

UPDATE

## China Shanshui: Strike Two...

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At the end of October 2018, Ms Justice Mangatal handed down her second decision striking out a winding up petition presented against China Shanshui Cement Group Limited (**China Shanshui**). This is but the latest instalment in a long and bitter saga involving one of China's largest producers and suppliers of cement.

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Following recent Grand Court decisions in *Torchlight* and *Ctrip*, Ms Justice Mangatal confirmed that the Cayman court will focus on the underlying purpose for bringing a just and equitable winding up petition and the existence of other remedies in deciding whether or not to make a winding-up order in respect of a Cayman Islands company.

In this case, the Court held that the petition was being used for an impermissible purpose - namely to obtain a *de facto* freeze of China Shanshui's bank accounts, without the burdens of having to satisfy the Court that this would have been an appropriate case in which to grant a freezing injunction. This was one of several bases upon which the petition was struck out.

### Brief history

In November 2014, the Chinese government issued an emergency decree halting expansion in the domestic cement industry. This led to fierce competition amongst PRC cement producers, who from that date onwards could only expand their capacities by merging with or acquiring other cement companies.

China Shanshui is one such company, with a long history of shareholder disputes and take-over battles. Its shares were listed on the Hong Kong Stock Exchange (**HKSE**) in 2008. Most of those shares were subsequently bought by rival cement companies, including Tianrui (International) Holding Company Limited (**Tianrui**), the petitioner in this case and the largest shareholder in China Shanshui.

The case took place against the background of a purported threat to China Shanshui's continued listing on the HKSE, due to an ongoing failure to comply with the HKSE listing rules which normally require that at least 25% of a listed entity's total shares be held by the public.

### The Petition

In its petition, Tianrui alleged that the affairs of China Shanshui had been conducted with a lack of probity and that Tianrui had justifiably lost confidence in China Shanshui's management.

One of Tianrui's main complaints centred around what it described as the improper issuance by China Shanshui of USD 530 million worth of convertible bonds in August and September 2018. Tianrui alleged that the bond issue appeared to have been on uncommercial terms and was part of a wider offensive led by two other major

shareholders of China Shanshui designed to dilute Tianrui's shareholding and render it incapable of resisting certain special resolutions, paving the way to a squeeze-out merger by those two other major shareholders.

Accordingly, Tianrui sought the winding-up of China Shanshui and, pending the hearing of its petition, the appointment of joint provisional liquidators over China Shanshui.

### **China Shanshui's Strike-Out Summons**

China Shanshui countered that the proceedings arose from Tianrui's cynical, misleading and destructive attempts to seize control of the company. It sought to strike out the petition based on three main arguments:

1. Tianrui's alleged misrepresentations in the petition proceedings;
2. that there were alternative remedies open to Tianrui, which it unreasonably failed to pursue; and
3. that Tianrui's petition was brought for an improper collateral purpose.

### **Ground One: Alleged misrepresentations**

China Shanshui alleged that Tianrui had misled the Court in a number of respects in the lead up to the strike out hearing. Although the Judge accepted that Tianrui had not explained the bond issue and certain other matters as fully as it might have, the Judge noted that these are adversarial proceedings and each party can be expected to put the matters it considers relevant before the Court. The Court also noted that, importantly, it had not granted any relief before China Shanshui had its opportunity to point out the omissions and shortcomings of Tianrui's evidence.

Therefore, the Court was not persuaded to strike out the petition on this ground alone, but its findings on the evidence influenced the Court's views as to whether Tianrui's petition had been brought for an improper collateral purpose.

### **Ground Two: Alternative remedies**

The Judge was taken to a number of English and Cayman authorities dealing with injunctive and derivative relief sought by minority shareholders. China Shanshui argued that, if Tianrui's claims had any merit, it could have commenced derivative action against the present board of directors and/or brought a Writ action in its own right, complaining of the dilution of its shareholding and sought injunctive relief and/or a declaration that the bond issue was void.

China Shanshui argued that as part of an injunction application, Tianrui could have sought to prevent completion of the bond transaction, restrained the conversion of the bonds or frozen the relevant funds pending the determination of the principal claim. In order to be granted an injunction, China Shanshui pointed out that Tianrui would have been required to establish a sufficiently strong case and provide a cross-undertaking in damages. Given that Tianrui did not pursue any of these less drastic remedies, China Shanshui invited the Judge to infer that Tianrui knew that its case was not well-founded.

The Judge held that it was "*very plain*" that there were a number of alternative remedies available to Tianrui. The Judge noted that the existence of alternative remedies which ought to have been pursued is fatal to the "*far more drastic and austere step*" of seeking to wind-up China Shanshui through a just and equitable petition.

The Judge also noted that, in her judgment:

*"...just as was the case in **Ctrip** before Kawaley J and in **Torchlight** before McMillan J, whatever the [2013 Privy Council] **Ebbvale** decision signifies in terms of a Petitioner having a range of purposes, it is plain that this Petition was not presented with the purpose of advancing a class remedy on behalf of other shareholders."*

### **Ground Three: Improper collateral purpose**

Separately, the Judge held that it was plain that the petition was brought for an improper collateral purpose, namely to obtain a *de facto* injunction in relation to the bonds and their issue, without meeting the necessary thresholds for such an injunction.

The Judge pointed to the orders sought in relation to the appointment of the provisional liquidators as evidence of Tianrui's true motivation. The final versions of the draft orders were described as markedly down-graded and the appointments as being on a "rather feather-like" basis. In a memorable line, the Judge therefore inferred that Tianrui "does not really want to kill the goose after all, especially now that it may have the chance to be (or indeed is already) getting fatter".

The Judge appeared to accept China Shanshui's submission that Tianrui was simply seeking to wrestle back some form of management control and that was the real purpose of the action they had taken.

## Comment

Before granting what is often referred to as stark and draconian relief, it has become increasingly clear of late that the Cayman courts will test and scrutinise the actual purpose of any just and equitable winding up petition. For example, in his recent decision in *Ctrip*, Mr Justice Kawaley noted that it is not proper for a shareholder to seek "to advance its own individual commercial interests" and labelled the petition in that case an abuse of process. Likewise, Mr Justice McMillan dismissed a drawn out just and equitable petition in *Torchlight* partly on the basis that petitioners "must demonstrate that the petition has been pursued in the interest of the shareholders as a class and not merely for their own individual interests whatever they may be".

With Ms Justice Mangatal's judgment in *China Shanshui* being the third such decision handed down in the second half of 2018, the Cayman courts have reinforced the message that winding-up petitions should not be brought lightly and without proper foundation. Furthermore, *China Shanshui* indicates that the Court will be astute to guard against potential attempts to freeze company funds through the use of unmeritorious winding-up petitions.

We understand that the decision is currently being appealed.

As an aside, we also understand that China Shanshui successfully complied with all of the HKSE's conditions and resumed trading on the HKSE with effect from 31 October 2018.

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