

3. SB3 was incorporated in the Cayman Islands on 11 August 2000 for the sole purpose of investing in the Company. SB3 has been a shareholder of the Company at all times since 11 October 2000. SB3 is 87.5% owned by Softbank Asia Net-Trans Fund Limited, a close-ended venture capital fund incorporated in the Cayman Islands on 5 April 2000.
 2. The registered office of the Company is at the offices of Maples and Calder, P.O. Box 309, Ugland House, South Church Street, George Town, Grand Cayman, Cayman Islands, British West Indies.
- ~~Information Security One Limited (the Company) was incorporated under the Companies Law,~~

The Petition of Softbank Asia Net-Trans (No.3) Fund (SB3) whose registered office is at Ugland House, PO Box 309, George Town, Grand Cayman, Cayman Islands, British West Indies and whose correspondence address is at SIIS Management Limited, S/F SBI Centre, 56 Des Voeux Road Central, ag Kong shows that:

To: The Grand Court



PETITION



AND IN THE MATTER OF INFORMATION SECURITY ONE LIMITED
 IN THE MATTER OF THE COMPANIES LAW (2004 REVISION)

CAUSE NO. 232 OF 2006

IN THE GRAND COURT OF THE CAYMAN ISLANDS



The grounds upon which SB3 petitions for the winding up of the Company pursuant to Section 94(d) of the Companies Law (2004 Revision) are that it is just and equitable because, as set out more particularly below, those in de facto control of the Company have:

(a) conducted the Company's affairs with a lack of probity and in a manner prejudicial to SB3 and certain other minority shareholders;

(b) sought to deny SB3's legitimate expectations, and contractual rights, of participation in the management of the Company;

(c) failed to provide information to SB3 and other shareholders which would enable it to assess, among other things, the financial position of the Company;

causing SB3 to have a justifiable and complete lack of confidence in the conduct and management of the Company's affairs.

Background

5. The Company was incorporated as an exempted company in the Cayman Islands on 19

September 2000 under the name of Internet Security One Limited. The Company changed its name to Information Security One Limited on 15 May 2001. In addition, the Company was registered under the laws of Hong Kong as an oversea company on 15 June 2001. The Company declared that it ceased to have a place of business in Hong Kong as of 8 November 2003. The latter fact was discovered during recent investigations by SB3. SB3 was not notified contemporaneously of the decision to declare that the Company had ceased to have a place of business in Hong Kong.

6. The authorised capital of the Company is US\$5,105,200, divided into 10,520,000 Series A Preferred Shares of US\$0.01 each and 500,000,000 Ordinary Shares of US\$0.01 each. These figures follow a 10-for-1 split on both classes of shares on 17 January 2001. There is set out below a chart showing the register of members of the Company as at 24 October 2005.

9. The Company is the holding company for a group of companies, referred to in this petition as the "Group". The Company does not trade. As the holding company of the Group, the

8. The Chief Financial Officer of the Company is Mr Philip Ko.

(c) Xiong Cheng Yiu is an independent non-executive Director.

(b) Dato' Wong Sin Just of SB3 ("Dato' Wong"); Neil Shen, Liu Ai Min and Gao Hong Bing ("Mr Gao") are non-executive directors; and

(a) Paul Cheng and Joseph Fong are executive directors;

7. The company has 7 directors:

Note: The figures for shareholders "as-if-converted" are derived from the fact that, as dealt with further below, holders of Preferred "A" shares were granted a right to convert those shares to common shares at a ratio of 1:1.

	Preferred A	Common	As-if-converted
	Shares	Shares	Shares
	Interest	Interest	Interest
SB3	4,000,000	2,000,000	6,000,000
	38.02%	2.94%	7.63%
Gavast Estates Ltd. (Nan Fung)	4,000,000	2,000,000	6,000,000
	38.02%	2.94%	7.63%
Trend Micro, Inc.	2,000,000	2,000,000	4,000,000
	19.01%	2.94%	5.09%
Internet Security Systems, K.K.	NII	2,000,000	2,000,000
	NII	2.94%	2.54%
ChinaNet Communications Ltd	NII	102,409	102,409
	NII	0.15%	0.13%
Winson Logistics Ltd.	500,000	NII	500,000
	4.75%	NII	0.64%
Openventure Co., Ltd	20,000	10,000	30,000
	0.19%	0.01%	0.04%
Cheng Dun Ying ("Paul Cheng")	NII	36,000,000	36,000,000
	NII	52.85%	45.78%
Deng Ku Hon ("Derek Deng")	NII	9,000,000	9,000,000
	NII	13.21%	11.45%
Shen Nan Peng ("Neil Shen")	NII	6,600,000	6,600,000
	NII	9.69%	8.39%
Ko Po Wen	NII	6,000,000	6,000,000
	NII	8.81%	7.63%
Fong Yiu Yuen Joseph ("Joseph Fong")	NII	2,400,000	2,400,000
	NII	3.52%	3.05%
Total	10,520,000	68,112,409	78,632,409
	100.00%	100.00%	100.00%

12. During 2000, the business of the Group required a significant injection of capital in order to develop in the way that Paul Cheng envisaged. At this time, and following discussions with Paul Cheng, SB3 and other strategic shareholders decided to invest in the Group. With the capital injection made available by the new shareholders, the intention was to expand the business such that the operations of the Group could be listed, through a suitable vehicle, by an initial public offering ("IPO"), or similar mechanism, on the Hong Kong Stock Exchange Growth Enterprise Market ("GEM"). The GEM is, in effect, the second-tier Stock Market in

11. The business of the Group was, principally, founded by Paul Cheng who remains the Chairman of the Company and its single largest shareholder.

10. security services in Hong Kong the remaining 1%.

As noted above, the core business of the Group is the sale and distribution of information and network security systems, of software and hardware, and the provision of information and network security solutions in the PRC. That business accounted for 82% of the Group's revenue for the year ended 31 December 2004. In addition, the Group also provides consultancy and maintenance of information security services in the PRC, which business accounted for around 10% of the Group's revenue for the same period. The remainder of the Group's business was derived in Hong Kong; the sale and distribution of information and network security systems (and provision of information and network security solutions) accounting for 7% of the Group's revenue, and consultancy and maintenance of information

Company holds all of the issued shares in Information Security One (Hong Kong) Limited ("ISHK"). ISHK is principally engaged in the distribution of IT security products in Hong Kong. The Company also holds all of the issued shares in Internet Security Solutions Limited ("ISSL"), a Hong Kong company, incorporated on 1 February 1996. ISSL originally provided for the distribution of information security products in the PRC and the provision of information security services in the PRC. That activity is now carried out by Information Security One (China) Limited ("IS-China"), a company incorporated in the Peoples Republic of China ("PRC") on 17 December 1999. The fate of IS-China is central to the complaints of SB3.

- Hong Kong, not dissimilar to the NASDAQ in the United States. The aim of a public offering was important to SB3 in its decision to invest.
13. In order to facilitate the injection into the Group of the new capital, the Company was incorporated and the Group organised such that the Company was the holding company of the Group. As noted above, the Company held ISHK and ISSL. IS-China was held by ISSL, and therefore indirectly by the Company.
14. Due to the growth of the Group's business in the PRC, the key entity within the Group soon became IS-China. By 2004, IS-China contributed the vast majority of the Group's revenue. Indeed, according to the Group's consolidated unaudited management accounts for that year, IS-China accounted for 82% of the Group's revenue.
15. In the circumstances, although the Group also provides certain IT services in Hong Kong (through ISHK), IS-China was clearly the "jewel in the crown" of the Group.
16. In the circumstances that are set out further below, SB3's interests as a minority shareholder of the Company (and therefore the holder of a minority interest in the business of the Group) have been unfairly prejudiced by the actions of those in de facto control of the Company (and other parts of the Group), principally Paul Cheng.
17. SB3's view is shared by a number of the other minority shareholders who have confirmed in writing their support for this application (including SB3, the "Minority Shareholders"). The Minority Shareholders are listed in the table below. In aggregate, the Minority Shareholders hold 57.03% of the Company's issued Series A Preferred Shares, and 40.52% of the Company's issued common shares, representing an as-if-converted stake of 42.73%.

a. The most valuable part of the Group, namely IS-China, has apparently been stripped out of the Group. In this regard, some time ago it was agreed by all concerned (including

20. In overview, the events which cause particular concern are as follows:

19. In addition, SB3 has been excluded from the management of the Company where it had legitimate expectations to be so involved, and the interests of the Minority Shareholders and the Company/Group as a whole are not being served by the present controlling management. The Minority Shareholders justifiably have little faith in such management. The Company should be placed into the hands of independent third party professionals in order that the affairs of the Company can be investigated with the interests of all stakeholders in mind.

