IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO: FSD 11 OF 2021 (RPJ)

IN THE MATTER OF THE COMPANIES ACT (2021 REVISION)

AND IN THE MATTER OF GRAND STATE INVESTMENTS LIMITED

IN CHAMBERS

Appearances:	**Tom Weisselberg QC, Nick Hoffman and Mark Burrows of Harneys Westwood & Riegels on behalf of the Petitioner**
	Tom Smith QC, Christopher Levers and Nour Khaleq of Ogier on behalf of the Company
Before:	**The Hon. Justice Parker**
Heard:	**6 April, 2021**
Draft Judgment Circulated:	**23 April, 2021**
Judgment Delivered:	**28 April, 2021**

HEADNOTE

Application to wind up company-ss92, 93 and 94 of Companies Law (2021 Revision)-construction of redemption procedure under Shareholders Agreement-bona fide dispute on substantial grounds-definition of debt-strike out as an abuse of process-application to appoint JPLs-s.104(2) of Companies law (2021 Revision)-prima facie case that a winding up order is likely to be granted-necessary to prevent dissipation or misuse of company assets and mismanagement-stay-section 4 Foreign Arbitral Awards Enforcement Act (1997 Revision).

JUDGMENT

Introduction

1. The Company is an exempted limited company incorporated in the Cayman Islands with its principal place of business in Chaoyang District, Beijing, PRC. The Company's share capital is divided into classes of shares; such classes being: (i) ordinary shares; (ii) A preferred shares; (iii) B preferred shares; (iv) C-1 preferred shares; and (v) C-2 preferred shares.

2. The Company is an investment holding vehicle for a number of entities in the PRC which provide kindergarten and school management services. The Company, Precious Winwin International Limited ("Ledudu BVI"), Dawn Power Group Limited, a limited company incorporated in Hong Kong ("Ledudu HK") and the PRC Entities form what is referred to as the "Ledudu Group".

3. The Company directly and wholly owns Ledudu BVI, a limited company incorporated in the British Virgin Islands ("BVI"), which in turn directly and wholly owns Ledudu HK.

4. Ledudu HK directly and wholly owns Ledudu (Beijing) Science and Technology Limited ("Ledudu Beijing"), a wholly foreign-owned enterprise established under the laws of the PRC. Ledudu Beijing controls the PRC Group Companies through a variable interest entity ("VIE") structure. Such VIE structures are apparently common in the PRC to facilitate foreign investment.

The nature of the dispute

5. The Petitioner, D.E. Shaw Composite Investments Asia 10 (Cayman) Limited, is the registered and beneficial owner of 3,652,523 Series C preferred shares of the Company which it subscribed for the consideration of US$20m. The Petitioner sought to redeem those shares pursuant the terms of the Company's amended and restated articles of association (the "Articles") dated 4 March 2013 and a shareholders agreement dated 4 March 2013 (the "Shareholders Agreement").

6. The Petitioner claims[1] that under the terms of the Shareholders Agreement (the relevant provisions of which are materially the same as the redemption provisions in the Articles), the redemption price (calculated to be US$71,098,887) was due on 30 October 2020. On 9 December 2020 the Petitioner served a statutory demand on the Company. The Company failed to pay the redemption price, or any portion of it, by the redemption date (and still has not made any payment towards it) and is therefore liable to be wound-up.

7. The Company does not dispute compliance with the redemption procedure or the calculation of the redemption price. However it claims that under the terms of the Shareholders Agreement (and the relevant provisions in the Articles), the Company does not have to pay the redemption price by the redemption date (30 October 2020) if it does not have legally

[1] *Pursuant to a Petition presented on 12 January 2021*

available funds with which to pay the redemption price, and that it does not need to make payment until such funds become available. The Company asserts that it does not in fact have any legally available funds to pay the debt and therefore the debt is not currently due and will not become due until it has such funds to pay the debt.

8. The Company claims that the debt is therefore disputed *bona fide* on substantial grounds, which dispute must be resolved before the Petitioner is entitled to seek a winding up on the basis of that debt.

9. Further, the Company claims that the Shareholders Agreement requires that the dispute is to be resolved by arbitration in Hong Kong. Consequently, the Company claims that the Petition should be struck-out, dismissed or stayed pending arbitration in Hong Kong. It raised these points with the Petitioner at an early stage on 29 December 2020 in response to the statutory demand and threat of winding up.

The Parties submissions

Petitioner

10. Mr Tom Weisselberg QC appeared for the Petitioner. He argued first that Joint Provisional Liquidators ("JPLs") need to be appointed in advance of the winding up petition being heard as assets of the Company are at risk of being dissipated and/or misused. If dissipation, misuse or some other form of impropriety has taken place, that will fundamentally change the basis on which the winding-up petition is pursued, such that the Petitioner would seek a winding up order on the alternative, but not mutually exclusive, grounds that a fraud has occurred and it is just and equitable that the Company be wound up, and that there has been non-payment of the redemption debt as currently alleged.

11. The Petitioner relies on the following facts to establish that there is a serious risk that if the JPLs are not appointed the Company's assets will be dissipated and/or misused:

a) the fact the Company has failed to account for the Series C subscription monies, despite being required to do so by the Series C Preferred Share Purchase Agreement dated 7 February 2013 (the "Share Purchase Agreement") and the Shareholders Agreement;

b) the fact the Company has failed to have its accounts audited, despite being required to do so by the Share Purchase Agreement and the Shareholders Agreement, and having been requested to do so;

c) apparent inconsistencies regarding the consolidation of the Company's accounts and Mr Fan's reliance on them; and

d) a number of disingenuous and/or untrue statements made by Mr Fan in the Second Affirmation of Mr Chun Fan ("Fan 2").

12. Mr Weisselberg QC also argues that there needs to be an independent investigation into the affairs of the Company to preserve and protect the Company's rights in respect of the misconduct and mismanagement in the Company's affairs. He submits that the Petitioner's concerns as to the dissipation and /or misuse of assets only crystallised following the service of the Company's evidence in support of the strike out application by way of Fan 2 served on 19 March 2021[2].

13. He argues that the disputes raised by the Company have been contrived in an attempt to stave off the winding up. They have not been made in good faith, are not genuine and are not maintainable or supported by the evidence. They are apt for summary dismissal within the winding up proceedings. As to the Company's argument on stay (see below) he says the disputes are not genuine and do not relate to all the petition debt.

