IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO. FSD 38 OF 2012 (PCJ)

The Hon Sir Peter Cresswell
20 April 2012

IN THE MATTER OF SECTIONS 15 & 86 OF THE COMPANIES LAW (2011 REVISION)

AND IN THE MATTER OF ALIBABA.COM LIMITED

APPEARANCES: Mr. Jayson Wood and Ms. Joanne Collett of Appleby for Alibaba.com Limited

Mr. Colin McKie of Maples and Calder for Alibaba Group Holding Limited

RULING

This is the hearing of a summons issued by Alibaba.com Limited ("the Company"), seeking the leave and directions of the Court to call a meeting of certain of the shareholders of the Company under section 86(1) of the Companies Law (2011 Revision) to consider, and if thought fit, to approve by special resolution, a scheme of arrangement ("the Scheme") between the Company and certain of its shareholders ("the Scheme Shareholders").

The Company is represented by Mr. Jayson Wood ("Mr. Wood").

This summons raises, among other matters, the question how to decide whether the "double majority" mandated by section 86 of the Companies Law has been achieved for the purposes of a Scheme of Arrangement between a company and its shareholders.

The evidential material filed in support of the summons comprises: - the first affirmation of Wong Lai Kin, Elsa made on 16 April 2012, the second affirmation of Wong Lai Kin, Elsa ("Ms Wong") made on 20 April 2012; letters from the Securities and Futures Commission ("SFC") and the Hong Kong Stock Exchange, both dated 20 April 2012; and the affirmation of Ms. Teresa Ko ("Ms. Ko") made 10 April 2012.

The Company is an exempted limited company incorporated in the Cayman Islands on 20 September 2006 and listed on the Main Board of The Stock Exchange of Hong Kong Limited.

The Company is an investment holding company and, through its subsidiaries, principally carries on business facilitating activities for suppliers and buyers through online marketplaces. The majority shareholder is Alibaba Group Holding Limited which holds approximately 51.2% of the issued shares of the Company.

The Scheme

The Offeror is Alibaba Group Holding Limited ("Alibaba Group" or "the Offeror") represented by Mr. Colin McKie ("Mr. McKie"). The circular in near-final form containing the terms of the Scheme, relevant financial and other information relating to the Company, letters from the independent Board committee and independent financial advisor, an explanatory memorandum pertaining to the Scheme, and the proposed Notices relating to the Court Meeting and the EGM, as cleared by the SFC and the Hong Kong Stock Exchange, are at Exhibit WLK8 & 9 to the second affirmation of Ms. Wong.

The object of the Scheme is for the Company to be privatised so that it becomes wholly owned by Alibaba Group, Alibaba Group Treasury Limited ("Alibaba Treasury") and Direct Solutions Management Limited ("Direct Solutions") following which the Company will apply to the Hong Kong Stock Exchange for the withdrawal of the listing of its shares.

The Scheme relates to, and if sanctioned will be binding upon, the Scheme Shareholders (i.e. holders of Scheme Shares being those shares which are not registered in the respective names of Alibaba Group, Alibaba Treasury and Direct Solutions).

Under Rule 2.10 of the Hong Kong Takeovers Code, only independent shareholders, that is shareholders other than the Offeror and Offeror Concert Parties, are permitted to vote on the Scheme. The Offeror Concert Parties (being parties acting in concert with the Offeror according to the definition of "acting in concert" under the Hong Kong Takeovers Code) are:

(i) Alibaba Treasury – wholly owned subsidiary of the Offeror, Alibaba Group.

(ii) Direct Solutions – wholly owned subsidiary of the Offeror.

(iii) Mr. MA Yun, Jack – Director of the Company and the Offeror.

(iv) Mr. Tsai Chung, Joseph – Director of the Company and the Offeror.

(v) Credit Suisse (Hong Kong) Limited – financial adviser to the Offeror.

(vi) Deutsche Bank AG Hong Kong Branch – financial adviser to the Offeror.

(vii) HSBC Group (being HSBC and persons controlling, controlled by or under the same control as HSBC other than persons holding the status of exempt fund manager or granted under the status of exempt principal trader under HSBC Group) – financial adviser to the Company.

(viii) HSBC Trustee (Hong Kong) Limited – trustee of the Company's share award scheme and prohibited from exercising voting rights attached to shares held by it under the trust deed.

(ix) Softbank Corp. – substantial shareholder in the Offeror.

(x) Yahoo! Inc. – substantial shareholder in the Offeror.

(collectively "the Offeror Concert Parties").

There is a possibility that there may be additional Offeror Concert Parties after 16 April 2012 as a result of the syndication of a loan facility. If there are such additional Offeror Concert Parties, the shares held by such additional Offeror Concert Parties will form part of the Scheme Shares but such shares will not be voted at the Court Meeting, as such voting is prohibited by the Hong Kong Takeovers Code. If there is sufficient time, the relevant disclosure of the additional Offeror Concert Parties will be included in the Scheme Document. Otherwise, the related disclosure will be made by the publication of an announcement on the website of the Hong Kong Stock Exchange. Evidence will be submitted to this Court to confirm whether there are such additional Offeror Concert Parties and if there are, the making of the disclosure to the shareholders of the Company.

In the event that the Scheme is sanctioned and becomes effective:

(a) the Scheme Shares will be cancelled in exchange for the payment by Alibaba Group to each Scheme Shareholder of HK$13.50 in cash for each Scheme Share held (the "Cancellation Price"); and

(b) Alibaba Group, Alibaba Treasury and Direct Solutions have undertaken to be bound by the terms of the Scheme, thereby ensuring the object of the Scheme is achieved.

The Cancellation Price represents:

(a) a premium of approximately 45.9% over the closing price of HK$9.25 per Share as quoted on the Hong Kong Stock Exchange on the Last Trading Day (being 8 February 2012);

(b) a premium of approximately 55.3% over the average closing price of approximately HK$8.70 per Share based on the daily closing prices as quoted on

the Hong Kong Stock Exchange for the 10 trading days up to and including the Last Trading Day;

(c) a premium of approximately 58.8% over the average closing price of approximately HK$8.50 per Share based on the daily closing prices as quoted on the Hong Kong Stock Exchange for the 30 trading days up to and including the Last Trading Day;

(d) a premium of approximately 60.4% over the average closing price of approximately HK$8.42 per Share based on the daily closing prices as quoted on the Hong Kong Stock Exchange for the 60 trading days up to and including the Last Trading Day;

(e) a premium of approximately 61.3% over the average closing price of approximately HK$8.37 per Share based on the daily closing prices as quoted on the Hong Kong Stock Exchange for the 120 trading days up to and including the Last Trading Day; and

(f) a price to earnings ratio of 33.2 times the diluted earnings per Share of the Company for the year ended December 31, 2011.

