15/02/08

IN CHAMBERS
IN THE GRAND COURT OF THE CAYMAN ISLANDS

CAUSE NO: 10/2008

IN THE MATTER of Section 35 of the Companies Law (2007 Revision)

IN THE MATTER of HANNSPREE INC.

Before: The Honourable Madame Justice Levers

Appearance:
Counsels for the Petitioner: Mr. C. McKie and Mr. C. Lynch of Maples and Calder

Heard: 1st February 2008

GRAND COURT CAYMAN ISLANDS

**JUDGMENT**

Levers, J.

By its petition dated the 8th January 2008, the company HannSpree Inc. seeks the Court's sanction pursuant to Section 35 (2) of the Companies Law (2007 Revision) for the proposed issue of 1,061,007,957.5596 shares in the capital of the Company with the par value of US$100 at a discount to par of US$99.9246 each. This is what is known as the Discounted Allotment. In accordance with Grand Court Rules, Order 106, Rule 6(1) the Company has also issued a summons for directions, the requirement of which will be examined later in this judgment.

The Discounted Allotment will raise US$80,000,000 for the Company which sum the Company intends to invest in its Taiwanese trading subsidiary which has suffered significant losses. It is submitted that the Company has no other viable alternative to raise the US$80,000,000 required. This is an application for the sanction of the issue of shares at a discount, which discount is in line with the Company's actual net asset value. There are however certain issues which must be examined by this Court:

**The Company**

The Company's principal business activity is to act as a holding company for its trading subsidiary, also called HannSpree Inc, of which it owns 99.19%. The subsidiary is a limited liability company incorporated in Taiwan. It carries on the business of selling liquid crystal display televisions, monitors and other similar products. The subsidiary has not proved successful and it has sustained losses. It has a negative net asset value of US$3,034,000. The Company's audited financial statements substantiate this. Therefore at a board meeting on 7th August 2007, the Company's directors concluded that the Company's net asset value was

US$100,000 which translated to a value of US$0.0754 per share in issue. The Company wishes to raise US$80,000,000 to invest further in the subsidiary. The shares will be offered to the existing shareholders with the first right of refusal. Certain investors have already instructed the Company that they are willing to invest US$80,000,000 in the Company in return however, for shareholdings that would be proportionate to each investor's contribution. The investors are fully aware, it is submitted, that the net asset value per share of the Company will be US$0.0754 and will only subscribe for the Company's shares at US$0.0754 per share with each share so issued to be treated as fully paid. It is submitted that the Company has no other viable alternative to raising this sum. The overwhelming majority of the shareholders are Taiwanese.

The holding company, the petitioner, in this matter is not a listed company but is a private company. There are 799 shareholders but approximately 25 of these shareholders own 90 odd percent of the ordinary shares of the Company. The discount represents the difference in value of what the Company is supposed to be based on its existing share capital and what it actually is based on its net asset value. There are already persons who are prepared to participate in and have underwritten the entire discount issue.

Not all existing shareholders however want to participate and that will be considered at a later stage in this judgment. The authority to make this application and comply with it comes from Article 6 of the Company's Articles of Association, which prevents the company from issuing shares at a discount except in accordance with the provisions of the law

> Article 6 – "the shares shall be at the disposal of the directors, and they may (subject to the provisions of the law) allot, grant options over, or otherwise dispose them to such persons, on such terms and conditions, and at such times as they think fit, but so that no share shall be issued at a discount except in accordance with the provisions of the law".

The law to be examined by the Court is contained in Section 35 (1) of the Companies Law which permits the Company to:

"issue at a discount shares in the company of a class already issued provided that:

> a) the issue of the shares at a discount have been authorised by the resolution of the company, and have been sanctioned by the Court;
> b) the resolution specify the maximum rate of discount to which the shares are to be issued;
> c) not less than one year, at the date of the issue, has elapsed since the date on which the company was entitled to commence business; and
> d) the shares to be issued at a discount are issued within one month after the date on which the issue is sanctioned by the Court or within such extended time as the Court may allow".

The matter of the restraints in (a), (b), and (c) above have been complied with and there is evidence to substantiate the same. The resolution has been

put before the Court, the maximum rate (in this case, exact) of discount is also specified and the company has only been in existence for 2 years.

Section 35(2) of the Companies Law reads:

> "the Court, if having regard to all the circumstances of the case it thinks proper so to do it may make an order sanctioning the issue on such terms as it thinks fit."

Counsel have researched the point thoroughly in making these submissions and they are to be commended. It has been brought to my attention that the Grand Court has not previously considered Section 35 of the Companies Law in any reported cases or indeed in any unreported cases known to the Petitioner's attorneys. It appears that there is no reported English decision considering an application pursuant to Section 47 of the U.K Companies Act 1929 or Section 57 of the U.K Companies Act 1948 (which was repealed in 1980). The Petitioner relies on relevant Commonwealth decisions, principally Australian decisions, which have been looked at carefully by this Court and will be referred to later in this judgment.

