERS

APPEARANCES:
Mr. Colin McKie of Maples & Calder for the Petitioner, ex parte

Heard: 15th July 2003

JUDGMENT

This is an application by SIIC Medical Science and Technology (Group) Limited by way of a Summons dated the 23rd of June 2003, to Summons a Scheme Meeting pursuant to section 86 (1) of the Companies Law (2003 Revision). The parties to the proposed Scheme are (1) the Company (2) the holders of the scheme shares of the Company. The object of the proposed Scheme is for the Company to become a wholly owned subsidiary of a third party Shanghai Industrial Holding Limited by:

(1) The Company reducing its share capital by cancelling and extinguishing order of the Share in issue on the day immediately preceding the date on which the Scheme becomes effective

other than those beneficially owned by the controlling parties; and

(2) The Company applying the credit thereby arising in its books of account as a result of the reduction of the share capital, referred to in sub-paragraph (1) above to a reserve account in the books of accounts of the Company.

The Scheme Shares comprise all the holders of the Companies issued shares, including the Excluded Parties but excluding Shanghai Industrial Holdings Limited ("SIHL"), SIHL Treasury Limited ("SIHL Treasury"), Central Force Investment Limited ("CFI"), and S.I. Infrastructure Holding Limited ("SIIH"). SIHL will pay the purchase price of the Scheme Shares to the scheme shareholders.

Background

The Company was incorporated as an exempted company limited by shares under the Companies Law Cap. 22. on 17th September 1999. The Company itself is a limited investment holding company and does not engage in trading activities. It has an authorized share capital of HK $100,000,000 in divided into 1,000,000,000 ordinary shares of HK$0.10 each. To date 620,300,000 Shares have been issued and are fully paid or credited as fully paid. There are no outstanding warrants to subscribe for Shares or any securities converted into new Shares.

On the 6th May 2002, the Company adopted a new share option scheme. As at the date hereof, the Company has not granted any options to any person pursuant to this new share option scheme.

Shanghai Industrial Holdings Limited ("SIHL") is a company incorporated in Hong Kong with limited liability. SIHL has the beneficial interest in 19,119,000 Shares, representing approximately 3.08 per cent of the issued share capital of the Company. The shares of SIHL are publicly traded and listed on the HK Stock Exchange. The ultimate controlling shareholder of SIHL is Shanghai Industrial Investment (Holding) Company Limited("SIIC"), a company incorporated in Hong Kong with limited liability.

Each of Central Force Investments Limited ("CFI"), SIHL Treasury Limited ("SIHL Treasury") and S.I. Infrastructure Holdings Limited ("SIIH") are companies incorporated in the British Virgin Islands with limited liability, and are wholly owned subsidiaries of SIHL. Together, CFI, SIHL Treasury and SIIH have the beneficial interest in 389,815,000 Shares, representing approximately 62.84 per cent of the issued share capital of the Company.

Each of Nanyang Enterprises Limited ("NEL") and Nanyang Enterprises Properties Limited ("NPL") are companies incorporated in Hong Kong with limited liability, and are indirect wholly owned subsidiaries of SIIC. Together NEL and NPL have the beneficial interest in 9,063,000 Shares.

Shen Wei Jaia, a director of the Company, has the beneficial interest in 225,000 Shares.

The Court considered the matter and made an Order in the following terms:-

1. That the relevant class of shareholders of the Company affected by the proposed Scheme of Arrangement comprise the holders of its ordinary shares of HK$0.10 each other than Shanghai Industrial Holdings Limited, Central Force Investments Limited, SIHL Treasury Limited and S.I. Infrastructure Holdings Limited (the "Holders of Scheme Shares");

2. That the Company may be at liberty to convene a meeting of the Holders of Scheme Shares (the "Meeting") for the purpose of considering and, if thought fit, approving (with or without modification) a Scheme of Arrangement proposed to be made between the Company and the Holders of Scheme Shares;

3. That direction may be given as to the method of convening the Meeting including the delivery of the Scheme documents, the publication of notices, and the time, date and place of the Meeting;

4. That provision be made for the appointment of a Chairman of the Meeting and he be directed to report the result thereof to the Court; and

5. Further or other relief.

As a result of the unusual feature of this Scheme, the Court was asked to give a written ruling on the Court's jurisdiction to summon a Meeting. The unusual feature being that a third party namely SHIL will be providing the consideration.