The Scheme is proposed to be implemented by:

(a) the Company reducing its share capital by the cancellation and extinguishment of all its issued shares other than those that are registered in the respective names of by Alibaba Group, Alibaba Treasury and Direct Solutions;

(b) the Company, forthwith upon the share capital reduction taking effect, increasing its share capital to its former amount by the issue of the same number of new shares to Alibaba Group as the number of the Company's shares cancelled and extinguished;

(c) the Company applying the credit arising in its books of account as a result of the share capital reduction to pay up in full at par the newly issued shares to Alibaba Group; and

(d) the Offeror paying or causing to be paid to each Scheme Shareholder the Cancellation Price.

<u>The Position of Creditors</u>

The purpose of the proposed share capital reduction is to facilitate the implementation of the Scheme involving the Scheme Shareholders receiving the Cancellation Price and the cancellation and extinguishment of all Scheme Shares. It follows that the Company's issued share capital will be reduced to the extent thereof.

However, it is the Company's intention, forthwith upon the share capital reduction taking place, to restore its share capital to its former amount. This will be achieved by the Company immediately issuing to Alibaba Group the same number of Shares as the number of Scheme Shares that were cancelled and extinguished. In this regard, the Company will apply the credit arising in its books of account as a result of the share capital reduction to pay up in full at par the new shares issued, credited as fully paid, and then allotting those newly issued Shares to Alibaba Group. The purpose of this restoration of share capital is to maintain the Company's former level of issued share capital in order to ensure that none of the Company's creditors can be in any way prejudiced by the cancellation and extinguishment of the Scheme Shares and/or the implementation of the Scheme.

Therefore the overall effect of the cancellation and extinguishment of the Scheme Shares followed by the immediate restoration as described in the previous paragraph is that the Company's issued share capital will not be reduced at all.

Further, the proposed reduction of Company's issued share capital does not involve either the diminution of any liability in respect of unpaid share capital or the payment to any shareholder of any paid-up capital. In addition, it will not alter the underlying assets, business operations, management or financial position of the Company.

The position of the Company's creditors will therefore not be impacted by the Scheme.

The Position of Incentive Holders Dealt with outside of Scheme

The Company has in issue certain share options, restricted share units and share awards convertible into shares of the Company. In addition, Alibaba Group currently has in issue certain share options and restricted share units relating to the shares of the Company (collectively "the Share Incentives").

The common theme to the Share Incentives is that they entitle holders thereof (the "Share Incentive Holders"), subject to the conditions attached to each respective class of incentive, to acquire shares in the Company in the future.

The Share Incentive Holders are not members of the Company and are not Scheme Shareholders. Consequently, they do not fall within the ambit of, nor can they be bound by, the proposed Scheme. However, given the object of the Scheme is for the Company to become wholly owned by Alibaba Group, Alibaba Treasury and Direct Solutions, an offer is proposed to be made by or on behalf of Alibaba Group to purchase the interests of the Share Incentive Holders. That offer is, in essence, that the Share Incentive Holders will be given the same opportunity to sell their interests for the Cancellation Price (or, in the case of the share options, the Cancellation Price less the exercise price). Specifically, they may:

(a) accept the offer and be paid out HK$13.50 per "share option", less the exercise price (if any) of the relevant option (provided that the exercise price (if any) is less than HK$13.50). If the exercise price of the relevant share option issued by

the Company, or share option issued by Alibaba Group, exceeds HK$13.50 (i.e. the "see-through" price will be zero), Alibaba Group will pay a nominal amount of HK$0.05 per 500 share options issued by the Company or 500 share options issued by Alibaba Group; or

(b) reject or not respond to the offer, in which case (except in the case of holders of restricted share units issued by the Company which will automatically cancel) the Share Incentive Holder's interest will continue and will be a matter of subsequent negotiation between Alibaba Group and the holder. Alibaba Group may decide to take steps to ensure that the Company remains a wholly-owned subsidiary by, for example, to the extent that it is legally entitled to do so, amending the terms of the schemes of the Share Incentives and/or amending the terms of the articles of association of the Company to ensure that the Share Incentive Holders are not entitled to receive any Shares; or

(c) if the relevant Share Incentives are or become exercisable, a Share Incentive Holder may choose to become a Scheme Shareholder (subject to payment of the exercise price and applicable taxes) by exercising the relevant Share Incentives prior to the Latest Options Exercise Date (being 8 June 2012).

The Scheme Document

The Scheme Shareholders are required to be provided with an explanatory memorandum or proxy statement with all the information reasonably necessary to enable them to make an informed decision about the merits of the proposed Scheme.

The Scheme Document sets out the terms of the Scheme, relevant financial and other information relating to the Company, letters from the independent Board committee and independent financial advisor, an explanatory memorandum pertaining to the Scheme, and the proposed Notices relating to the Court Meeting and the EGM.

Section 86(1), O.102 r.20 (3)-(7) and PD 2/2010

The matters to which the Court should have regard at the first hearing in respect of a scheme of arrangement are set out in section 86(1) of the Companies Law (2011 Revision), the Grand Court Rules O.102 r.20(3)-(7) and paragraphs 3 and 4 of Practice Direction 2/2010.

The Companies Law (2011 Revision)

Section 86(1) of the Companies Law (2011 Revision) provides:

> *"86.(1) Where a compromise or arrangement is proposed between a company and its creditors or any class of them, or between the company and its members or any class of*

them, the Court may, on the application of the company or of any creditor or member of the company, or where a company is being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members of the company or class of members, as the case may be, to be summoned in such manner as the Court directs.

To fall within the ambit of Section 86(1) of the Companies Law (2011 Revision), the proposed scheme must constitute *"a compromise or arrangement"* between a company and its creditors and/or shareholders.

In my opinion a takeover scheme in the nature of that proposed by the Scheme comprises an arrangement for the purposes of section 86(1) of the Companies Law (2011 Revision).

The Grand Court Rules 1995 (As Amended)

The Grand Court Rules O.102 r.20(3)-(7) contain specific requirements in relation to the first hearing of a Summons. Each of those requirements will be considered in turn.

(a) GCR O.102 r.20(3)

The Affirmations of Ms. Wong address the purpose and effect of the proposed Scheme, the fact that there is only one class of shares, and the information necessary to enable the Court to determine whether the proposed time and place for the Court Meeting and the method of giving notice is appropriate in all the circumstances.

(b) GCR O.102 r. 20(4)

The Second Affirmation of Ms. Wong's exhibits the draft Scheme Document and draft proxy forms. A draft notice of the Court Meeting and a draft explanatory memorandum is included in the Scheme Document.

Voting instructions for the beneficial owners of Company shares have been included in the Scheme Document.

(c) GCR O.102 r.20(5)

The First Affirmation of Ms. Wong sets out the relevant listing rules and practice of the SFC and the Hong Kong Stock Exchange. The Affirmation of Ms. Ko explains the steps required to achieve compliance with such rules and practices. The Second Affirmation of Ms. Wong deposes to compliance with, or waiver of, all such rules and practices.

(d) GCR O.102 r.20(6)

The issue of the voting process for determining the majority in number count for shares held by custodians or clearing houses is addressed below.

(e) GCR O.102 r.20(7)

The Explanatory Memorandum provided with the Scheme Document contains the timetable setting out all principal events.

Grand Court Practice Direction 2 of 2010

Practice Direction 2/2010 provides certain matters which should be considered by the Court.

