# Wu Yang Construction Group Ltd v Mao Yong Hui and Another
# [2007] SGCA 55

**Case Number** : CA 60/2006

**Decision Date** : 13 December 2007

**Tribunal/Court** : Court of Appeal

**Coram** : Andrew Ang J; Chan Sek Keong CJ; Kan Ting Chiu J

**Counsel Name(s)** : Hee Theng Fong, Tay Wee Chong and Wendy Low Wei Ling (Hee Theng Fong & Co) for the appellant; Cheah Kok Lim (Ang & Partners) for the first respondent; Foo Maw Shen and Ong Wei Chin (Yeo Wee Kiong Law Corporation) for the second respondent

**Parties** : Wu Yang Construction Group Ltd — Mao Yong Hui; VGO Corporation Limited

*Civil Procedure – Mareva injunctions – Whether court having jurisdiction to grant injunction – Whether dispute referable to arbitration existing – Applicable principles in granting Mareva injunctions – Section 12(7) International Arbitration Act (Cap 143A, 2002 Rev Ed) – Order 69A Rules of Court (Cap 322, R 5, 2004 Rev Ed)*

*Companies – Shares – Allotment – Company diversifying business by buying over business of another company as going concern – Allotment of shares forming purchase consideration – Whether company financing dealings in its own shares – Whether transaction in breach of s 76 Companies Act (Cap 50, 1994 Rev Ed) – Relevance of whether transaction in commercial interests of company – Section 76(1)(a) Companies Act (Cap 50, 1994 Rev Ed)*

*Companies – Shares – Parties having standing to invoke s 76 Companies Act (Cap 50, 1994 Rev Ed) – Prescribed persons under s 76A(3) Companies Act (Cap 50, 1994 Rev Ed) – Sections 76A(2) Companies Act (Cap 50, 1994 Rev Ed)*

13 December 2007

Chan Sek Keong CJ (delivering the grounds of decision of the court):

**Introduction**

1 Wu Yang Construction Group Ltd ("Wu Yang"), the appellant in this appeal, was the plaintiff in Originating Summons No 343 of 2005 ("OS 343"). The defendants originally named in OS 343 were: (a) Zhejiang Jinyi Group Co, Ltd ("ZJL"), (b) Chen Jinyi ("CJY") and (c) Kingsea Limited ("Kingsea"). Subsequently, Mao Yong Hui ("Mao") and VGO Corporation Limited ("VGO") were joined as fourth and fifth defendants respectively.

2 This appeal concerned the validity of a freezing order (Mareva injunction) granted by the judge in the court below ("the Judge") on Wu Yang's *ex parte* application to restrain CJY and Kingsea from dealing with, *inter alia*, the shares of VGO held by or registered in the name of Kingsea ("the freezing order"). It was common ground in this appeal that the freezing order affected a block of 59,339,238 shares in VGO ("the Escrow Shares") which had earlier been held by VGO in escrow to secure certain liabilities of Kingsea. The Escrow Shares formed part of a larger block of 134,705,882 shares in VGO ("the New VGO Shares") which were to have been issued by VGO to Kingsea as consideration for the acquisition of the food and beverage business of Kingsea's wholly-owned subsidiary, Spring Wave Ltd ("Spring Wave"). The number of New VGO shares which were to be issued was eventually reduced to 123,918,506: see [12] below. Wu Yang claimed that it had equitable title to the Escrow Shares as CJY (the sole shareholder of Kingsea) had transferred them to Wu Yang to

offset the amount which ZJL owed to Wu Yang.

3 Mao and VGO then intervened in the proceedings and succeeded in obtaining an order to vary the freezing order by excluding the Escrow Shares from it. Wu Yang appealed against the Judge's variation order, claiming that it had prior equitable title to the Escrow Shares *vis-à-vis* VGO and Mao by reason of their inequitable conduct.

4 We dismissed the appeal at the conclusion of the hearing on several grounds, which we will elaborate on after we have summarised the relevant facts that led to this appeal.

**How Wu Yang acquired its claim to the VGO shares**

5 Wu Yang and ZJL are Chinese companies which had business dealings with each other. ZJL's managing director and controlling shareholder was CJY (holding 50.23% of its issued shares), who was also the sole shareholder of Kingsea, a British Virgin Islands company. Between 1 June 2003 and 18 November 2003, ZJL borrowed a total sum of RMB30m from Wu Yang. This transaction was documented in nine agreements. Under the fifth agreement dated 12 July 2004, CJY indicated his willingness to "pledge" 134,700,000 shares in VGO (with a market value of about S$15.08m) to Wu Yang. On 12 August 2004, CJY confirmed to Wu Yang that Kingsea held 31,764,784 shares in VGO, and that all those shares would be pledged to Wu Yang "as irrevocable joint liability guarantee for the repayment of the amount owed by [ZJL] to Wu Yang". ZJL and CJY later confirmed (via an agreement dated 10 October 2004) that the value of those 31,764,784 shares was not less than S$3,176,478.40.

6 The last agreement dated 3 February 2005 ("the Set-Off Agreement") provided that CJY would transfer "all his shareholding in VGO" to "offset the amounts owed by [ZJL] and [CJY] to [Wu Yang]" (then totalling RMB40m). Pursuant to this agreement, CJY signed a share transfer registration document in Chinese, which was not registrable in Singapore.

**How Mao acquired his interest in the Escrow Shares**

7 Between 15 and 19 March 2005, VGO's wholly-owned subsidiary, Hangzhou Velizia Food Co Ltd (formerly known as Hangzhou Kingsea Food Co Ltd ("HKFC")), sent three letters of demand to Kingsea for payment of the sum of RMB23,626,039 which Kingsea owed as a result of its breach of certain warranties (set out at [10] below) since 2003. When Kingsea failed to make payment, VGO, which was then holding the Escrow Shares as security for Kingsea's fulfilment of those warranties, exercised its power of sale and sold the shares to Mao on 22 March 2005 for S$3,560,354.28, payable in instalments.