**The Evidence Before The Court**

It is worthy of mention before I look at the evidence that the issue of discounted shares in the Company of a class already issued is what Section 35 (1) of the Companies Law deals with. This perhaps is the reason why since there are other ways in which the desired result can be achieved (for example by issuing a different class of shares), the authorities on this issue are not as abundant as other matters arising under the Companies Law.

**The Action Of The Company**

By way of a resolution, the Company approved at its December extraordinary general meeting that the authorised share capital was to be increased to US$110,000,000,000 divided into US$1,100,000,000 shares of a par value of US$100.00 each. This further increase in authorised share capital was to allow for the Discounted Allotment i.e. the issue of 1,061,007,957.5596 with the par value of US$100.00 deemed fully paid at US$0.0754 per share. The evidence before this Court satisfies Section 35 (1) (a), (b) and (c) of the Companies Law. The matter of the vote and the notice given to shareholders is of some importance in view of Section 35 (2)

of the Companies Law. The Court has to have regard to all the circumstances of this case and must think it is proper to order the sanction or on such terms as the Court thinks fit. On the face of it, all the requirements under Section 35 (2) have been complied with but it is incumbent upon this Court in an application such as this with 799 shareholders to satisfy itself that adequate notice has been given and that adequate information has been given to the shareholders to enable them to make an informed decision.

Section 109 of the Articles of Association of the Company deals with the question of notices. The notices of the meeting were sent by the Company by registered mail which appears to be the usual method used by the Company as averred by one of the directors in his supporting affidavit. Section 109 (b) states:

> "Where a notice is sent by post service the notice should be deemed to be affected by properly addressing pre-paying and posting a letter containing the notice by airmail if available and to have been affected in the case of a notice of a meeting at the expiration of 3 days after it was posted".

The evidence supports the fact that the petitioner acted in accordance with the requirement. However, only 25 shareholders turned up at the meeting. This, as Mr. McKie stresses, is a large turnout in terms of value but not in terms of numbers. The persons, he submits, that voted are those who would

be most affected, but that in the event that I am not satisfied that the persons entitled to vote have been given adequate notice and information, I may make further directions as to the information to be disseminated if I so desire. Of course, in this case there are some new subscribers coming on board and I do not need to take them into consideration in the determination of this matter. In this there was quorum as required by Section 45 (a) of the Articles which reads:

> (a) "No business shall be transacted at any general meeting unless a quorum of Members is present at the time that the meeting proceeds to business; save as herein otherwise provided, one or more Members holding in the aggregate not less that one-third of the total issued share capital of the Company present in person or by proxy and entitled to vote shall be a quorum".

The quorum is therefore satisfied but whether I feel that the matter should be further aired amongst the shareholders is the question I now have to determine.

It is my view that the test to be applied is whether the application is being made for a proper and discernable purpose and whether it is commercially justified. The law already specifies that the test is whether it is proper to discount but I have introduced the word discernable as I would opine that it

would be untenable to have the Court look at whether it's proper without the reason being discernable.

The whole concept of par value has disappeared in Australia but, before it did so, the Australian Courts appear to have developed their own procedure and tests for this sort of application. All three Australian cases that have been brought to the attention of this Court involve listed companies, whilst the Company is not. The test must be the same in any case. Two of the three applications were opposed. Counsel for the Petitioner relies on the case of *In re Esmeralda Exploration Limited* [1991] 33 FCR 192 where it was held that the Court when considering an application to confirm the issues of shares at a discount under Section 90 of the Corporations Law should have regard to the following factors:

i) The public interest in ensuring that prospective shareholders and creditors are not misled by a nominal capital figure that exceeds the true capital of the company.

ii) The effect of the proposal upon the interests of actual or prospective shareholders and creditors.

iii) The extent to which shareholders have been informed of the reasons for the issue prior to voting on it.

iv) The extent to which creditors may find the proposal objectionable and the notice both formal and substantive that they have been given to enable them to object if they so wish.

v) The objectives of the proposed issue and the extent to which it serves the interests of the shareholders and creditors of the company.

In conjunction with (v) it is appropriate to look at the case of *Biala Pty Ltd and Another v Mallina Holdings Ltd*. Court of Appeal of the Federal Court of Australia –General Division [1997] 144 ALR 24 in which it was said:

> "The trial judge was correct in holding that it was not necessary or appropriate for him to consider whether the proposed issue of shares at a discount was objectively the best course for the company to adopt. It was enough for the trial judge to find as he did that the proposed issue was a commercially appropriate course for the Company to pursue."

There is of course the case of *Re First Technology International Ltd (HK) Co. Limited* [2005] HK CFI 11 (unreported, 18 November 2005) in which the Judge at first instance of the High Court of Hong Kong held that the existing shareholders, the future share subscribers or creditors of the company would not be prejudiced by the issue of shares at a discount and that issuing shares at a discount would be an effective way to raise further capital for the company. The point made in that case is that the Judge seems to have held that future shareholders must be considered. I would respectfully disagree when it comes to an ordinary application. Unfortunately, the matter is not a full report and it must I think turn on its

own facts. There seems to be no rationale for the reasoning set out that future shareholders should be considered. Therefore I am persuaded by the Australian authorities and follow those in this application.