	Preferred A	Common	As-if-converted
	Shares Interest	Shares Interest	Shares Interest
Paul Cheng	NII	NII	36,000,000 45.78%
			36,000,000 52.85%

represented as below:

18. It is expected that Paul Cheng will oppose the application. It is not known what stance will be taken by the other shareholders, namely Gavast Estates Ltd; ChinaNet Communications Ltd; Winsion Logistics Ltd; Openventure Co Ltd; and Joseph Fong. Paul Cheng's stake can be

Note: Trend Micro, Inc. is listed on the Tokyo Stock Exchange, stock code 4704.JP.
 Internet Security Systems, K.K. is listed on the Tokyo Stock Exchange, stock code 4297.JP.
 Derek Deng, Neil Shen and Ko Po Wen are all founding shareholders of the Company.

	Preferred A	Common	As-if-converted
	Shares Interest	Shares Interest	Shares Interest
SB3	4,000,000 38.02%	2,000,000 2.94%	6,000,000 7.63%
Trend Micro, Inc.	2,000,000 19.01%	2,000,000 2.94%	4,000,000 5.09%
Internet Security Systems, K.K.	NII	2,000,000 2.94%	2,000,000 2.54%
Derek Deng	NII	9,000,000 13.21%	9,000,000 11.45%
Neil Shen	NII	6,600,000 9.69%	6,600,000 8.39%
Ko Po Wen	NII	6,000,000 8.81%	6,000,000 7.63%
Total	6,000,000 57.03%	27,600,000 40.52%	33,600,000 42.73%

are unclear. The Minority Shareholders are concerned about other shortcomings in the KPMG have discovered a number of intra-group cash transfers for which the purposes

c.

see further below), its commercial rationale is still unclear. KPMG. Despite the fact that KPMG made inquiries regarding this transfer (as to which the management accounts and it was not brought to SB3's attention until discovered by commercial rationale behind the transfer of funds. The transaction was not shown in made in December 2002, but no adequate explanation has been given to SB3 for the with which the Group has no apparent commercial relationship. The remittance was The sum of US\$2 million has apparently been remitted from the Group to a company

b.

been given that opportunity.

acquire such an interest. In particular, none of the Minority Shareholders have equivalent interest) in the new holding company, or even the opportunity to shareholders of the Company have not been given any interest (let alone an although such a transfer has apparently taken place, most of the existing/original element, to its new holding company. However, as matters have transpired, way of a few stages, the first of which being the transfer of IS-China, the Group's key Company from a market intelligence perspective. The reorganization was to proceed by ("ISSKK") and Trend Micro, in the belief that this would protect the interests of the operating businesses in competition with the Group, e.g. Internet Security Systems KK Paul Cheng also proposed to buy back the shares from those shareholders who were given an opportunity to exit through a buy-back exercise relating to their shareholding. after its unsuccessful attempt to obtain a GEM board listing in early 2003 would be company of IS-China, and those shareholders who had lost confidence in the Company involved would be allocated an equivalent or greater stake in the "new" holding basis that those of the existing shareholders of the Company who wished to remain intention was to transfer the ownership of IS-China to a new holding company, on the For the purpose of the overview in this paragraph, however, it suffices to say that the dealt with in some detail below, in the section headed "Restructuring of the Group". SB3) that the Group undergo a reorganisation/restructuring. The reasons for this are

23. The new investors were SB3; Trend Micro, Incorporated; Cavast Estates Limited; and Trend Capital Investment Limited (together "Series A Subscribers"). The Series A Subscribers executed a Subscription and Shareholders Agreement dated 29 September 2000. They agreed to invest a total of US\$8,520,000 for a total of 852 Series A Preferred shares in the Company.

Sum	6,000	100.00%
Paul Cheng	3,600	60.00%
Derek Deng, formerly named Deng Dong Dong	900	15.00%
Neil Shen	660	11.00%
Ko Po Wen	600	10.00%
Fong Yiu Yuen Joseph	240	4.00%
Common Shares Interest		

22. Immediately prior to the influx of the new investors (including SB3) in 2000, the Company's shareholders comprised:

SB3's involvement in the Company

21. In all the circumstances, as summarised above and dealt with in more detail below, the Company should be wound-up on the grounds that it is just and equitable to do so and/or other appropriate relief be given in favour of the Minority Shareholders. Given the increasingly cavalier manner in which Paul Cheng and those allied with him are treating the Company, the Group and its business, and given the matters that have been uncovered by the investigations of SB3, principally through an independent business review conducted by KPMG and recent information received from the PRC (dealt with further below), liquidators should be appointed to the Company as soon as possible.

management of the Company discovered by KPMG. These include a lack of any budgets or forecasts, and the fact that the opening balances on the management accounts for IS-China as at 1 January 2005 do not match the closing balances on the audited accounts as at 31 December 2004.

26. In addition, certain of the Series A Subscribers and ISSKK entered into an Option Deed, dated 30 September 2000 and amended by an amendment document dated 30 December 2000. The Option Deed as amended will be referred to herein as the "Option Deed". Pursuant to the Option Deed, the Optionholders (as defined therein) were entitled to exercise an option to subscribe to Ordinary Shares in the Company, in addition to any Series A Preferred Shares held by them. Under the Option Deed, the number of ordinary shares in respect of which the Optionholders were granted options was as follows:

It is notable that such US\$10,520,000 investment is equivalent to over half of the then total asset value of the Company, which amounted to HK\$159,802,000 (i.e. US\$20,487,436) as at 31 December 2000.

Subscriber	Number of Series A Preferred Shares	Total Subscription Price (US\$)
SB3	400	4,000,000
Trend Micro, Incorporated	200	2,000,000
Gavast Estates Limited	400	4,000,000
Open Venture Company Limited	2	20,000
Infoage Pacific Corporation	50	500,000
Infoage Pacific Corporation Limited		

25. By 30 December 2000, the 5 Series A Subscribers had agreed to subscribe for a total of 1,052 Series A Preferred shares in the Company for a total of US\$10,520,000. The details are as follows:

24. Subsequent to the amendments made in December 2000, another Series A Subscriber, namely Infoage Pacific Corporation Limited, was added. Gavast Estates Limited also increased the size of its investment. Also, by then, Trend Capital Investment Limited had changed its name to Open Venture Company Limited.

amended, shall be referred to as the "SSA".
 Subscription and Shareholders Agreement" dated 30 December 2000. The agreement, as amended, shall be referred to as the "SSA".
 agreement was subsequently amended by a document entitled "Amendment No. 1 to Subscription and Shareholders Agreement" dated 30 December 2000. The agreement, as amended, shall be referred to as the "SSA".
 for the purpose of financing the expansion of the business of the Group (as defined). That

29. The SSA was stated (at recital (D)) to have been entered into "for the purposes of (i) recording the terms and conditions on which the Subscribers will subscribe for the Series A Preferred Shares in the Company; and (ii) establishing certain restrictions on the share capital of the Company and regulating the relationship between the shareholders of the Company and certain aspects of the affairs of the Company" (emphasis added). The emphasis is added because, as dealt with later in this petition, there have been suggestions by Paul Cheng and Philip Ko to say that any "privileges" attaching to holders of Series A Preferred shares should disappear completely after any repurchase of those shares (as had been contemplated by the reorganisation dealt with subsequently in this petition). The purported reason given by Paul Cheng and Philip Ko was that all shareholders would then be of the same class. It is important to SB3 to invest in businesses where it has a measure of control. This is because SB3 will only invest as a "strategic" investor, and given that its business (and that of Softbank as a whole) is to invest, its business reputation can suffer if investee companies do very badly or are badly managed. Also, as a fund (or at least a constituent part of a fund), SB3 does, of course, owe duties to its own investors; it is difficult to fulfil those duties without such measure of control.

27. As stated at paragraph 6 above, there was subsequently a 10-for-1 split in respect of the Company's shares so the number of shares in the tables above need to be multiplied by 10.

28. On 20 August 2001, SB3 exercised its option to take up its allotment of 200 ordinary shares at the price of US\$2,000,000. At the time of the SSA, the authorised share capital of the Company was US\$50,000 divided in 50,000 shares of US\$1 each. The share capital structure of the Company was subsequently altered to that described at paragraph 6 above.