(a) Convening of Class Meetings

For the purposes of s.86(2), paragraph 3.2 of PD 2/2010 requires the Court to consider whether it is appropriate to convene class meetings of shareholders so as to ensure that the rights of the persons attending the meeting(s) are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

In *Re Euro Bank Corporation (In Liquidation)* [2003] CILR 205, Henderson J said:

> "9. The second question is the definition of the relevant classes. The general rule, as stated in *UDL Argos Engr. & Heavy Indus. Co. Ltd.* v. *Li Oi Lin* ([2001] 4 H.K.C.F.A.R. at 367, *per* Lord Millett) is that –
>
> > *"the principle upon which the classes of creditors or members are to be constituted is that they should depend upon the similarity or dissimilarity of their rights against the company and the way in which those rights are affected by the Scheme, and not upon the similarity or dissimilarity of their private interests arising from matters extraneous to such rights."*
>
> 10. The Hong Kong Court of Final Appeal went on to set out certain principles derived from a "consistent line of authority." The following three principles are pertinent (*ibid.*, at 372, *per* Lord Millett):
>
> > "1. Persons whose rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings. Persons whose rights are sufficiently similar that they can consult together with a view to their common interest should be summoned to a single meeting.
> >
> > 2. The test is based on similarity or dissimilarity of legal rights against the company, not on similarity or dissimilarity of interests not derived from such legal rights. The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings.
> >
> > 3. The question is whether the rights which are to be released or varied under the Scheme or the new rights which the Scheme gives in their place are so different

that the Scheme must be treated as a compromise or arrangement with more than one class."

11. This court is required to define the relevant classes by O.102, r.21(3)(b) of the Grand Court Rules and Practice Direction No. 1/02, s.3.2. The liquidators propose just two classes: the shareholders and the scheme participants.

12. It is clear that the shareholders constitute a class whose legal rights against the company are sufficiently similar that they can consult together effectively on the scheme for the payment of post-liquidation interest. Their case poses no difficulty.

13. The scheme participants are the depositors and the trade creditors. It must be conceded that there is a certain divergence of interest within this proposed class...."

In my opinion the shareholders of the Company effected by the proposed Scheme comprise all of those persons holding ordinary shares of HK$0.0001 each, other than the Offeror, Alibaba Treasury and Direct Solutions. All such Scheme Shareholders have rights and interests sufficiently similar to each other that they can consult together. In my opinion there is no need for separate meetings of different classes of shareholders.

(b) The Court Meeting (See PD 2/2010 paragraph 3.6)).

The Court Meeting is proposed to be held in Hong Kong. I accept the submission that this is reasonable given that the majority of shareholders of the Company are situated in Hong Kong.

Notice of the Court Meeting is proposed to be given to Shareholders by:

(a) pre-paid surface mail, or by courier delivery to, Shareholders having registered addresses in Hong Kong, to the address listed on the Company's share register;

(b) airmail to, or by international courier delivery to, Shareholders having registered addresses outside Hong Kong to the address listed on the Company's share register; and

(c) advertisement in the South China Morning Post in English and in the Hong Kong Economic Journal in Chinese.

In my opinion the proposed method of giving notice of the Court Meeting is appropriate in the circumstances.

The proposed time for convening the Court Meeting is at least 28 clear days after (a) the Scheme Document and requisite documents have been dispatched to Shareholders by mail/courier; and (b) the advertisements have been placed.

The expected timetable is contained in the Scheme Document. It is proposed that the Scheme Document be mailed/couriered to Scheme Shareholders and advertised on or about 24 April

2012, and that the Court Meeting be held on or about 25 May 2012. This timetable is materially longer than the 21 day period prescribed in the Company's Articles of Association for convening an EGM for the purpose of passing a special resolution.

The Scheme itself is not overly complex and involves, effectively, each Scheme Shareholder deciding whether or not to accept the offer of HK$13.50 per share from Alibaba Group. The relevant financial data and historical share prices are in the Scheme Document, and may also be accessed on the internet since the Company's shares are listed on the Hong Kong Stock Exchange. Further, a concise explanatory memorandum is being provided to each shareholder.

In my opinion, 28 clear days notice is a reasonable time for Scheme Shareholders to consider and make an informed decision in relation to the proposed Scheme.

(c) The Scheme Document (See PD 2/2010 3.7)

The Scheme Document is finely detailed in relation to the purpose, effect, mechanics, and efficacy of the proposed Scheme. Further, it is accompanied by an Explanatory Memorandum which, it is submitted, leaves the Scheme Shareholder in no doubt as to the offer being made and the ramifications if that offer is accepted or rejected. In the circumstances, in my opinion the Scheme Shareholders will have sufficient information to enable them to make an informed decision about the merits of the proposed Scheme.

(d) Foreign Regulatory Requirements (See PD 2/2010 3.8)

The affirmation of Ms. Ko addresses the issue of compliance with the regulatory requirements of the SFC and Hong Kong Stock Exchange, and confirms that such requirements have been met.

The Position of The Company

As at 5 April 2012, 1,397,521,826 shares in the Company, representing approximately 27.92% of its issued and paid-up share capital, were held in the name of HKSCC Nominees Limited ("HKSCC") as common nominee for securities held in Hong Kong's Central Clearing and Settlement System ("CCASS") depository. HKSCC is the only recognised custodian for central clearing in Hong Kong entered on the Company's list of shareholders.

In relation to voting its shares at the Court Meeting, it is HKSCC's normal practice at any meeting of shareholders (including court meetings) to:

(a) appoint a number of proxies to attend and vote in person based on instructions it receives from participants (such as clearing houses or nominees) ("Participants"); and/or

(b) appoint such person or persons as it thinks fit to act as its representative(s) to attend and vote at the court meeting according to the instructions it receives from the Participants.

Such appointees of HKSCC may be the beneficial owners themselves, or persons specified by the Participants, or staff members of HKSCC. The appointee(s) will signify on the voting paper distributed at the Court Meeting the number of shares voted "for" the resolution, the number of shares voted "against" the resolution, and/or the number of shares abstained from voting according to the instructions they have received from the Participants.

It is not the standard practice in Hong Kong to require major nominee shareholders (such as HKSCC) to disclose the number of beneficial owners being represented. However, CCASS has indicated that if directed by the Court to do so, it will provide information relating to the number of Participant votes "for" and "against" the Scheme.

The Company's position is that on balance, it would be inappropriate to depart from the standard practice for the purpose of HKSCC voting at the proposed Court Meeting.

The "Majority in Number" Count

Under s.86(2) of the Companies Law (2011 Revision), before a shareholders' scheme of arrangement can be sanctioned by the Court, it must be agreed to by a majority in number holding 75% of the class of shareholders subject to the scheme. This "double majority" test is standard in common law jurisdictions whose company statutes are based on teh English Companies Acts.[1] The first part of the test, the Majority in Number test is sometimes referred to as the "headcount" test.

The "majority in number" requirement has the potential to create issues where a custodian is registered on the register of members of a company as the owner of shares.

The Company's submissions

Mr. Wood, for the Company, submitted as follows.

