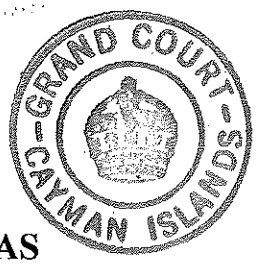
IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO: - FSD 8 of 2012 (PCJ)

Before The Hon Mr. Justice Cresswell
In Chambers
26 September 2013



IN THE MATTER OF THE COMPANIES LAW (2011 REVISION) (AS AMENDED)

AND IN THE MATTER OF DYXNET HOLDINGS LIMITED

Appearances: Mr. Neil Timms QC instructed by and with Charlotte Hoffman of Turners for the Respondent

Mr. Michael Mulligan of Conyers Dill and Pearman for the Petitioners

RULING

TABLE OF CONTENTS

1. THE APPLICATION

The Respondent, Dyxnet Holdings Limited ("Dyxnet" or "the Company") by Summons dated 13 March 2013 (amended with leave on 26 September) applies for security for costs. The amendment set out the basis on which security is sought. It reads

"….. for an Order under the Court's inherent jurisdiction to be exercised in accordance with the principles relating to a non-resident limited liability company when there is reason to believe its assets will be insufficient to pay the costs of the defendant that:-

1. The Petitioners do furnish security for the costs of the Company herein in the sum of US$1,919,688 or such further or other sum that the Court may deem fit and proper…"

2. THE APPLICATION IN A NUTSHELL

In *In the matter of Freerider Limited* [2010 (1) CILR 285] ("Freerider") Foster J held that in the absence of provision in the Companies Winding Up Rules (as amended by the 2010 and 2013 Amendment Rules) ("CWR") specifically giving power to order security for costs in winding-up proceedings governed by the CWR, the Grand Court has no inherent jurisdiction to make such an order.

The Company accepts that the Petition is subject to the CWR. The Company says that the decision of Foster J in *Freerider* as to jurisdiction was wrong (and accepts that it has to convince me that the decision was wrong). The Company's case is that the Court has an "an inherent jurisdiction [to grant security for costs] "…to be exercised in accordance with the principles relating to a non-resident limited liability company when there is reason to believe its assets will be insufficient to pay the costs of the defendant…"

The Petitioners say that *Freerider* was correctly decided and that the Court has no jurisdiction to make the order sought.

The Company says that if there is jurisdiction the Court should grant security having applied the relevant principles that govern the exercise of the discretion. The Petitioners say that even if there is jurisdiction, the Court should not grant security having applied those principles.

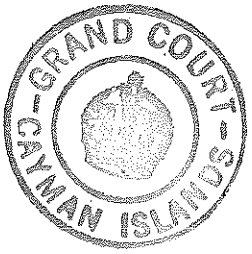
3. THE EVIDENCE

The evidence before the Court is as follows

On behalf of the Respondent:-

The First, Second, Third, Fourth and Fifth Affirmations of Lap Man

The First Affidavit of Astrid Stewart.



On behalf of the Petitioners:-

The Second, Third and Fourth Affidavit of Mr Peter Mok

The First Affidavit of Mr. James Boyd.

4. THE HISTORY OF THE WRIT ACTION AND THE PETITION

The history of this matter and the Writ Action are set out in the latest version of the Agreed Case Memorandum as follows.

"Dyxnet is a holding company incorporated in the Cayman Islands and is the parent company of the Dyxnet group of subsidiaries ("Group") whose business involves providing Internet Protocol Virtual Private Network ("IP VPN") services to customers in the People's Republic of China ("PRC"), Hong Kong and Taiwan.

The Petitioners are companies that are incorporated in the British Virgin Islands. Current Ventures II Limited has been in voluntary liquidation since 8 August 2011. The Petitioners have been shareholders in Dyxnet since January 2001. Until 3 January 2012, Mr Peter Mok was the Petitioners' representative on the Dyxnet board of directors.

On 1 November 2011, Dyxnet carried out a rights issue ("Rights Issue") to which the Petitioners did not subscribe. As a result the Petitioners' collective shareholding was reduced from 26% to less than 1%.

It is Dyxnet's position that the Rights Issue was carried out in order to raise funds for the Company to avoid the threat of a regulatory investigation by the telecommunications authority in the PRC ("CA Threat"). The Petitioners' case is that Dyxnet did not require additional capital as the CA Threat is speculative, and instead, the real purpose of the Rights Issue was to dilute the holdings of the minority shareholders prior to a sale of the Group to France Telecom at a value far in excess of the valuation upon which the Rights Issue is based, and in any event the rights issue is invalid as it was based upon an improper valuation of the Company.

The Petitioners commenced a Writ Action on 1 November 2011 with cause number FSD 177 of 2011 challenging the validity of the Rights Issue on the basis that the board of directors had allotted shares that were not based on a fair and proper valuation.

On 3 January 2012, Mr Peter Mok, the Petitioners' representative on the Dyxnet board of directors, was removed as a director.

On 20 January 2012, the Petitioners issued the winding up petition with cause number FSD 8 of 2012. The Petitioners [sought] the winding up of Dyxnet on just and equitable grounds based on oppressive and unfair conduct as a result of, among other things, the dilution of their economic interest by the Rights Issue and the removal of Mr Mok as a director, or alternative relief by way of a purchase of their shares. [Following an amendment dated 4 May 2012 to the Petition, the only relief now sought by the Petitioners is the purchase of their shares.]

Dyxnet provides IP VPN services in the PRC, Hong Kong and Taiwan. The Group employs more than 400 staff across all offices.