Option Holder	Number of Shares	Option Price (US\$)
SB3	200	2,000,000
Trend Micro, Incorporated	200	2,000,000
ISSKK	200	2,000,000
Gavast Estates Limited	200	2,000,000
OpenVenture Company Limited	1	10,000

30. SB3 was given the right to involvement in the management of the Company pursuant to the terms of the SSA, and in particular the right to nominate a board director and to have a veto in respect of certain Reserved Matters (as defined in the SSA). These rights are very important to SB3 given its investment/business criteria and the duties it owes to investors in the fund of which SB3 is part. These terms of the SSA give SB3 a legitimate expectation to be involved in the management and control of the Company and, given the purpose of the investment (as specifically stated in the SSA), the Group as a whole.

Events from 2001 to 2003

31. It was intended that the IPO would take place in the 4th quarter of 2001. However, it was delayed many times and eventually suspended in 2003. Broadly, in 2001, the management reported that the IPO would be delayed until the 1st half of 2002 as the time taken to conduct due diligence work and valuations had been longer than expected. In the 2nd quarter of 2002, the management explained that the IPO would be further delayed because of a backlog of GEM IPO applicants. Then, in early August 2002, the sponsor and lead manager for the GEM IPO of the Company changed. However, by the time the GEM listing committee provisional hearing started towards the end of 2002, the business of the Company had started to deteriorate due to the outbreak of SARS in the PRC. Further, the management was unable to provide satisfactory answers to the enquiries of the listing committee. On 27 February 2003, Paul Cheng reported to the board that the proposed IPO would be suspended. He stated that as a result of various concerns raised by the listing committee, he believed it was in the best interests of the Company to concentrate on the operation of the Company.

32. The other event of significance in this period relates to the relationship between the Company, or more specifically its subsidiary, ISSL, and ISSKK. ISSKK is a minority shareholder in the Company and was the major supplier to the Company in 2001 and 2002. The Company and ISSKK signed original equipment manufacturer (“OEM”) agreements in March 2001 by which the Company was granted the rights to market, distribute and license certain products of ISSKK in the PRC, Hong Kong and Macau. Notwithstanding ISSKK’s status as a shareholder of the Company, Phillip Ko reported to the Finance Committee of the Company on 12 September

2003 that the Group had received several complaints from its clients in Shanghai concerning

poor IT support given by ISSKK. A warning letter from a reseller in Shanghai had also been received. On 5 December 2003, Mr Ko reported that ISSKK had started to set up its own sales network in the PRC. According to Mr Ko, ISSKK claimed that it was owed approximately US\$3.9 million as of 28 November 2003. Although going beyond 2003, it is useful to note that at a Finance Committee meeting on 17 February 2004, Mr Ko reported that a settlement had been reached and that ISSKK had agreed to waive all accounts payable to it, which figure, according to the Group, was finalized as US\$1.7 million. As part of these discussions, on 14 January 2004, an agreement was reached with ISSKK whereby ISSL was to transfer and assign to ISSKK all its legal and beneficial right, title and interest in respect of the copyright of the Chinese translation of the instructions, usage manual and ancillary literature of the ISSKK product, and that all distribution agreements between ISSL and ISSKK be terminated in return for which ISSKK should waive its rights to payment of US\$3,774,807.00 allegedly owed by ISSL. The higher figure (of US\$3.7 million) was used in the agreement on the basis that that was the figure which ISSKK alleged to be correct.

33. At a meeting of the Board of the Company on 7 May 2003, it was decided that a Finance Committee be formed in order to maintain a tighter rein on the Company's finances. It was agreed that the Finance Committee would comprise of 4 members, 2 to be nominated by the Company, one to be nominated by Gavast Estates Limited and one by SB3. Subsequently, a Finance Committee manual was produced by SB3, and approved by the Board. Until its termination, to which see further below, the Finance Committee met regularly and liaised as to the expenditure of cash. The formation of the Finance Committee and, in particular, the fact that one of the Committee's members was to be nominated by SB3 again shows the level of involvement that SB3 could legitimately expect. This was important to SB3 given its status and its need to maintain checks and balances in respect of its investee companies.

34. At the same board meeting on 7 May 2003, it was reported that the Company's cash balance had reduced from approximately HK\$53 million at the end of January 2003 to approximately HK\$28 million at the end of February 2003, and that this was mainly caused by an approximate

HK\$21 million cash outflow to a related company during that period. This event is referred to

further below.

Restructuring of the Group

35. At a further Board meeting on 10 September 2003, there were discussions as to how to move forward the business of the Group. The need for this followed the failure of the effort to effect an IPO of the Company. In this regard, the following factors were relevant:

- (a) the complicated nature of intra-group contractual relations had contributed to the delay in the due diligence process and to the subsequent failure of the application to the GEM listing committee;
- (b) the deterioration of the distribution relationship with ISSKK; and
- (c) the complication of a debt waiver arrangement between the Company; ISSL; IS-China; and a company called Beijing Henderford Science and Technology Development Co Limited.

36. It was also considered by the directors attending the Board meeting on 10 September 2003 that these factors weighed against any additional fund raising even outside an IPO.

37. At the meeting, it was unanimously resolved (with Neil Shen abstaining) that the Company would undergo a restructuring exercise, stated to be "for the protection of investors' interests". This restructuring exercise shall be referred to simply as the "Restructuring Plan", as a form of convenience. In very broad outline at the meeting, it was agreed that the Restructuring Plan would consist of the following 3 stages:

(Transaction 1) Paul Cheng would purchase, subsequently decided to be in the name of a "NewCo", the entire share capital of IS-China from ISSL for cash at a consideration of no less than IS-China's cash level of approximately RMB12 million;

(Transaction 2) After the sale of IS-China, the Company would distribute substantially all cash of ISSL (in US dollars) proportionally to the holders of Series A Preferred Shares of the Company;

(Transaction 3) Concurrent to Transaction 1 and Transaction 2 above, Paul Cheng (through NewCo) would sell to Series A Preferred Shareholders of the Company existing shares of IS-China at a valuation of no greater than Paul Cheng's purchase of IS-China in Transaction 1 above, with a result that Series A Preferred Shareholders' shareholdings in IS-China (i.e. through their shareholdings in NewCo) would be no less than their shareholding in the Company.

38. For Transaction 3, note that the two largest Series A Preferred Shareholders of the Company are SB3 and Gavast Estates Limited (often referred to in the contemporaneous documents as "Nan Fung"). Nan Fung is a substantial privately held group in Hong Kong principally engaged in property development but with other interests. Gavast Estates Limited is the vehicle which Nan Fung had used for this particular investment.

39. At the same meeting (on 10 September 2003), it was agreed that the Finance Committee manual that had been prepared by SB3 would be followed to the full extent and it was also resolved that the Company would add the signature of a person designated by SB3 for all cash transactions concerning the bank accounts of the Company, emphasizing again the important role SB3 was to play in the running of the Company, or at least the controls which SB3 could expect to exercise. The relevant forms were passed to Phillip Ko in this regard, but it is not known whether they were processed with the Bank.

40. The outline of the Restructuring Plan indicates clearly that the intention was to reorganise the Group so that each of the then present shareholders would maintain their equity stake in IS-China albeit that, as a result of the Restructuring Plan, the stake would be held directly in IS-

China (or at least through a single special purpose holding company, i.e. NewCo), rather than indirectly through the Company and ISSL.

41. As appears below, the Restructuring Plan took a number of months to progress. During this time, the parameters of the Restructuring Plan changed. Part of this movement was legitimate and could be expected, the structure agreed at the Board meeting of 10 September 2003 being only an outline. However, the most fundamental changes were, in the view of SB3, a result of improper activities of Paul Cheng and others in order to reduce so far as possible, and potentially eliminate, the involvement of SB3, both in the management and control of the Company/Group and the holding in IS-China.

42. A meeting took place in Beijing on 10 October 2003, attended by Dato' Wong, Neil Shen, Paul Cheng and Derek Deng at which the broad outline of the Restructuring Plan was again discussed. Derek Deng is a shareholder of the Company (per the table at paragraph 6 above) and between 19 September 2000 and 1 November 2001 was also a director of the Company. The result of the meeting was confirmed in a memorandum of understanding in which the preferred shareholders (i.e. the Series A Subscribers), including SB3, indicated that they would proceed to wind up the Company unless action on the Restructuring Plan was taken. This memorandum was forwarded to Neil Shen, Derek Deng and Paul Cheng in an email dated 19 October 2003.

43. During the following months, there were further discussions and correspondence between the parties. In particular, draft term sheets were circulated where the 3 stages of the Restructuring Plan were sketched out in outline, with a view to those term sheets being provided to relevant lawyers to prepare the formal documentation.

