

HONG KONG / JUDGMENT

DICHAIN HOLDINGS LTD v. ORIENT DAY DEVELOPMENTS LTD AND OTHERS

COURT

Court of First Instance

DECIDED

9 March 2007

CASE / FILE NUMBER

HCMP2128/2006

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bjbj HCMP 2128/2006 IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION COURT OF FIRST INSTANCE MISCELLANEOUS PROCEEDINGS NO. 2128 OF 2006

BETWEEN DICHAIN HOLDINGS LIMITED Plaintiff and ORIENT DAY DEVELOPEMNTS LIMITED
1st Defendant PEARL ORIENTAL INNOVATION LIMITED 2nd Defendant FARSIGHT HOLDINGS
LIMITED 3rd Defendant

HCA 2401/2006 IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION
COURT OF FIRST INSTANCE ACTION NO. 2401 OF 2006

BETWE suRmi gP N2m) e|vU\ gP W gP to above. The parties and issues are connected; the matter for me is whether they should be consolidated or follow one after the other before the same judge; otherwise, that they should run independently. HCMP 2128/2006 This originating application derives from a reorganisation of the 2nd Defendant, Pearl Orientation. Hitherto Pearl Orientation, a listed company, was controlled by the Plaintiff, Dichain Holdings, which held some 44.4% of the shares. Towards the end of 2005 Pearl Orientation fell into financial difficulty. Dichain Holdings was not in a position to assist. A decision was made to introduce new blood. This arrived in the shape of the 1st Defendant (Orient Day). A tripartite agreement was entered into among Pearl Oriental, Orient Day and Dichain Holdings, by which it was agreed that 4 billion new shares in Pearl Oriental would be allotted to Orient Day for \$40 million. This was called the Subscription Agreement. It is dated 22 February 2006. Dichain Holdings is a party as warrantor. The Subscription Agreement was, inter alia, subject to Orient Day being satisfied with the results of a due diligence enquiry. It purported to be satisfied; there was completion on 24 May 2006. In addition, there has been a sale by Dichain Holdings to Orient Day of more shares, and a convertible bond has issued to Orient Day. The result is that the interest of Dichain Holdings in

Pearl Orient (including a small interest held in the name of an associate company, the 3rd Defendant, Farsight Holdings) is now 7.31%, and Orient Day has become the dominant shareholder. The warranty required of and made by Dichain Holdings is set out in clause 6 of the Subscription Agreement. The document is largely in Chinese characters. Dichain Holdings solicitors have prepared a translation; this has not been satisfied. It reads as follows:

6. Dichain Holdings warrants to Orient Day that:
- (a) Within one year counting from the date of completion of this Agreement, Dichain Holdings will procure Pearl Oriental and the lending banks to reach agreement(s) so as to release Pearl Oriental from liabilities (if any) arising out of the guarantee(s) in respect of borrowings;
 - (b) Dichain Holdings agrees to entrust the possession of a total of 1 billion shares of Pearl Oriental which are between them registered in the name of Dichain Holdings and Farsight Holdings (Free from all and any Encumbrance) (abbreviated as entrusted Shares) to the solicitors of Pearl Oriental for custody until the compliance with sub-clause (a) above;
 - (c) up to the date of completion of this Agreement, save and except the outstanding bank borrowings totalling approximately HK\$86 million due from its subsidiary to which the unreleased corporate guarantee(s) provided by Pearl Oriental relate, and the amount payable by Pearl Oriental as at 22nd February 2006 totalling about HK\$3.49 million which has been disclosed (see the information on the page attached), Pearl Oriental does not owe any other debts or contingent debts (including but not limited to the debts owed to its directors or management (if any)); In the event of Pearl Oriental suffering any economic loss as a result of breach of the aforesaid warranty on the part of Dichain Holdings, Pearl Oriental will be entitled to sell or transfer part or whole of the entrusted Shares to recover its rightful economic compensation (including all costs or expenses arising therefrom). Orient Day has not complied with clause 6(b); it has not given up possession of its 1 billion shares (the total interest of Orient Day and Farsight Holdings) to Pearl Oriental's solicitors. Miss Fu Li, a director of Dichain Holdings, explained why. She said there has been a falling out; that Orient Day failed to appoint Dichain Holdings Mr Fan Di (the former Chairman of Pearl Oriental) as a consultant which has thus hampered negotiations leading prospectively to a release of Pearl Oriental's obligations under guarantees as referred to in clause 6(a). Orient Day denies that it is in breach of clause 6(b) for not having passed possession of the shares. In any event, it asserts that provided it can give the necessary indemnity in money terms it should not have to part with its shares. The purpose of this summons is to seek a direction which will allow it to retain possession of them. Focus of attention is on the guaranteed amount of \$86 million and liability to pay \$3.49 million referred to in clause 6(c). Miss Fu deposes that the \$86 million liability was provided for in arriving at the price of the stake in Pearl Oriental paid by Orient Day; thus is not an obligation falling on Dichain Holdings under clause 6(a). Of the \$86 million, \$28.8 million has already been paid from the injection of capital of Orient Day. She says that that was a matter of urgency which was the very reason for the new capital as provided by Orient Day. Presupposing that Dichain Holdings