14. To the extent that any dispute genuinely exists over payment of the redemption debt it is not necessary for that issue to be determined for a winding up order to be made as there can be no dispute that at least the statutory minimum of CI$100 is due and owing to the Petitioner. If there is any dispute over whether the redemption price is due and payable or the Petitioner is estopped from enforcing or waived its redemption rights, it can only be a dispute as to the precise amount.[3]

Matters covered at the hearing

15. An application was made by the Petitioner rather late in the day, a little more than a week before the hearing of the Petition by way of email correspondence to the Court, to adjourn the Company's strike-out application and to hear the JPL application *ex parte* on notice. At the hearing, the adjournment was no longer pursued and it was submitted on behalf of the Petitioner that all matters should be heard.

16. There was preliminary argument by the Company that the court should not hear the Petitioner's application for the appointment of JPLs, including for reasons of timing and

[2] *§ 31(c) in particular where the Company admits Ledudu BVI (Precious Win Win) does not have any funds despite reassurances to the contrary :see Fung 3 §§14-33.*
[3] See *Krisenergy at § 40 CICA*

procedural fairness, in circumstances where the Company had not had time to properly prepare its response or file evidence.

17. At the hearing I decided to hear the strike out application first, as one of the conditions for the appointment of provisional liquidators is that there is a *prima facie* case for making a winding up order. The Company argued that there is no such *prima facie* case and the Petition should be struck out or dismissed. If the court did not strike out the Petition it was likely that the court would make a winding up order and appoint official liquidators so the appointment of JPL's may not be necessary. Accordingly, it was necessary to determine the strike-out application which was likely to resolve a number of matters.

18. In this regard, in the event the court determined the strike out should not succeed, I also agreed with Mr Weisselberg QC's submission to hear argument on the Petitioner's application to appoint JPL's prior to any winding up order being made. The Company's position was that the Petitioner had not complied with the procedural requirements in the Companies Winding Up Rules (CWR) and it would be procedurally unfair to the Company for it to be dealt with at the hearing. To deal with this I indicated that the Company would be given the time and opportunity, should it be necessary, to file evidence and make further submissions.

Company

Strike out application

19. Mr Tom Smith QC appeared for the Company. He argued that the Petition should be struck out on the grounds that it is an abuse of process; or in the alternative, that the Petition be dismissed and/or stayed to permit the dispute as to the alleged debt to be determined in arbitration as contractually agreed by the parties.

20. He maintained that the alleged debt, which forms the subject matter of the Petition, is *bona fide* disputed on substantial grounds, namely that: under the terms of the Shareholders Agreement, which is governed by Hong Kong law, the requirement by the Company to satisfy a redemption request is not automatic, but instead conditional; in particular, the terms of the Shareholders Agreement provide that, in circumstances where the Company is unable to immediately pay some or all of the redemption proceeds because it does not have sufficient funds to do so, it is only required to make ongoing payments "*from time to time out of legally available funds*"; and this is the position the Company currently finds itself in. In the

alternative the Petitioner has waived its redemption rights or is estopped from enforcing them in light of the facts set out in the First Affirmation of Chun Fan ("Fan 1").

21. In the circumstances, there is a genuine and substantial dispute as to the existence of the alleged debt. The alleged non-payment of the debt cannot therefore form the basis of the assertion that the Company is insolvent. As such, the Petition must be struck out.

Stay application

22. Alternatively, and without prejudice to the Company's primary submission that the Petition should be struck out on the basis that the debt is disputed, Mr Smith QC argued that the issues raised by the Company in relation to the debt are subject to the Arbitration Agreement at section 14.13 of the Shareholders Agreement which requires that any dispute between the Company and the Petitioner connected with, or related to, the Shareholders Agreement be referred to arbitration in Hong Kong. Accordingly, the Petition should be stayed and/or dismissed to permit the parties to resolve their disputes, which revolve around matters governed by Hong Kong law, by the dispute resolution mechanism to which the Company and the Petitioner contractually agreed.

23. He informed the Court that whilst not a pre-condition for this Court to exercise its discretion in favour of a stay, on 15 March 2021, in light of the dispute between the Company and the Petitioner with respect to the operation of the Shareholders Agreement, the Company issued a Notice of Arbitration in the form prescribed by the HKIAC Administered Arbitration Rules pursuant to the terms of the Arbitration Agreement.

Strike out application

The law

24. As is well known, section 92 (d) of the Companies Act (2021 Revision) states that a company may be wound up by the court "*if it is unable to pay its debts'.* The test in the Cayman Islands is one of cash flow insolvency.

25. The Petitioner seeks to prove, as it must to the civil standard on a balance of probabilities[4], under the section 93 statutory demand procedure that:

[4] *French, Applications to Wind Up Companies § 7.90*

a) *a creditor….to whom the company is indebted at law or in equity in a sum exceeding one hundred dollars then due has served on the company, by leaving it at its registered office, a demand under that persons hand requiring the company to pay the sum so due, and the company has for the space of three weeks succeeding the service of such demand, neglected to pay such sum or to secure or compound for the same to the satisfaction of the creditor;*

…..or

c) *it is proved to the satisfaction of the court that the company is unable to pay its debts.*

26. Section 94 deals with the question of standing in relation to the persons who may present a petition being any creditor, including a contingent or prospective creditor, under section 94(1)(b).

27. The law in the Cayman Islands is well settled in relation to the proper use of the winding up procedure: where a debt which forms the subject matter of a winding up petition is genuinely disputed on substantial grounds, the general practice of the Court is to strike it out or dismiss it.

28. In *Parmalat Capital Finance Limited v Food Holdings Limited et al* [2008 CILR 202] the Privy Council, hearing an appeal from the Cayman Islands, stated (emphasis added):

> "*If a petitioner's debt is bona fide disputed on substantial grounds,* ***the normal practice is for this court to dismiss the petition and leave the creditor, first, to establish his claim in an action.*** *The main reason for this practice is the danger of abuse of the winding-up procedure.* ***A party to a dispute should not be allowed to use the threat of a winding-up petition as a means of forcing the company to pay a bona fide disputed debt****. This is a rule of practice rather than law and there is no doubt that the court retains a discretion to make a winding-up order, even though there is a dispute: see, for example, Brinds Ltd v Offshore Oil N.L (2)*". (my emphasis).