In order to provide these services, the Group leases the existing physical telecommunications infrastructure in different cities and overlays its own equipment on to it to form a PoP (or "point

of presence", which is simply an access point for connecting customers). The PoPs are then linked from one city to another via the internet to allow the Group's customers (which include multi-billion dollar corporates), to connect to their own offices in different cities to form their own virtual private network (all operating on the Group's IP VPN) for the purpose of running important applications such as databases, phone systems, internet access and video conferencing. The internet connections between PoPs are conducted through the usual telecommunications infrastructure, i.e. using the infra-structure of China Telecom and China Unicom. Dyxnet is therefore a paying customer of China Telecom and China Unicom (both of which are owned and controlled by the PRC). China Telecom and China Unicom also provide IP VPN services so they are in direct competition to Dyxnet. The Group is one of only 24 companies in the PRC licensed to provide IP VPN services. The Group is the most powerful non-state owned competitor providing IP VPN services in the PRC.

To operate as an IP VPN service provider, the Group must hold valid licences in the jurisdictions in which it provides services. Over 90% of the Group's revenue is generated in the PRC. Accordingly, the most valuable asset and key licence of the Group is the PRC domestic IP VPN licence held by the Dyxnet subsidiary, Shenzen Diyixian Anlai, a company incorporated in the PRC.

All telecommunications industry service providers in the PRC are regulated by the PRC's Communications Authority (the "Authority"). The Authority is part of the PRC's Ministry of Industry and Information Technology ("MIIT"). The activities of the Authority include regulation of the issuance and renewal of VPN licences, the handling of investigations/complaints and the enforcement of applicable laws and regulations. The Authority enforces the provisions of the PRC's Telecom Ordinance under which it has the power to cancel, suspend or refuse to issue new IP VPN licences and levy fines.

On 22 September 2011, Dxynet received a letter from the Authority dated 15 September 2011 ("CA Letter") in which the Shanghai branch of the Authority requisitioned the Shanghai branches of China Telecom, China Unicom, China Mobile (also state controlled) and China Railway Communications and "relevant domestic IP VPN service providers" to collect and

report to the Authority any evidence or suspicion of any service provider (which included the Group) breaching any licence regulations.

Dyxnet is confident that the Group is not in breach of its licences. However, if China Telecom and/or China Unicom were minded to report that the Group had breached its licences (and being competitors it would be in their interests to make such an allegation), a full investigation may arise. Dyxnet's case is that given the Group is the most powerful competitor in the market that is not owned by the PRC, China Telecom and China Unicom have strong reasons to encourage the Authority to commence a formal investigation. The potential liability from such an investigation could range from anywhere between HK$75 million (approx. US$10 million) to HK$135 million (approx. US$17 million) and/or refusal to renew the Group's IP VPN licence in the PRC.

A similar process was carried out in respect of one of the Group's main competitors, CPCNet, during the period December 2009 to early 2011. The process began by MIIT requesting China Telecom and China Unicom to carry out an information gathering exercise in respect of the operations of CPCNet. China Telecom and China Unicom wrote to all customers seeking this information. The mere receipt of these letters caused serious loss to CPCNet and directly led CPCNet customers to switch their business from CPCNet to other IP VPN service providers, including the Group.

On 11 October 2011, the directors of Dyxnet, including Mr Mok, met to consider the Authority's letter and Dyxnet's response. The directors (with the exception of Mr Mok) considered that the Authority's Letter afforded competitors of the Group, including, in particular, China Telecom and China Unicom, an opportunity to make spurious complaints to the Authority concerning the Group's compliance with its IP VPN licence. They further considered that there was a substantial risk that, in particular, China Telecom and/or China Unicom would make such a spurious complaint.

Further, at that meeting the directors (with the exception of Mr Mok) considered that the Company needed to raise capital so that Dyxnet would be able to demonstrate that it had sufficient available assets to pay any possible fine to the Authority and therefore be able to show

that, on any view, the Group remained solvent such that any possible investigation by the Authority could not imperil its solvency.

At that time Dyxnet's net cash was approximately HK$20 million. The maximum possible fine was determined to be HK$132.5 million (i.e. five times the Group's estimated IP VPN revenue from Dyxnet's Shanghai branch for the year ending 31 December 2011, which was HK$26.5 million). The absolute minimum capital required to be raised was, therefore, HK$112.5 million.

As a result, the directors (with the exception of Mr Mok) determined that it would be sufficient to raise HK$120 million of fresh capital and that the capital should be raised by way of the Rights Issue.

The board of directors of Dyxnet approved the 2011 Rights Issue on 18 October 2011 and, after considering the terms of the prospectus dated 19 October 2011 ("Prospectus"), the shareholders approved it at an EGM on 31 October 2011 (shareholder approval being one of the pre-conditions to the 2011 Rights Issue). The Rights Issue was approved by the shareholders: 16 shareholders representing 73.7% voted in favour, and the two Plaintiffs representing 26.02% voted against. The turnout at the meeting was 99.72%.

The Rights Issue was made available equally to all shareholders, including the Petitioners. The 2011 Rights Issue became unconditional on 1 November 2011 and the First Tranche of new shares was issued.

Summary of Writ Action

The Petitioners commenced the Writ Action on 1 November 2011 seeking a declaration that the Rights Issue is invalid and should be set aside and the cancellation of any shares issued pursuant to the Rights Issue.

On 1 November 2011, the Petitioners also filed a Summons seeking an interim injunction to prohibit Dyxnet from:

(i) Taking any further action in respect of the Rights Issue; and

(ii) Treating any shares that had already been issued pursuant to the Rights Issue as valid for voting purposes or any other purpose.

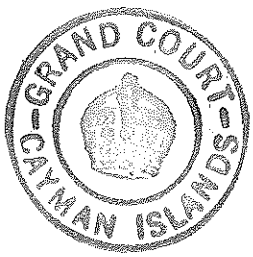
Foster J heard the Summons ex parte on 2 November 2011. Foster J granted the interlocutory injunction on the terms sought together with a further order enjoining the Company from using or otherwise dealing with any subscription proceeds received to date pursuant to the Rights Issue ("Ex Parte Injunction").