44. The first draft of the restructuring term sheet was sent out by Ms. Nancy Ruth Fung of SB3 ("Ms. Fung") on 25 November 2003. It provided that, rather than the Company distributing substantially all of ISSL's cash to the holders of Series A Preferred Shares as set out in paragraph 37 above, under Transaction 2 the Company would instead give:

- (i) all Series A Subscribers the right to sell their shares in the Company back to the Company for a total consideration of US\$1.5 million; and
- (ii) all ordinary shareholders the right to sell their shares in the Company back to the Company for a total consideration of US\$1.5 million.
- It also provided that shares in NewCo would be allocated to the Series A Subscribers and the ordinary shareholders in Transaction 3 in proportion to their then current shareholdings in the Company. As indicated above, "NewCo" is the special purpose vehicle ("SPV") that Paul Cheng would use to purchase the entire share capital of IS-China in Transaction 1 and the SPV in which the Series A Subscribers would invest in Transaction 3.
45. On 26 November 2003, Philip Ko sent an email to Ms Fung in which he described the purpose of the restructuring as "*To protect the financial investors' interests and truly recognize their primary objective of investing in IS-One i.e. the prosper in the PRC market*" (sic). This email demonstrates the clear intention to invest in the PRC business of the Group, and therefore reinforces one of the main aims of SB3. In turn, this highlights why the stripping out of IS-China, explained further below, was such a crucial blow to SB3.
46. Although inconsistent with the first draft of the term sheet, Mr Ko's email continued by stating that only SB3, Nan Fung, OpenVenture, and Winson Logistics were to get paid in Transaction 2, and that ISSKK and Trend Micro would be discouraged from investing in "NewCo" as they had businesses in the PRC which conflicted with the interests of the Group.
47. A further important development in the negotiations was that the Restructuring Plan was to result in SB3 (and Nan Fung) receiving a 19% stake in IS-China and that (as stated above) IS-China would be held by a newly incorporated company, namely "NewCo" as referred to above. The increased stake for SB3 and Nan Fung was intended to compensate them for the fact that they would no longer be preferred shareholders and thus enjoying the protection that position would afford on, for example, the winding-up of the Company. It was also a result of the fact that SB3 and Nan Fung were not to receive any compensation in return for forfeiting the ordinary shares they held in the Company.

48. "NewCo" was subsequently incorporated in the Cayman Islands as Infinisecurity One (Holdings) Limited ("IOH"). The initial shareholders of IOH were Paul Cheng, Joseph Fong, Neil Shen and Derek Deng. Rather than have IOH then issue new shares to the preferred shareholders who still wished to participate in the investment, such as SB3 and Nan Fung, it was agreed that these initial shareholders of IOH would sell a portion of their own shares to those investors.

49. On 15 December 2003, Mr Ko informed those involved by an email of that date that the distribution of US\$1.5 million to ordinary shareholders, which would later come to be referred to as "Transaction 4", should be in the form of dividend rather than share repurchase. In a further email, dated 14 January 2004, Mr Ko suggested that Transaction 4 should be put aside for the time being, and that he would instruct the law firm of Conyers Dill & Pearman to draft the documents for Transactions 1, 2 and 3.

50. By an email dated 4 March 2004, Ms. Fung asked Mr Ko to confirm how much cash would be available for the distribution to ordinary shareholders, i.e. Transaction 4, after completion of Transactions 1, 2 and 3. She referred to the fact that the Company should have had US\$3.36 million cash as per the January 2004 management accounts prepared by Mr Ko. On the next day, Mr Ko replied that he could not confirm that there would be US\$1.5 million cash available for the ordinary shareholders due to pending expenditure of HK\$12 million (i.e. US\$1.5 million) in respect of replacing ISSKK equipment. This is notwithstanding that Mr Ko had advised the Finance Committee, on 17 February 2004, that the US\$1.5 million would be available, albeit that it would be payable over two years and not at one time. By way of explanation concerning the expenditure of HK\$12 million to replace ISSKK equipment, during March 2004 the problems in the relationship with ISSKK had continued. Notwithstanding that the commercial relationship had been formally terminated in January 2004, by March 2004 there was some concern that ISSKK was seeking to compete directly with IS-China in the PRC market and was approaching customers of IS-China in this regard. As a result, Paul Cheng proposed to spend the sum of about HK\$12 million to replace the existing ISSKK products, being used by customers, with the Group's own branded products, the idea being that this would reduce any contact between the customers and ISSKK (whilst still using ISSKK

products, it was that company to whom the customers were likely to go to for support and other services). There was some dispute as to whether the funds of the Company should be used to make this acquisition, and there was also an impact on the Restructuring Plan in that the use of the HK\$12 million for this purpose would reduce the amount of cash available for distribution to preferred shareholders.

51. During the same period, various draft documents had been prepared by Conyers Dill & Pearman, and also by Boughton Peterson Yang & Anderson, Hong Kong lawyers, and circulated amongst the relevant parties for comment.

52. Several e-mails were exchanged on 1 April 2004 highlighting issues concerning the cash transfer required to implement the first stage of the Restructuring Plan. Mr Ko reported that the cash balance of the Group (excluding IS-China) was then about US\$930,000 and was therefore

inadequate for the repurchase of Series A Preferred Shares. He added, however, that there was about US\$2.3 million cash (in RMB) held in IS-China. During this exchange of emails on 1 April 2004, Mr Ko also advised that neither ISSL nor IS-China was in a profitable position, so no dividend should be distributed. He added, however, that IS-China should still be able to transfer US\$1.5 million to ISSL as debt repayment. Mr Ko wrote in an e-mail later that day: *"In view of this, I suggest to have the disposal of IS-China to be done first since after the disposal, it still needs to have all the relevant documents to be translated into Chinese and submitted to the PRC authorities for re-registration approval; and the consideration of acquisition i.e. US\$1.5 million will only due after 60 days of the S&P transaction. ... in order to save time".* One of the concerns that arose, therefore, is that if IS-China was transferred out of the Group, the US\$2.3 million held by IS-China would result in there not being adequate cash available for the future implementation of Transaction 4, i.e. the distribution of US\$1.5 million to the ordinary shareholders of the Company. In fact, there would only be US\$930,000 left for the ordinary shareholders.

53. In the first half of April 2004, there was some disagreement between Paul Cheng and Philip Ko of the Company on the one hand, and Mr. Ruiping Wang ("Mr. Wang") and Ms. Fung of SB3 on the other, as to prerequisites and procedures of the Restructuring Plan. Paul Cheng stated in

an e-mail dated 2 April 2004 that the remitting of cash out of IS-China had not been agreed at the outset. He also arranged to send out on 6 April 2004 a notice of board meeting to be held on 8 April 2004. Mr. Wang replied on 7 April 2004, suggesting the holding of a board of directors meeting at a date convenient to all as the 8 April date proposed was not convenient to SB3. Mr. Wang also suggested that there should be a shareholders' meeting. There was increased anxiety in the correspondence, with the representatives of SB3 stressing that the Restructuring Plan required all of Transactions 1 to 3 to be carried out concurrently, or least as concurrently as possible.

54. By 16 April 2004, certain elements of the disagreement appeared to have been dealt with by the suggestion of Paul Cheng that SB3 (and Nan Fung) could swap their shareholdings in the Company for shares in NewCo (i.e. IOH). Yet, SB3 continued to stress that Transactions 1, 2 and 3 should happen concurrently. On 7 May 2004, Philip Ko gave step by step advice on how he considered SB3 (and Nan Fung) could swap their shareholdings in the Company for shares in NewCo with SB3 (and Nan Fung) accepting, instead of cash, promissory notes issued by the Company.

55. At this point, SB3 believed the differences and technical issues were beginning to be resolved. However, Paul Cheng then introduced a further element in an email dated 9 May 2004, namely that upon the repurchase of the preferred shares, the SSA would terminate (stressing that it would be null and void); that Dato' Wong should resign from the Board of the Company; and that SB3 would no longer have the right to appoint any director. A further element was that SB3 and Nan Fung would transfer all interests in their ordinary shares in the Company to Paul Cheng; Derek Deng; Neil Shen; and Joseph Fong in proportion to their shareholdings in IOH.

56. This was not accepted by SB3. There was correspondence on the issue in which Paul Cheng explained that it was his view that this was part of the consideration for increasing the effective stake of SB3 and Nan Fung in IS-China from around 7% to around 19%. One of the objectives (accepted by all) of the Restructuring Plan was therefore to increase the effective stake of SB3 (and Nan Fung) in the business being conducted by the Group, principally, of course, through IS-China.