Is the proposal a Scheme within the meaning of section 86 and does the Court have the jurisdiction to summon this meeting?

Section 86 of the Companies Law reads:

> "(1) Where a compromise or arrangement is proposed between a company and its creditors or any class of them, or between the company and its members or any class of them, the Court may, on the application of the company or of any creditor or member of the company, or where a company is being wound up, of the liquidator, order a meeting of he creditors or class of creditors, or of the members of the company or class of members, as the case may be, to be summonsed in such manner as the Court directs.
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> (2) If a majority in number representing seventy-five per cent in value of the creditors or class of creditors, or members or class of members, as the case may be, present and voting either in person or by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors or the class of creditors, or company or, where a company is in the course of being wound up, on the liquidator and contributories of the company.
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> (3) An order made under subsection (2) shall have no effect until a copy of the order has been delivered to the Registrar for registration, and a copy of every such order shall be annexed to every copy of the memorandum of association of the company issued after the order has been made, or, in the case of a company not having a memorandum, of every copy so issued of the instrument constituting or defining the constitution of the company.
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> (4) If a company makes default in complying with subsection (3), the company and every officer of the company who is in default shall be liable to a fine of

> two dollars for each copy in respect of which default is made.
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> (5) In this section the expression "company" means any company liable to be wound up under this Law and the expression "arrangement" includes a reorganization of eh share capital of the company by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both those methods."

Section 86 is substantially the same as section 425 of the English Companies Act [1985] and its predecessors, and is substantially the same as a number of Commonwealth company statutes. Section 425 describes the type of transaction to which it and other sections apply as a compromise or arrangement between a company and its creditors or any class of them or its members or any class of them. "An arrangement" is expressly stated to include a re-organization of the companies share capital by the consolidation of shares of different class or by the division of shares into shares of different classes or by both. The Courts have construed "arrangement" as a word of very wide import covering almost every type of legal transaction, so long as there is some element of give and take and has the approval of the company concerned either through its board or through the members in general meeting. This particular Scheme as proposed is that the holders of the scheme shares exchange their shares for cash and the company extinguish its liability under its articles to the holders of the Scheme Shares. It has been submitted that the proposed exchange of right is *prima facie* "an arrangement" or "a compromise" within the meaning of section 86 and the applicant argued that the arrangement should be construed broadly. In re

National Bank [1966] 1 WLR at page 819 at 829(g) per Plowman J. in (objectors submissions) seems to me to involve imposing a limitation or qualification either on the generality of the word "arrangement" in section 206 or else in the discretion of the Court under that section. The legislature has not seen fit to impose any such limitation in terms and I see no reasons for implying any. The word "compromise" or "arrangement" within the meaning of section 86 should be construed broadly.

What therefore, if any, are the special features of this particular scheme which may preclude it from being a scheme.

Firstly, SIHL, one of the essential parties to the Scheme, is neither the Company nor its members or creditors. Does that mean that the Court has no jurisdiction to convene the meeting?

Secondly, is the fact that SIHL could have proceeded by way of tender offer followed by compulsory acquisition under section 88, an improper use of the section 86 machinery and therefore an abuse of process?

Thirdly, the Company having granted various options of which $38,200,000 are outstanding and exercisable. Of those $21,000,000 have either consented to their cancellation or not to exercise them pending the hearing of the Petition. That still leaves $17,200,000 outstanding and exercisable options; Does this affect the Court's jurisdiction?

The First Point

SIHL one of the essential parties to the Scheme is neither the company nor its members or creditors. Does that mean that the Court has no jurisdiction to convene the meeting? It is proposed in this case that SIHL should bear the obligation to pay re holders of the Scheme Shares, the consideration of Hong Kong $2.15 per share. SIHL's obligation will be embedded in an undertaking given to the Court. Does this feature may preclude this arrange from being a scheme?