29. The approach in *Parmalat* was expressly followed in *Camulos Partners Offshore Limited v Kathrein and Company* [2010 (1) CILR 303] where the Cayman Islands Court of Appeal, said (emphasis added):

> "*When a petitioning creditor's debt is disputed on substantial grounds, the court should restrain the prosecution of the petition as an abuse of process of the court "even though it should appear to the court that the company is insolvent"...****It is the fact that the petitioner is seeking to make improper use of the court's winding-up jurisdiction to resolve an inter parties dispute which attracts the sanction of a strike-out***".

30. In *Re Sky Solar Holdings Ltd* (unreported, Kawaley J, 12 October 2020), this Court recently undertook a review of the authorities on the legal test to be applied in this context. Kawaley J, quoting the dicta of Parker J in *Re Primus Investments Fund, LP and Mayer Investments Fund LP* (Parker J, unreported, 16 June 2020) which itself quoted the dicta of Vos JA in *Re GFN* [2009 CILR 650] summarised the position as follows:

> *"54. Vos JA summarised the law as follows at § 94 of GFN (CICA):*
>
> (a) *A person with a good arguable case that a debt is due and owing to him from the company may present a petition to wind up as a creditor under the Companies Law.*
>
> (b) *The normal practice is that the court will dismiss or stay a petition in circumstances where there is a bona fide dispute and substantial dispute as to the existence of the debt upon which the petition is based.*
>
> (c) *In an appropriate case, however, the winding up court can refuse to dismiss or stay the petition and can determine the question of the disputed debt in the petition itself.*
>
> (d) *Appropriate cases include those where the court doubts the debt is actually disputed bona fide on substantial grounds, or where the creditor if he established the debt would otherwise lose his remedy altogether or where other injustice might result.*
>
> (e) *Where the winding up court decides to hear a petition based on a disputed debt it will only make a winding up order on the grounds that the company is unable to pay its debts or that it is just and equitable to wind up, having determined that the petitioner is, on a balance of probabilities, a creditor of the company.*

Relevant provisions of Shareholders Agreement

31. The relevant terms of the Shareholders Agreement provide that:

(a) it is governed by the laws of Hong Kong: section 14.4[5];

(b) at any time and from time to time after the earliest of, *inter alia*, 1 September 2015, each holder of C Shares shall have the right to require and demand the Company to redeem part of, or all of, the holder's C Shares, provided there has not been an initial public offering (IPO) in respect of the Company Shares: section 12.3 (the parties accept that there has been no IPO);

[5] It is to be noted that the Articles are likely to be governed by Cayman Islands law and Article 163 mirrors the relevant provisions of section 12.3 of the Shareholders Agreement.

(c) the Company shall pay to each holder of C Shares who has submitted a valid redemption request the Series C Redemption Price (as defined in the Shareholders Agreement): section 12.3(a); and

(d) pursuant to the Arbitration Agreement, the parties are required to use their best efforts to resolve all disputes by negotiation and, failing that, or in any event upon the request of either party 15 days after a dispute has arisen, by reference to arbitration in Hong Kong, administered by the Hong Kong International Arbitration Centre ("HKIAC") under the HKIAC Rules.

32. Section 12.3(a) of the Shareholders Agreement requires the Company to pay, upon receipt of a valid redemption request, the Series C Redemption Price. However, section 12.3(a) of the Shareholders Agreement is subject to section 12.3(d) which provides that:

> 12.3 (d)."*[if] the Company fails to pay on the Series C Redemption Date the full Series C Redemption Price in respect of each Redeemed Series C Share* ***because it has inadequate funds legally available therefor or for any other reason,*** *the funds that are legally available shall nonetheless be paid and applied on the Series C Redemption Date in a pro-rata manner against each Redeemed Series C Share in accordance with the relative full amounts owed thereon,* ***and the shortfall shall be paid and applied from time to time out of legally available funds immediately as and when such funds become legally available in a pro-rata manner against each Redeeming Series C Share*** *in accordance with the relative remaining amounts owed thereon, such that, in any case, the full Series C Redemption Price shall not be deemed to have been paid in respect of any Redeemed Series C Share and the redemption shall not be deemed to have been consummated in respect of any Redeemed Series C Share on the Series C Redemption Date, and the Redeeming Series C Investor shall remain entitled to all of its rights, including (without limitation) its voting rights, in respect of each Redeemed Series C Share, and each of the Redeemed Series C Shares shall remain "outstanding", until such time as the Series C Redemption Price in respect of each Redeemed Series C Share has been paid in full whereupon all such rights shall automatically cease. Any portion of the Series C Redemption Price not paid by the Company in respect of any Redeemed Series C Share on the Series C Redemption Date shall continue to be owed to the holder thereof as a debt.*" (my emphasis)

Decision on strike out

33. This clause gave rise to a number of submissions in both written and oral argument. There is no definition of legally available funds in the Shareholders Agreement. In the absence of such a definition the court will approach the term on the basis of its natural, ordinary meaning. Giving the term that meaning it seems to me that funds will be legally available if they are either (i) owned by the Company; or (ii) funds which the Company can obtain by exercising its legal rights. The court was not referred to any different position which would apply under Hong Kong law.

34. The plain language of Section 12.3(d) seems to contemplate a situation in which the Company, faced with a redemption request, is not immediately in a position to make payment of the Series C Redemption Price; whether because the Company does not possess adequate legally available funds to do so or "*for any other reason*". In those circumstances, it would appear to me to be arguable that section 12.3(d) expressly provides the Company with an obligation to pay the Series C Redemption Price, or any shortfall in payment of the same, not immediately upon demand, but instead when it has sufficient legally available funds. That being so no presently payable debt would arguably arise until the Company has such available funds. I note, although it is disputed by the Petitioner, that Mr Fan says that this was agreed in order to '*avoid a liquidation scenario*"[6].