57. A further, and very important, consequence of these events was that one of the proposals was to take away the management involvement of SB3. For example, SB3 would not have the right of veto in respect of the Reserved Matters. Paul Cheng and Philip Ko sought to justify this position by alleging that such rights existed only as a result of SB3 being a preferred shareholder and only out of the SSA, and that the SSA would no longer be necessary if there were not two classes of shareholders. As indicated earlier, SB3 does not accept that as accurate. For the protection of the interests of SB3 investors, SB3 had to ensure that a number of matters were completed before forfeiting its veto rights and all other interests in the Company.

58. Given Paul Cheng's suggestion to execute Transaction 1 without the concurrent execution of Transaction 2 and 3, the following was explained to Paul Cheng and Philip Ko. First, SB3 would be willing to forfeit its directorship and veto right concerning the Company but only after completion of Transactions 1 to 3. Secondly, SB3 would need to be ensured of the execution of Transaction 3, that is, the purchase of shares in "NewCo" (IOH), the 100% shareholder of IS-China, with the signing of a share purchase agreement. The agreement was expected to provide SB3 with reasonable protection in case NewCo were to buy or sell IS-China against the interests of SB3. If SB3 agreed to forfeit its directorship and veto right in the Company without the signing of a share purchase agreement to invest in NewCo, SB3 would risk losing control over its initial investment in the Company, without any access into the newly restructured organisation.

59. SB3 also explained to Paul Cheng and Philip Ko that the inter-company borrowing and lending relationship between IS-China and the Company must be clarified, and that a loan repayment schedule be arranged. Evidence of the extent of the position was brought to the attention of SB3 when the audit report of IS-China for the year ended 31 December 2004 was requested and delivered to SB3 on 29 April 2005. As at 31 December 2004, IS-China was indebted to the Company and ISSL in the sums of RMB26.2 million (i.e. US\$3.23 million) and RMB16.9 million (i.e. US\$2.09 million) respectively.

60. As can be seen from the narrative above, by the time of May/June 2004, some tension had set in regarding the progress of the Restructuring Plan and other issues, for example whether the Company should spend HK\$12 million to replace ISSKK products being used by customers. The ISSKK products issue was raised as one requiring urgent attention in an email from Phillip Ko dated 28 May 2004. In that email, Mr Ko indicated that Paul Cheng had instructed him to convene a Board meeting for 3 June 2004, to discuss current market conditions given ISSKK's activities, and also to discuss the current issues concerning the Restructuring Plan. The directors were asked to advise whether the proposed time and date for the Board meeting was convenient or otherwise suggest another time. It was the view of SB3 that the matters to be discussed at the meeting were of some importance. In an email dated 31 May 2004 (at 1:37 p.m.) Dato' Wong therefore stated that in view of the short notice a clear agenda should be prepared for the meeting. In response, Mr Ko sent an email merely stating as follows:

"As my understanding, the agenda in the forthcoming meeting are:

1. *The current market conditions and our responsive measures under ISSKK's aggressive promotion scheme for capturing our existing clients; and*
2. *The current status of the Group Restructuring."*

61. This was not satisfactory to SB3 who responded immediately by email stating:

"Pls revise as the it(sic) should be more exact particularly on the resolutions to be voted on. The agenda can be very brief but there should be detailed write up to support each resolution."

62. The response from Mr Ko was as follows:

"Dear all,

The resolutions for the IS One responsive measures to ISSKK's promotion scheme and the Group Restructuring should include detailed procedures and/or specific terms and conditions which are to be figured out and agreed upon after thorough discussion in the forthcoming board meeting. Therefore, it is difficult to write up what exactly the resolutions are now.

*Regards,
Philip*

63. At the 3 June 2004 meeting, the issue which had given rise to the call for an urgent Board meeting was discussed first, namely the expenditure of HK\$12 million to purchase replacement products to counter the efforts being made by ISSKK to take away business from the Group. This proposal was contrary to the previous reporting to the Finance Committee that the replacement costs would be payable over 2 years (per the Finance Committee meeting on 17 February 2004). At the meeting, Dato' Wong reiterated SB3's view that the replacement should be done only after the Group restructuring because of the tight cash resources available. Nevertheless, by a majority of 3 votes (namely: Paul Cheng; Joseph Fong; and Mr. Gao), the expenditure was approved.

64. Then, without any warning having been given that such an item would be discussed at the Board meeting, Paul Cheng proposed a resolution to dismiss the Finance Committee with immediate effect, alleging that this would improve operational efficiency and, more surprisingly, alleging that the "objective" of the formation of the Finance Committee had already been achieved. SB3 disagreed strongly with this view and Dato' Wong stated that the Finance Committee was necessary to continue in existence as a monitoring body. SB3's representatives were sufficiently disturbed by this development that, after making their views known, they left the meeting.

65. According to the Minute of the Board Meeting later circulated, Paul Cheng declared that a quorum was still present and again by a majority of 3 votes, the resolution to dissolve the Finance Committee was passed.

68. Correspondence ensued by which drafts of the proposed documents were circulated. During this exchange, it was decided that it would perhaps be more efficient if a single document was prepared dealing with each of 3 issues, namely a shareholders' agreement; share subscription agreement; and share repurchase agreement. Mr Ko also advised that the completion of the disposal of IS-China had been extended to a date on or before 31 December 2004; this statement was made in response to a request from Ms. Fung of SB3 in which she noted from the monthly reporting for August 2004 that IS-China had apparently not been formally disposed of. The so-called "3-in-1" agreement was first circulated on 24 September 2004 under cover of an email from Mark Loynd of SB3. Progress thereafter was slow because Paul Cheng wanted to take legal advice on the documents. By 7 December 2004, no comments had

67. By an email dated 2 August 2004 to various directors and shareholders' representatives, Philip Ko advised that the disposal of IS-China was completed on 30 July 2004. He circulated an unsigned copy of the sale and purchase agreement in respect of the disposal. At the same time, Mr Ko's email indicated that the second stage of the Restructuring Plan should then be progressed, namely the repurchase of the preferred shares of the Company. SB3 requested a signed copy many times subsequently to try to determine the true position but, as dealt with below, such a document was only received on 5 October 2005.

66. A further resolution, proposed by Paul Cheng, was also passed, namely that Transaction 1 of the Restructuring Plan (the disposal of IS-China to IOH) should go ahead alone, with Transactions 2 and 3 to be carried out subsequently, on the purported basis it was not possible to conclude all 3 Transactions concurrently. One curious issue is that the Board minute notes that Paul Cheng, Joseph Fong, and Neil Shen each had an interest in the resolution given that they were the beneficial holders of shares in the Company and in IOH, the acquiring party. The Board minute states that "by virtue of Article 72 of the articles of the Company, none of the [3 gentlemen concerned] was excluded from being counted in the quorum or prohibited from voting". Article 72 concerns the convening of extraordinary general meetings of the Company. By Article 107(c)(iii), a director should not be entitled to vote, nor be included in counting for the purposes of reaching a quorum, if a resolution is in respect of any contract or arrangement "or any other proposal whatsoever" in which he has any interest.

been received and SB3, through Ms. Fung, therefore sent an email asking what comments there were and also asking whether Paul Cheng would prefer to have a telephone conversation with the other directors to discuss progress. Again, there was little progress for some time, although during correspondence between the parties involved, SB3 requested the audited accounts for the Company and were told that the latest audited accounts for the Company were as at 31 December 2001.

69. By this time, SB3 were becoming very concerned by the lack of progress on the Restructuring Plan, particularly given that Paul Cheng and others had purportedly passed a resolution at the 3 June 2004 meeting to proceed alone with the disposal of IS-China and, according to the information provided by Philip Ko, such disposal had in fact been concluded. Notwithstanding this, there had been little or no progress on the remainder of the Restructuring Plan, namely those stages by which SB3 (and others) would receive an equity interest in IS-China's new holding vehicle.

70. SB3 therefore instructed Hong Kong solicitors, Messrs. Munros, to write to Paul Cheng and to the Company expressing its concerns. Paul Cheng replied in writing. He denied any wrongdoing and alleged that the terms for the disposal of IS-China had been proposed and agreed by SB3 at the outset. To clarify SB3's position, although it was agreed that IS-China be disposed of at a cash sale price of US\$1.5 million when discussing the Restructuring Plan, such disposal was only contemplated to occur as part of the overall Restructuring Plan. Under the overall Restructuring Plan, those parties holding, and who wished to continue to hold, a stake in the Company (and therefore indirectly in IS-China) would maintain, or even increase, such interest in IS-China. It is of course a completely different matter if the disposal of IS-China were to be made completely separate from any such restructuring. If IS-China were to be simply "sold" then obviously such a sale would have to be at a full commercial value. As dealt with further below, on any view, such valuation is considerably in excess of US\$1.5 million.

