

HONG KONG / JUDGMENT

RE PERFECT SENSE GROUP LTD

COURT

Court of First Instance

DECIDED

30 May 2007

CASE / FILE NUMBER

HCMP341/2007

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bjbj HCMP 341/2007 IN THE HIGH COURT OF THE HONG KONG SPECIAL ADMINISTRATIVE
REGION COURT OF FIRST INSTANCE MISCELLANEOUS PROCEEDINGS NO. 341 OF 2007

IN THE MATTER of PERFECT SENSE GROUP LIMITED and IN THE MATTER of the Companies
Ordinance, Cap. 32 of the Laws of Hong Kong

Before: Hon Kwan J in Court Date of Hearing: 29 May 2007 Date of Judgment: 29 May 2007 Date of
Handing Down of Reasons for Judgment: 30 May 2007

REASONS FOR JUDGMENT

This is a petition presented by Perfect Recovery Limited (the Company) on 11 May 2007 pursuant to section 166 of the Companies Ordinance, Cap. 32, for sanction of a scheme of arrangement with its creditors. The background The Company was incorporated in Hong Kong on 11 April 2003 as a private company. Its present authorised and issued share capital is \$10,000.00, divided into 100 ordinary shares of HK\$100.00 each, all of which are owned by NICI AG, a company incorporated in Germany (the Parent Company). On 6 February 2007, the Company changed its name from NICI Asia Limited to Perfect Sense Group Limited , to enable the third party which purchased the business of the Company pursuant to a merger and acquisition process (the M&A Option) to adopt the name NICI Asia Limited . On 15 February 2007, the Company further changed its name to its present name, Perfect Recovery Limited. The Company is part of a sizeable group of companies (the NICI Group) headed by the Parent Company with operations in Germany, France and the United Kingdom. The core business of the NICI Group is the distribution and sale of plush puppets, toys and gifts. The Company acted as the sourcing agent for the business of the Parent Company. It had no significant independent customers and was substantially dependent on dealings with the Parent Company. On 16 May

2006, the Parent Company filed insolvency proceedings in the Local Court of Coburg in Germany. This was largely due to allegations that the former chief executive and majority shareholder of the Parent Company had manipulated and overstated the sales figures by approximately 60% to generate liquidity and to cover operating expenses. On the same day, the court appointed a preliminary insolvency receiver for the Parent Company. As the preliminary insolvency receiver proceeded to restructure the Parent Company's operations, it was unable to continue to meet the high volume of orders from the Company and this substantially affected the business of the Company. Further, the Parent Company had guaranteed a substantial proportion of the lines of credit extended to the Company by bank creditors. The bank creditors sought to withdraw their lines of credit after the appointment of the preliminary insolvency receiver, causing the Company immediate financial difficulties. On 12 June 2006, the Company entered into an informal standstill arrangement with its bank creditors and formalised those arrangements in August 2006 (the Standstill Agreement). Pursuant to the Standstill Agreement, the bank creditors agreed not to demand repayment of the sums owed to them, to pursue legal proceedings or enforce any security until the termination of the moratorium. In return, the Company agreed to restructure its banking procedures to enable the bank creditors to monitor its day-to-day cash position and agreed to grant security in favour of the bank creditors. The Company was thus able to continue to operate at a reduced level while a restructuring plan was put in place. On 1 August 2006, the Company newly incorporated wholly owned subsidiary and subsequently sell all of the shares in that subsidiary to an investor as part of an integrated sale of the business in conjunction with the Parent Company. The M&A Option involved three stages:

- (1) a hive-down, by which the trading assets and business of the Company (and potentially its liabilities by reason of the operation of the Transfer of Businesses (Protection of Creditors) Ordinance, Cap. 49) were sold to a newly incorporated wholly owned subsidiary of the Company (the Subsidiary);
- (2) the sale by the Company of the entire issued share capital of the Subsidiary to an independent party acceptable to the stakeholders of the Company as a going concern, with the proceeds from the sale of the Subsidiary (the M&A Proceeds) forming part of the assets of the Company available immediately for distribution to scheme creditors in accordance with the scheme;
- (3) the implementation of the scheme and the making of all distributions to scheme creditors, followed by a members voluntary liquidation of the Company. The aim of the hive-down was to make the M&A Option as attractive as possible to investors by packaging the Company's business and assets in such a way as to ensure that only the assets of the Company (and not its liabilities) were transferred to the Subsidiary and in turn transferred to an investor pursuant to the operation of Cap. 49. On 26 October 2006, the Company and the Subsidiary executed an asset sale and purchase agreement, by which the business of the Company was transferred to the Subsidiary on that date. On 27 October 2006, a notice of transfer of business was advertised in the Gazette and several newspapers in accordance with Cap. 49. As no proceedings were instituted against the Company within a month thereof, the

