eHi Car Services Limited strikes-out "abusive" winding-up petition by minority shareholder Ctrip Investment Holding Ltd

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Overview

The Grand Court of the Cayman Islands has decided that a minority shareholder may not pursue a winding-up petition in order to delay or prevent a Board approved privatisation of the company.

It is an abuse of process to seek to use a winding-up petition, which is class remedy, to further the commercial interests of a particular minority shareholder.

The stringent requirements necessary to support a winding-up petition apply in the context of a privatisation offer and apply whether a winding-up order or alternative orders are sought under section 93(5) of the Companies Law.

Introduction

The decision in Re eHi Car Services Limited (FSD 63 of 2018, unreported, 29 June 2018) arose in the context of the proposed privatization of eHi Car Services Limited ("**eHi**" or the "**Company**"). Carey Olsen represented eHi. Ctrip was represented by Harneys.

The case will provide comfort to Cayman Islands incorporated companies considering or undergoing privatisation. In a detailed judgment, Justice Kawaley (the "**Judge**") of the Grand Court of the Cayman Islands (the "**Court**") decided that the use by Ctrip Investment Holding Ltd ("**Ctrip**" or the "**Petitioner**") of a minority shareholder's winding-up petition to further its own commercial interests was an abuse of process and was struck out.

Importantly, the decision now stands as authority for the principle that a minority shareholder may not pursue a winding-up petition in order to delay or prevent a Board approved privatisation offer. The appropriate course for a dissenting minority shareholder is to vote against the privatisation at the EGM and if the privatisation passes, to exercise its dissenting shareholder rights under section 238 of the Law.

Background

eHi is a New York Stock Exchange ("**NYSE**") listed company (NYSE: EHIC) and China's leading car rental services provider. Ctrip forms part of a PRC travel conglomerate. Ctrip is a minority shareholder in eHi.

In December 2017 the Board of eHi approved the creation of a Special Committee to evaluate and negotiate privatisation proposals for eHi. The Special Committee was comprised of three independent directors. It was advised by its own independently retained legal counsel and financial advisors.

A privatisation consortium was formed which included MBK Partners Fund IV, LP, Baring Private Equity Asia Limited and eHi's Chairman, Mr Ruiping Zhang (the "**Teamsport Consortium**"). The Crawford Group, Inc, a large institutional shareholder of eHi, together with a number of other funds, joined the Teamsport Consortium. Ctrip also entered into negotiations to join the Teamsport Consortium, but ultimately it did not participate. In January 2018, the Teamsport Consortium submitted a preliminary, non-binding proposal to acquire the outstanding shares of eHi for US$6.675 per ordinary share (US$13.35 per ADS) (the "**Teamsport Proposal**").

Two days before the Board convened a meeting to consider the Teamsport Proposal, eHi received a preliminary, non-binding offer from Ocean Link, with an offer of US$7.25 per ordinary share (US$14.50 per ADS) (the "**Ocean Link bid**"). The Board later learned that Ctrip was a participant in the Ocean Link bid. In addition, Ocean Link advised the Board that together with Ctrip, it had assumed control of sufficient shares to block the Teamsport Proposal or any other competing bids (but on no view did it have sufficient shares to carry its own bid).

Prior to a meeting of the Board convened to consider the Teamsport Proposal and the recent Ocean Link bid, the Teamsport Consortium increased its offer price to US$6.75 per ordinary share (US$13.50 per ADS) with a deadline for acceptance of 4 April 2018 (later extended to 6 April 2018).

The Special Committee recommended to the Board that it accept the Teamsport Proposal. In turn, the Board met and considered the Teamsport Proposal, the Ocean Link offer and the recommendation of the Special Committee. The Board resolved to enter into the Teamsport Proposal.

Ctrip's abusive winding-up petition

On 13 April 2018, Ctrip presented a winding-up petition against eHi seeking the following orders under section 93(5) of the Companies Law (2018 Revision) (the "**Law**"):

1. Declarations that the Board meetings and resolutions of 6 and 10 April 2018 were void;
2. The Special Committee be required to reconsider the Ocean Link bid and provide its recommendations to the Board with detailed reasons; and
3. The findings of the Special Committee are to be considered at a duly convened meeting of the Board.

On the same day, Ctrip filed an injunction seeking:

1. To restrain reliance on any resolutions passed at the 6 and 10 April 2018 Board meetings which approved the Teamsport Proposal or which sought to adversely affect the rights of Ctrip; and
2. A direction that the Special Committee report to the Board on the viability of the competing bid made Ocean Link.

In response, eHi applied to strike-out/dismiss the winding-up petition on a preliminary basis on various grounds, including that the evidence filed by Ctrip did not support a case for winding-up, suitable alternative relief was available to Ctrip and that in all the circumstances the presentation of a winding-up petition by Ctrip was an abuse of the process of the Court.

In the event, Ctrip abandoned its injunction application shortly before it was due to be heard, after receiving eHi's strike-out application and supporting evidence. Ctrip sought to amend its winding-up petition by making various allegations of misconduct and impropriety against the Directors of eHi. It sought the following amended orders:

1. A permanent restraint upon eHi from acting on the Board resolutions of 6 April and 10 April 2018;
2. The Court appoint a person to solicit the highest possible bids for eHi;
3. The Special Committee be directed to use its best endeavours to fulfil its proper role; and
4. The Board refrain from issuing further shares prior to an EGM at which privatisation proposals are considered.

