

HONG KONG / JUDGMENT

RE H3C TECHNOLOGIES CO LTD

COURT

Court of First Instance

DECIDED

2 August 2007

CASE / FILE NUMBER

HCMP1141/2007

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b1bj Companies Ordinance, Chapter 32 of the Laws of Hong Kong

Before: Hon Kwan J in Court Date of Hearing: 31 July 2007 Date of Judgment: 31 July 2007 Date of
Handing Down of Reasons for Judgment: 2 August 2007

REASONS FOR JUDGMENT

This is a petition presented by H3C Technologies Co., Limited (the Company) for confirmation of reduction of its share premium account, pursuant to section 59 of the Companies Ordinance, Cap. 32. The Company was incorporated on 29 October 2003 under its former name, and has commenced business shortly after incorporation. The principal activities of the Company are the research, development, manufacturing and sales of datacom equipment products. Its present authorised and issued share capital is US\$9,705,000.00, divided into 9,705,000 shares of US\$1.00 each, and there is only one class of shares in issue. Since 29 March 2007, the Company has become a wholly owned subsidiary of 3Com Technologies. The ultimate holding company of the Company is 3Com Corporation, a public company incorporated in the state of Delaware in the United States. On 4 August 2006, the Company petitioned to this court for reduction of its share capital by cancellation of a sum close to US\$80 million standing in the credit of its share premium account on the ground of excess of wants. Sanction for reduction was granted on 28 September 2006. Accordingly, the amount standing in the credit of the share premium account was reduced from US\$365,782,953.74 to US\$285,813,753.74. As at the presentation of this petition, the Company still has the sum of US\$285,813,753.74 standing to the credit of its share premium account. The amount was accumulated as a result of contributions of additional capital into the Company by its shareholders. There is provision in the articles of association that the Company may, by special resolution, reduce its share capital, any capital redemption reserve fund or any share premium account in any manner and with, and subject to, any incident authorised, and consent required, by law. By a special resolution of the Company duly passed on 11 June 2007, it

was resolved that the amount standing to the credit of the share premium account be reduced from US\$285,813,753.74 to US\$85,813,753.74, such reduction being effected by transferring US\$200,000,000.00 to a distributable capital reserve account to be applied in accordance with the memorandum and articles of association of the Company and all applicable laws, including but not limited to returning to the shareholders in cash, applying to eliminate accumulated losses of the Company and/or other application as the directors of the Company may think fit and proper, such capital being in excess of the needs of the Company. It is envisaged that the reduced capital would be applied in this manner and almost half of the credit arising would be set aside for the future amortisation of the Company's intangible assets:

- (1) creating a distributable reserve of US\$104 million, which would be returned to the shareholders by way of declared dividends, to be paid by non-cash transfer of the Company's loan receivable assets;
- (2) creating a non-distributable reserve account of US\$24 million, which would be used to offset future amortization charge of the Company; and
- (3) creating a non-distributable reserve account of US\$72 million, which would be used to offset future writing off the trademark and goodwill of the Company. The proposed reduction does not involve the diminution of any liability or the payment to any shareholder of paid-up share capital. The directors have formed the opinion that the proposed reduction of US\$200,000,000.00 is not required for the future operations of the Company. In or around the time the Company was incorporated, the Company planned to fund the operation and growth of its subsidiary in Mainland China and other future operations. For this reason, the shareholders injected US\$155 million odd capital reserves into the Company over and above the authorised and issued share capital. In addition to the cash contributed to the Company, the two parent companies also contributed business to the venture that carried an intangible asset and goodwill value in the value of about US\$210 million. That brought the total share premium to about US\$365 million. As it transpired, only US\$80 million was required to invest in the subsidiary in China, Hangzhou H3C Technologies Co., Ltd., and another US\$10 million was used to set up other new subsidiaries. The subsidiary is currently profitable and has a positive cash flow, and in the foreseeable future would have more than enough funds to finance all its operational needs without requiring additional capital injection from the Company. At the end of 2006, the subsidiary paid a dividend of US\$30 million to the Company. Even with the reduction of the share premium account in September 2006 which resulted in the return of excess capital of US\$80 million to the shareholders, the Company still has a credit balance in its share premium account of US\$285 million odd which is much more than the Company would need for its ongoing operations. Further, as at the end of March 2007, the subsidiary has paid a total dividend of US\$53 million to the Company, with another US\$140 million being eligible to be distributed to the Company in 2007. As a result of the satisfactory performance of the subsidiary, the reserves kept in the share premium account for the purpose of supporting the subsidiary were not used. Moreover, due to the amortization of the intangibles and possible write down in the future of the goodwill and