**How Kingsea acquired its interest in the VGO shares**

8 In 2002, VGO (then called "e-World of Sports.com Ltd", a public company listed on the Singapore Stock Exchange) decided to diversify its existing business into the food and beverage industry. At that time, Spring Wave was carrying on a food, beverage and mineral water business through a few subsidiaries in China; amongst them were HKFC and Heilongjiang Kingsea Wudalianchi Mineral Water (Group) Co Ltd ("KSWDLC").

9 On 7 October 2002, VGO entered into a sale and purchase agreement with Kingsea ("the S&P Agreement") to acquire: (a) the entire issued share capital of Spring Wave, which then comprised only one fully paid ordinary share of US$1, and (b) a shareholder's loan of RMB42.1m (approximately S$8.7m), which Kingsea had advanced to Spring Wave to acquire the business of HKFC. The purchase

consideration was agreed at RMB55m and was to be satisfied by the allotment of the New VGO Shares of S$0.01 each, credited as fully paid, at an issue price of S$0.085 per share. The initial understanding was that the completion of this transaction was subject to the consolidated net asset value ("NAV") of Spring Wave being confirmed at RMB55m.

10 Under cl 5.8 of the S&P Agreement, Kingsea gave six main warranties which it undertook to make good. The two warranties relevant to the present appeal were:

(a) "the concession warranty" – a warranty that KSWDLC would acquire an exclusive concession and/or right to extract a minimum of 85 tons of spring water per day from the Wu Da Lian Chi spring (valued at RMB5m) within three months from the "Completion Date" (defined as the seventh business day after the fulfilment of the last condition precedent under the S&P Agreement), failing which Kingsea would pay RMB2.513m to HKFC; and

(b) "the Agang debt warranty" – a warranty that the long-term debt of RMB4,456,723 owed by KSWDLC to Agang Group Co Ltd ("the Agang debt") would be forgiven and waived by the creditor within three months from the Completion Date, failing which Kingsea was to pay to KSWDLC such amount as was necessary to satisfy the debt.

These two warranties concerned an asset and a liability which Wu Yang has characterised, in this appeal, as non-existent assets of Spring Wave. It is alleged that VGO issued part of the New VGO Shares to Kingsea in exchange for these non-existent assets (see [24] below).

11 Under cl 5.9 of the S&P Agreement, Kingsea agreed to deposit 81,175,347 of the New VGO Shares (with a market value of about RMB33.14m) with VGO as security for the performance of its obligations under cl 5.8. Under cl 5.10, VGO had the right to sell as many of the New VGO Shares held in escrow as would be necessary to satisfy the liabilities of Kingsea in the event of the latter breaching any of its obligations under cl 5.8. Under cl 5.11, VGO undertook to release to Kingsea the shares held in escrow upon the latter's full compliance with its obligations under cl 5.8.

12 On 17 March 2003, VGO entered into a supplemental deed with Kingsea ("the Supplemental Deed") to provide for the consequences of an audit done that month, which lowered the NAV of Spring Wave as at 1 January 2003 from RMB55m to RMB50,596,000, resulting in a shortfall of RMB4,404,000. In spite of Spring Wave's lower NAV, the parties agreed to complete the transaction. The Supplemental Deed provided that: (a) only 123,918,506 of the New VGO Shares would be issued on completion so as to reflect Spring Wave's lower NAV; and (b) Kingsea would inject cash or other assets into HKFC to the amount of RMB4,404,000 within two months after the Completion Date, whereupon VGO would issue a second tranche of 10,787,376 of the New VGO Shares.

13 Completion of the transaction took place on 17 March 2003 when VGO issued the first tranche of 123,918,506 of the New VGO Shares ("the Issued VGO Shares") and 12,430,240 "Introducer Shares" (the latter were issued to Mao and one Chai Wei for their services in introducing the transaction to VGO). Further, instead of holding in escrow 81,175,347 of the Issued VGO Shares as originally agreed (see [11] above), VGO released 36,737,968 of those shares to Kingsea as Kingsea had fulfilled one of the warranties under cl 5.8 of the S&P Agreement, leaving a balance of 44,437,379 of the Issued VGO Shares held in escrow to secure Kingsea's other warranties.

14 On 23 February 2004, VGO and Kingsea signed a further supplemental agreement under which Kingsea acknowledged that it was in breach of the remaining five warranties under cl 5.8 of the S&P Agreement ("the breached warranties"). The parties agreed that the breaches would be remedied in the following ways:

(a) Kingsea would assist VGO to dispose of HKFC's interest in KSWDLC, failing which Kingsea would pay VGO the sum of RMB6,969,723 in respect of its total liability under both the concession warranty and the Agang debt warranty; and

(b) Kingsea would pay VGO the sum of RMB1,104,000 and deposit with VGO an additional 9,068,861 of the Issued VGO Shares as security for the sums payable in respect of the breached warranties.

15 On 28 December 2004, VGO and Kingsea signed another agreement whereby Kingsea deposited a further lot of 5,832,998 of the Issued VGO Shares as additional security for Kingsea's continuing breach of the warranties. After this deposit, VGO held 59,339,238 of the Issued VGO Shares in escrow (these 59,339,238 shares were the Escrow Shares mentioned at [2] above).

16 As mentioned at [7] above, the Escrow Shares were sold by VGO to Mao upon Kingsea's failure to pay the sums due in respect of the breached warranties (see [14] above).

**Summary of the competing claims to the Escrow Shares**

17 On the date of completion of the S&P Agreement (*ie*, 17 March 2003), VGO was an equitable mortgagee of 44,437,379 of the Issued VGO Shares, which it held as security for the fulfilment of Kingsea's warranties under cl 5.8 of the S&P Agreement (see [13] above). The number of the Issued VGO Shares held in escrow was augmented by two other deposits made on 23 February 2004 and 28 December 2004 respectively (see [14]–[15] above).