35. In this regard, the court was referred to evidence which showed that when the Company was negotiating with the Petitioner (and other investors) with respect to its subscription for shares in the Company, the nature and extent of the Company's obligation to pay a redeeming shareholder and, in particular, the deadline (if any) for making redemption payments was a point of focus[7]. Mr Weisselberg QC objected to this evidence on the basis that were no grounds upon which the court can look outside the terms of the agreement at the parties' subjective intentions or drafts[8]. That is not the purpose for which it was adduced. The evidence goes to the question of whether it was 'on people's radars' as Mr Smith QC put it, and not as the Petitioner alleged a point invented by the Company in bad faith to avoid paying a due debt. The relevance is that it is therefore a point that received some attention before the agreement was concluded.

36. To complete the picture, the court was also referred to a communication on 9 January 2013 from O'Melveny & Myers LLP ("OM&M"), counsel for the Series C investors of the Company (which included the Petitioner), which circulated a further version of the draft Shareholders Agreement. This version was amended by OM&M to make the timing of the Company's payment obligation arguably open-ended. The draft no longer required the Company to pay any shortfall in the redemption payment "*in any event [...] over 12 months following the Series C Redemption Date*". Instead, it only required the Company to pay the shortfall "*from time to time*". This final form of wording, suggested by the Petitioner's attorneys, was apparently accepted by the Company and adopted in the final version of the Shareholders Agreement. The relevance again is that the point received attention from external counsel acting on behalf of the Petitioner.

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[6] Fan 1 § 69
[7] *§§28-37 Fan 1 ,p 116 CF-1, p114 CF-1 ,p 112 CF-1*
[8] *ITS v West Bromwich*

37. I accept Mr Smith QC's submissions that it is plainly arguable that the Shareholders Agreement provides that the Company does not have to pay the Petition Debt unless it has sufficient "*legally available*" funds to do so. Mr Smith QC accepted that the Petitioner is a contingent creditor in that the Company may become liable in the future to pay the redemption price as and when it has legally available funds. Until such time as this condition is satisfied, then there is no presently due debt.

38. I therefore reject Mr Weisselberg QC's submission that the description of the portion of the redemption price not paid on the redemption date in section 12.3(d) (which is identical to Article 163(d)) is a 'debt' which is due and payable straight away. The debt remains from the time of redemption, but it does not become payable until the Company has legally available funds. The clause, on a plain reading seems to provide a practical way for investors to redeem their shares in an orderly manner. From a commercial point of view this seems to me to make sense as it does not potentially force the Company into a position of acute cash flow difficulties.

39. Furthermore, the terms of the Shareholders Agreement make provision to compensate a redeeming investor for any delays in payment. Section 12.3(a) provides that the Series C Redemption Price is the aggregate sum of:

> (a) the issue price of the C Shares; and
>
> (b) an amount equal to 18% internal rate of return based on the issue price of the C Shares **from the date of issuance of such share through the date when such share is redeemed**; and any declared but unpaid dividend on such share. (my emphasis)

40. I accept Mr Smith QC's contention that this would mean in practice that in return for what he referred to as the 'grace period' provided to the Company to make the Series C Redemption Payment, redeeming investors such as the Petitioner would be entitled to a higher return in respect of the interest rate component of the Series C Redemption Price as well as any additional dividends which were declared by the Company in the intervening period. 18% is, as Mr Smith QC submitted, a healthy internal rate of interest and results in the calculation of just over US$71m for the Petitioner's US$20m investment. I accept the Company's case that this is in effect a commercial *quid pro quo* for not receiving the money straight away, but when the Company has the legally available funds with which to pay.

41. Section 12.3(e) provides that:

"*the Company shall in good faith use all reasonable efforts to increase as expeditiously as possible the amount of legally available redemption funds including without limitation, withholding any capital expenditure...causing any other Group Company to distribute any and all available funds to the Company for the purposes of paying the Series C Redemption Price for all Redeemed Series C Shares on the Series C Redemption Date...*".

42. The term "Group Company" is defined as meaning "*the Company, Ledudu BVI, Ledudu HK, and the PRC Entities, together with each Subsidiary of any of the foregoing*".

43. A question which arises is whether the language of section 12.3(e) indicates that funds (other than those that may be withheld for capital expenditure purposes) which are required for the Company's ordinary business purposes should be regarded as being "available" for the purposes of paying the redemption price for redeemed C Shares. The clause does not on its terms require the Company to withhold its expenditure in its ordinary course of trading (operational expenditure) in order to satisfy redemption requests. I reject Mr Weisselberg QC's submission that the phrases "*increase as expeditiously as possible*" and "*without limitation*" change that plain omission. The reference which is made is only with regard to discretionary spending of a capital expenditure kind, which seems to me to imply that ordinary operational business expenditure is not covered. The extent of the commitment provided for by the sub clause is that the Company should make all reasonable efforts to increase the funds which are 'legally available' by considering in its discretion to withhold capital expenditure.

44. Further, I find that the reference to the Company "causing" any other Group Company to distribute "available" funds would require the Company to have a legally enforceable right against such company to procure payment of the relevant funds. Again it seems to me that funds held by a Group Company will only be "available" if they are not required for that Group Company's ordinary business purposes and are available for distribution.

45. I do not accept the Petitioner's submission, that because section 12.3(e) places an obligation on the Company to use '*in good faith all reasonable efforts'* to increase the amount of legally available funds including, *inter alia*, by causing any other Group Company to distribute any and all available funds to it, this means that the Company is free to use the funds belonging to the other Group Companies to make redemption payments[9]. I accept that the Company is not able to compel any other Group Company to pay over its funds, as was suggested by the

[9] *§§20 to 24 of Fung 2.*

Petitioner, and its only absolute recourse for legally available funds would be from its own monies.

46. Section 12.3(e) obliges the Company, in so far as it is able to do so, to cause any other Group Company to distribute to the Company any funds which may properly and lawfully be distributed to the Company. In other words, in my view it is only if: (i) the Company has a legal right to compel the transfer of assets from a Group Company to it; and (ii) there are sufficient "available" funds held by that Group Company, that the Company can require a Group Company to provide it with assets for the purpose of making the redemption payment.