71. Presumably in response to the exchange of correspondence between Munros and Paul Cheng, a directors' meeting of the Company was called for 30 May 2005 by way of a notice dated 26 May 2005. Dato' Wong notified the relevant parties by email that he would be travelling in the

morning of 30 May and would be unable to attend. Given the importance of the matters to be discussed at the meeting, SB3 asked that the meeting be deferred so that Dato' Wong could participate. SB3 also questioned the validity of the meeting given that only very short notice had been given. Philip Ko questioned the correctness of the challenge to short notice and insisted that the originally designated time of 30 May 2005 be maintained.

72. Notwithstanding the lack of proper notice, the Board of Directors meeting went ahead on 30 May 2005. At the time of the commencement of the meeting, Mr. Wang of SB3 dialled into the telephone conference facility, explained that he did not have a proxy from Dato' Wong and would like to draw the directors' attention to the fact that the meeting is invalid due to inadequate notice having been given. Mr. Wang then said he would leave the meeting and he did so. Five minutes later, Mr. Mark West, a solicitor with Munros, also dialled into the meeting to reiterate that the meeting was invalid. Paul Cheng aggressively challenged this view and cut off Mr West from the telephone conference.

73. The representative of one of the preferred shareholders, Gavast Estates Limited (the Nan Fung investor), did attend the meeting and reported in outline to SB3 as follows:

- Paul Cheng proposed to pass 2 resolutions:
 - (i) to dissolve formally the Finance Committee (or to ratify the earlier resolution dissolving the Finance Committee). The reason given by Paul Cheng at this meeting was that the Finance Committee had been "illegally set up in the first place". This is in stark contrast to the reasons previously given; and
 - (ii) to dispose of IS-China to IOH for US\$1.5 million.

- Paul Cheng explained that the meeting had been called at a short notice due to SB3's own demand that a board meeting be called "as soon as practicable" in its solicitors' letter of 25 May 2005.

- The restructuring, including disposal of IS-China at US\$1.5 million, had been SB3's idea in the first place, and SB3 was only now "making noises" to try to enlarge its interests to 19%,

76. This was of some concern to SB3. Notwithstanding Dato' Wong's position as a director of IOH, SB3 was not aware of any negotiations with Mizuho. Further, there were concerns as to

75. The next event in relation to the Restructuring Plan, so far as SB3 is concerned, occurred in September 2005 when Philip Ko gave notice to convene a Board meeting of IOH on 21 September 2005. In this regard, it should be noted that although SB3 had not been given any equity stake in IOH, nor invited to acquire such a stake, Dato' Wong had been appointed as a director of IOH. The purpose of the meeting was stated to be to consider and, if thought fit, pass a resolution to approve and authorise a director to sign and execute a share subscription agreement between IOH and Mizuho Securities Co Ltd ("Mizuho"). Under that agreement (the "Mizuho Agreement"), it was apparent that Mizuho was to subscribe for 900 ordinary shares in IOH, at a consideration of US\$450,000.

74. Given the further delay in any concrete move towards SB3 being entitled or invited to participate in the new holding company of IS-China, SB3 engaged a firm of accountants in Hong Kong, Baker Tilly, to conduct a valuation in respect of the Group in August 2005. Perhaps not surprisingly, the result of that exercise concluded that the value of IS-China to the Group was substantially in excess of US\$1.5 million. Baker Tilly valued IS-China at HK\$37.4 million (i.e. US\$4.79 million) using the adjusted net book value method, and at HK\$100.50 million (i.e. US\$12.88 million) using the multiplier method.

- With Paul Cheng abstaining, both resolutions listed above were passed.

IOH, as the new holding company of IS-China.

- Paul Cheng said that there would shortly be called a shareholders' meeting at which all shareholders (including SB3) would be invited to take a pro rata stake in NewCo, namely

Cheng and others.

of Nan Fung being similarly increased, and that this was known to, and recognised by, Paul but it should only be entitled to a pro rata 7.63%. As dealt with above, however, it had long been the intention (of all parties involved) that SB3 increase its stake to 19% with the stake

the content of the Mizuho Agreement. Because of this, SB3 instructed solicitors in Hong Kong, Messrs. Tanner De Witt, to write to Mizuho. The principal concern raised was that the Mizuho Agreement contained a warranty to Mizuho that there was no agreement or commitment to give or create any option, right to acquire etc., any part of the share capital of IOH. Obviously, it was the position of SB3 that it itself had received such a commitment, namely the right to participate in IOH as a result of the Restructuring Plan. Further, the Mizuho Agreement "confirmed" to Mizuho that IOH held 100% of IS-China, yet SB3 had still not received formal confirmation that the transfer of IS-China from ISSL to IOH had been concluded. A short email was received in reply from Mizuho noting the concerns of SB3 and stating that Mizuho would review its investment in IOH in accordance with its investment policy. A notice was then received by email from Philip Ko dated 20 September 2005 postponing to 22 September 2005 the Board meeting originally fixed for 21 September 2005. Again, this is in stark contrast to the occasion when others had sought the short deferral of an earlier (and very important) Board meeting (namely that on 30 May 2005) where Paul Cheng and Philip Ko strenuously opposed such an adjournment.

77. At the IOH Board meeting on 22 September 2005, the resolution to approve and authorise a director to sign and execute the Mizuho Agreement was passed, with Paul Cheng, Joseph Fong, Mr. Chen Zheng, and Mr Gao voting in favour. Mr. Alex Mong of Nan Fung was present as a director of IOH but abstained from voting. SB3's representative voted against the resolution.

78. Several new directors of IOH took part in the meeting who had been appointed without the knowledge of SB3. SB3 asked why these directors had been appointed without any notification being given to SB3 (or at least to Dato' Wong as a board member). There was no response. SB3 also asked whether the number of shares in IOH which had been issued had changed. Philip Ko responded that the number of shares had been increased from 6,200 to 50,000 shares, adding that there was no obligation to tell SB3 (or even Dato' Wong as a director of IOH) of this significant development.

79. As stated above, another concern about the Mizuho Agreement was that it referred to the fact that IOH had completed its purchase of IS-China. Although Philip Ko had indicated that the

80. Subsequent to the meeting on 22 September 2005, Ms. Fung, on behalf of SB3, wrote to Phillip Ko to ask if cash consideration was paid by IOH in respect of the purchase of IS-China and, if so, why it had not been reflected in the accounts of the Company. Mr Ko's response on 4 October 2005 was that the amount of US\$1.5 million had been received in early May 2005 and had been deposited into the bank account of ISSL. He went on to say that notwithstanding this, because of the correspondence from Messrs. Munros in late May 2005, in which the validity of the disposal was questioned, the disposal was "not booked in the monthly management accounts".
81. The same day that this information was received, Mr Ko circulated an email, at the request of Paul Cheng, giving notice of a Board of directors meeting of the Company for 7 October 2005, at which a resolution would be proposed to make an offer to IOH to "buy back" 100% of the shares in IS-China, also at the consideration of US\$1.5 million.
82. However, at the meeting on 7 October 2005, Paul Cheng merely criticised SB3 and, in effect, blamed SB3 for the fact that the Restructuring Plan had dragged on for so long and had now reached a stage where it could not be progressed any further. No resolution was actually

agreement in respect of such disposal had been executed on 30 July 2004, he had subsequently advised that completion of the disposal had been adjourned to 31 December 2004, and no information had been received by SB3 since then to state that the disposal had in fact taken place. In particular, there was no indication in the financial reporting packages received by SB3 (in its capacity as a shareholder of the Company) to indicate that the disposal had been completed. Given the reference to the sale in the Mizuho Agreement, SB3 asked at the 22 September 2005 meeting when IS-China was sold and for how much. Phillip Ko replied that the price had remained at US\$1.5 million and that such sum had been received on 4 May 2005. Ms. Fung then asked what percentage stake in IOH it was intended to give to Mizuho. Phillip Ko's response was "around 1.7%". On the basis that Mizuho were being asked to contribute US\$450,000, this attributes a value to IOH (and in effect IS-China, IOH existing only to hold such company) of a sum in excess of US\$26 million.

proposed. Needless to say, SB3 does not accept Paul Cheng's characterisation of events, or his criticisms of SB3.