trademark, up to US\$200 million odd of cash could sit under-utilised, as it would not be able to be usefully employed in the business of the Company. According to the audited accounts, as at 31 December 2006, cash at banks and on hand of the Company stood at US\$73 million odd. As of the same date, there were account receivables amounting to US\$19 million odd and goods inventories of the value of US\$10 million odd. Current liabilities as at that date stood at US\$85 million odd. As at 31 March 2007, cash at banks and on hand stood at US\$167 million odd, account receivables amounted to US\$20 million odd and goods inventories at US\$10 million odd. Current liabilities as at that date stood at US\$84 million odd. Thus, even as the turnover of the Company has increased, no increase has been required for the working capital. As the majority of the business transactions would remain attributable to the Company acting as an agent between its subsidiary in China and its parent companies, no material change is expected to the future requirements of working capital. And because most of the business would be done vis- -vis either its shareholders or the subsidiary, the amount owed to third parties would remain small. Of the total liabilities of US\$84 million, about US\$38 million was an accrual for a special payment to the employees as a result of the change in ownership in the Company. The other portion of the liabilities consisted mainly of account payable to the subsidiary (US\$39.9 million odd), which, as of March 2007, is 99.2% of the total accounts payable. The balance of the current liabilities consisted of typical accrued expenses and liabilities. It is expected that such liabilities would be paid in the ordinary course of business on a regular basis. In any event, the Company estimates it will still have bank balances and cash of approximately US\$200 million on a consolidated basis, with about US\$20 million in the Company's own account after the reduction of the share premium account. Excluding the amounts due to the subsidiary, the Company has enough cash to cover its liabilities and still leave a margin of about 200% of such liabilities. A letter of consent of the subsidiary in China was produced, in which it consented to the proposed reduction of the Company's share premium account. Updated management accounts up to 30 June 2007 were produced at the hearing of the petition. Current assets of the Company were US\$178 million, of which cash in hand and at bank amounted to US\$28 million and short-term investment of US\$113 million. Current liabilities were US\$52 million. The latest bank confirmation showed that as of 18 July 2007, the Company maintained a strong cash position. The financial position of the Company is apparently sound. It can be seen from the cash position summary report from the inception of the Company to the end of March 2007 that the Company has more than sufficient cash flow to maintain its business. At the hearing of the summons for directions on 10 July 2007, I made an order that section 59(2) shall not apply as regards any class of creditors of the Company. Directions given for advertisement of a notice of presentation of the petition have been complied with. The principles upon which the court may sanction a reduction of the share premium account are similar in all respects to those concerning the reduction of the share capital (*Re Lippo China Resources Ltd.* [1998] 1 HKLRD 20 at 23J to 24B). The special resolution to reduce the share premium account was passed by the sole shareholder. The proposed reduction, based on the excess of wants of capital, is for a discernible purpose. I am satisfied that the interests of creditors would not be prejudiced. I have therefore sanctioned the proposed reduction and made an order in

terms of the draft submitted. (S Kwan) Judge of the Court of First Instance High Court Mr William Wong, instructed by Messrs. Peter K S Chan & Co, for the Petitioner PAGE - 1udk 1udk i\$&P vo 5t+ 3(UB= vo 5 HCMP.dot setup Microsoft Word 9.0 Judiciary Hong Kong Title Microsoft Word Document MSWordDoc Word.Document.8

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