I believe this matter was explored to some extent in Re *Glendale Land Development Ltd. (In liquidation)* quoting from re *A&C Constructions* [1970] SASR at page 565, per Bray CJ and Welds J:

> "It is however, in my view, a fallacy to assume that therefore no other person can be a party to the scheme. In my view, so long as the scheme can properly be described as a compromise or arrangement between a company and its members or creditors or any class of them within the meaning of s 181 (1) of the South Australian Companies Act 1962, it is immaterial that other persons are parties to it, but its binding force on such other parties will derive from the scheme as a contract, or from some other contract, and not from the order of the court.
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> A scheme that includes provisions that may without doubt be said to constitute a compromise or arrangement of the kind described by section 181 does not cease to fall within the jurisdiction conferred upon the court by that section by reason only of the

> inclusion within the scheme of an outsider. – a person not the company, a member or a creditor – but the extent to which the stranger will be bound by the scheme will depend on the inherent contractual validity of the scheme will depend on the inherent contractual validity of the scheme with respect to the stranger, and not upon any order of the court under section 181 signifying its approval of he scheme.
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> In my earlier judgment I held that approval of the scheme by the court would not create any rights or obligations as between MPCL (the outsider) on the one hand and the company, its creditors or members on the other hand. It is therefore necessary that in some other way MPCL become bound to implement the scheme.
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> In cases such as the present where participation by an outsider is an essential element in the scheme I think that normally the court should not approve the scheme unless the outsider first becomes bound by contract to implement the scheme. Again I think that where, as here, the scheme involves transactions directly between creditors or members on the one hand and the outsider on the other, a contract should ordinarily be made with the company but for the benefit of those other parties as well. The existing agreement between MPCL, the liquidator and the proposed scheme administrators does not, in my view, contain adequate provisions for this purpose, and in the present case, as in relation to the scheme administrators, it would be appropriate if the proposed scheme were amended so as to make its operation conditional upon MPCL's entering into a covenant with the company for the benefit of the company, the liquidator, scheme creditors and the scheme participants to do all things necessary to be done on its part to implement the scheme."

The essential requirement of the covenant that is spoken of is that it be reduced into writing and be enforceable and not necessarily that it be under seal. In these particular circumstances, it is my view that the covenant having been reduced to

writing and the third party having a document that is enforceable by the company and the holders of the Scheme Shares, it is still *prima facie* a scheme of arrangements and this Court is not denied jurisdiction. The exchange of rights is prima facie on "arrangement" or "compromise" within the meaning of the section.

Second Point

Is the fact that SIHL could have proceeded by way of a tender offer followed by compulsory acquisition under s. 88, an improper use of the s. 86 machinery and therefore an abuse of process.

On a section 86 Scheme, the Petitioner must establish before the Court that the scheme is a fair one without which the scheme will not be sanctioned and the minority expropriated, but under a tender offer a dissenting shareholder must commence proceedings under s. 88 and establish before the Court that the scheme is unfair to him. In re *National Bank Ltd.* 1 WLR [1966] where it was held that section 206 of the Companies Act [1948], gave to the court the widest disposable discretion to approve any sort of arrangement between a company and its shareholders and that there was no stipulation, either under that section or section 207, as to disclosure of valuations, profits, assets or liabilities; that what ought to be disclosed would depend on the nature of a particular scheme; that it was inherent in the present scheme that information which was exempt from the situation by virtue of paragraph 23 of Schedule 8 be withheld; and that,

if the Court was satisfied on the evidence that the scheme was, nevertheless, fair it would be approved. It also held that the requirement in section 209 that a scheme within that section should have the support of a nine-tenths majority did not apply where application was made to the court for approval of a compromise arrangement under section 206.

Under section 86, the Petitioner must establish before the Court that the Scheme is a fair one without which the scheme will not be sanctioned and the minority expropriated. But, under a tender offer, a dissenting shareholder must commence proceedings under section 88 and establish before the court that the scheme is unfair to him. It is my view, that if section 86 is available as a mean to effecting a binding compromise between a company and its members then it should be available as an alternative route to section 88 and I am of the view that the scheme is still a *prima facie* scheme of arrangement or compromise notwithstanding that the third party could have proceeded by way of a tender offer.

Thirdly, the Company has granted various options of which 38,200,000 are outstanding and exercisable. Of those 21,000,000 have either consented to their cancellation or not to exercise them pending the hearing of the Petition. That still leaves 17,200,000 outstanding and exercisable options.

The Company has proposed to amend the Article so as to make the issuing of shares after the extraordinary General Meeting to be subject to the Scheme. In this particular case in any event all the holders of the 17,200,000 options have agreed not to exercise their rights under the option, to surrender their options and to receive "the see through" price offered by SIHL.

It is my view that none of those matters deprive the court of the jurisdiction and I therefore held that the proposed scheme is a scheme under section 86 and the Court had jurisdiction.

Dated this 22 day of August 2003

Justice P. Levers
Judge of the Grand Court