83. By an email dated 10 October 2005, Philip Ko circulated draft minutes of the 7 October meeting. The draft minutes did not accord with the recollection and record of SB3. A response to Mr Ko's email was therefore sent recording this dissension, and enclosing a marked up version of the minutes according to the recollection of SB3.

84. A further meeting of the Board of directors of the Company was called for 17 October 2005. The purpose of the meeting was said to be "to consider certain matters relating to (a) the current conditions of Information Security One (China) Limited and possibly funding means and arrangements for its business." Dato' Wong was unable to attend at the proposed time of 17 October 2005 and therefore suggested alternative dates. One of those suggestions was agreed to, and the meeting was thus adjourned to 19 October 2005.

85. At the meeting on 19 October 2005, no resolution was proposed for voting. There was instead a general discussion as to the current state of affairs and Paul Cheng said he would offer to buy SB3's shares in the Company. Dato' Wong indicated that any sale should be by way of implementation of the sale mechanism in the SSA (clause 13) and that as the initiator of a suggestion that shares be sold, as well as the major shareholder of the Company, Paul Cheng should offer a price to all shareholders. The others in attendance agreed with Dato' Wong's comments, but Paul Cheng disagreed and refused to take a count of votes to implement the sale mechanism in the SSA.

86. By this stage, the Restructuring Plan had appeared to have ground to a halt and yet, so far as SB3 was aware, the ownership of IS-China still vested in IOH, in which SB3 had no equity interest. Given this, and given the mounting concern in respect of the management of the Group, SB3 exercised its rights under the SSA to appoint representatives to inspect the books and records of the Company. KPMG were appointed and the report which they produced dated 3 January 2006 highlighted a number of issues of grave concern to SB3.

37. In the meantime, whilst the KPMG report was being compiled, an EGM of IOH was called and held on 7 December 2005. At that meeting, the authorized share capital of IOH was increased from US\$50,000 to US\$1 million and Dato' Wong was removed as a director of the Company. Paul Cheng did, however, agree to provide to SB3 the register of members and register of directors of IOH.

Matters highlighted by the KPMG Report

88. The findings of KPMG are summarised below.

Status of IS-China

89. According to the books and records inspected by KPMG, the change in ownership of IS-China from ISSL to IOH was registered with the appropriate authorities in the PRC. However, KPMG also noted that notwithstanding this, the Group has continued to consolidate IS-China into its management accounts and to provide IS-China with funding and generally to treat IS-China as a member of the Group.

90. It is also noted that as at 31 August 2005, according to the books and records of ISSL and ISHK, IS-China owed those companies, in aggregate, the sum of HK\$46.7 million (i.e. US\$5.99 million). Even more significantly in this regard, KPMG noted that for the monthly management accounts of August 2005 (consolidated) the receipt of US\$1.5 million was recorded as "*refund for possible cancellation of disposal of a subsidiary*". This statement is difficult enough to reconcile on its face, but is even more suspicious given that the funds had actually been received on 4 May 2005.

91. As at 14 November 2005, the balance of the ISSL bank account into which the "sale consideration" of US\$1.5 million was paid on 4 May 2005 stood at around US\$1.1 million.

92. Again notwithstanding receipt of the consideration in May 2005, ISSL and ISHK continued to pay, on behalf of IS-China certain advances to various individuals and entities (in the aggregate

- sum of around US\$2.3 million). Likewise, IS-China remitted HK\$3.5 million (approximately US\$450,000) and HK\$5,200 (approximately US\$670) to ISSL and ISHK respectively.
93. From their investigations, KPMG were able to determine that during the period 1 April 2002 to 31 August 2005, the Company, ISSL and ISHK provided funding to IS-China in the total sum of HK\$33.4 million (approximately US\$4.3 million).
- Best Most Holding Limited*
94. As mentioned earlier in this petition, in December 2002, the Company made a remittance of US\$2 million. That remittance was to a company called Best Most Holding Limited ("Best Most"). During their enquiry, KPMG sought from Phillip Ko an explanation for the remittance. His explanation was that Best Most is a Hong Kong company and that the payment had been made on behalf of ISHK, that company having requested Best Most to act as a sourcing agent for Eastern European software products. This is notwithstanding that the relevant accounting vouchers (and audited accounts) show the payment as a "distribution right".
95. On conducting a search at Companies Registry, it was determined that Best Most is not a company incorporated in Hong Kong. In light of this, Phillip Ko was asked to provide KPMG with various details, including the contract documents evidencing the trading relationship; an explanation why it was necessary to pay a lump sum; and whether Best Most did in fact provide the sources in question. According to the KPMG report, his response was merely to give incomplete details relating to the bank transfer. The only other information that KPMG was able to determine was that the account into which the US\$2 million was paid, apparently by a transfer from CITIC Ka Wah Bank Limited, does indeed appear to be in the name of Best Most.

Intra-group cash transfers with unknown purpose

96. From 31 January 2003 to 28 February 2003, there was a reduction in cash from HK\$53 million (approximately US\$6.8 million) to HK\$28 million (approximately US\$3.6 million). According to the KPMG report, when questioned on this, Philip Ko said that he could not provide any supporting evidence to demonstrate the reason for such drop, as the transaction had been recorded by the previous CFO, David Chan. This matter had been questioned by SB3 in the board of directors meeting on 7 May 2003 and David Chan explained that it was mainly caused by an approximate HK\$21 million (approximately US\$2.7 million) cash outflow to a related company and shown as a receivable "due from related company" in March 2003. However, no further supporting documentation was provided.

Qualified opinion by auditors

97. The KPMG report states that the auditors of the Group have qualified their audit report of the Company for the reasons that there had been a complete failure to prepare consolidated accounts. Further, the auditors qualified their audit reports in respect of ISHK on the ground there was a fundamental uncertainty as to the going concern basis on which the financial statements had been prepared. In their report, KPMG stated that this is because of the losses being made by the Company, ISSL and ISHK. It is only IS-China that makes any meaningful profit.

General reservations

98. In conducting their investigations, KPMG determined that there were a number of failings in the way in which the Company and the Group are managed. As an example, KPMG noted that the opening balance on the management account for IS-China as at 1 January 2005 differs significantly to the closing balance on the audited accounts as at 31 December 2004. Further examples are (a) the fact that the consolidated management accounts for the months May 2005 to August 2005 still included IS-China, notwithstanding the apparent completion of the sale of IS-China to IOH on 4 May 2005; and (b) the fact that, as referred to above, in December 2004,

SB3 learned that the latest audited accounts for the Company were for the period ended 31 December 2001.

99. A further shortcoming was that Philip Ko indicated that, notwithstanding his role as Chief Financial Officer, he did not prepare budgets or forecasts. He was even unaware that audited accounts for certain Group companies had been completed when in fact they had been.

100. A further example is the fact that, when questioned about the performance of IS-China, the Group's principal subsidiary, Mr Ko said that he was only aware of the monthly turnover level.

Winding-Up

101. SB3 invested in the Company on behalf of its own investors, SB3 representing an investment fund, with certain investment objectives in mind, principally investing in a technology business operating in the PRC market with operations that were legitimately and reasonably believed to have a realistic prospect of an IPO in the not too distant future. It was important to SB3 that it maintain some level of control over the management of the Company. As set out in the bulk of this petition, Paul Cheng and the other de facto controllers of the Company have steadily diluted SB3's position. In this regard, the Court is respectfully referred to the following:

(a) The dismissal of the Finance Committee, first at a meeting where such matter had not been proposed in the agenda (which agenda itself was subject to detailed discussion beforehand); and secondly when "ratifying" that decision, giving entirely different reasons for the dissolution;

(b) The threatened removal of SB3's rights to appoint a director and exercise a veto in respect of the Reserved Matters if the Group went ahead with the Restructuring Plan; and

(c) Summary removal of the SB3 representative on the board of IOH.

102. Overall, the relationship of trust and confidence between the shareholders no longer exists as a result of the actions of the de facto controllers of the Company. Such controllers have ignored and sought to remove SB3's legitimate (and contractual) expectations of management. As dealt with in this petition, SB3 has tried to explore ways in which its interests (and the interests of the Minority Shareholders generally) could be protected, but to no avail. Hence, the only option appears to be to invoke the jurisdiction of this Court and seek a winding-up of the Company.

