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UPDATE

Section 238 dissenting shareholders succeed in appointing provisional liquidators over merger company

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The decision is a cautionary tale for companies which fail to comply with the orders of the Court and is a guide for dissenting shareholders as to the steps that may be taken where a company fails to engage in the section 238 process.

The recent decision of the Grand Court *In the Matter of Bona Film Group Limited*[1] (the **Company**) is an one relating to fair value proceedings under s.238 of the Companies Law (2016 Revision) (the **Law**)[2].

Background

The Dissenters (comprising a number of funds) rejected the Company's merger offer of US$11.1 million and triggered the fair value determination procedure pursuant to s.238 of the Law. During the course of the fair value proceedings, the Dissenters filed expert evidence asserting that their shares were worth over US$49.9 million. The Dissenters also alleged that the Company had attempted to put its only valuable asset out of reach by transferring it to a related company in the People's Republic of China, rendering worthless any judgment obtained by the Dissenters in the fair value proceedings.

The Dissenters contended that the Company had refused to engage with the s.238 process and failed, in breach of orders of the Court, to file valuation evidence. Eventually the Court made an 'unless order' giving the Company a final date by which to file evidence. The Company failed to do so and was accordingly barred from filing any valuation evidence in the proceedings.

The Dissenters filed a winding up petition seeking the appointment of provisional liquidators over the Company to prevent the dissipation and misuse of the Company's assets. The Dissenters, who had received US$11.1 million from the Company by way of interim payment, claimed that they were creditors of the Company in the amount of US$38.9 million.

The Winding Up Petition

The Company objected to the presentation of the winding up petition on the bases that:

(a) the debt was the subject of a *bona fide* dispute and accordingly a winding up order could not be made;

(b) a creditor must have an existing right to be paid in order to have standing to bring a winding up petition; and

[1] FSD 215 of 2016 (RMJ).

[2] For further information on sec. 238 of the Law see our previous briefings entitled: *Cayman Court makes first ruling on the meaning of 'fair value' under the statutory merger regime* – September 2015; *Going private: How to obtain fair value under the Cayman statutory mergers* – November 2015 and *s. 238 fair value determinations: more guidance from the Court* – March 2017.

(c) unless and until it was determined that the fair value of the shares exceeded the US$11.1m already paid by the Company, the Dissenters were not creditors of the Company and were at best contingent creditors without a right to petition.

The Court dismissed these arguments. The Court reiterated the accepted position that:

(a) if a petitioner's debt is bona fide disputed on substantial grounds, the normal practice is for the court to dismiss the petition and leave the creditor first to establish his claim in an action[3]; and

(b) to obtain a winding up order, the contingent creditor would have to show something in the affairs of the company to justify the apprehension that when the time for repayment of the debt arrived, the company would be unable to repay[4].

Ultimately, the Court found that it was appropriate for a winding up petition to be presented, and that even though the Dissenters may be seen as contingent, they were entitled to present a petition.

Indeed, such was the Court's concern as to the Company's conduct that, having established that the winding up petition was properly presented, the Court appointed provisional liquidators to prevent the misuse or dissipation of the Company's assets and/or to prevent mismanagement or misconduct.

Conclusion

Whilst most companies will not act in such a manner, the case is a timely reminder that the Court will exercise all the powers available to it to ensure that parties comply with its orders and that justice is done. In the context of a s.238 fair value determination, this can lead not only to a party being debarred from producing valuation evidence, it can also lead to the appointment of liquidators and loss of control over the company.

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[3] As per Lord Hoffman in *Parmalat Capital Finance Ltd & Others-v-Food Holdings Ltd (In Liquidation) and Another* [2009] 1 BCLC 274, (a Privy Council authority, on appeal from the Cayman Islands);

'*if a petitioner's debt is bona fide disputed on substantial grounds, the normal practice is for the 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 the 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*'.

[4] Applying the test previously set down by Scott J in *Re A Company* (No 003028 o f1987) BCLC at 294, i.e. that to obtain a winding up, '*the contingent creditor would have to show something in the affairs of the company to justify the apprehension that when the time for repayment of the debt arrived, the company would be unable to repay, and that in those circumstances the company ought to be at once wound up*'.