18 In contrast, it was only on 12 August 2004 that CJY and Kingsea jointly agreed to "pledge" 31,764,784 of the Issued VGO Shares to guarantee repayment of the loan owed by ZJL to Wu Yang (see [5] above). Even assuming that this "pledge" was valid, which was not proved in the court below (see *Wu Yang Construction Group Ltd v Zhejiang Jinyi Group Co, Ltd* [2006] 4 SLR 451 ("the GD") at [14]), no notice of it was given to VGO. On 3 February 2005, when Wu Yang, ZJL and CJY signed the Set-Off Agreement (see [6] above), VGO already had a prior interest in the Escrow Shares as equitable mortgagee. Until and unless Kingsea discharged its liabilities to VGO, this priority could not be dislodged by the transfer of 31,764,784 of the Issued VGO Shares to Wu Yang.

19 Hence, there was no question that, at all material times, VGO had a prior interest in the Escrow Shares, and, therefore, when Mao purchased those shares from VGO on 22 March 2005, he was entitled to the priority that VGO had in the shares. It is in this factual matrix that we must now consider the merits of the freezing order.

**OS 343 – the freezing order**

20 On 23 March 2005, one day after VGO had sold the Escrow Shares to Mao, Wu Yang filed OS 343, naming ZJL, CJY and Kingsea as defendants and seeking orders that, *inter alia*, they be restrained from dealing with the VGO Issued Shares and that those shares be transferred to Wu Yang. The title of OS 343 recited that it was filed in support of an intended arbitration between Wu Yang as claimant and ZJL and CJY as respondents. On the same day, Wu Yang obtained the freezing order, which was served on VGO the next day, whereupon VGO notified Wu Yang of the sale of the Escrow Shares to Mao. On 6 April 2005, Wu Yang filed a notice of arbitration addressed to ZJL, CJY and Kingsea pursuant to the International Arbitration Act (Cap 143A, 2002 Rev Ed) ("IAA") and the rules of the Singapore International Arbitration Centre (see further [26]–[27] below).

21 VGO and Mao applied to court on 15 April 2005 and 25 April 2005, respectively, to intervene

in the action and to vary the freezing order by excluding the Escrow Shares from that order. They relied on the ground that VGO had sold the Escrow Shares to Mao, who had priority to the shares over Wu Yang.

22 The Judge heard the two applications on 25 July 2005. At that hearing, counsel for Wu Yang raised – in the words of the Judge (see the GD at [17]) – "out of the blue" two new issues, *viz*, that: (a) the Issued VGO Shares had been allotted in breach of s 76 of the Companies Act (Cap 50, 1994 Rev Ed) ("the CA"), in that VGO had provided financial assistance to Kingsea for the latter to acquire those shares; and (b) Mao had conspired with VGO to keep the Escrow Shares out of the reach of Wu Yang, and, therefore, his claim to the Escrow Shares should be postponed to that of Wu Yang's.

23 The Judge varied the freezing order by freeing up the Escrow Shares on the grounds that there was insufficient evidence of a conspiracy between VGO and Mao and that VGO had not provided financial assistance to Kingsea in breach of s 76 of the CA.

**The proceedings on appeal**

***Issues for determination raised by Wu Yang***

24 Wu Yang's principal contention in this appeal was that its claim to the Escrow Shares had priority to Mao's claim on the following main grounds:

(a) VGO had contravened s 76 of the CA as it had allotted the Issued VGO Shares to Kingsea in exchange for non-existent assets of Spring Wave (see [10] above); and

(b) Mao was not a *bona fide* purchaser of the Escrow Shares.

***Additional issues raised by the respondents***

25 The respondents, in turn, raised other preliminary issues for determination by this court. The relevant ones were:

(a) whether the freezing order had been properly granted under s 12(7) of the IAA; and

(b) whether Wu Yang had any *locus standi* to invoke s 76 of the CA.

**Our decision on the issues raised**

***Jurisdiction to grant freezing order in aid of arbitration***

26 In our view, the court below did not have the jurisdiction to grant the freezing order. When Wu Yang obtained the freezing order pursuant to s 12(7) of the IAA and O 69A of the Rules of Court (Cap 322, R 5, 2004 Rev Ed), it did not have an underlying cause of action against CJY and Kingsea in Singapore. Although Wu Yang had given the court an undertaking that it would commence arbitration proceedings against ZJL and CJY, which it duly did on 6 April 2005 (see the GD at [5]), the Judge was not told what the issue to be arbitrated on was or whether there was any arbitrable issue at all. Wu Yang's notice of arbitration was based on an alleged dispute pertaining to the Set-Off Agreement. Wu Yang basically claimed that CJY had breached his agreement to transfer all his shares in VGO to Wu Yang to offset the amounts which he and ZJL owed to Wu Yang.

27 However, there was no allegation that ZJL and/or CJY had disputed Wu Yang's claims. The

truth was that there was no dispute referable to arbitration. If the Judge had known the actual facts, he would never have granted the freezing order.

28 The law is clear. If no substantive relief is claimed against a party, a freezing order cannot be issued against that party: see *Swift-Fortune Ltd v Magnifica Marine SA* [2007] 1 SLR 629 and *Fourie v Le Roux and others* [2007] 1 WLR 320. The freezing order should have been discharged on this ground alone.

***Wu Yang's locus standi to raise the issue of financial assistance***

29 We now consider the *locus standi* of Wu Yang to raise the issue of financial assistance under s 76 of the CA. Section 76A(2) of the CA provides that in the event of a breach of, *inter alia*, s 76(1)(*a*), the contract or transaction related to the breach shall be voidable at the option of the company. Additionally, s 76A(3) prescribes the parties who may apply to the court to have the contract set aside, namely: (a) a member of the company; (b) a holder of debentures of the company; (c) a trustee for the holders of debentures of the company; or (d) a director of the company. Whatever interest Wu Yang might have had in the Escrow Shares, it was not a prescribed person under s 76A(3). Therefore, it had no *locus standi* to invoke s 76 against VGO.