interpretation is correct and it is not liable for the remaining indebtedness at clause 6(c), the potential liability is less than \$700,000. This is an amount, actually \$695,655.37, which Pearl Oriental and Orient Day claim to be due as being a liability of Pearl Oriental not disclosed under clause 6(c). There is no admission of liability. But were it to be due, it is said, this does not justify the tying up of Dichain Holdings shares in Pearl Oriental, which as at December 2006 were valued at more than \$65 million. It is proposed for Dichain Holdings that in lieu of that, it should be required to pay into court (say) \$1 million which will provide adequate security. To lock up shares having a value so hugely in excess of the prospective liability is unreasonable and unnecessary. The response forthcoming from one Zhou Li Yang, a director of Pearl Oriental on behalf of both Defendants, is that the deposit of Dichain Holdings shares certificates amounts to an equitable charge on the shares and that is that. Any dispute that may have arisen is neither here nor there. By failing to deposit the shares Dichain Holdings is in breach. Its proposal to vary the terms of clause 6 is a unilateral one to which it cannot commit Orient Day or Pearl Oriental. Furthermore, Dichain Holdings is potentially liable to make good the balance due by the associate and referred to in clause 6(c); said to be RMB60 million. Whether or not the associate has the means independent of the guarantee from the parent company, and thus the warranty of Dichain Holdings, the fact is that until it is cleared the obligation remains. A form of charge over the shares held by Dichain Holdings was and remains necessary to protect Orient Day's investment. HCA 2401/2006 The primary cause of action arises from Dichain Holdings failure to comply with clause 6 and deliver its shares; in particular, because it prospectively remains exposed to compensate Pearl Oriental should the outstanding guarantee be called up. The claim is in specific performance requiring delivery thereof. There is also claimed the sum of \$695,655.37. Discussion Should these two matters be consolidated, or otherwise heard in tandem? It goes without saying, and indeed is accepted, that there is a common element, and that is the terms of the Subscription Agreement and whether or not Dichain Holdings is or should remain under an obligation to hand over the shares. Mr Yau for Dichain Holdings, whilst conceding that, submits that the action having just begun, there remains outstanding discovery, the usual completion and exchange of witness statements and such further directions and activity that may derive from that which will prolong the outcome. This will unfairly prejudice his client, which invites a ruling on a point of construction which can and should be able to be dealt with much more speedily. And there is the need for urgency; Dichain Holdings should be entitled to take advantage of the state of the market at any given time in dealing with its shares. But insofar as his client relies on a factual matrix surrounding the completion of the Subscription Agreement which has to be resolved before the interpreting of clause 6 can be properly pursued, it seems to me that there will need to be a trial in any event. On an ordinary reading of clause 6, Dichain Holdings is liable to deliver the shares which may be held pending the release of Pearl Oriental from the liabilities referred in 6(a). This it would seem, on an ordinary reading, to include the situation where Pearl Oriental remains exposed because the guarantee is extant, even though there are funds available to the subsidiary to satisfy the debt without recourse to the guarantee. If in fact the clause is intended to read otherwise there will need to be adduced

evidence to establish this. Thus it follows that a preliminary determination without the need to hear and test such evidence will not be possible.

Conclusion

In the circumstances, from the point of view of case management, justice amongst the various parties is best served by a consolidation of the two matters and I so order. The proceedings under HCMP 2128 of 2006 shall be continued as if begun by writ of summons. The affidavits filed in support and in opposition shall respectively stand as the statement of claim and statement of defence and counterclaim; the plaintiffs and defendant in HCA 2401 of 2006 shall within 14 days file and serve on each other a list of documents, followed by mutual discovery and inspection of documents within 14 days of such service; the affirmations filed in HCMP 2128 of 2006 shall stand as witness statements; the parties may within 14 days of inspection of documents file and serve additional witness statements; the affirmations aforesaid and such additional witness statements shall stand as evidence in chief unless the trial judge directs otherwise; the parties shall not be entitled to rely on affidavit evidence if the deponent thereof has not been brought to the trial for cross-examination; liberty to apply; liberty to apply for an early date for trial (including freedom to fix during the legal vacation) upon compliance with the aforesaid directions; costs nisi of this ruling to the Plaintiffs in HCA 2401/2006 in any event. (D M B Gill) Deputy High Court Judge Mr A Yau, instructed by Messrs Lau, Chan & Ko, for the Plaintiff (in HCMP 2128/2006) and Defendant (in HCA 2401/2006) Mr S Chan, instructed by Messrs Lau, Kwong & Hung, for the Defendants (in HCMP 2128/2006) and Plaintiff (in HCA 2401/2006) PAGE - A B C D E F G H I J K L M N O P Q R S T U V A B C D E F G H I J K L M N O P Q R 1udk 1udk i\$&`G Gill-HCMP.dot setup Microsoft Word 9.0 Judiciary Hong Kong Title Microsoft Word Document MSWordDoc Word.Document.8

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