It is of course extremely important that the larger the discount the greater care that should be taken by the Court as the greater the prejudice to the smaller shareholders. One has to be extremely careful that full and frank disclosure has been made. I cannot do justice to this matter without commending Mr. McKie highly for the full and frank disclosures that he has made and for the helpful way in which he has played Devil's advocate in bringing all matters to my notice. The Court is grateful to Counsel for his assistance. There are no creditors in this matter except for the attorneys involved. Therefore there would be no need to advertise prior to implementing the Order of the Court. In Re Tony Barlow Australia Ltd [1997] 23 ACSR 303 Anderson J. approved the discounted issue subject to the conditions that more information was to be provided to shareholders in relation to the reasons and objectives of the proposed issue, as the information before the Court did not enable persons to positively conclude that the proposal was in the best commercial interest of the Company. It was the Court's view that the deficiencies in the information could be cured by

providing more information to shareholders and giving them more time in which to consider the proposals. Orders were made directing that further material be provided to the shareholders and a further meeting be held.

In this case, although only 25 persons were present at the meeting, they represented 90% of the shareholding of the Company and indeed a careful look at the register would show that one already existing shareholder has by picking up the new issue maintained its approximate 30% shareholding of the Company. It is my view that the requirements under the Law and the test to be applied have been satisfied. Obviously the grant would be beneficial to the creditors. It is also for a discernable purpose that it is being made and it is clear that it is commercially justified. I do however have some reservation as to the lack of information provided to the shareholders. I therefore grant the application and approve the discounted issue subject to the conditions:

1. Within 28 days of this Order, the Company do dispatch in accordance with its Articles of Association to its shareholders, in English and translated into Chinese, the following documents:

    1.1 a circular which describes the purpose or purposes to which the Company and its Taiwanese subsidiary, HANNSPREE Inc, intend to put the proceeds of the Discounted Allotment (as defined in paragraph 3 hereof);

1.2 the audited financial statements for the company for the period ending 30 June 2007;

1.3 this Order;

2. Not earlier than 17 days after dispatching the documents referred to in paragraph 1 hereof, the Company do file with the Court an affidavit verifying the dispatch of those documents and identifying whether or not it has received any objections from its shareholders to the Discounted Allotment (as defined in paragraph 3 hereof).

3. Pursuant to section 35 (2) of the Companies Law (2007 Revision), the issue of shares at a discount resolved on by Ordinary Resolution passed at an Extraordinary General Meeting of the Company held on 5 December 2007 in the following terms:

> "The Company, subject to the sanction of the Grand Court of the Cayman Islands, be and is authorized to issue 1,061,007,957.5596 new shares of US$100, which are to be credited as fully paid at US$0.0754 per share, being a discount to par of US$99.9246 per share." (the Discounted Allotment")

be and is hereby sanctioned provided that:

3.1 on or before the date upon which the Company files its affidavit pursuant to paragraph 2 hereof, the Company has not received any objections from its shareholders to the Discounted Allotment; and

3.2 such shares be issued within one month of the date upon which the Company files its affidavit pursuant to paragraph 2 hereof.

4. If the Company has, on or before the date upon which the Company files its affidavit pursuant to paragraph 2 hereof, received any objections from its shareholders to the Discounted Allotment, the Company be at liberty to restore its Petition filed herein.

5. Liberty to any shareholder of the Company to apply to set aside or vary the terms of this Order provided that any such application is made not later than 17 days after the Company dispatches the documents referred to in paragraph 1.

6. No order on the Summons.

7. No order as to costs.

I should now like to mention the matter of the Grand Court Rules, Order 102 rule 6 (1):

> "upon the issue of a petition by which any such application as is mentioned in rule 4(a), (b), (c), (e) or (f) is made, the petitioner must at the same time take out a summons for directions under this rule."

The aforementioned Rule 4 (b) deals with the issuing by the Company of shares at a discount. It reads:

> "under Section 35 of the Law, for an order sanctioning the issue by a company of shares at a discount."

I believe the inclusion of 4 (b) must be a typographical error and through this judgment I wish to bring it to the attention of the Rules Committee to consider the same. The UK in 1980 abolished the power to issue shares at a discount. The relevant rules of the United Kingdom therefore would be the 1979 rules which then still permitted shares at a discount and required the seeking of the Court's sanction. Reference can be made to the Supreme

Court Practice 1979, Volume 1, Part 1, Order 102, Rule 5. The same rules still apply in the Hong Kong Ordinance Rules of the High Court Order 102 Rule 5(1) (d) and 7(1) which are exactly the same as the old English rules. In each case, there is no requirement to issue a summons for directions.

The Rules Committee perhaps should reconsider the question of a summons for directions being required to be taken out and rectify the position. Such a summons seems completely unnecessary in respect of applications pursuant to Section 35(2) of the Companies Law.

Dated this 15th day of February 2008

Judge of the Grand Court