***Wu Yang's claim of priority to the Escrow Shares***

30 Wu Yang's claim that it had priority to the Escrow Shares was made on the basis that Mao had acquired those shares from VGO on 22 March 2005, more than a month after the date (*ie*, 3 February 2005) of the purported transfer of the shares to Wu Yang. This argument had no merit whatsoever since Mao's priority in the Escrow Shares was derived from VGO's priority, which subsisted long before Wu Yang had acquired any interest in the Issued VGO Shares. Wu Yang's claim crystallised, at the earliest, on 12 August 2004 (with respect to 31,764,784 of the Issued VGO Shares) and, at the latest, on 3 February 2005 (the date of the Set-Off Agreement). As mentioned at [18] above, VGO was not notified of the purported "pledge" or transfer of 31,764,784 of the Issued VGO Shares to Wu Yang. In any case, the legal effect of that transaction was doubtful under Singapore law as there was no transfer of physical possession of the relevant share certificates from the transferor to the transferee.

31 Wu Yang's alternative argument was that the court should deny Mao priority over the Escrow Shares because he had conspired with VGO to deprive Wu Yang of its claim to those shares. We found that this argument likewise had no merit as there was no evidence of any such conspiracy between VGO and Mao; nor was there any plausible reason for VGO to be involved in such a conspiracy as it already had a valid security in the Escrow Shares at the material time, which security it realised by selling the Escrow Shares to Mao.

***Did VGO provide financial assistance to Kingsea?***

*The purchase consideration for Spring Wave was not based on its NAV*

32 Given our conclusions on the other issues, it was technically not necessary for us to examine Wu Yang's arguments that VGO breached s 76(1)(*a*) of the CA in allotting the Issued VGO Shares to Kingsea. However, in view of counsel's criticisms of the Judge's decision, we considered it desirable to examine Wu Yang's arguments, and, in particular, to re-examine the decision of this court in *Intraco Ltd v Multi-Pak Singapore Pte Ltd* [1995] 1 SLR 313 ("*Intraco*"), which seems to have caused some confusion among corporate lawyers as to the scope of s 76. Counsel's basic argument was that although VGO had agreed to purchase the business of Spring Wave based on the latter's NAV, it had

allotted to Kingsea, as consideration for the purchase, the Issued VGO Shares whose value exceeded the NAV of Spring Wave (see [9] and [12] above). Counsel submitted that this amounted to VGO providing financial assistance to Kingsea to enable the latter to acquire shares in VGO, and was thus a breach of s 76 of the CA.

33 We rejected this argument for two reasons. First, on the facts, the consideration for the acquisition of the business of Spring Wave was not based solely on its NAV. Second, even if the consideration was indeed based on such NAV, there was in fact no discrepancy between the NAV of Spring Wave and the value of the Issued VGO Shares.

34 Clause 2.1 of the circular dated 11 February 2003, which VGO issued to its shareholders in respect of its acquisition of Spring Wave, defined the consideration for the transaction as follows:

> The Purchase Consideration payable to [Kingsea] by [VGO] for the entire issued share capital of Spring Wave, and the transfer and assignment of the Shareholders' Loans is RMB55 million … The Purchase Consideration was determined after negotiations between [Kingsea] and [VGO] on arm's length and "willing-buyer, willing-seller" bases, *taking into consideration the estimated fair value of the net assets of [HKFC] as at the Completion Date*. The estimated fair value of the net assets of [HKFC] as at 1 January 2003 is approximately RMB55 million. The Purchase Consideration will be satisfied in full by the allotment and issue of 134,705,882 Shares at an issue price of S$0.085 for each new Share.
>
> The Consideration Shares represent approximately 54.2 per cent. of the issued and paid-up share capital of [VGO] as at the Latest Practicable Date and approximately 34.0 per cent. of the enlarged issued and paid-up share capital of [VGO] after the Merger.
>
> [emphasis added]

It is clear from cl 2.1 of the above circular that the consideration of RMB55m merely took into account the NAV of *HKFC* (the then principal operating subsidiary of Spring Wave) as a relevant factor in determining the purchase price.

35 In effect, VGO acquired Spring Wave, including its goodwill, assets and liabilities, as a going concern. The liabilities of Spring Wave were dealt with on the basis that Kingsea was to discharge them, failing which Kingsea would indemnify VGO. As security for Kingsea's performance of these obligations, VGO retained the Escrow Shares (see [9]–[11] above). Therefore, far from providing financial assistance to Kingsea to acquire the Issued VGO Shares, VGO made sure that no financial assistance would be given and that its capital would not be diminished.

36 Furthermore, the concession pertaining to the Wu Da Lian Chi spring (see [10] above) was an existing asset of HKFC (through its interest in KSWDLC) as it entitled KSWDLC to extract, on a non-exclusive basis, up to 30,000$m^3$ of spring water per year. What VGO wanted was an exclusive concession to extract 85 tons of spring water a day. For that purpose, RMB5m was imputed as the value of the exclusive concession; but, pursuant to the concession warranty, if Kingsea failed to get the exclusive concession within three months from the Completion Date, Kingsea would pay RMB2.513m to HKFC. In other words, the non-exclusive concession was valued at RMB2.487m. Subsequently, Kingsea failed to get the exclusive concession as warranted, which meant that Kingsea became liable to pay RMB2.513m to HKFC. With regard to the Agang debt of RMB4,456,723, Kingsea likewise became liable, under the Agang debt warranty, to pay a further RMB4,456,723 to KSWDLC as it also failed to secure a waiver of this debt.

37 Eventually, however, the losses arising from the breaches of both the concession warranty and the Agang debt warranty were taken out of the balance sheet for the purpose of determining the actual NAV of Spring Wave (*ie*, the losses were not reflected in HKFC's books) as HKFC's interest in KSWDLC was disposed of as planned (see [14] above) for RMB16m. However, Kingsea's liability to pay the amounts set out at [36] above (which totalled RMB6,969,723) inspired counsel for Wu Yang to argue that VGO had issued and allotted to Kingsea shares (*viz*, the Issued VGO Shares) with an excess value of RMB6,969,723.