There are two approaches which have been taken by the Court.

The traditional approach of the Courts in all common law jurisdictions to the position of a custodian, assuming it is instructed to vote some of its shares in favour of the scheme and others against, has been to treat the custodian for the majority in number test as one vote "for" the scheme, and one vote "against" the scheme.

[1] Mr. McKie informed the Court that to his knowledge they include: the UK, Australia, Bermuda, Hong Kong, India, Ireland, Jamaica, Singapore, and South Africa.

In the Cayman Islands, the traditional approach to "headcount" where a custodian is the registered member was consistently applied by the Grand Court until January this year. See for example the Order made in the scheme of arrangement relating to The Ming An (Holdings) Ltd. Other schemes in which the traditional approach was adopted were New World TMT Limited (HKSE listed), China Resources Cement Holdings Limited (HKSE Listed), Seagate Technology (NASDAQ listed), Garmin Ltd (NASDAQ Listed), XL Capital (NYSE Listed), Gartmore Group Limited (LSE Listed), Entertainment One (AIM Listed), Noble Group (NYSE listed), TOM Online Inc. (HKSE listed), SIIC Medical Science and Technology (Group) Ltd (HKSE Listed), and the bondholder scheme Castle Holdco 4 Ltd/Countrywide plc (Euroclear and Clearstream).

Mr. Wood (and Mr. McKie, who had appeared in many of these cases) accepted that he was not able to produce any Cayman Island authority where the position of custodians had been expressly considered (except the Little Sheep Case below).

Mr. Wood's submissions continued as follows.

The traditional Cayman Islands position is reflected in England as shown in the decision in *Re Equitable Life Assurance Society* [2002] BCC 319. In that case Lloyd J, in the context of a creditor scheme but expressly by analogy to shareholder schemes, held that a nominee could vote some of its shares "for" and some "against", thereby splitting its vote for the headcount test one vote "for" and one vote "against". He said that at p.320:

> "By analogy with creditors' meetings in insolvency law, it was possible and would be right for the court to direct at Stage 1 that at the creditors' meetings split voting was permissible, particularly by nominee or trustee creditors, so that they might vote both for and against the scheme in relation to different parts of the value of that creditor's claim, and such person would be on both sides of the head count for the majority in number. The general wording of s. 425(2) *[of the English Companies Act 1985, equivalent to Cayman Companies Law, s.86(2)]* did not prevent this." *(emphasis added)*

This approach clearly reflects what the judge regarded as the uncontroversial and orthodox position, that it is the actual/registered holders who are counted for the "headcount", not those behind them with a beneficial interest.

Similarly in Hong Kong, in the recent decision of the Court of Appeal of the Hong Kong Special Administrative Region in *Re PCCW Limited* [CACV 85/2009], Barma J confirmed the adoption of the traditional approach in Hong Kong at para 193:

> "It was also suggested that the requirements of section 166(2) *[of the Hong Kong Companies Ordinance, equivalent to Cayman Companies Law, s.86(2)]* had to be considered in the light of the fact that the vast majority of shareholders in publicly listed companies hold their shares through CCASS, and therefore would not be entitled to vote, as they would not be the registered holders of their shares. The effect of this is that CCASS would vote shares registered in its name in accordance with the instructions (if any) received from its market participants. Such market participants generally seek instructions from the beneficial owners of the shares held through them with

CCASS. The result is that CCASS will vote a certain number of the shares registered in its name in favour of the resolution, and a certain number against it, according to such instructions as it may receive. This does not affect the number of shares voted for and against the resolution in value terms. However, in terms of headcount, CCASS will be counted as one vote in favour and one vote against the resolution, thereby cancelling itself out. This, it is said distorts the position in terms of the desires of the beneficial owners of the shares held by it." *(emphasis added)*

Because of the inability of the Courts in England and Hong Kong to look through the register, there have been many calls for the "headcount" test to be modified or removed. See for example the report of the Standing Committee on Company Law Reform to the Financial Secretary of the Government of Hong Kong especially at 6.8-6.9 and 6.14-6.16. See also the UK Company Law Review Steering Group "Modern Company Law for a Competitive Economy: Completing the Structure", Interim Report (November 2000) at para. 11.34 and Final Report (June 2001) at para. 13.10; however, the UK Parliament did not act on this recommendation and the statute retains the headcount test – see section 899(1) of the Companies Act 2006.

Company's Submissions on the Little Sheep Decision

In January 2012, against what Mr. Wood submits is the longstanding position taken by the Courts in the Cayman Islands, England, and Hong Kong in relation to the "headcount" test, the decision in *Re Little Sheep Group Limited* (Unreported, 20 January 2012) was handed down by Mr. Justice Jones.

In the Little Sheep Case, the petitioner's Counsel argued at the directions hearing, *inter alia*, that for the purposes of the headcount test, a custodian shareholder should be counted as one person having voted either for or against the scheme depending on its net voting position.

The traditional approach (where the custodian has votes for and against- to count one vote for and one against) was not argued, nor was the Re Equitable Life Assurance Society decision referred to by Mr. Justice Jones in his judgment.

The petitioner's argument was rejected and Mr. Justice Jones held that for the purposes of the "headcount" test, it was appropriate to count the parties from whom the clearing house receives instructions. His Lordship relied heavily on GCR O.102, r.20(6)(b) which provides that the court may direct the custodian to specify the number of votes cast for and against and the number of participants from which instructions were received in relation to the voting.

Mr. Justice Jones considered that a clearing house could be a "multi headed member", and the number of participants from whom instructions were received (both for and against) would determine the votes attributable to the clearing house for the purpose of the head count test.

The basis for the petitioner's argument was that GCR O.102, r.20(6)(b) was *ultra vires* because it was tantamount to treating the participants as members. Mr. Justice Jones held this was not the

case, and considered his approach was "simple, practical and well understood by institutions such as CCASS which have been acting upon it for many years without difficulty."

Mr. Wood accepted that the approach of Mr. Justice Jones is consistent with paragraph 4 of Practice Direction 2/2010.

Mr. Wood submitted that the approach of Mr. Justice Jones in the Little Sheep Case ought not be followed for the following reasons.

First, it is inconsistent with the established position in the Cayman Islands, England, and Hong Kong, and that established position was not raised or argued by the petitioner's Counsel. The decision stands on its own without precedent.

Secondly, Mr. Justice Jones' approach is inconsistent with the plain language of s.86(2) and the well-established principle that "member" in the context of the Companies Law means "member of record" (see definition of "member" in Companies Law, s.38).

Thirdly, Mr. Justice Jones' heavy reliance on GCR O.102, r.20(6)(b) was misplaced. Under s.86, the headcount test is mandatory. However, the power of the Court to direct a custodian to specify the number of votes cast for and against and the number of participants from which instructions are received is discretionary. GCR O.102, r.20(6)(b) must therefore speak to something other than the headcount test. The logical answer is that the Court may use this power to assist in the exercise of its general discretion whether or not to sanction a scheme (for example, if the Court believes that the voting at the meeting to approve the scheme may be manipulated via the headcount requirement by a small number of non-custodian shareholders).