The inter partes hearing took place on 25 and 28 November 2011. Foster J discharged the Ex Parte Injunction and granted an interim injunction that enjoined Dyxnet, until trial of the action or further order of the Court, from treating the shares issued pursuant to the Rights Issue as validly issued for any purpose whatsoever ("Interim Injunction"). This Order did not continue that part of the Ex Parte Injunction that enjoined Dyxnet from taking any further action in respect of the shares issued pursuant to the Rights Issue and preventing Dyxnet from dealing with the subscription proceeds. This was because the Petitioners conceded that they would not seek to restrict Dyxnet from dealing with the subscription proceeds of the Rights Issue on the basis that they did not want to interfere with the commercial operations of the Company.

Foster J granted Dyxnet leave to appeal. On 2 December 2011 Dyxnet filed its Notice and Grounds of Appeal.

At the invitation of the Court of Appeal, on 15 December 2011 Dyxnet issued a Summons seeking the variation or discharge of the Interlocutory Injunction. The Petitioners opposed the application.

On 22 December 2011, to enable Dyxnet to deal with the proceeds of the Rights Issue and to avoid the need for an Appeal, Dyxnet and the Petitioners agreed that the Interim Injunction would be discharged on Dyxnet giving the following undertakings:



(i) Dyxnet would seek shareholder approval at an extraordinary general meeting in advance of any sale or disposition of Dyxnet's shares in its subsidiaries or associates;

(ii) In the event of such a sale, Dyxnet would retain at least 26.02% of the proceeds received by it from such sale. This represents the percentage of shares held by the Petitioners before the Rights Issue; and

(iii) The Petitioners would be provided with the minutes of board meetings and unaudited financial statements at agreed times.

On 22 December 2011, Foster J duly made a consent order in these terms. These undertakings remain in force. On 29 December 2011 the Company withdrew its Notice of Appeal.

The parties' attorneys corresponded to confirm whether or not the Petitioners intended to amend their Statement of Claim. It was agreed that Dyxnet would have a general extension of time to file its Defence until the Petitioners had confirmed their position.

On 30 December 2011, the Petitioners wrote to Dyxnet offering to sell its shares to Dyxnet or the majority of the shareholders (at the pre-Rights Issue percentage of shares) at a value based on sale to a third party. On 5 January 2012, Maples and Calder confirmed that they were taking instructions, but no response to this offer has been made.

On 3 January 2012, Mr Mok was removed from the board of directors of Dyxnet by way of a majority vote of shareholders at an EGM that had been requisitioned by one of Dyxnet's shareholders.

On 20 January 2012, the Petitioners confirmed that they would not amend their Statement of Claim. On 28 February 2012 the Company filed its Defence and served a request for Further and Better Particulars of the Statement of Claim.

The Petitioners did not file a Reply (and so pleadings closed on 13 March 2012). On 19 April 2012 the Petitioners served Further and Better Particulars of the Statement of Claim.

Summary of Winding Up Proceedings to date

On 20 January 2012, the Petitioners presented and served the Petition.

On the same day the Petitioners also filed a Summons for directions pursuant to CWR O. 3, r. 11. Foster J heard the application on 10 February 2012 and made orders that Dyxnet is properly able to participate in the proceedings, that the Petition and related affidavits, the summons and order all be served on Dyxnet's shareholders, and the Petition is not be advertised. Following service of those materials, none of Dyxnet's other shareholders have elected to participate in these proceedings.

Dyxnet issued the Summons to strike out the Petition on 7 February 2012. This Summons was listed for hearing on 27 April 2012.

On 19 April 2012 the Petitioners sent a draft Amended Petition.

By order dated 27 April 2012 the Writ Action was discontinued. The costs of the Writ Action were reserved to the trial Judge in cause number FSD 8 of 2012. On the same day directions were given in these proceedings. On 4 May 2012 the Petitioners filed an Amended Petition. The amendments include a deletion of the winding up prayer in the Petition. The Petitioners seek a "buy-out" order in the Petition under section 95(3) of the Companies Law (2011 Revision) (As Amended).

On 10 September (upon the Court noting that it expressed no opinion on the entry into and/or completion by the Company of the agreement for the sale and purchase of the entire issued share capital of Diyixian.com Limited and Shareholder Loan dated 13 August 2013 between the Company and Upwise Investments Limited (the "Proposed Disposal")), it was ordered that in the event of completion of the Proposed Disposal by the Company, the Company shall retain at least 26.02% of the cash consideration paid on the date of completion pending further direction of the Court or the hearing of the Petition.

5 DYXNET'S SUBMISSIONS

Mr Neil Timms QC on behalf of Dyxnet submitted as follows.

Both Petitioners were incorporated in the BVI. Current Ventures II has been in liquidation since August 2011. Current Ventures IIA was, according to its constitutional documents, due to be liquidated in October 2012. The fact that a company is in liquidation is prima facie evidence that it is unable to pay the costs. A similar approach should be taken to a company on the verge of liquidation.

The Court has jurisdiction to grant full and adequate security under its inherent jurisdiction as if section 74 of the Companies Law (2012 Revision) applied.

The Petitioners cannot show a high probability of success. Questions of valuation, disputes about the rationale for a rights issue and proof of a quasi partnership are questions of fact that can only be determined at trial. Analysis of the true position of the Petitioners demonstrates they would be unable to meet a costs order.

The GCR do not apply to proceedings governed by the CWR save where set out in the CWR or in GCR O. 1, r.2. In *In the Matter of the Sphinx Group of Companies* [2010] 2 CILR 1], however, Smellie CJ determined that in the absence of express rules in the CWR, the Court was entitled to make orders in winding up proceedings in the exercise of its inherent jurisdiction. This case dealt with whether it was possible to make representation orders in winding up proceedings.