47. As to the practical application of this interpretation I accept the following submissions of Mr Smith QC:

Shareholder control

(i) the Company only enjoys shareholder control with respect to three entities within the Ledudu Group: Ledudu BVI, Ledudu HK and Ledudu Beijing, and does so through three levels of shareholding. Accordingly, with the exception of Ledudu Beijing, none of the PRC entities in the Ledudu Group are related to the Company by way of shareholder control;

(ii) rather, the various PRC Group Companies, which are companies responsible for the management and operation of the kindergartens and schools, have only a purely contractual relationship with Ledudu Beijing via what is referred to as a variable interest entity (VIE) structure[10];

(iii) with respect to those entities which are the direct or indirect subsidiaries of the Company, there are no contractual arrangements which entitle the Company to call upon those subsidiaries to provide funds to the Company; and

(iv) further, the Company's evidence is that its direct and indirect subsidiaries do not have funds available to be distributed to the Company[11]:

[10] *§§15 to 17 of Fan 1 and §§23 and 24 of Fan 2.*

[11] *§79 of Fan 1 and §30 of Fan 2.*

Contractual relationship (namely the PRC Group Companies)

(i) the Company has no right to require any of the PRC Group Companies to distribute their profits to the Company[12];

(ii) there are no contractual or other legal rights which would entitle the Company to receive a distribution from the PRC Group Companies[13]; and

(iii) further, it would be illegal under PRC law for the PRC Group Companies, as private non-enterprise organisations, to distribute their profits[14].

48. There is no evidence that the Company has the legal right to obtain funds which are available from any group company. Even if a dispute was raised on this point, which on the current state of the evidence it is not, it would have to be resolved in arbitration in Hong Kong not under the winding up procedure of this court (see below).

The evidence as to the company's financial position

49. The evidence of Fan 1 and Fan 2, is that the Company does not have any funds which are available for these purposes. Its financial statements as at 31 December 2020 indicate that the current financial position is as follows:

(a) US$3,128.86 in its bank account;

(b) US$37,998,128.86 in current assets, which is substantively comprised of receivables; and

(c) US$7,716,368 in current liabilities.

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[12] *It is noted at paragraphs 82 to 83 of Fan 1 that Ledudu Beijing has entered into a Service Agreement with Ledudu English School under which Ledudu English School is, subject to the conditions provided therein, required to pay regular service fees to Ledudu Beijing in exchange for services provided by Ledudu Beijing. However, payment can only be made where there is a surplus profit enjoyed by Ledudu English School. As there has been no such surplus, the company's position is that there exists no basis upon which payments can be made under this Agreement.*

[13] *§§77 to 86 of Fan 1 and § 28 of Fan 2.*

[14] *§§84 to 86 of Fan 1 and §29 of Fan 2.*

50. Given the above, it is apparent that the Company does not have legally available funds from which to satisfy the debt. The Petitioner does not question the accuracy of the Company's financial statements but interprets them differently. I note in passing that although Mr Weisselberg QC in his written argument asserted that this financial statement is in itself was evidence of insolvency, it is not pleaded in the Petition and there is no evidence before the court on the point. There is no evidence of when the current liabilities are due to be paid. There is no evidence to show that the Company will not be able to meet its unpaid debts when they fall due, for example from current assets.

51. In this regard I reject Mr Weisselberg QC's submissions that the balance sheet as at 30 June 2020[15] shows that the Company, *inter alia*, had cash assets in the region of US$24 million. I accept the evidence of Mr Fan who is the best person to explain these matters.

52. The financial statements relied upon by the Petitioner are not those of the Company alone; Mr Fan explains that they are consolidated financial statements prepared for the Company but which represent the consolidated financial position of the entire Ledudu Group, including the PRC Group Companies (whose financial position is consolidated for accounting purposes)[16]. Neither do the statements of the Ledudu Group[17] assist the Petitioner's case. Those statements also include the assets and liabilities of the entire Ledudu Group, including the PRC Group Companies. As the assets of the PRC Group Companies cannot be considered legally available funds, the amounts shown on those financial statements do not represent assets and/or cash to which the Company has access[18]. Finally on this point the bank account statements of Ledudu BVI the Petitioner relies upon does not assist it. These are outdated bank account statements which do not reflect the current financial position of that entity[19].

53. The recent financial position of the Company is provided for in its financial statements, including its various cash balances for the second half of 2020 as follows:

    (a) US$1,008,013.06 as at 30 June 2020

    (b) US$553,959.83 as at 30 September 2020; and

    (c) US$3,128.86 as at 31 December 2020.

[15] *exhibited at pages 17 to 18 of Exhibit EF-2*
[16] *§13 to 14 of Fan 2*
[17] *exhibited at pages 5 to 34 of Exhibit EF-2*
[18] *see §31 of Fan 2.*
[19] *see §31(c) of Fan 2.*

54. I accept Mr Fan's explanation that the Company's diminished financial position is explained by the difficulties which have arisen due to the economic climate in the PRC in the second half of 2020; particularly that in relation to the education sector, which has suffered financially as a result of school and kindergarten closures mandated by the PRC government in its effort to curb the spread of COVID-19[20].

55. I accept Mr Smith QC's submissions that during this period, the companies within the Ledudu Group responsible for operating the kindergartens and schools would have earned little to no revenue. However, those entities would have continued to incur significant operating costs including, but not limited to, the payment of utilities and salaries to its teachers.

56. On that basis, it is not surprising to see significant reductions in the Company's cash position through the second half of 2020. There is no basis for the court to conclude that the Company had legally available funds to pay the debt which is therefore not due and payable.

57. In conclusion the Petitioner has not established that the Company is insolvent for the purposes of sections 92(d) and 93 of the Companies Law. It has not established that insolvency has been proved because the debt has not been paid.

58. For completeness I should add that I do not accept Mr Weisselberg QC's submission that the effect of the *Krisenergy* case[21] is that it does not matter in relation to the dispute of a debt if a portion of it which is undisputed (because the Company had US$3,128.66 available) which exceeds the statutory minimum. Norris J, who was quoted in that case, was dealing with the standing of a petitioner where a creditor needs to show to establish his *locus standi* that at least part of the debt is undisputed and exceeds the statutory minimum.

59. This case, unlike the case Norris J was dealing with, is not an interim application to restrain a petition where standing is an issue. The issue raised on this application by the Company to strike out the Petition is whether the Petitioner has shown substantive grounds to establish the Company's insolvency or whether the debt is genuinely and substantially disputed.