Fourthly, as justification for disapplying the traditional approach, Mr. Justice Jones stated that the law in Hong Kong is different to the laws of the Cayman Islands. However, he does not explain how or why this should be so when the relevant Hong Kong legislation is materially identical to s.86.

Fifthly, there appears to be no utility in simply drilling down to one level of beneficial ownership beneath the custodian when, in reality, the true (i.e. ultimate) beneficial owners will lie potentially many levels below that. Not only does this approach ignore the concept of a "member" being the person whose name appears on the register of members, but once that door is opened, other layers of beneficial owners would presumably be entitled to come forward and demand to be counted.

Sixthly, the statement that

"This mechanism is simple, practical and well understood by institutions such as CCASS which have been acting upon it for many years without any difficulty"

is not accurate. CCASS has not been "acting upon it for many years".

Mr. Wood, with the assistance of Mr. McKie, helpfully provided three Tables headed "Comparison of Headcount Tests" which set out what Mr. Wood and Mr. McKie submit are (1) the position under the orthodox approach; (2) the position on the Little Sheep approach; and (3) the position counting true beneficial holders. Those tables are annexed to this judgment and I refer to them.

In each of the three tables the line of boxes above "Company 100 shares" denotes "registered shareholders". The middle line of boxes denotes "participants in CCASS" who are all major banks or other financial institutions in Hong Kong. Those banks or other financial institutions may hold shares proprietarily, or as nominees, or both. The top line of boxes represents beneficial owners who use the nominee services of participants in CCASS. Thus, in Chart 2, middle line of boxes, in the case of the first red box and the second green box the participant in CCASS holds the shares in the first line as nominee. In the case of the first green box, the second red box and the third and fourth red boxes the participant in CCASS holds the shares proprietarily.

Mr. Wood invited the Court to decline to follow the "headcount" test prescribed in the Little Sheep case and to make an order following what he described as the traditional approach.

The Offeror's submissions

Mr. McKie, on behalf of the Offeror, Alibaba Group submitted as follows.

GCR O. 102, r. 21 was brought into force in July 2002. It has since been revoked and replaced by GCR O. 102, r. 20. There has been no material change to sub-rule (6).

GCR O. 102, r. 20(6)(a) expressly enables the Court to permit HKSCC to vote both in favour and against the resolution at the Court Meeting on the instructions of "*its*" clients. The ability of a nominee to cast a vote either way is consistent with *Re Equitable Life* [2002] BCC 319 and *Re PCCW* [2009] HKCA 178.

The only 'clients' or 'members' of HKSCC/CCASS are the Participants, being banks and other financial institutions who participate in CCASS.

GCR O. 102, r. 20(6)(b) enables the Court, where possible, to require the custodian (in this case HKSCC) to 'specify' the numbers of votes cast by "*clients or members on whose instructions they are cast*". Although it is not clear what the intended difference between a "*client*" of a custodian or clearing house and a "*member*", in this case the reference must still also be to the Participants.

The purpose of GCR O.102, r.20(6)(b) is so that at the hearing to sanction the scheme the Court has available to it the fullest possible information as to how the custodian (likely to be the registered holder of the largest shareholding) has in fact been instructed how to cast its votes at the court meeting. This information might be relevant to the Court's residual discretion to sanction the scheme or require new meetings to be held even if the meeting has been held in

accordance with the Court's directions, the resolution has been passed by the statutory majorities at the court meeting – in Hong Kong, see *Re PCCW*; in England, see *Re NFU* [1973] 1 All ER 135 and *Re BAIC* [2006] 1 BCLC 665, and for reconvening meetings see *Re Dorman Long* [1934] 1 Ch 635.

For instance, that information may disclose that a Participant has directed HKSCC to vote in respect of an anomalously small proportion of its shares compared to the other Participants, which might suggest that the scheme circular had not been transmitted by that Participant to the underlying beneficial owners of those shares.

The Court only has a discretion to make such an order because it may not always be possible and lawful for the custodian or clearing house to provide information from the equivalent of the Participants. In this case, CCASS is in fact able to provide this information to the Court.

The information that is to be provided to the Court is necessarily limited to the equivalent of the Participants. Where (as will often be the case) they hold their interests in shares as trustees or nominees for others it is likely to be impracticable for the clearing house to obtain the underlying information, not least because the terms of those trust or nominee arrangements are likely to be governed by a variety of laws, not necessarily the law governing the rules of the clearing house. In this case, there is no realistic possibility of the Participants providing to CCASS information regarding instructions from underlying interests.

The plain wording of GCR O. 102, r. 20(6) does not purport to state how the votes of the custodian are to be counted at the court meeting for the purposes of the headcount test. It is submitted that, accordingly, GCR O. 102, r. 6 leaves the common law rules with respect to the headcount test unchanged.

The common law rule has been authoritatively stated in England in *Re Equitable Life* by Lloyd J (as he then was) who has very considerable experience in this area (and appearing before him were very distinguished Counsel also highly experienced in this area) and in Hong Kong in *Re PCCW* by Rogers VP, Lam and Barma JJ (and appearing before them were very distinguished English and Hong Kong Counsel highly experienced in this area). There are no other English, Hong Kong, or Irish or Commonwealth decisions touching on this. The leading English textbooks are silent on the subject.

Re Equitable Life concerned a proposed scheme pursuant to section 425 of the Companies Act 1985 in respect of the petitioner's policyholders, i.e. it was a creditors' scheme. The terms of s. 425(2) are in all material respects identical to those of s. 86(2) of the Companies Law – see p. 335D. Nothing turns on the fact that this was a creditors' scheme rather than a members' scheme, and in fact the relevant passages positively state the position to be the same for creditors as well as members.

Lloyd J permitted creditors who were trustees and nominees holding for others to cast some of their votes 'FOR' the resolution and others 'AGAINST', and any such trustee or nominee splitting its vote would count once each way on the headcount. See p. 326C to 327D, and in particular:

"However, reviewing [section 425(2) of the Companies Act 1985] in the context of the widespread practice of nomineeship and trusteeship, both for debt, for example bonds, and rights under policies, many of which are held by trustees, for example under group pension schemes and, likewise, in respect of shares, especially in an increasingly paperless securities world, it seems to me that it would be inappropriate to construe these general words as not permitting a particular member or creditor to cast different parts of the value of his claim or his membership rights in different ways.

That does, in a sense, produce an oddity, because if you had, let us say, in an extremely simple case, ten members, one of whom wished to cast a split vote, you would really have to count that person on the headcount both for and against. So you would have on the face of it 11 members voting. But since that person would be on both sides of the head count, both in the 'yes' and the 'no' lobbies, that makes no difference to the calculation of the majority in number, whereas it permits an appropriate way to achieve and calculate the true majority in value.

For those reasons it seems to me that it is possible and would be right to permit split voting." (emphasis added)

Re PCCW concerned a proposed takeover scheme of a company incorporated in Hong Kong whose shares were listed on the HKSE pursuant to s. 166 of the Companies Ordinance. The terms of s. 166(2) are in all material respects identical to those of s. 86(2) of the Companies Law.