In *Freerider* Foster J. decided that in the absence of express provision in the CWR providing it, the Court had no power to grant security for costs in proceedings governed by them. He decided that as CWR O.24 made provision for costs and GCR O.23 was not specifically incorporated, the absence of power must be deliberate and such power would be inconsistent with the overall scheme. He therefore concluded that the Court had no inherent power to grant security in winding-up proceedings. Foster J did not have the advantage of considering the decision of the

Privy Council in *In the Matter of Bancredit Cayman Limited* [2009] CILR 578 ("Bancredit") and his decision is wrongly decided.

CWR O.1. r. 4 refers for utility to certain Grand Court Rules that specifically apply to winding up proceedings. It is not exhaustive. CWR O.24 is not a comprehensive scheme. It is supplementary to the existing powers of the Court in relation to costs and determines how costs will be applied in particular circumstances.

The Privy Council in *Bancredit* determined that security could be awarded against a company that had appealed a liquidator's decision to reject a proof of debt. That appeal fell within section 74 of the Companies Law (2004 Revision) and GCR O.23, r.1. The Privy Council held that the power of the Court to grant security in suitable circumstances was independent of the Company Law or O.23 and was to be exercised in whatever way appears just in the circumstances. The rules of court regulate but do not confer jurisdiction. It is the settled law that the ordinary practice as to ordering security for costs applies in winding up proceedings and that was the position when RSC O.23 applied only to "causes or matters" and not to "proceedings".

The general practice of the Court on security applies to winding up proceedings. The general rule is that an unsuccessful petitioner must pay the costs of the company *(McPherson's Law of Company Liquidation* 2nd Ed 3.085; 3.086). A petitioner was generally required to furnish security if insolvent, resident abroad or in other special circumstances (McPherson *ibid* 3.072). If the CWR were to regulate the settled law by limiting the inherent jurisdiction it must do so specifically. It cannot have been the intention that the CWR should displace such a fundamental general principle by making no reference to the power, and that is not the effect of the omission. The decisions in *Gong v CDH China Management Company Limited* [2011 (1) CILR 57] and *Elliott v Cayman Islands Health Service Authority* [2007] CILR 163], that security should be limited by reference to the additional cost of enforcement in the foreign jurisdiction were both concerned with natural persons as plaintiffs.

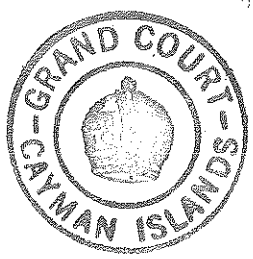
In *Gong* Jones J., following the approach of Sanderson J (Ag). in *Elliott*, considered security in the context of GCR O.23, r.1(1)(a). He determined that security in respect of a natural person

plaintiff who was ordinarily resident abroad with no assets in the Cayman Islands must be capped by reference to the additional cost of enforcement in the foreign jurisdiction. The purpose of the rule was now solely to protect defendants against the extra difficulty and cost of enforcing a Cayman costs order in a foreign jurisdiction.

The departure from the former practice was justified on the basis that the discretionary power could not be used for a purpose contrary to the public policy of the Islands. Jones J. determined:

1) the foreign residence ground must be reconciled with Article 14 of the European Convention for the Protection of Human Rights and Fundamental Freedoms to which the Islands are a party; and

2) as a matter of public policy foreigners were to be encouraged to litigate here.



The former approach to security still applies in respect of limited companies.

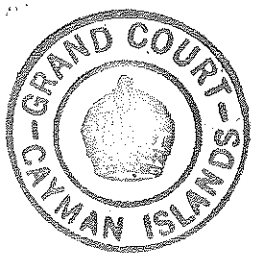
By section 74 of the Companies Law (2012 Revision) the Court, if satisfied in a legal proceeding that there is reason to believe that if a defendant is successful in his defence, the assets of a company will be insufficient to pay his costs, may require that the company provide sufficient security to be given for such costs. For these purposes, proceedings include those brought by Petition (RSC. O. 23/3/2).

The same approach is to be adopted in respect of foreign limited companies for the same public policy reasons. There is no good reason why foreign companies should be at an advantage over local companies. Indeed it is discriminatory for foreign resident limited companies to be treated differently from domestic companies. It is unnecessary for the Court to consider if *Gong* and *Elliott* were wrongly decided because they were concerned with GCR O. 23, r. 1 (1)(a), not the inherent jurisdiction, and the Petitioners in this case are both limited companies.

If unsuccessful, the Petitioners will not only have to pay the Defendant's costs but their assets available to meet the order will have been depleted by their own costs. The Petitioners have a

portfolio of assets that are almost entirely illiquid shares. There is clearly reason to believe that if Dyxnet is successful in its defence, the Petitioner's assets will be insufficient to pay its costs.

6. THE PETITIONERS' SUBMISSIONS



Mr Michael Mulligan for the Petitioners submitted as follows.

In the absence of provision in the CWR specifically giving power to order security for costs in winding-up proceedings governed by the CWR (which includes all winding up petitions presented on or after 1 March 2009), the Court has no jurisdiction to make the order sought by the Company. The Court's inherent jurisdiction should only be exercised if consistent with, and supplementary to, the whole scheme of the CWR. Since O.23 of the GCR is not included within the rules explicitly incorporated into the CWR (unlike O.62 of the GCR on costs) - either by O.1, r.4 of the CWR or by O.1, r.2(4) of the GCR - and as the Insolvency Rules Committee explicitly made provision for costs in O.24 but not security for costs, it is more likely than not that this was a deliberate omission. A power to order security for costs would be inconsistent within the overall scheme of the CWR. Foster J, in *Freerider*, held that the Court did not have inherent jurisdiction to make an order for security for costs in winding up proceedings.