60. The debt for these purposes is approximately US$71m as set out in the statutory demand following the redemption procedure. It is disputed *bona fide* and the Petitioner cannot succeed on the basis that US$3,128.66 has not been paid.[22]

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[20] Fan 2 §§9-11.
[21] *§61 quoting from Angel v British Gas, per Norris J § 29.*
[22] *In Re a Company WLR [1984] Ch 1090 per Mervyn Davies J at p 1094*

61. Mr Fan's evidence which I accept is that due to the COVID-19 pandemic there are no surplus funds available [23]. The question of whether the Company has legally available funds is disputed under the interpretation of section 12.3. There can be no good basis for suggesting that the Company has not paid the lesser sum (of US$3,128.66) because it is insolvent.

62. As to the Petitioner's case that these arguments have been contrived by the Company to avoid its clear contractual duties, this is not a case where it can be properly said that the matters relied upon by the Company are "smokescreens" or "contrived arguments presented late in the day" of the sort considered by Cheryll Richards J in *Re Adenium Energy Capital Ltd* (unreported, Richards J, 29 July 2020). These matters were brought to the Petitioner's attention on 29 December 2020 [24] and the Company has been consistent in its reliance on them. They are plainly arguable, substantial and *bona fide* defences to raise.

63. Therefore the issues raised by the Company give rise to a *bona fide* dispute on substantial grounds and the Petition falls to be struck out.

Decision on stay

64. The Arbitration Agreement provides, *inter alia*, that:

> *"14.13 Arbitration. The parties hereto agree to use their best efforts to resolve by negotiation* ***any dispute, controversy or claim which may arise in connection with, or related to, this Agreement.*** *If the parties cannot resolve directly any such dispute, or in any event upon the request of either party 15 days after a dispute has arisen, then such dispute, controversy or claim shall be finally settled by arbitration in Hong Kong by the Hong Kong International Arbitration Centre (the "HKIAC") under the Hong Kong International Arbitration Centre Administered Arbitration Rules in force when the Notice of Arbitration is submitted in accordance with those Rules. There shall be three (3) arbitrators. The complainant and the respondent to such dispute shall each appoint one (1) arbitrator who is qualified to practice law in Hong Kong within thirty (30) days after giving or receiving the request for arbitration and absent such appointment within the foregoing time period, the Chairman of the HKIAC shall appoint the relevant arbitrator. The Chairman of HKIAC shall select the third arbitrator who shall be qualified to practice law in Hong Kong. The language of the arbitration shall be Chinese. The arbitration award(s) will be final and binding on the parties, and judgment on any arbitration award may be entered and enforced in any court of competent jurisdiction". (my emphasis).*

[23] *Fan 1 §71 Fan 2 §8*
[24] *in response to the statutory demand dated 9 December 2020 and the Petitioner's attorneys letter of 13 November 2020*

65. There is no dispute as to the validity of the Arbitration Agreement. The disputes which have arisen between the parties are in my view matters which fall within the scope of the Arbitration Agreement. In these circumstances, it is appropriate that the Petition be stayed to permit the dispute resolution mechanism contractually agreed by the parties to be utilised.

66. In *Re Sphinx Group of Companies*[25] the issue was the extent to which a fee agreement entered into between the companies' liquidators and its attorneys was amenable to arbitration. The liquidators were seeking sanction to release a reserve held by the estate, but it's attorneys contended that there were sums due under the agreement and that the reserve should be maintained to deal with those claims. The liquidators sought to refer the matter to arbitration, but the attorneys argued that the issue of whether the reserves should be maintained is a matter for the Grand Court alone and was therefore not amenable to arbitration.

67. In deciding the issue, the Cayman Islands Court of Appeal considered it important to determine the nature of the real dispute between the parties. It held that the true dispute concerned the validity of the claims brought by the attorneys and the related issue of whether the release would be appropriate; this latter issue was wholly dependent on the resolution of the first. As the true dispute fell squarely within the arbitration provisions of the agreement, the Court of Appeal directed that the application be stayed pending resolution of the arbitration.

68. In *Re Times Property Holdings Limited*[26] the issue before the court was whether a creditor's petition should be stayed pending arbitration. Similarly to the present case, the subject matter of the petition was a debt, challenged by the company, arising in connection with alleged breaches of a subscription agreement governed by foreign law.

69. In deciding to stay the petition in favour of arbitration, Foster J made the following statements of principle at §19 (emphasis added):

> "***Where, as here, parties have expressly agreed that any dispute between them arising out of the relevant contract is to be determined in a particular forum by a particular tribunal, it is not obvious to me why they not be held to that agreement. In the present case the parties have clearly and unequivocally agreed that any dispute concerning or arising out of the subscription agreement which has not been resolved through negotiation within 30 days is to be resolved by arbitration in Hong Kong***. *Furthermore, that arbitration process, with the active participation of each of the parties in*

[25] *Unreported CICA 2 February 2016*
[26] *[2011 (1) CILR 223]*

> *dispute, has already commenced and is now well under way with the substantive hearing set to take place in only six months' time.* ***The arbitration proceedings will obviously determine whether the grounds on which the company disputes its alleged indebtedness to the petitioners are successfully made out or not...***
> *In my view there is no evidence from which it may be inferred that the company's dispute of its alleged indebtedness to the petitioners is not bona fide. Furthermore, although, as I have said, the analysis of the documents and the evidence by counsel for the petitioners was persuasive, the fact remains that there are factual disputes as well as legal disputes between the parties which, in my view, are not appropriate for resolution on the basis of affidavit evidence without cross-examination, even if that had been practically possible and appropriate at the hearing of the amended petition. Moreover, it did seem to me that there are issues arising in the dispute, such as, for example, the argument about implication of the terms in the subscription agreement for which the company contends, on which the law of Hong Kong may well be different from the law of the Cayman Islands.*
> ***...I do not anyway feel able to conclude that the company's arguments are of so little substance that they have no reasonable prospect of success. It is my opinion that the company's dispute of the alleged indebtedness is bona fide and on sufficiently substantial grounds that they should be tried in the appropriate forum, which is the Hong Kong arbitration****".*

70. Acknowledgement for the freedom of parties to choose dispute resolution mechanisms also underpinned the decision of the English Court of Appeal in *Salford Estates (No 2) Limited v Altomart Limited*[27].