38 It was therefore not surprising that the Judge found Wu Yang's argument that VGO had provided financial assistance to Kingsea to be "completely without merit" and "commercially impractical" (see the GD at [19]) and held that the fact situation "[did] *not even fall within* the literal ambit of s 76 of the [CA] in the first instance" [emphasis in original] (see the GD at [20]) and was "clearly *not* within [its] spirit and intent" [emphasis in original] (see the GD at [19]): see also, generally, the GD at [19]–[23] and [35].

*Counsel's criticism of the Judge's decision unjustified*

39 Before us, counsel for Wu Yang focused his criticism of the Judge's decision on the latter's alleged failure to carry out the fact-finding process required under s 76 of the CA. It was submitted that the Judge had adopted the simplistic test that, so long as the transaction in question was entered into in good faith in the commercial interests of the company, s 76 would not be breached. In support of this contention, counsel relied on the Judge's statements in the GD at [19], [35], [46], [47] and [50].

40 Counsel contended that the Judge should have analysed the transaction between VGO and Kingsea (which took the form of an "equity-business swap") using a two-step approach by determining, first, whether issuing shares in exchange for assets with a lower value amounted to giving financial assistance; and, if it did, then, second, whether, in the present case, such financial assistance was given directly or indirectly for the purpose of or in connection with Kingsea's acquisition of the Issued VGO Shares. Counsel referred to *Intraco* ([32] *supra*) where this two-step analysis was carried out. He complained, citing the GD at [18] and [22], that the Judge not only failed to carry out a similar analysis, but also wrongly adopted the simplistic approach that the impugned transaction had to be a sham or for an illegitimate purpose before it could contravene s 76. Counsel also referred us to *Chaston v SWP Group plc* [2003] 1 BCLC 675 ("*Chaston*"), *Belmont Finance Corp v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393 ("*Belmont (No 2)*"), *Brady v Brady* [1989] AC 755 ("*Brady*") and *Milburn v Pivot Ltd* (1997) 25 ACSR 237, where the courts went through the two-step analysis just mentioned to determine whether the requisite elements of the respective statutory equivalents of s 76 of the CA in each of these cases were present.

41 In particular, counsel pointed out that the English Court of Appeal held, in *Chaston*, that the English equivalent of s 76 of the CA could still be contravened even if the directors had acted in good faith in the best interests of the company. In *Chaston*, a listed company ("SWP") made a takeover bid for another company ("DRCH") for £2.5m. Chaston, a director and major shareholder of DRCH's subsidiary ("DRC"), arranged for a due diligence report on DRCH to be carried out. DRC paid £19,681.25 for the report. Following the takeover, SWP, as the assignee of DRC, brought a claim against Chaston for damages for breach of fiduciary duty. SWP alleged that Chaston had procured the grant of financial assistance by DRC "for the purpose of [the] acquisition" by SWP of the shares in DRCH, contrary to s 151 of the Companies Act 1985 (c 6) (UK). SWP contended that the payment of the due diligence fees by DRC fell within the definition of "financial assistance" contained in s 152(1)(a)(iv), namely, "any other financial assistance given by a company [*ie*, DRC] the net assets of which are thereby reduced to a material extent".

42 At first instance, the trial court dismissed the action. On appeal, Chaston contended that the payment by DRC for the due diligence report did not constitute financial assistance as there was no net transfer of value by the company being acquired (DRCH), and, further, the due diligence exercise had not been done to assist SWP in acquiring the shares of DRCH. The English Court of Appeal held that the mischief at which s 151 was directed was the use, directly or indirectly, of the resources of the target company and its subsidiaries to assist the purchaser financially in acquiring the shares of the target company. What mattered was the commercial substance and reality of the transaction. Applying this test, the English Court of Appeal held that the payment by DRC for the due diligence report amounted to "financial assistance" to SWP for the purpose of s 151 as the due diligence exercise had been done for the benefit of SWP, who had the responsibility of carrying out that exercise and, thus, of paying for it. The court held that it was irrelevant that: (a) there had been no detriment to the target company; (b) the financial assistance had been given in advance, and not in the course of the takeover of DRCH; and (c) the payment of the due diligence fees had no impact on the target company's share price. The court further held that the financial assistance had been given "for the purpose" of SWP's acquisition of DRCH as it had been given to further such acquisition, which was sufficient to bring the transaction within the ambit of s 151. Arden LJ, in concluding her judgment, said (see *Chaston* at [50]):

> Section 153 [the UK equivalent of the "substantial purpose" provision in s 76(3) of the CA] makes it clear that a transaction can fall within s 151 even if only one of the purposes for which it was carried out was to assist the acquisition of shares. Here the liability to pay the fees of D & T [the accountants who carried out the due diligence exercise] was clearly incurred for the purpose of the acquisition by SWP of DRCH's shares. *Brady v Brady* makes it clear that an unlawful purpose is not removed by the fact that, as the judge found here, the directors were motivated by the best interests of the company. Their motivation was only a reason for their acts, not a purpose in itself (see *Brady v Brady*).

43 Counsel for Wu Yang also criticised the Judge for relying on the decision in *Intraco* as authority for the principle that so long as the impugned transaction is in the commercial interests of the company whose shares were being purchased, s 76 of the CA is not breached. Counsel pointed out that in *Intraco*, the court found that the transaction concerned (which was an "equity-debt swap") was in the commercial interests of Multi-Pak; *for that reason*, the court held that the main purpose of that transaction was not to assist Intraco to acquire the Multi-Pak shares. Counsel argued that that was the fundamental point in *Intraco*, *viz*, the court's finding that the main purpose of the equity-debt swap was *not* to assist Intraco to acquire shares in Multi-Pak. Counsel submitted that if the Court of Appeal had found otherwise, then the fact that the transaction was in the commercial interests of Multi-Pak could not have taken it outside the ambit of s 76.

44 In our view, counsel's criticism that the Judge did not adopt the two-step analysis of s 76 (as applied in *Intraco*) had no merit. The Judge had referred (see the GD at [38]) to the two-step process described by Hoffmann J in the English High Court decision of *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd* [1986] BCLC 1 at 10, as follows:

> There are two elements in the commission of an offence under s 54 [of the then UK Act and corresponding, in substance at least, to s 76 of the CA]. The first is the giving of financial assistance and the second is that it should have been given 'for the purposes of or in connection with' … a purchase of shares.