operation of the Ordinance resulted in the Company's assets being transferred to the Subsidiary without its liabilities on 26 October 2006, completing the hive-down. As part of the M&A Option, the insolvency administrator sold the business of the Parent Company to entities created by the US investment fund Strategic Value Partners the Investor) on 15 November 2006. The sale closed on 30 November 2006. The Investor agreed to purchase the entire issued share capital of the Subsidiary for scheme creditors to recover as much as possible from the satisfaction of their liabilities, notwithstanding the existence of certain disputed claims. Upon a copy of the order sanctioning the scheme being presented to the Companies Registry, all property of the Company shall be held on trust for the scheme creditors, and this would include the M&A Proceeds. Under the scheme, manufacturers of products supplied to the NICI Group (the Suppliers) will ultimately receive a distribution which represents 60% of their outstanding liabilities. Other scheme creditors, including the bank creditors, shall receive a distribution of no more than 20% of their outstanding liabilities. The liabilities due to scheme creditors shall be satisfied and discharged in full by the payment of the distributions under the scheme. It was considered necessary to provide for such tiered distributions in order to ensure that the proceeds received from the sale of the entire shareholding of the Subsidiary to the Investor were maximised. The Suppliers are to receive an enhanced distribution as the relationship and goodwill between the Company and the Suppliers are key components to the success of the business on a continuing basis. The bank creditors agreed to vote in favour of the scheme pursuant to an agreement with the Company dated 24 November 2006 (the Inter-Creditor Agreement), which superseded the Standstill Agreement. Insofar as distributions are to be made to bank creditors, all such payments shall be deemed to be of principal only. Distributions under the scheme shall be paid in the following order of priority:

- (1) firstly, to satisfy in full all scheme expenses;
- (2) secondly, to make adequate provision for the disputed claims as mentioned below by way of a reserve representing no more than 20% of the claims of each disputed claimant; and
- (3) once all scheme expenses have been paid in full or provided for, to satisfy all scheme creditors pro rata to their respective scheme liability in accordance with the tiered distributions as follows:
 - (i) the Suppliers 60% of the scheme liabilities; (ii) bank creditors (except a specified bank or its affiliates in respect of any guarantee claim that bank may have) 20% of the scheme liabilities; (iii) other scheme creditors 20% of the scheme liabilities; and (iv) disputed claimants no more than 20% of the claim of the disputed claimant as such distribution shall be paid from the reserve mentioned below. The Company and its advisers considered that the overall rate of return available to scheme creditors is expected to be more favourable than that which would be available in the event the Company was liquidated, and distributions will be paid earlier than would occur upon the liquidation of the Company. The court has jurisdiction to sanction a scheme of arrangement involving the distribution of assets other than in accordance with creditors rights in a liquidation, albeit the power

should be exercised carefully in justified circumstances (Re Anglo American Insurance Limited [2001] 1 BCLC 755). Liabilities of the Company The liabilities of the Company can be broadly divided into five categories: liabilities owed to bank creditors; liabilities owed to the Suppliers; inter-group liabilities; liabilities owed to other creditors; and potential liabilities relating to the disputed claims. There are six bank creditors. The total liabilities to them amounted to tement despatched to the scheme creditors. It is pertinent to note that although the disputed claims are excluded from the operation of the scheme, the scheme proceeds on the basis that a reserve (the Disputed Claim Reserve) shall be made on the same basis as if these parties were scheme creditors. It is hoped that the disputed claims can be compromised and settled by the scheme administrator as a matter of Hong Kong law on terms no more favourable than those set out in the scheme. It is provided in the scheme that in the event that the scheme administrator is unable to compromise any of the disputed claims, the scheme creditors preserve the right to any claims they may have against the Korean Branch. The proposer of a scheme is free to select the creditors to whom a scheme should be put, provided that the rights of the creditors and the effect of the scheme on those rights are not so dissimilar as to make it impossible for those creditors to consult together with a view to acting in their common interest (Re Sea Assets Limited [2001] EWCA Civ 1696, paras. 33 to 51 and 66). The scheme meeting At the hearing of the originating summons on 22 March 2007 for leave to convene a meeting of scheme creditors, the Company sought leave to convene the meeting at a period of notice shorter than the customary 21 days. A period of notice of five business days was proposed and these reasons were advanced in support:

- (1) A significant number of the Suppliers (representing 8.5% in value of the liabilities due to scheme creditors) had sold part of their liabilities to the Parent Company on substantially the same economic terms as provided for in the scheme.
- (2) The Parent Company had agreed to vote in favour of the scheme in respect of those liabilities acquired from the Suppliers.
- (3) The remaining liabilities of the Suppliers would be compromised and discharged in accordance with the terms of the scheme. In this regard, the majority of such suppliers (representing 6.8% in value of the scheme liability) had confirmed in writing that they would vote in favour of the scheme and for that purpose had appointed the chairman of the scheme meeting to vote in favour of the scheme.
- (4) Save for the disputed claims, the majority of other Suppliers which had not sold their respective liabilities had indicated to the Company that they were in agreement with the economic terms set out in the scheme and would vote in favour of the scheme.
- (5) The terms of the Inter-Creditor Agreement provided that the bank creditors were obliged to vote in favour of the scheme provided certain economic terms were satisfied and the scheme had been drafted to satisfy those terms.

- (6) One of the terms of the hive-down was a requirement that the Company should implement the scheme to ensure that the business can continue free from all uncertainties surrounding the sale and transfer of the business to the Subsidiary. In summary, approximately 76.9% in number and 98.4% in value of the scheme creditors have pre-approved claims and agreed to support the scheme. I have allowed a shorter than usual notice period in the special circumstances of this case. The directions given on 22 March 2007 for the service of the scheme documents and the advertisement of an appropriate notice were complied with. At the scheme meeting on 10 May 2007, the debts of 35 scheme creditors were admitted for the purpose of voting and all had voted in favour of the scheme, representing 100% in value of the total indebtedness admitted for voting. There were no grounds for thinking that the class of creditors was not fairly represented at the meeting or any of those voting was acting otherwise than in good faith for the benefit of his interest as a member of the class. Sanction of the scheme One single meeting of scheme creditors was convened to consider and, if thought appropriate, approve the scheme. Notwithstanding that some of the bank creditors may have a contingent claim against the Parent Company under the guarantees, the Company considered that all scheme creditors have the same rights in a winding up of the Company and all scheme creditors have a common interest that would make it possible for them to consult together with a view as to how that common interest was best pursued. Further, it was not thought necessary to treat the Suppliers as a separate class on account of their proposed enhanced distribution. The rights of the Suppliers are not so dissimilar to those of the other creditors as to make it impossible for the creditors to consult. There is a single compromise between the Company and all of its admitted unsecured creditors, all based on the sale of the business to the Investor in the restructuring plan. Paying the Suppliers a greater dividend ensured continuity of supply for the business and made it more saleable to the Investor. I am satisfied that the class of creditors was properly constituted in the scheme. The scheme creditors were given a sufficient explanation of the scheme in the explanatory statement so as to enable them to make an informed decision how to vote at the meeting. As mentioned earlier, 100% of the creditors admitted for voting have voted in favour of the scheme. Having regard to the financial position of the Company, the fact that the scheme is an important component of the reconstruction of the NICI Group as a whole, the prospects of improved recoveries for scheme creditors when compared with a formal and separate liquidation of each of the Parent Company and the Company, I am satisfied that the scheme is such that an intelligent and honest man, being a member of the class concerned and acting in respect of his interest, might reasonably approve. I have therefore sanctioned the scheme in terms of the draft order submitted. (S Kwan) Judge of the Court of First Instance High Court Mr. Roger Beresford, instructed by White & Case, for the
- Petitioner PAGE - 1udk 1udk 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 S T U V i\$&`G hccw (for Susan Kwan only).dot setup Microsoft Word 9.0 Judiciary Hong Kong Title Microsoft Word Document MSWordDoc Word.Document.8

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