SB3's tangible interest in the liquidation

103. The Company is a holding company. The assets available on a winding-up would therefore be a reflection of the assets of the constituent parts of the Group. The key constituent of the Group has been IS-China. Actions can and should be taken by liquidators of the Company, if appointed, to ensure that IS-China is fully brought back into the Group. If that is achieved, the Company would be solvent, and SB3 would therefore have a tangible interest in its liquidation. If that was not achieved, SB3 is unable to say whether the Company would be solvent or not. As dealt with at length in this petition, the reason that SB3 is unable to assess the Company's current solvency is the lack of any reliable or recent financial information from the Company and those in de facto control of it.

Need for early appointment of Liquidators

104. SB3 justifiably and legitimately has a complete lack of confidence in the current management of the Company. Furthermore, the actions taken by the de facto controllers of the Company thus far give a real and justifiable concern that there is a risk of dissipation of assets to the detriment of SB3 and indeed other Minority Shareholders, and/or that the de facto controllers will otherwise act to the detriment and prejudice of the Minority Shareholders. The IS-China situation offers a very good example as to why third party independent professionals should be placed in charge of the Company to preserve and recover assets and investigate the true position. As set out above, according to the de facto controllers of the Company, IS-China's "sale" was completed in May 2005 at the price of US\$1.5 million (when its true value, based

on the price at which Mizuho was offered shares, was in the region of US\$26 million; a similar valuation being arrived at when considering an earlier proposal, in May 2005, when a company called "GoTo Asia" was given a price of US\$500,000 in order to acquire a 2% stake). Notwithstanding that such sale was allegedly completed in May 2005, the figures for IS-China were still being included in the consolidated accounts of the Group as late as August 2005; IS-China was still receiving funding from the Group; a board of directors meeting was called for the purpose of "buying back" IS-China but this was never followed through (and indeed at the board meeting in question, the resolution not even proposed by Paul Cheng). In addition, the CFO, Philip Ko, knows nothing of the operations of IS-China other than monthly turnover. In fact, no financial update has been provided by the Company to SB3 since August 2005. It is now June 2006 and there has been no improvement in the position.

105. Even more recently, SB3 received from an unknown source (but apparently in the PRC) certain emails. The emails are somewhat childish and are apparently difficult to translate into English given the language used. They appear, however, to be from someone with knowledge of the situation at hand and indicate that Paul Cheng has been attempting to raise funds by selling an interest in IS-China to a yet further group, this time being unidentified investors in the United States.

106. Subsequent to these emails, SB3 was given to understand that Paul Cheng's efforts in the USA had fallen through, but that more concrete information existed that Paul Cheng has:

(a) transferred out of IS-China the bulk of that Company's cash to bank accounts controlled by him personally, allegedly through the use of fake distribution relationships;

(b) transferred (or permitted the transfer) to other entities intellectual property rights in at least two of IS-China's key products, namely "Cyberwall" and "IDS" (or "Internet Detection System"). This has been determined by reference to various licences and certificates registered with or issued by the relevant PRC authorities; and

(c) entered into negotiations to sell IS-China to "Yi Yang Security Tech", a subsidiary of "Yi Yang Communications Equity Limited", a company listed on the main board of the Shanghai Stock Exchange.

107. In addition, the investigations carried out by KPMG in their independent business review revealed a number of transactions that require explanation and which the CFO at least was not able to provide.

108. The matters summarised in paragraphs 104 to 107 above demonstrate that those in de facto control of the Company have conducted its affairs with a lack of probity and in a manner that is prejudicial to SB3 and certain other Minority Shareholders.

Conclusion

In circumstances where SB3 has a justifiable and complete lack of confidence in the conduct and management of the Company's affairs because those in de facto control of the Company have:

(a) conducted the Company's affairs with a lack of probity and in a manner prejudicial to SB3 and certain other Minority Shareholders;

(b) sought to deny SB3's legitimate expectations, and contractual rights, of participation in the management of the Company;

(c) failed to provide information to SB3 and other shareholders which would enable it to assess, among other things, the financial position of the Company,

it is just and equitable that the Company should be wound up pursuant to Section 94(d) of the Companies Law (2004 Revision).

THE PETITIONER THEREFORE PRAYS THAT:

(1) The Company may be wound up by the Court under the provisions of the Companies Law (2004 Revision).

(2) Simon Lovell Clayton Whicker of KPMG Cayman Islands, and Edward Simon Middleton and Jacky Chung Wing Muk of KPMG Hong Kong, be appointed Joint Official Liquidators of the Company with power to act jointly and severally (the **Official Liquidators**).

(3) The Official Liquidators shall not be required to give security for their appointment.

(4) The Official Liquidators shall have power:

(a) to bring or defend any action, suit, prosecution or other legal proceedings, whether criminal or civil, by way of court process or arbitration, in the name and on behalf of the Company.

(b) to take possession of, collect and get in all property or assets (of whatever nature) to which the Company is or appears to be entitled;

(c) to do all things as may be necessary or expedient for the protection of the Company's assets;

(d) to do all things (including the carrying on of the business of the Company) so as may be necessary or expedient for the beneficial realisation of the property or assets of the Company (including power to borrow money);

- (e) to appoint attorneys, solicitors and other professional qualified persons both in the Cayman Islands and elsewhere to assist them in the performance of their duties;
- (f) to appoint agents both in the Cayman Islands and elsewhere to do any business which they are unable to do themselves or which can more conveniently be done by an agent and power to employ and dismiss officers and employees of the Company;
- (g) to make any power which is necessary or incidental to the performance of their duties;
- (h) to open and maintain bank accounts in the name of the Company or themselves anywhere in the world as may be necessary for the better performance of their duties;
- (i) to exercise and execute all the powers set out in Section 109 of the Companies Law (2004 Revision) without sanction or intervention of the Court and unprejudiced by the generality hereof;
- (j) to compromise all calls and liabilities to calls, debts and liabilities capable of resulting in debts, and all claims whether present or future, certain or contingent, ascertained or sounding only in damages, subsisting or supposed to subsist between the Company and any contributory or alleged contributory or alleged contributory or other debtor or person apprehending liability to the Company, upon receipt of such sums payable at such times and generally on such terms as may be agreed upon, with power to take securities for the discharge of such debts or liabilities and to give complete discharges in respect of all or such calls debts, or liabilities; and

- (k) to do and execute all such other things as may be necessary for winding-up the affairs of the Company and distributing its assets;
- and for the avoidance of doubt the powers bestowed on the Official Liquidators may be exercised by them within and outside the Cayman Islands.
- (5) The Official Liquidators be at liberty to apply for further directions relating to the winding-up of the affairs of the Company and the distribution of its assets.
- (6) The reasonable costs of the Petitioner of and incidental to the Petition be paid forthwith from the assets of the Company to be taxed if not agreed.
- (7) The Official Liquidators be at liberty to and do pay themselves, their agents, employees, attorneys, solicitors and whosoever else they may employ or instruct, remuneration and costs in priority to all other debts of the Company pursuant to section 123 of the Companies Law (2004 Revision), and:
- (i) the Official Liquidators shall be entitled to receive remuneration for their services by reference to the time properly given by them and their staff in attending to matters arising in the winding-up and the hourly rates and the amount of remuneration shall be determined in accordance with Rules 4.127 – 131;
- (ii) the remuneration of any other agents, employed or instructed by or on behalf of the Official Liquidators in connection with the performance of their duties be fixed and approved at the rate or rates in the country in which such person is ordinarily employed or engaged in practice;
- (iii) the Official Liquidators be at liberty to pay their agents, employees, attorneys, solicitors and whosoever else they employ or instruct either weekly or monthly or at such other intervals as they consider appropriate;

(iv) the Official Liquidators be at liberty to meet all disbursements reasonably incurred in connection with the performance of their duties;

and for the avoidance of doubt all payments made pursuant to paragraphs 7(i)-(iv) above shall be made as and when they fall due out of the assets of the Company and shall be expenses in the Liquidation.

(8) Such other orders and directions may be made as the Court thinks fit.

DATED this 15th day of June 2006

Campbell

CAMPBELLS
Attorneys-at-Law for the Petitioner

Note: It is intended to serve this Petition on Information Security One Limited

INDORSEMENT

Notice of Hearing

This Petition, having been presented to the Court on June 2006, will be the subject of a directions application to be heard at the Law Courts, George Town, Grand Cayman on June 2006 at a.m./p.m.

This Petition is filed by Campbells, Attorneys-at-Law for the Petitioner, whose address for service is that of its Attorneys-at-Law, Fourth Floor, Scotia Centre, P.O. Box 884, George Town, Grand Cayman, Cayman Islands, B.W.I. (Ref: JRM/GM/12749)