In *Bancredit*, the Privy Council held that the Court does retain an inherent jurisdiction to award security for costs which is not fettered by the absence of a specific security for costs procedure in the winding up rules. This case was however decided by reference to the insolvency regime that existed in the Cayman Islands before the CWR came into force on 1 March 2009.

There is no lacuna in the CWR relating to security for costs. The Court does not have inherent jurisdiction to make an order for security for costs in these proceedings and the Company's application should be dismissed following the decision of the Court in *Freerider*. The modern practice is that a judge of first instance will, as a matter of judicial comity, usually follow the decision of another judge of first instance unless he is convinced that that judgment was wrong.

The matter of security for costs is governed by the CWR which provide no power for the Court to make such an order in proceedings governed by them. The Company's application should therefore be dismissed.

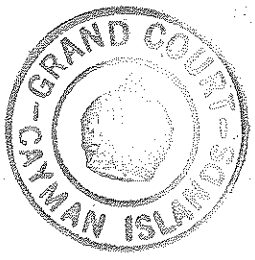
Alternatively, (if there is jurisdiction to grant security) there has been significant delay in bringing the application. There is no evidence before the Court that there is a real risk that any future order for costs will not be met by the Petitioners. The conduct of the Company and its senior management must be taken into consideration. The application for security is being used oppressively to stifle a genuine claim brought by minority shareholders. The Company could seek to enforce any order for costs against the Petitioners in the British Virgin Islands as readily as it could were the Petitioners resident in the Cayman Islands and the cost of doing so would not be significantly more. The costs claimed by the Company are entirely unreasonable. The Company is secured to the extent of the value of the Petitioners' shareholdings.

7. ANALYSIS AND CONCLUSIONS

It is common ground that the CWR 2008 (as amended in 2010 and 2013) apply to the Petition in the present case.

The current provisions for security for costs are found in GCR O.23, r. 1 and section 74 of the Companies Law.

Security for Costs – the GCR



The GCR provide in O.23, r.1:

"Security for costs of action, etc. (O.23, r.1)

1. (1) Where, on the application of a defendant to an action or other proceedings it appears to the Court –

(a) that the plaintiff is ordinarily resident out of the jurisdiction; or

(b) that the plaintiff (not being a plaintiff who is suing in a representative capacity) is a nominal plaintiff who is suing for the benefit of some other person and that there is reason to believe that he will be unable to pay the costs of the defendant if ordered to do so; or

(c) subject to paragraph (3), that the plaintiff's address is not stated in the writ or other originating process or is incorrectly stated therein; or

(d) that the plaintiff has changed his address during the course of the proceedings with a view to evading the consequences of the litigation,

then if, having regard to all the circumstances of the case, the Court thinks it just to do so, it may order the plaintiff to give such security for the defendant's costs of the action or other proceedings as it thinks just.

(2) For the purposes of this rule a person is deemed to be ordinarily resident out of the jurisdiction if he does not have the right either to reside permanently in the Islands or have the right to work in the Islands. …

(4) The references in the foregoing paragraphs to a plaintiff and a defendant shall be construed as references to the person (howsoever described on the record) who is in the position of plaintiff or defendant, as the case may be, in the proceedings in question, including a proceeding on a counterclaim."

Section 74 of the Companies Law

Section 74 of the Companies Law (which provides that "Where a company is plaintiff in any action, suit or other legal proceeding, any Judge having jurisdiction in the matter, if he is satisfied that there is reason to believe that if the defendant is successful in his defence the assets of the company will be insufficient to pay his costs, may require sufficient security to be given for such costs, and may stay all proceedings until such security is given") only applies to

companies formed and registered under the Companies Law (section 2(1)). Thus section 74 does not apply to the Petitioners.

The changes in late 1988/early 1989 – Amendments to GCR and the introduction of the CWR

The GCR (Revised Edition Amended 01.01.09/Amended 01.11.09) provide in O. 1, r. 2:-

> "(4) Except for Orders 3 (Time), 4 (Assignment, Transfer and Consolidation of Proceedings), 5 (Mode of Beginning Proceedings), 38 Part II (Writs of Subpoena), 39 (Evidence by Deposition), 62 (Costs), 67 (Change of Attorney), 45-51 (Enforcement) and 52 (Committal) these Rules **shall not apply** to any proceedings which are –
>
> (a) governed by the Matrimonial Causes Rules (2005 Revision),
>
> (b) governed by the Grand Court (Bankruptcy) Rules 1977, as amended,
>
> (c) governed by the Companies Winding Up Rules 2008; or
>
> (d) on appeal from civil proceedings in the Summary Court." (emphasis added)

The CWR (made by the Insolvency Rules Committee pursuant to section 155 of the Companies (Amendment) Law 2007) which first came into force in early 2009 provide in O.1, r.2:

> "(1) These Rules shall apply to –
>
> (a) every winding up petition presented on or after the commencement date;
>
> (b) every other application made under Part V of the Law on or after the commencement date;…
>
> (2) The English Insolvency Rules 1986 (SI.1986/1925) shall cease to have any application with effect from the commencement date."

Part V of the Law includes section 95. (The order now sought in the Amended Petition is "(1) An order made under section 95(3) of the Companies Law (2011 Revision) (As Amended) providing for the purchase of the pre-Rights Issue shares of the Petitioners by other members or by the Company itself…").

CWR O.1, r.4 provides:

"Application of Grand Court Rules (O.1, r.4)

4. (1) Every petition, summons, order or other document required to be served by these Rules, shall be served in accordance with GCR Orders 10 and 65, unless some other method of service is expressly required or permitted by these Rules.

(2) Every affidavit or other document filed in the Court office shall comply with the requirements of GCR Orders 41 and 66.