See further Barma J (with whom Lam J agreed) at para. 193, quoted above.

The Hong Kong Court of Appeal clearly accepted that to count one vote in favour and one against was the correct way to treat the votes of HKSCC/CCASS. Given that the SFC was the appellant in that case, there is no question that the Court of Appeal was not fully informed as to the practices of CCASS.

As a matter of comity, this Court routinely applies the relevant decisions of the English and Commonwealth Courts where the relevant law is the same. Section 86(2) of the Companies Law is in all material respects identical to s. 425(2) of the English Companies Act, s. 166(2) of the Hong Kong Companies Ordinance (and company statutes in many other jurisdictions).

In respect of the conduct of scheme meetings it appears that the Commonwealth Courts have invariably followed the common law established by the English courts. For instance, in respect of the proper constitution of the class of creditors or members to be convened, the test to be applied under English law is the same as in Hong Kong, Australia (Victoria and New South Wales), and South Africa. See the judgment of Lord Millett (sitting as a Non-permanent Judge of the HK Court of Final Appeal) in *UDL Argos* at paras 15 to 17, and with whom Li CJ, and Bokhary, Chan and Ribeiro PJJ agreed.

Indeed, the Grand Court adopted Lord Millett's formulation of the test – see *Re Euro Bank Corp* [2003] CILR 205 at paras 9 and 10 – and therefore must have taken the view that as a matter of

comity Cayman Islands law as to the constitution of the relevant class to be convened should be in conformity with English/Commonwealth law .

There being no statutory difference between s. 86(2) of the Companies Law and the English and Hong Kong company statutes, and GCR O. 102, r. 20 being silent as to how the headcount should be calculated, the Grand Court should be very slow to rely on Practice Direction No 2 of 2010 as a basis to depart from the common-law as stated in *Re Equitable Life* and *Re PCCW*.

Practice Direction No 2 of 2010

Practice Direction No 1 of 2002 was issued in July 2002. Practice Direction No 2 of 2010 revoked the Practice Direction No 1 of 2002 but for the purposes of this hearing the relevant terms are the same. The 2002 Practice Direction was issued at the same time as what was then GCR O. 102, r. 21 came into force.

Paragraph 4 of the 2010 Practice Direction is expressly directed to GCR O. 102, r. 20(6) – see para. 4.1. The first sentence of para. 4.4 it states:

> "*Custodians and clearing houses may be required to specify both the number of clients or members from whom they have received instructions*".

The requirement that CCASS obtain information from the Participants (being its 'clients' or 'members') is not controversial for the reasons stated previously. However, the second sentence of para. 4.4 states:

> "*The majority in number will be calculated on the basis of the number of clients or members giving instructions to the custodian or clearing house.*"

In this case, only the Participants can give instructions to HKSCC. It is likely that in this case some, perhaps all, of the Participants hold their interests in the Scheme Shares qua trustees or nominees for others (who may themselves be trustees or nominees for others, and so on). Those holders of the ultimate beneficial interest in the Scheme Shares (at whatever degree of remove beyond the Participants) will give instructions through a chain of voting instructions which will enable the Participants to direct HKSCC as to how it should cast its votes. However, none of those holders are 'clients' or 'members' of HKSCC/CCASS, so the second sentence of para. 4.4 can have no relevance to them.

It is conceded that the second sentence of para. 4.4 quoted above clearly contemplates that in this case the Participants should be counted for the purposes of the headcount vote. However, it is submitted:

(1) The plain meaning of GCR O. 102, r. 20(6)(b) as set out above should prevail to the extent that this second sentence purports to provide a different meaning.

(2) A practice direction is of very limited authority, being directions given without argument.

(3) It is not open to the Court by practice direction to alter well-established common law rules as to how votes should be counted at a scheme meeting.

See, by analogy, *Re Dorman Long* at pp 660 to 662. This was case concerning the sanction of a scheme of arrangement between a company and its members. This is a seminal case concerning the conduct of scheme meetings and its correctness has not been doubted since. In that case the Court had convened the scheme meetings and the petitioners had sent forms of proxy that conformed to Practice Notes [1896] WN 56 and [1910] WN 154. At the sanction hearing Maugham J held that these practice notes could not preclude a member from making use at the scheme meeting of such other proper form of proxy as he may be advised, and said:

> "*It is not open to the Court by practice notes – which have no statutory force and very little judicial force, as they are directions given without argument – to preclude people who are given a statutory right to vote by proxy from so exercising their vote.*"

Observations on the Little Sheep Decision

The arguments above do not appear to have been put to Mr Justice Jones.

The company had sought a direction that CCASS be counted as one person for the purposes of the headcount vote (presumably to be counted as a vote in favour or a vote against the scheme depending on the weight of shares). See para. 7. Such a direction is not sought in this case because it would have the obvious effect of disenfranchising the minority underlying investors instructing, directly or indirectly, CCASS for the purposes of the headcount vote. It is unsurprising that Mr Justice Jones found this to be an unattractive submission.

The true construction of GCR O. 102, r. 20(6)(b), namely that the Court requires information to be provided, was not put to Mr Justice Jones but instead Counsel for the petitioner submitted that r. 20(6) was ultra vires – see paras 1 and 15. Properly understood, GCR O. 102, r. 20(6) is intra vires, and accordingly the judge was right to reject Counsel's submission.

However, Mr Justice Jones did not specifically consider the terms of the second sentence of para. 4.4 of Practice Direction No 2 of 2010, and whether it was consistent with the true meaning and effect of GCR O. 102, r. 20(6).

With respect to the common-law position, the decision in *Re Equitable Life* does not appear to have been before him.

Although *Re PCCW* was before the Judge (see paras 13 and 14) it appears that his attention was not drawn to para. 193 of the judgment of Barma J which states the established practice of CCASS that HKSCC, upon splitting its vote, will count as one vote each way. Mr Justice Jones statement as to the practice of CCASS/HKSCC whereby the Court is,

> "*entitled to treat it* [CCASS, sic, but he must have meant HKSCC] *as* [a] *multi-headed member for the purposes of the* [head]*count. Rule 21(6)(b) sets out a mechanism for determining the number of heads which will be attributed to CCASS* [sic]. *This mechanism is simple, practical and well understood by institutions such as CCASS which have been acting upon it for many years without any difficulty.*" (emphasis added)

is clearly incompatible with Barma J's clear statement that HKSCC's CCASS split vote is counted as one vote each way.

Throughout the judgment Mr Justice Jones appears to have operated on the assumption that the Participants and the "underlying investors" are one and the same, and that therefore directions that would ascertain the Participants' voting instructions to HKSCC/CCASS would enable the Court to see how the underlying investors were in fact voting. See paras 4, 6 to 9, 14 and 18. He makes no reference to any evidence that the Participants are in fact banks and other financial institutions that often hold their interests in shares as trustees or nominees for others. It follows that the headcount vote of the Participants would not, in fact, be the same as the headcount vote of the ultimate beneficial owners.