It was clear to us, from the GD, that the Judge found that: (a) VGO's sole purpose in acquiring Spring Wave's business as a going concern was to extend VGO's own business to the food and beverage industry; (b) that objective was in the commercial interests of VGO; and (c) that objective was

realised. No financial assistance had been given because the allotment of the Issued VGO Shares to Kingsea was merely the means to achieve VGO's commercial objective. VGO could have arranged to pay cash to Kingsea to enable the latter to subscribe for shares in VGO – such a transaction would not have offended s 76 either, because the purpose of the payment to Kingsea would have remained unchanged. It was in this context that the Judge observed that s 76 was not intended to interfere with commercial decisions taken in a *bona fide* fashion. VGO's acquisition of the business of Spring Wave was such a commercial decision.

*The rationale underlying section 76 of the CA*

45 As confusion still exists as to what this court actually decided in *Intraco*, we would like to take this opportunity to clarify the legal position. It is well known that s 76 of the CA is based on s 54 of the Companies Act 1948 (c 38) (UK). The provision was enacted to prevent abuses in the form of persons or syndicates indirectly using the funds of the target company to acquire control of the target company by, first, obtaining bank loans to finance their purchase of the target company, and then, after gaining control of the target company, using the target company's funds to repay those bank loans: see Arden LJ's comment in *Chaston* ([40] *supra*) at [48] (referring to a passage from *Brady* ([40] *supra*), which is reproduced below at [48]). Such practices might deplete the assets of the target company and thereby offend the rule on capital maintenance, which protects the interests of creditors. This was one of the reasons for the holding by Sundaresh Menon JC in *PP v Lew Syn Pau* [2006] 4 SLR 210 ("*Lew Syn Pau*") that the accused in that case had not contravened s 76 of the CA. In the present case, the Judge likewise found that there was no depletion of VGO's capital as a result of the allotment of the Issued VGO Shares.

46 Section 76 also requires the court to determine, assuming financial assistance was indeed given, whether it was given for the purpose of or in connection with the acquisition of shares in the target company (see s 76(1)(*a*)). The expression "financial assistance" suggests any form of material assistance to which a monetary value can be ascribed, without which the party acquiring a company's shares ("the intended purchaser") would have been unable to acquire the shares. The financial assistance may be direct (*eg*, by the target company giving a loan to the intended purchaser to buy the shares) or indirect (*eg*, where the target company releases the intended purchaser from a debt, which has the effect of reducing the price payable for the shares, or, as in *Chaston*, where the target company's subsidiary pays for the cost of a due diligence report which should have been paid for by the intended purchaser). The provision is breached even where the assistance given is merely *in connection with* the acquisition of the target company's shares. In *Lew Syn Pau*, Menon JC rejected an argument that s 76 should be interpreted so as to prohibit only those instances of financial assistance where the intended purchaser does in fact acquire a controlling interest in the target company. He held (at [67]) that the language of s 76(1) of the CA did not admit of such a restrictive interpretation, and noted (at [68]) that neither the committee chaired by Mr Wilfred Greene KC nor the committee chaired by Lord Jenkins, which were appointed by the UK Board of Trade to review the Companies Act 1929 (c 23) (UK) and the Companies Act 1948 ([45] *supra*) respectively, had recommended that the corresponding English provisions be amended so as to be applicable only in cases where the intended purchaser acquired control of the target company.

47 Implicit in the above (rejected) argument is the premise that if a controlling interest in the target company is obtained via the target company itself giving financial assistance, such a transaction would not be in the interests of the target company. As a matter of commercial logic or reality, this is not necessarily so. A poorly-managed company with under-utilised assets is a tempting target of acquisition by entrepreneurial managers who can make better use of the company's assets or enhance the value of the company's business to the shareholders. That would certainly be in the interests of the target company, as well as its shareholders and its creditors. However, because of

the express language used in the English equivalent of s 76 of the CA, the English courts have held that even if a transaction is in the commercial interests of the target company that does not thereby prevent it from offending the English equivalent of s 76 if the main purpose or one of the purposes of the transaction is to provide financial assistance to the intended purchaser to enable the latter to acquire shares in the target company: see *Brady* ([40] *supra*) and *Chaston.*

48 In *Brady*, Lord Oliver of Aylmerton adverted to this point (at 779–780) in his discussion on the distinction between the *purpose* of a transaction and the *reason* for that transaction:

> If one postulates the case of a bidder for control of a public company financing his bid from the company's own funds – the obvious mischief at which the section is aimed – the immediate purpose which it is sought to achieve is that of completing the purchase and vesting control of the company in the bidder. The reasons why that course is considered desirable may be many and varied. The company may have fallen on hard times so that a change of management is considered necessary to avert disaster. It may merely be thought, and no doubt would be thought by the purchaser and the directors whom he nominates once he has control, that the business of the company will be more profitable under his management than it was heretofore. These may be excellent reasons but they cannot, in my judgment, constitute a "larger purpose" of which the provision of assistance is merely an incident. The purpose and the only purpose of the financial assistance is and remains that of enabling the shares to be acquired and the financial or commercial advantages flowing from the acquisition, whilst they may form the reason for forming the purpose of providing assistance, are a by-product of it rather than an independent purpose of which the assistance can properly be considered to be an incident.

*The decision in Intraco*

49 As alluded to earlier (at [32] and [45] above), the decision of the Court of Appeal in *Intraco* has caused some confusion as to the scope of s 76(1) of the CA and the proper test to apply in determining whether a transaction between the target company and the intended purchaser which results in the intended purchaser acquiring shares in the target company offends that provision. *Intraco* was decided based on s 76(1) of the Companies Act (Cap 50, 1990 Rev Ed) ("the 1990 CA"), which read as follows:

> Except as otherwise expressly provided by this Act, a company shall not —
>
> (*a*) whether directly or indirectly, give any financial assistance for the purpose of, or in connection with —
>
> (i) the acquisition by any person, whether before or at the same time as the giving of financial assistance, of —
>
> (A) shares or units of shares in the company …

Section 76(1) of the CA is substantially the same.