(3) Every order or direction made in a winding up proceeding shall comply with the requirements of GCR Order 42.

(4) All funds required to be paid into or out of Court in connection with any winding up proceedings shall be lodged, paid, invested and dealt with in accordance with GCR Order 92."

See further other references to the GCR in the CWR.

The decision in Freerider

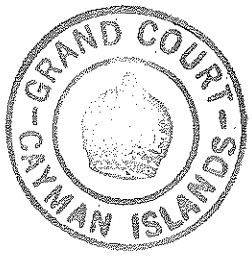
In *Freerider* Foster J held that the Court does not have power to order security for costs in proceedings governed by the CWR.

In that case the petitioner sought the winding up of a Cayman company on the just and equitable ground. The company was established as a quasi-partnership between the petitioner and respondent (each party holding 50% of the voting shares) to exploit commercially an invention of the petitioner. However, the relationship between the parties had irretrievably broken down, and the petitioner sought the winding up of the company to end their joint venture. The petition was opposed by the only other voting shareholder, the respondent. Both shareholders were resident overseas. The Grand Court had directed that since this was in reality a dispute between shareholders, the petition be heard *inter partes,* with the company not to participate and incur costs. The respondent sought an order for security for costs.

The respondent submitted that, notwithstanding that O.23 of the GCR had not been specifically extended to proceedings governed by the CWR, the Court possessed an inherent jurisdiction to make an order for security for costs in such proceedings since, by analogy with the power to amend a defective petition, such a power supplemented and was consistent with the overall scheme of the Rules.

Foster J held, refusing the application for security for costs, that in the absence of provision in the CWR specifically giving power to order security for costs in winding-up proceedings governed by the CWR, the Grand Court had no inherent jurisdiction to make such an order. The Court's inherent jurisdiction would only be exercised if consistent with, and supplementary to, the whole scheme of the Rules. Since O.23 of the GCR was not included within those rules explicitly incorporated into the CWR (unlike O.62 of the GCR on costs) – either by O.1, r.4 of the CWR or by O.1, r.2(4) of the GCR – and as the Insolvency Rules Committee had explicitly made provision for costs in O.24 but not security for costs, it was likely that this was a deliberate omission and a power to order security for costs, in contrast with the power to permit amendment, would be inconsistent within the overall scheme. Thus the Court did not have inherent jurisdiction to make an order for security for costs and the application was refused.

In his judgment Foster J said:



"The petition in the present case is dated and was filed on March 6th, 2009 and accordingly it is governed by the Companies Winding Up Rules and not by the Grand Court Rules. The Companies Winding Up Rules contain no provision relating to security for costs.

Order 1, r.4 of the Companies Winding Up Rules does provide that certain of the Grand Court Rules should apply in winding-up proceedings. They are O.10 and O.65 (in para. (1)), O.41 and 66 (in para. (2)), O.42 (in para. (3)) and O.92 (in para. (4)). Order 23 is clearly not one of the Grand Court Rules which is incorporated into the Companies Winding Up Rules or said to apply to proceedings such as these.

The Grand Court Rules themselves provide in O.1, r.2(4) as follows:

> "Except for Orders 3 (Time), 4 (Assignment, Transfer and Consolidation of Proceedings), 5 (Mode of Beginning Proceedings), 38 Part II (Writs of Subpoena), 39 (Evidence by Deposition), 62 (Costs), 67 (Change of Attorney), 45–51 (Enforcement) and 52 (Committal) these Rules shall not apply to any proceedings which are—
>
> . . .
>
> (c) governed by the Companies Winding Up Rules 2008 . . ."

It is notable that O.62 of the Grand Court Rules relating to costs is specifically made applicable to proceedings governed by the Companies Winding Up Rules but, as I have said, there is no inclusion of O.23.

Having heard the submissions of counsel for Mr. Heinen, counsel for Mr. Le Comte conceded that O.23 of the Grand Court Rules is not made applicable to proceedings governed by the Companies Winding Up Rules but argued that the court nonetheless has an inherent jurisdiction to make an order for security for costs in such proceedings in appropriate circumstances.

Reference was made by both counsel to the recent judgment of the Court of Appeal in *HSH Cayman I GP Ltd.* v. *ABN AMRO Bank N.V.* 2010 (1) CILR 114 in which the circumstances in which the court has and may invoke an inherent jurisdiction was extensively discussed in the context of the court below having exercised a purported inherent power to dispense with strict

compliance with certain provisions of the Companies Winding Up Rules. Chadwick, P., in giving the judgment of the court, referred to the decision of the Court of Appeal in England in *Raja* v. *Van Hoogstraten (No. 9).* He also referred to the recent decision of the Privy Council in *Texan Management Ltd.* v. *Pacific Elec. Wire & Cable Co. Ltd.* when it was said with reference to the *Raja* case ([2009] UKPC 46, at para. 57):

> ". . . [T]he modern tendency is to treat the inherent jurisdiction as inapplicable where it is inconsistent with the CPR [Civil Procedure Rules], on the basis that it would be wrong to exercise the inherent jurisdiction to adopt a different approach and arrive at a different outcome from that which would result from an application of the rules: *Raja* v. *Van Hoogstraten (No. 9)* [2009] 1 W.L.R. 1143. That decision concerned the court's power under the inherent jurisdiction to set aside an order made without notice *ex debito justitiae.* It was held that although the inherent jurisdiction may supplement rules of court, it cannot be used to lay down procedure which is contrary to or inconsistent with them, and therefore where the subject matter of an application is governed by the CPR it should be dealt with in accordance with them and not by exercising the court's inherent jurisdiction."