Had Mr Justice Jones had regard to such evidence he would have concluded that there was no practical means by which CCASS could obtain the information with respect to how the ultimate beneficial owners of the shares had instructed (directly, of through a chain of nominees) the Participants to instruct HKSCC.

Finally, Mr Justice Jones appears to have supported the conclusion by reference by the following analogy. He stated that, "*When shares are registered in the names of two or more natural persons as joint owners, it is open to the Court to treat them as a single head for the purposes of the count. Similarly, when shares are registered in the name of a custodian or clearing house such as CCASS* [sic, he must have meant HKSCC], *the Court is bound to treat it as a member of the company but it is also entitled to treat it as* [a] *multi-headed member for the purposes of the* [head]*count.*" Clearly the legal effect of joint ownership of property (where the four unities are present, including unity of interest) is quite different from a nominee or custodian arrangement where the relationship will be one of agency or trusteeship. The analogy is erroneous.

For these reasons Mr. McKie supported the submissions of Mr. Wood.

Analysis and Conclusions

I am here concerned with the first of the two tests in s.86(2) of the Companies Law (2011 Revision) the Majority in Number test.

In his judgment in Little Sheep, Mr. Justice Jones said:

> "16. I remind myself that the basic rule of statutory interpretation is that it is taken to be the Legislature's intention that a statute will be construed in accordance with the

general guides to legislative intention laid down by law. I must consider section 86(2) in its proper context and seek to avoid an interpretation which produces an unworkable or impractical result, which is inherently unlikely to have been intended by the Legislature. (See Francis Bennion's *Statutory Interpretation* (Fourth Edition), Section 313, pages 832-9). The purpose of section 86 is to provide a mechanism whereby rights vested in large numbers of shareholders (or creditors) can be varied in circumstances where it would be impractical to negotiate and reach agreement with each one separately. The mechanism is that the rights of shareholders or classes of shareholders (or creditors) may be varied with majority consent. Because vested contractual rights are being compulsorily varied, an essential part of this mechanism is that the procedure for obtaining majority consent is fixed by the Court and the scheme of arrangement (which is a contract) becomes binding upon the parties only if it is sanctioned by the Court. The company has no power to summon an extraordinary general meeting for the purposes of considering and, if though fit, approving a scheme of arrangement. A meeting for this purpose can be convened only by order of the Court "in such manner as the Court directs". These words give the Court a wide discretion to give directions about the procedure by which the meeting will be convened and also the mechanisms by which the statutory majorities will be calculated.

17. Mr Meeson submits, rightly in my view, that the concept of a "majority in number" implies some form of head-count. However, section 86 does not stipulate any mechanism by which the head-count should be conducted. It is a matter for the Court to fix the mechanism in accordance with the Rules, having regard to the circumstances of the case. When shares are registered in the names of two or more natural persons as joint owners, it is open to the Court to treat them as a single head for the purpose of the count. Similarly, when shares are registered in the name of a custodian or clearing house such as CCASS, the Court is bound to treat it as a member of the company but it is also entitled to treat it as multi-headed member for the purpose of the count. Rule 21(6)(b) sets out the mechanism for determining the number of heads which will be attributed to CCASS. This mechanism is simple, practical and well understood by institutions such as CCASS which have been acting upon it for many years without any difficulty.

18. On its true construction, section 86 does not mean that each member must necessarily be treated as one head for the purposes of the calculating majority in number. Nor does it mean that each member must necessarily cast only one vote for the purpose of calculating the majority in value. For these reasons I made an order that CCASS be permitted to vote for and against the Scheme in accordance with the instructions from its Participants and that it shall specify the number of votes cast in favour of the Scheme and the number of Participants on whose instructions they are cast and the number of votes cast against the Scheme and the number of Participants on whose instructions they are cast. CCASS will be treated as a multi-headed member for the purposes of the head-count. The number of Participants from whom it received

instructions (both for and against) will determine the number of votes attributable to CCASS for the purpose of determining whether the majority in number has been achieved."

A decision is required from the Court today because of the very tight timetable proposed for the Scheme.

Decisions of Co-ordinate Courts

I refer to Halsbury's Laws of England volume 11, (5th edn.), Civil Procedure, p. 115, para. 98:

> "There is no statute or common law rule by which one court is bound to abide by the decision of another court of co-ordinate jurisdiction. Where, however, a judge of first instance after consideration has come to a definite decision on a matter arising out of a complicated and difficult enactment, the opinion has been expressed that a second judge of first instance of co-ordinate jurisdiction should follow that decision; and the modern practice is that a judge of first instance will as a matter of judicial comity usually follow the decision of another judge of first instance unless he is convinced that that judgment was wrong. Where there are conflicting decisions of courts of co-ordinate jurisdiction the later decision is to be preferred if reached after full consideration of early decisions."

Having regard to the principles set out in paragraph 98 and the cases there cited, I, as a judge of co-ordinate jurisdiction to Mr. Justice Jones, would be inclined to follow his decision. It should be noted that his decision is consistent with and reflects PD 2/2010.

Given the constraints on time and the need for an immediate decision, there is, in my opinion, a practical answer. I refer to GCR O.102 r.20 (Schemes of Arrangement) and, in particular, to GCR O.102 r.20(6) which reads:

Schemes of Arrangement (O.102, r.20(6))

> "(6) The Court shall give such directions as may be necessary for the purpose of enabling it to determine whether or not the stator majorities will have been achieved. If all or substantially all of the shares or debt instruments to which the proposed scheme relates are registered in the name of one or more custodians or clearing houses, the Court may direct that –
>
> (a) such custodian or clearing house may cast votes both for and against the proposed scheme in accordance with the instructions of its clients;
>
> (b) such custodian or clearing house shall specify the number of votes cast in favour of the scheme and the number of clients or members on whose instructions they are cast and the number of votes cast against the proposed scheme and the number of clients or members on whose instructions they are cast."

I direct that to the extent that the shares to which the proposed scheme relates are registered in the name of one or more custodians or clearing houses [or nominees of clearing houses] (a) such custodian or clearing house [or nominee of clearing houses] may cast votes both for and against the proposed scheme in accordance with the instructions of its clients; (b) such custodian or clearing house [or nominee of clearing houses] shall specify the number of votes cast in favour of the scheme and the number of clients or members on whose instructions they are cast and the number of votes cast against the proposed scheme and the number of clients or members on whose instructions they are cast. This direction is specifically directed to HKSCC/CCASS and is very similar to the direction given by Mr. Justice Jones at the same stage in the Little Sheep Case.

Compliance with this direction will enable the Court at the hearing of the petition to consider the question whether a majority of members has been achieved with all the potentially material information before the court.

In the circumstances set out above, I make an order in the terms of the draft order before the Court with appropriate amendments to reflect this ruling.

I order accordingly.

DATED this 1st day of May 2012

Cresswell J

The Honourable Justice Cresswell
Judge of the Grand Court

Footnote – The words in square brackets in the above direction were added on 27th April on Mr. Wood's application in the light of a communication dated 25 April from HKSCC.