50 In *Intraco*, the transaction between Intraco (the intended purchaser) and Multi-Pak (the target company) was, on the face of it, straightforward. Multi-Pak was formed to operate a paper mill to supply paper to City Carton Co Pte Ltd ("City Carton"), which manufactured paper cartons. City Carton was owned by the controlling shareholders of Multi-Pak through another company. City Carton had a wholly-owned subsidiary called Box-Pak (S) Pte Ltd ("Box-Pak"). City Carton and Box-Pak together owed Intraco $2,545,897.83. This debt was worthless as both the debtors were insolvent.

Multi-Pak and Intraco originally planned to restructure City Carton by the former injecting new capital into City Carton and the latter converting part of its receivables into City Carton equity. The parties eventually abandoned the plan. Instead, a new scheme was carried out in two stages. First, Multi-Pak paid $2,371,079.62 to Intraco to buy the worthless debts of $2,545,897.83 (*ie*, the debts owed to Intraco by City Carton and Box-Pak). This was followed by Intraco using the same funds to: (a) subscribe for 20,000 shares in Multi-Pak at the paid-up value of $2m, and (b) lend Multi-Pak the sum of $371,079.62, that being the balance of the $2,371,079.62 which Multi-Pak had paid to Intraco. How the precise consideration of $2,371,079.62 was arrived at by the parties was never explained either at first instance or on appeal. Furthermore, no money actually changed hands in the implementation of this plan as the parties merely exchanged cheques for the equivalent amounts that were set off against each other.

51 As the equity-debt swap was structured, there was little doubt that Multi-Pak, in agreeing to the transaction, had provided financial assistance (in the form of the payment of $2,371,079.62) to Intraco for the purpose of or in connection with Intraco's acquisition of the shares in Multi-Pak. Yet, the court decided that the transaction did not offend s 76(1) of the 1990 CA on the following grounds (see *Intraco* at 324, [26]):

> Assuming that the transactions amounted to giving financial assistance to [Intraco] to subscribe for the shares, there would still be the second 'element' with which [Multi-Pak] had to contend. We have discussed the commercial benefits that would accrue to [Multi-Pak]. Looking at the transactions in their proper commercial context, we did not think that they were entered into solely or mainly for the purpose of enabling [Intraco] to acquire the shares in [Multi-Pak] at no costs to themselves. The transactions were entered into bona fide in the commercial interest of [Multi-Pak] as well. In our judgment, the transactions were not in breach of s 76 of [the 1990 CA].

52 With respect, the reasoning in the above passage is obscure. It is not clear what principle the court was trying to establish or apply in relation to s 76(1) of the 1990 CA. The court appeared to lay down the principle that if an equity-debt swap was in the commercial interests of the target company, s 76(1) of the 1990 CA would not be breached. If that was indeed what the court in *Intraco* meant, the proposition laid down would be too wide and would also be inconsistent with the language of s 76(1). The court in *Intraco* did not cite any authority for this proposition, which is inconsistent with the case law relating to the corresponding provision in the English companies legislation from which s 76(1) was derived: see *Brady* and *Chaston*. It may be noted that the court did not at any time articulate what Multi-Pak's purpose in agreeing to the equity-debt swap was. In fact, it appears that there was no purpose for the transaction other than to assist Intraco to salvage whatever it could from the potential losses arising from the inability of City Carton and Box-Pak to pay the debts which they owed to Intraco. The purpose of the transaction was precisely that, although, ultimately, the entire exercise failed because Multi-Pak itself became insolvent, and that in turn led Multi-Pak's liquidators to try to recover the payment of $2,371,079.62 from Intraco. What the court found as being of benefit to Multi-Pak (*ie*, having a government-linked company like Intraco as one of its shareholders and a member of its board of directors) was the *reason* for, and not the purpose of, the transaction. The court confused these two elements (see Lord Oliver's comments in *Brady* as reproduced at [48] above), and came to the wrong conclusion on the scope of s 76(1) of the 1990 CA.

53 The way in which the court dealt with the issues on appeal was also unexpected. In the High Court (see *Multi-Pak Singapore Pte Ltd v Intraco Ltd* [1994] 2 SLR 282 ("*Intraco (HC)*")), Multi-Pak's action against Intraco was for the return of $2,371,079.62 based on three causes of action, *viz*: (a) constructive trust; (b) conspiracy; and (c) resulting trust. The constructive trust claim was

based on an alleged breach of fiduciary duty by the directors of Multi-Pak (namely, misapplying Multi-Pak's funds) coupled with Intraco's knowledge of such breach and of the fact that the transaction did not benefit Multi-Pak. The conspiracy action was based on Multi-Pak's directors and Intraco allegedly acting in concert to breach s 157(1) of the 1990 CA, while the resulting trust action was premised on the equity-debt swap being a sham. The directors, although named as defendants, were not served with the writ and therefore did not appear. There was thus no evidence from the directors that the equity-debt swap benefited Multi-Pak. In fact, counsel for Intraco conceded that apart from, perhaps, Intraco's representation on Multi-Pak's board possibly making it easier for Multi-Pak to obtain banking facilities, Multi-Pak in fact derived no interest whatsoever from the transaction. Chao Hick Tin J found against Intraco on the constructive trust claim and the conspiracy claim. However, he dismissed Multi-Pak's claim based on resulting trust.