The Court of Appeal concluded, *inter alia* (2010 (1) CILR 114, at para. 27), that—

> "(3) In the absence of a power to relieve from the consequences of failure to comply with the Winding Up Rules either in the Rules themselves; or incorporated in the Rules by reference to the Grand Court Rules; or made applicable to winding up by the Grand Court Rules; or exercisable pursuant to s.18(2) of the Grand Court Law, the judge was entitled to invoke the inherent jurisdiction of the court to control its own process. But, in exercising that power, he was not entitled to vary the scheme for the winding up of companies in this jurisdiction laid down by the Winding Up Rules."

The upshot of this guidance, as I understand it, is that the court's inherent power may be exercised to supplement the Companies Winding Up Rules but only in a way that is not inconsistent with their overall scheme. If my understanding is correct, the question in this case is

therefore whether an inherent power to order the petitioner to give security for costs would or would not be inconsistent with the overall scheme of the Companies Winding Up Rules.

Counsel for Mr. Le Comte pointed out that in a recent decision of Jones, J. at another stage of the same case—*HSH Cayman I GP Ltd.* — he granted leave to the petitioners to amend their petitions notwithstanding that the Companies Winding Up Rules do not contain any express power to allow a winding-up petition to be amended and the power to allow the amendment of a petition contained in O.20, Rs. 5 and 7 is not one of the Grand Court Rules which the Companies Winding Up Rules provide is applicable. In giving leave to amend, the judge considered that the court has an inherent power to allow amendment of a winding-up petition on the ground that such a power is clearly not inconsistent with the overall scheme of the Companies Winding Up Rules. He considered that the existence of a power to amend is a useful supplement to the Companies Winding Up Rules and is anyway necessary to give effect to the Rules because it would otherwise be impossible to make an order substituting a party to the proceedings. Counsel for Mr. Le Comte argued that by analogy the power to make an order for security for costs was also not inconsistent with the overall scheme of the Companies Winding Up Rules and was a desirable and useful supplement to them. He contended that there is an obvious lacuna in the Companies Winding Up Rules in this respect and that it should be filled by the exercise of the court's inherent jurisdiction.

In my opinion, it cannot be said that an inherent power to order security for costs would not be inconsistent with the overall scheme of the Companies Winding Up Rules. Both the Grand Court Rules and the Companies Winding Up Rules incorporate specific orders of the former into the latter, including O.62 relating to costs. The Companies Winding Up Rules also contain other provisions relating to costs, particularly the provisions of O.24, yet they make no reference to security for costs. In the circumstances, it does not seem to me that I can or should assume that the absence of a provision in the Companies Winding Up Rules relating to security for costs was an omission by the Insolvency Rules Committee, established pursuant to s.155 of the Companies (Amendment) Law 2007. It may equally well have been intentional. In fact, on balance it seems to me that the probability is that it was. Clearly, the Rules Committee had costs in mind in determining that O.62 of the Grand Court Rules should be applicable and also in including the

provisions of O.24 of the Companies Winding Up Rules. In those circumstances it would be surprising if the absence of any provision relating to security for costs was simply an accidental omission. I do not consider that it can or should necessarily be inferred that there is a lacuna in the Companies Winding Up Rules in this respect. It is more likely in my opinion that the absence of any provision for security of costs in the Companies Winding Up Rules reflects a deliberate decision by the Rule Committee having regard to the nature of proceedings governed by the Rules. I do not think it is appropriate for me to speculate in this regard but I do not consider that it can be said that security for costs is or should necessarily be inferred to be part of the overall scheme of the Companies Winding Up Rules.

I respectfully agree with Jones, J. that an inherent power to allow amendment of a winding-up petition is clearly supplemental to the Companies Winding Up Rules and not inconsistent with the overall scheme; on the contrary, it is necessary and appropriate. A power to allow an amendment of the petition is, in my opinion, fundamentally different from a power to order security for costs and I do not accept the analogy which was suggested. As I have said, in my view it cannot be said that power to order security for costs is necessarily consistent with the overall scheme of the Companies Winding Up Rules. It follows that it is accordingly not a power which can appropriately be exercised inherently in those circumstances. The matter of security for costs is governed by the Companies Winding Up Rules which provide no power for the court to make such an order in proceedings governed by them."

Decisions of courts of co-ordinate jurisdiction

Halsbury's Laws of England Civil Procedure (Volume 11 (2009) 5th Edition paragraph 98 (Decisions of co-ordinate courts) states:-

"There is no statute or common law rule by which one court is bound to abide by the decision of another court of co-ordinate jurisdiction. Where, however, a judge of first instance after consideration has come to a definite decision on a matter arising out of a complicated and difficult enactment, the opinion has been expressed that a second judge of first instance of co-ordinate jurisdiction should follow that decision; and the modern practice is that a judge of first instance will as a matter of judicial comity usually follow the decision of another judge of first

instance unless he is convinced that that judgment was wrong. Where there are conflicting decisions of courts of co-ordinate jurisdiction the later decision is to be preferred if reached after full consideration of earlier decisions."

This practice applies in the Cayman Islands. In *In the matter of Bank of Credit and Commerce International (Overseas) Limited (in liquidation)* [1994-1995 CILR 56] Harre CJ said:-

"[Counsel] asks me to take the view that this and other observations of my learned predecessor to which I shall refer later were in part *obiter,* in part distinguishable and should not in any event be followed. I would not lightly adopt the last of these alternatives, although it is open to me to do so. The principle is to be found in the following passage from the judgment of Lord Goddard, C.J. in *Huddersfield Police Auth. V. Watson* ([1947] K.B. at 848):

> "... I can only say for myself that I think the modern practice, and the modern view of the subject, is that a judge of first instance, though he would always follow the decision of another judge of first instance, unless he is convinced the judgment is wrong, would follow it as a matter of judicial comity. He certainly is not bound to follow the decision of a judge of equal jurisdiction."

Am I convinced that the decision in Freerider was wrong?