GRAND COURT · CAYMAN ISLANDS

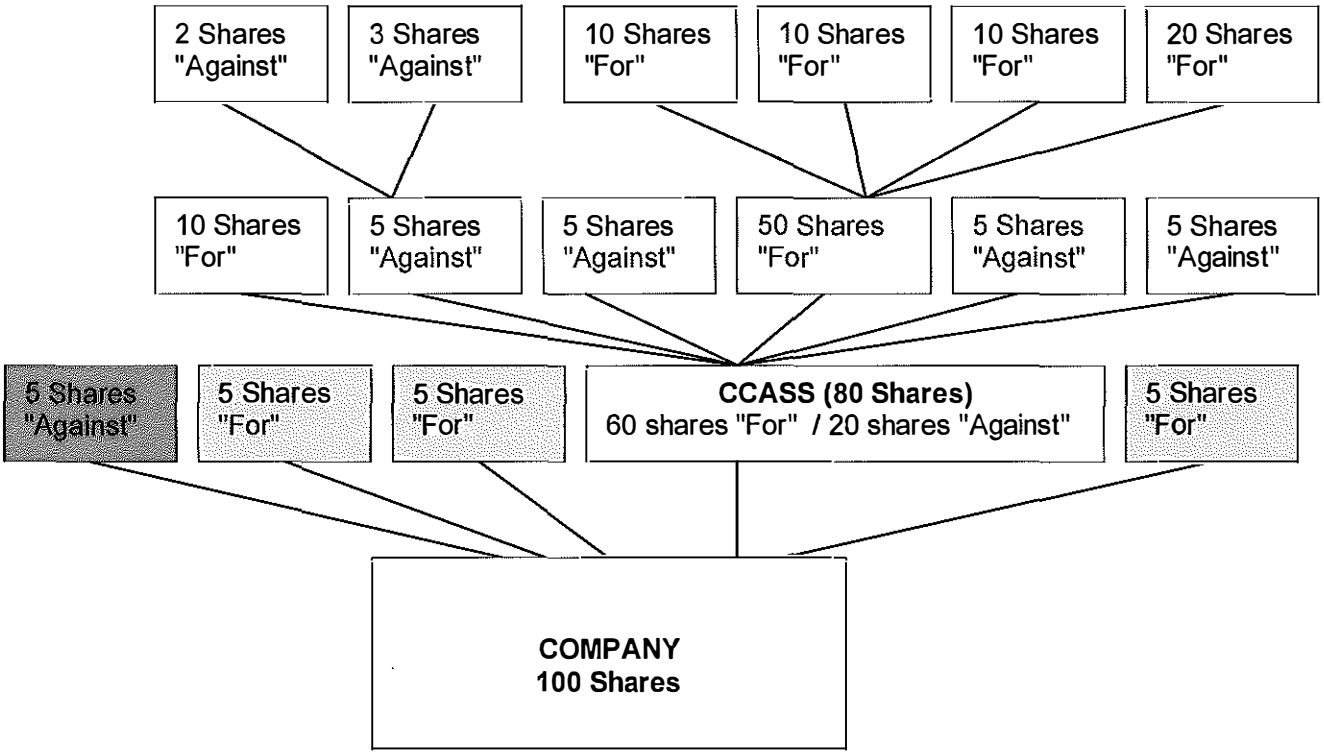
COMPARISON OF HEADCOUNT TESTS

Notes:

- Shaded boxes in the three examples represent shareholders counted on each methodology.
- The voting is the same in each example. All that changes is the headcount methodology

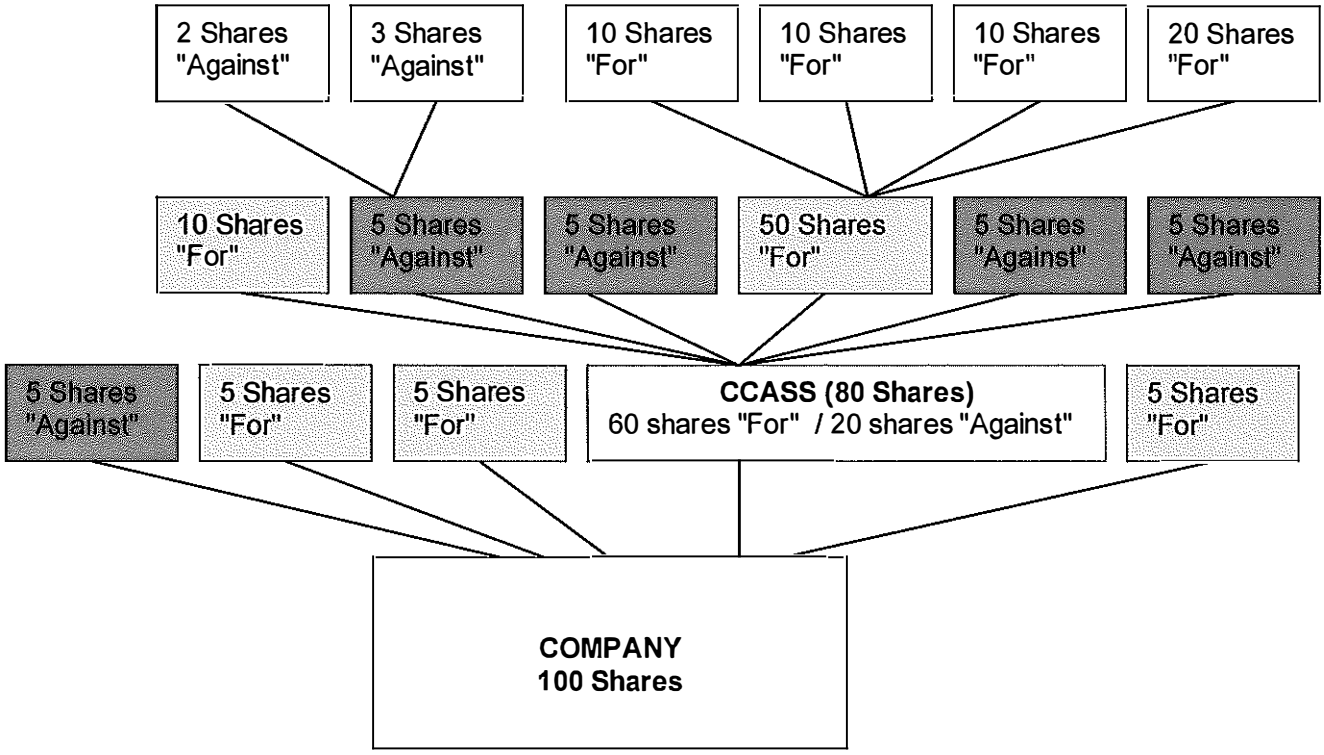
1 The "Orthodox" Approach:

4 votes "For" and 2 votes "Against" -- **PASSES**



2 On the "Little Sheep" Approach:

5 votes "for" and 5 votes "against" – **FAILS**



3 Counting true beneficial holders

Note: This method is entirely theoretical, and is included for illustrative purposes only. It is not possible to use in practice. While the third level (and levels beyond that) of beneficial interests almost certainly exist, the division of beneficial interests at and beyond these levels is not visible to the Company.

8 votes "for" and 6 votes "against" - **PASSES**