71. In *Salford Estates*, the English Court of Appeal held that, despite the court not having the jurisdiction to apply the mandatory stay provided for in section 9 of the UK Arbitration Act 1996, as the petition was presented on the basis of the company's insolvency, it was appropriate for the court to exercise its inherent jurisdiction to stay a petition in a manner consistent with the legislative policy behind that Act.

72. The Court of Appeal went on to state at §40 that :

> *"Exercise of the discretion otherwise than consistently with the policy underlying the 1996 Act [the equivalent of which is section 4 of the Foreign Arbitral Awards Enforcement Act (1997 Revision)] would inevitably encourage parties to an arbitration agreement – as a standard tactic – to by-pass the arbitration agreement and the 1996 Act by presenting a winding up petition".*

73. I accept Mr Smith QC's submission that the starting point for the court in assessing how to exercise its discretion will be to ensure that the parties' freedom to choose a dispute resolution mechanism is respected and that any decision to arbitrate made by the parties is upheld.

[27] *[2014] EWCA Civ 1575*

74. Mr Smith QC accepted that this does not mean that the mere assertion of a dispute which does not pass the *bona fide* and substantial dispute test will be sufficient. This court will need to be satisfied as to the existence of a *bona fide* dispute on substantial grounds prior to being able to exercise its discretion to stay winding up proceedings in favour of arbitration: see *In the matter of Duet Real Estate Partners 1 LP*[28] and *Re Adenium Energy Capital Ltd* .

75. As the court has held, the debt is *bona fide* disputed on substantial grounds. Once that has been established, and in circumstances where the dispute falls within the scope of an arbitration agreement the court will normally exercise its discretion to stay the Petition.

76. As noted by Foster J in *Re Times Property Holdings* where the debt is disputed on substantial grounds, and the discrete issue grounding a petition has been agreed by the parties to be resolved by way of arbitration, the Court will err on the side of caution by declining to make a winding up order and, instead, stay the petition pending determination of the arbitration.

77. In these circumstances if it had been necessary to do so, the court would have ordered a stay. The following reasons advanced by Mr Smith QC are accepted by this court: the Petitioner has accepted that the Arbitration Agreement is valid and operative; the arbitration has now been commenced; the discrete issues to be decided in arbitration are issues of Hong Kong and PRC law concerning specific issues of foreign law with which the Cayman Court may not be familiar; certain issues, including those regarding the waiver of the Petitioner's right to redeem, are not suitable to be determined on the basis of affidavit evidence or without the benefit of cross-examination; and the arbitration is to be conducted in Hong Kong, in Chinese. As the Company's representative speaks little to no English, that forum is distinctly better suited to resolve the discrete questions in issue.

78. Indeed, arbitration in Hong Kong is likely to have been agreed on the basis that disputes under the Shareholders Agreement, a Hong Kong law governed document, would be best resolved by arbitrators qualified in Hong Kong law and who are fluent in both English and Chinese. As can be seen by the various documents exhibited to the evidence, a number of them are in Chinese. The relevant witnesses are individuals who speak Chinese.

79. Accordingly, the disputes regarding the validity and existence of the debt claimed in the Petition, which are subject to Arbitration Agreement would in the alternative to the Petition being struck out, have been stayed.

[28] *(unreported, Jones J, 7 June 2011*)

Waiver/estoppel

80. In view of the court's conclusions on strike out and stay as set out above it is not necessary to consider whether as a matter of Hong Kong law the Petitioner has waived or is estopped from enforcing its redemption rights as a result of its conduct and the court proposes to say no more about them.

Decision on JPL application

81. The appointment of JPLs to a trading company has serious implications for its business and requires careful consideration by the court. I have concluded that the appointment of JPLs is not necessary or appropriate because the Petitioner cannot demonstrate a *prima facie* case for the making of a winding up order. In addition the Petitioner's allegations of risk of dissipation of assets and misconduct against the Company's management do not meet the threshold test established by the authorities to appoint JPLs under section 104(2) of the Companies Act. I will give short reasons for this conclusion.

82. The Petitioner's application is made pursuant to section 104(2) of the Companies Act. Section 104(2) requires the satisfaction of a two stage test. First, is there a *prima face* case for a winding up order (s.104(2)(a)). Second, if there is, is the appointment of a provisional liquidator necessary to achieve one or more of the purposes set out in section 104(2)(b), namely to prevent (1) the dissipation or misuse of the Company's assets, (2) the oppression of minority shareholders, or (3) the mismanagement or misconduct of the Company's directors[29]. The Petitioner relies on the first and third grounds.

83. The *prima facie* case test was considered in *Re Asia Strategic Capital Fund LP*[30] as follows (emphasis added):

> "*In establishing whether a good prima facie case has been made for a winding-up order, as is required prior to the appointment of a provisional liquidator by the Companies Law (2013 Revision), s.104(2), it is not necessary to demonstrate that a winding-up order* ***will*** *be granted: a prima facie case is established* ***if the allegations made in the petition for the appointment of provisional liquidators are supported by the evidence and have not been disproved****, with any conflicts of evidence to be resolved at a substantive hearing*".

[29] §§ 33-34 *Re Asia Strategic Capital Fund* (*unreported, Segal J, 30 April 2015.*
[30] *[2015 (1) CILR N-4]*

84. Further, in *Revenue and Customs Commissioners v Rochdale Drinks*[31] the English Court of Appeal explained (at §77) that the phrase *prima facie* case meant that it was necessary for the petitioner to show that it was likely to obtain a winding up order:

> "*Given the potential seriousness of the appointment of a provisional liquidator, I consider that in the case of a creditor's petition the threshold that the petitioner must cross before inviting such an appointment ought to be nothing less than a demonstration that he is* ***likely to*** *obtain a winding-up order on the hearing of the petition.*" Per Rimer LJ (my emphasis)

85. The Petitioner claims that a *prima facie* case for a winding up order is made out because the Company is unable to pay its debts pursuant to section 92(d) of the Companies Act for the reasons pleaded in the Petition. The court has found that there is a *bona fide* dispute on substantial grounds that the debt is not due and owing because the Company does not have any legally available funds from which to make payment. The Petitioner does not therefore overcome the first hurdle.