I am concerned with a decision of another judge of co-ordinate jurisdiction sitting in the Financial Services Division.

I have carefully consider Mr. Timms' submissions set out above.

I am not convinced that the decision of Foster J was wrong. Accordingly I follow and apply that decision. Because of the importance of the point I will grant leave to appeal so that the point can be considered by the Court of Appeal.

The Privy Council in *Bancredit* was concerned with

(a) O.23, r.1 of the Grand Court Rules 1995 (as revised in 2003);

(b) Applications under the Insolvency Rules 1986 which were -

(c) "Essentially free-standing" originating applications.

The decision of the Chief Justice in *In the matter of Cybervest Fund* [2006 CILR 80] was well before the introduction of the CWR.

The decision of the Chief Justice in *In the matter of the Sphinx Group of Companies* [2010 (2) CILR 1] was concerned with a representation order, not security for costs.

The formulation of the jurisdiction asserted in the amended summons

The formulation of the jurisdiction asserted in the amended summons should be noted - "an Order under the Court's inherent jurisdiction to be exercised in accordance with the principles relating to a non-resident limited liability company when there is reason to believe its assets will be insufficient to pay the costs of the defendant".

The application does not rely in terms on O.23, r.1, whether O.23, r.1 is to be regarded as an extension or limitation of the Court's inherent jurisdiction (see Lord Neuberger in *Bancredit* at paras 30 and 31).

Section 74 of the Companies Law has never been part of the inherent jurisdiction of the Grand Court. Whether it is to be regarded as an extension or limitation of the inherent jurisdiction (see Lord Neuberger in *Bancredit* at paras 30 and 31), it only applies to companies formed and registered under the Companies Law (Section 2(1)).

The Civil Procedure Rules and the Insolvency Rules in England and Wales

The Civil Procedure Rules are, of course, not applicable in the Cayman Islands. CPR 25.13 provides:

"Conditions to be satisfied

(1) The court may make an order for security for costs under rule 25.12 if –

(a) it is satisfied, having regard to all the circumstances of the case, that it is just to make such an order: and

(b) (i) one or more of the conditions in paragraph (2) applies, or

(ii) an enactment permits the court to require security for costs.

(2) The conditions are –

(a) the claimant is –

(i) resident out of the jurisdiction; but

(ii) not resident in a Brussels Contracting State, a State bound by the Lugano Convention or a Regulation State, as defined in section 1(3) of the Civil Jurisdiction and Judgments Act 1982;

(b) [omitted]

(c) the claimant is a company or other body (whether incorporated inside or outside Great Britain) and there is reason to believe that it will be unable to pay the defendant's costs if ordered to do so;

(d) the claimant has changed his address since the claim was commenced with a view to evading the consequences of the litigation;

(e) the claimant failed to give his address in the claim form, or gave an incorrect address in that form;

(f) the claimant is acting as a nominal claimant, other than as a representative claimant under Part 19, and there is reason to believe that he will be unable to pay the defendant's costs if ordered to do so;

(g) the claimant has taken steps in relation to his assets that would make it difficult to enforce an order for costs against him.."

Rule 25.13(2)(c) applies to all companies, whether limited or unlimited and whether incorporated in England and Wales or elsewhere (see generally *Jirehouse Capital v Beller* [2009] 1 W.L.R. 751). In times past the rule duplicated section 726(1) of the Companies Act 1985. However, as from October 1, 2009, section 726(1) was repealed and not replaced (Companies Act 2006 (Commencement No.8 Transitional Provisions and Savings) Order 2008 (SI 2008/2860). (Civil Procedure Volume 1 25.13.12)

By the Insolvency (Amendment) Rules 2010, 7.51A (Principal court rules and practice to apply)

"...the provisions of the CPR (including any related practice direction) not referred to in the table apply to proceedings under the Act and Rules with any necessary modifications, except so far as inconsistent with these Rules."

Thus the approach adopted in England and Wales differs from that adopted in GCR O.1, r.2(4).

The role of Rules Committees

Rules Committees have a central part to play in formulating rules, in particular for present purposes in relation to security for costs.

In *C.T. Bowring & Co. (Ins.) Ltd. v. Corsi & Partners Ltd.* ([1994] 2 Lloyd's Rep. 570), Dillon, L.J., said at page 571

"to add a new category, not covered by any enactment, to those listed in r.1(1) in which a plaintiff can be ordered to give security would now be a matter for the Rules Committee, and not for the discretion, as a matter of inherent jurisdiction, of the individual Judge in the individual case."

The practice as to security for costs as reflected in Court Rules changes from time to time. The conditions to be satisfied in paragraph (2) of CPR 25.13 are more extensive than those in GCR O.23. The Rules Committees in this jurisdiction when making rules from time to time will no doubt consider such matters as whether the public policy of the Cayman Islands as stated by Jones J in *Gong* at paragraphs 13 and 14 should or should not be taken into account, whether article 7 of the Bill of Rights (the right to a fair trial and public hearing) is or is not engaged, and other considerations.

Freerider

Foster J said in *Freerider*

"...it does not seem to me that I can or should assume that the absence of a provision in the Companies Winding Up Rules relating to security for costs was an omission by the Insolvency Rules Committee... It may equally well have been intentional. In fact, on balance it seems to me that the probability is that it was."

Foster J was no doubt familiar with the general approach of the Insolvency Rules Committee, including the extent of its practice to review the working of the CWR from time to time.

The decision in *Freerider* was in March 2010. No relevant change to the GCR or CWR has been made since then.

In all the circumstances set out above I do not consider that I should depart from the decision in *Freerider* given by a judge of co-ordinate jurisdiction.

The application is accordingly dismissed.

DATED this 8th day of October 2013

Cresswell J

The Hon. Mr. Justice Cresswell
Judge of the Grand Court