54 The issue on appeal was whether Intraco was liable as a constructive trustee and/or a conspirator with Multi-Pak's directors in respect of the latter's breach of their duties under s 157(1) of the 1990 CA. The Court of Appeal held that, on the evidence, the charge of conspiracy could not be proved. It also held that the equity-debt swap was commercially beneficial to Multi-Pak, reasoning that Multi-Pak's directors must have had such a belief as they would not otherwise have entered into the transaction: see *Intraco* at 322–323, [23]. If the court had stopped at this point, the decision in *Intraco* would have been unexceptional, even though the finding of fact that Multi-Pak had benefited from the equity-debt swap was doubtful as there was no evidence of the state of mind of Multi-Pak's directors when Multi-Pak entered into the transaction. It was not necessary for the court to go further to pronounce on the scope of s 76 (1) of the 1990 CA as that was an irrelevant issue. This was all the more so because, as pointed out by Chao J below (see *Intraco (HC)* at 283, [13]), the Court of Appeal had in previous interlocutory proceedings between the same parties, namely, in Multi-Pak's application to amend its pleadings so as to include a claim based on s 76 of the 1990 CA, held that an action founded on that statutory provision was time- barred (see *Multi-Pak Singapore Pte Ltd v Intraco Ltd* [1993] 2 SLR 113).

55 A careful reading of the grounds of judgment in *Intraco* will show why the Court of Appeal's attention was directed to s 76(1) of the 1990 CA. Counsel for Intraco had argued (at 321–322, [20]) that:

> [I]t was not a breach of s 76 when a company [*ie*, Multi-Pak] entered into a transaction with a party [*ie*, Intraco] in its own commercial interests and not solely to provide financial assistance to the other party to buy shares in it, although it resulted in the other being put in funds to acquire the shares.

In support of his proposition, counsel cited two passages from the judgments of Buckley and Waller LJJ in *Belmont (No 2)* ([40] *supra*), which were reproduced by the court in *Intraco* at 321–322, [20]–[21] as follows:

> We were referred to the following passage from the judgment of Buckley LJ in *Belmont (No 2)* at p 402:
>
>> If A Ltd buys from B a chattel or a commodity, like a ship or merchandise, which A Ltd genuinely wants to acquire for its own purposes, and does so having no other purpose in view, the fact that B thereafter employs the proceeds of the sale in buying shares in A Ltd should not, I would suppose, be held to offend against the section; but the position may be different if A Ltd makes the purchase in order to put B in funds to buy shares in A Ltd. If A Ltd buys something from B without regard to its own commercial interests, the sole purpose of the transaction being to put B in funds to acquire shares in A Ltd, this would, in my

> opinion, clearly contravene the section, even if the price paid was a fair price for what is bought, and a fortiori that would be so if the sale to A Ltd was at an inflated price. The sole purpose would be to enable (ie to assist) B to pay for the shares. … If the transaction is of a kind which A Ltd could in its own commercial interests legitimately enter into, and the transaction is genuinely entered into by A Ltd in its own commercial interests and not merely as a means of assisting B financially to buy shares of A Ltd, the circumstance that A Ltd enters into the transaction with B, partly with the object of putting B in funds to acquire its own shares or with the knowledge of B's intended use of the proceeds of sale, might, I think, involve no contravention of the section but I do not wish to express a concluded opinion on that point.

Waller LJ said, at p 414:

> To avoid a contravention of s 54 it is not sufficient, in my view, to show that the company is purchasing an asset which is worth the price being paid. The company must also show that the decision to purchase is made in the commercial interests of the company. If this were so, then the fact that the proceeds are used by the seller for the purchase of shares in the company would not necessarily infringe s 54. That would only happen if the decision was made partly with the intention on the part of the board that the proceeds should be used for the purchase of shares in the company.

56 The situations discussed in these passages were quite different from the fact situation in *Intraco*, but the court nevertheless accepted counsel's argument and held (at 322, [22]) that "[t]he crucial question that fell to be considered was the interests of [Multi-Pak] in the transactions". Proceeding on the basis of this principle, the court analysed the equity-debt swap and found that it was in the interests of Multi-Pak to enter into that transaction, as a business alliance with Intraco, which was a government-linked company, would benefit Multi-Pak commercially and, therefore, Multi-Pak's directors were not in breach of their duties.

57 It is unnecessary for us to analyse the statements of Buckley and Waller LJJ for the purpose of demonstrating that they had no application to the facts in *Intraco*. What is important to note is that the court's holding on the scope of s 76(1) of the 1990 CA was entirely unnecessary to the determination of the issue of whether Intraco was liable as a constructive trustee. In our view, whatever the court said in relation to the meaning and the scope of s 76(1) was *obiter*.

58 In our opinion, the fact that a transaction, by which the target company has provided financial assistance to the intended purchaser to acquire shares in the target company, is in the interests of the target company does not, by itself, lead to the conclusion that the transaction therefore cannot offend s 76 of the CA. The element of commercial interest is only relevant in the context of examining the purpose for which the target company enters into a transaction. The purpose of the transaction could be the acquisition of a business or an asset; it might even be the acquisition of a commercial relationship in order to tap into the goodwill of another company. In *Intraco*, however, it was, as found by the Court of Appeal, Multi-Pak that sought to tap into the connections of Intraco as a government-linked company by paying $2,371,079.62 for that privilege. Seen in this light, it is difficult to believe that that was the purpose of Multi-Pak's directors when they authorised the transaction. It could of course be argued that, in fact, the net sum that was ultimately paid by Multi-Pak was only $371,079.62 since Intraco – in a sense – "paid back" $2m to Multi-Pak in exchange for new shares in Multi-Pak (see [50] above). However, the fact remains that the shareholding of other shareholders of Multi-Pak was diluted to the value of $2m.

59 In the present case, it was clear beyond any doubt that VGO's sole purpose in acquiring

Spring Wave as a going concern from Kingsea was to expand its own business into the food and beverage industry. In return for acquiring Spring Wave as a going concern, VGO agreed to allot the Issued VGO Shares as fully paid-up shares. The transaction (which, as stated at [40] above, took the form of an equity-business swap) was undoubtedly in the commercial interests of VGO since it would acquire a going concern with substantial assets in return for allotting the Issued VGO Shares. The purpose of this equity-business swap was certainly not the giving of financial assistance to Kingsea to enable the latter to acquire shares in VGO but, rather, the acquisition of Spring Wave's food and beverage business by VGO. In the circumstances, the transaction did not offend s 76 of the CA.

60 The appeal was accordingly dismissed with costs for the reasons set out in these grounds of decision.

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