86. Furthermore, the court has found that the issues as to the validity and existence of the debt are subject to the Arbitration Agreement entered into between the parties which requires that any dispute between the Company and the Petitioner be settled by arbitration. The interpretation of the relevant sections of the Shareholders Agreement will if necessary fall to be determined by the Arbitration Panel in Hong Kong by the notice of arbitration commenced on 15 March 2021.The only answer to this from the Petitioner is that the dispute was not a genuine one, and that there is an unarguable claim for US$3,128.66. I have rejected both of these contentions. It is apparent to me that there is a genuine dispute between the parties (which is not contrived or fanciful) on which the Company has a realistic prospect of success.[32]

87. Had it been necessary to do so the court would not have considered the second limb to have been satisfied either. Section 104(2) of the Companies Act sets out the limited circumstances in which a provisional liquidator may be appointed on an application made by a creditor or contributory. The circumstances are limited to those where, provided a *prima facie* case for winding up can be made out, the Court considers that it is "necessary" to prevent (i) the dissipation or misuse of the Company's assets; and (ii) the mismanagement or misconduct by the Company's management.

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[31] *[2013] BCC 419*

[32] *Primus (unreported 16 June 2020) Parker J at §56 and the cases cited therein*

88. The relevant test for establishing a risk of dissipation of assets was described by Justice Segal in *Re Asia Strategic Capital Fund L.P* as follows (emphasis added):

> [45] ' On *a contributory's petition, as in the present case, it is sufficient if it is shown that the assets of the Company (or partnership)* ***are being, or are likely to be, dissipated to the detriment of the petitioners*** *(see Levy v Napier 1962 SC 468; South Downs Packers v Beaker (1984) ACLR 990; Re Nerang Investments (1985) 9 ACLR 646 and Re Bike World (1992) 6 ACSR 681).*

89. Segal J cited the judgment of the English High Court in *Re a Company (No 003102 of 1991) ex parte Nyckeln Finance Co Ltd*[33] in which Harman J considered the circumstances where a provisional liquidator would be appointed to protect assets in the context of a creditor's winding up petition (emphasis added):

> "*If there is a risk of assets being dissipated – that is made away with other than by the rateable distribution amongst all the company's creditors at the date of the presentation of the winding-up petition – there must be a good case for the court appointing its own officers… it is not a dissipation in the Mareva sense of deliberately making away with the assets but any* ***serious risk that the assets may not continue to be available*** *to the [partnership]"*

90. The threshold for establishing such a risk was described as "a heavy burden" in *Re CW Group Holding Company Limited*[34] and as requiring clear or strong evidence as to necessity. At § 61 of the judgment, added emphasis was given as to the requirement to satisfy the Court that an application for the appointment of JPLs is 'necessary'.

91. The Petitioner has not discharged the burden in this case. The Petitioner's evidence does not establish any serious risk of dissipation of assets and/or mismanagement, nor does it explain why the appointment of joint provisional liquidators is necessary to prevent any alleged dissipation or mismanagement.

92. A mere failure to account for subscription monies to the satisfaction of the Petitioner cannot demonstrate a serious risk that the Company's property will be improperly dissipated or misused. In fact the Company's evidence demonstrates that it does not presently have any significant assets which are capable of being dissipated and/or misused.

93. In case it becomes relevant I deal with my findings briefly on the Petitioner's specific allegations:

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[33] *[1991] BCLC 539],*
[34] *unreported, Parker J, 3 August 2018*

Mismanagement

94. Mismanagement or misconduct on the part of directors connotes culpable behaviour involving a breach of duty or improper behaviour that involves a breach of the governing documents and governance regime[35].

95. The Petitioner's allegations regarding the misconduct of the Company's directors does not make this out.

Failure to Audit Accounts

96. It is not disputed that the Company has not produced audited financial statements. The Company's evidence demonstrates that the delay in the production of audited financial statements of all entities within the Ledudu Group was agreed by the Company's board which included the Petitioner's representative[36] .

Consolidation of Accounts

97. The Company's evidence with respect to how the accounts of the Company and the Ledudu Group are consolidated is consistent.

98. The Petitioner interprets §19 of Fan 2 as saying that the accounts of the Company are consolidated accounts for the Ledudu Group as a whole, both onshore and offshore. I do not accept that is correct set against the explanation given by Mr Fan[37].

Dishonest or disingenuous conduct

99. These are serious allegations and if the Petitioner had legitimate concerns regarding the management of the Company, one would have expected to see evidence which demonstrates (i) a pattern of the Company attempting to deny the Petitioner its rights under the Share Purchase Agreement or the Shareholders Agreement; and (ii) a pattern of complaints made by the Petitioner to the Company which have gone unanswered. No such evidence is before the Court.

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[35] *Re Asia ibid § 60 Segal J*
[36] *Fan 2 § 40*
[37] *§13 of Fan 2; § 16 of Fan 2; §17 of Fan 2.*

100. On the other hand, the Company's evidence in Fan 1 and Fan 2 in answer to the allegations of mismanagement by the Petitioner is credible.[38] The Company also points to the fact that none of the other shareholders of the Company have ever raised complaints about the management of the Company or Mr Fan and submits that many of the Company's shareholders support the Company's strike-out application and the dismissal of the Petition. There is nothing to gainsay this position from the Petitioner.

101. I also find that the Petitioner has not shown that the Company has failed to comply with the terms of the relevant constitutional and governance documents, as modified where applicable by the agreement of the Company's investors and board, including the Petitioner's representative.

Conclusion

a) The Petitioner has not satisfied the court that there is a debt due which has not been paid and that the Company is insolvent. There are *bona fide* and substantial disputes in relation to these matters. The Petition is struck out as an abuse of process.

b) The disputes regarding the debt claimed in the Petition, which are subject to the Arbitration Agreement would in the alternative to the Petition being struck out, have been stayed.

c) The Petitioner has not satisfied the conditions necessary for the appointment of provisional liquidators and the application is dismissed.

Costs should follow the event and be paid by the Petitioner. If there is a dispute about costs, I will deal with the matter on written submissions.

THE HON. JUSTICE PARKER
JUDGE OF THE GRAND COURT

[38] *§§32 to 33 and §§37 to 52 of Fan 2 and pp 1 to 6 and 43 to 50 of CF-2*