Applicable law

Where a winding-up petition is presented by a shareholder of a company on the ground that it is just and equitable that the company should be wound up, the Court may instead of winding-up the company, make the following "alternative statutory" orders:

- an order regulating the conduct of the company's affairs in the future;
- an order requiring the company to refrain from doing or continuing an act complained of by the petitioner or to do an act which the petitioner has complained it has omitted to do;
- an order authorising civil proceedings to be brought in the name and on behalf of the company by the petitioner on such terms as the Court may direct; or
- an order providing for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of a purchase by the company itself, a reduction of the company's capital accordingly. [1]

As was common ground amongst eHi and Ctrip, and noted by the Judge, "*... the precondition for the alternative statutory remedies under section 95(3) to a winding-up order becoming available was the establishment of grounds sufficient to justify a winding-up order*".

In terms of the legal threshold to be met to support Ctrip's winding-up petition, the Judge held that such petition will be dismissed where the company did not cross the forbidden line so as to constitute a visible departure from the standards of fair dealing and the conditions of fair play which a shareholder is entitled to expect. In support of this finding the Judge cited the English decision in *Loch v John Blackwood* [1974] AC 783 and the Grand Court of the Cayman Islands decision in *Re The Washington Special Opportunities Fund* (FSD 151 of 2015,

1 Section 95(3) of the Law

Continued

unreported, 1 March 2016)

eHi's application to strike-out the petition on a preliminary basis was governed by Order 18, rule 9, of the Grand Court Rules. In summary, the Court has jurisdiction to strike-out a petition in circumstances where it:

- discloses no reasonable cause of action or defence, as the case may be;
- is scandalous, frivolous or vexatious;
- may prejudice, embarrass or delay the fair trial of the action; or
- is otherwise an abuse of process of the Court.

The Judgment

The Court struck-out Ctrip's petition in its entirety. The Judge explained that it arose from "... *the cynical and abusive presentation of a winding-up petition on the just and equitable ground*". [2]

The Judge found that:

- "*far from seeking to advance a class remedy on behalf of other shareholders, [Ctrip] was seeking to advance its own individual commercial interests*".[3]
- "*It is obvious that Ctrip's main motive in petitioning is not simply its status as a shareholder but primarily its status as a participant in a rival bid to the one the Board has decided to accept.*" [4]

The Court found that Ctrip had abused the winding-up jurisdiction and had made a "*hopeless*" attack on the Board's decision to proceed with the Teamsport Proposal.

In relation to Ctrip's allegations of misconduct against the Board, the Court was equally unimpressed.

Alleged misconduct in relation to the 6 and 10 April Board meetings

In relation to the 6 and 10 April 2018 Board meetings, Ctrip alleged that the meeting notices and agendas were defective, the materials for the 6 April 2018 meeting were supplied too late and the Directors exercised their powers for an improper purpose, namely supporting the Teamsport Proposal over the best interests of eHi.

The Judge found that:

"*The pleas in relation to the convening of the two Board meetings were clearly hopeless and bound to fail to establish any impropriety on the Company's part. The only valid complaint was that the meeting papers were delivered unreasonably late, but this was cured by the fact that the second meeting four days later reconsidered the decisions taken at the first meeting.*" [5]

Validity of the 6 April 2018 resolution

The Court considered the allegation by Ctrip that in approving the Teamsport Proposal the independent directors had acted for an improper purpose. The Judge stated the legal test to impugn the exercise of a power was whether, "*the main or substantial purpose for which the power has been exercised must be shown to have been improper...*". [6] In considering the main or substantial purpose, the Court will follow the decision of Howard Smith Limited v Ampol Ltd [1974] A.C. 821 where Lord Wilberforce held:

"[The Court] *will necessarily give credit to the bona fide opinion of the directors, if such is to be found to exist, and will respect their judgment as to matters of management...*"

The Judge noted that the Special Committee had been appointed by eHi and it had retained its own reputable legal and financial advisors. This ensured that the involvement of the Chairman or any shareholder with a nominee on the board did not distort the assessment of a bid in which they were interested having regard to the interests of shareholders generally.

It was further noted that the allegations of improper motives appeared to rest on an assertion (supported by no legal authority), that a company chairman could not be involved in a privatisation, even if the decision to accept or reject the privatisation was substantially made by independent directors. The Judge found this argument to be, "*unsustainable*" and "*...where no evidence was adduced by the Petitioner supporting a potential finding that the bona fides of the independent directors was in question, the bare allegation that they were improperly motivated was bound to fail.*" [7]

The Court found that whilst there may be cases where the fact that a leading board member was involved in a bid would excite suspicion, "*This is not such a case ...There is nothing in the transcripts to suggest any actual impropriety on the Chairman's part. There is no evidential basis for a potential finding that the Special Committee members, despite having retained reputable advisors, were in fact 'lackeys' of the Chairman*". [8]

The Judge found that the evidence filed by Ctrip lacked, "*any particularised allegations of improper motive on the part of specific directors*", "*consisted primarily of argument*" and "*advocates for the merits of the Ocean Link bid*". The Judge held that the "*...improper motives allegation is wholly unmeritorious and that it would be an abuse of the process of this Court for such an insubstantial allegation to be further pursued*". [9]

2 Paragraph 1
3 Paragraph 3
4 Paragraph 13
5 Paragraph 19
6 Paragraph 25
7 Paragraph 27
8 Paragraph 43
9 Paragraphs 30 and 31

Continued

Interests of the Chairman were preferred

For substantially the same reasons as set out above, the Court found there was no reason to find that the interests of the Chairman were preferred over the interests of eHi. The Judge found the allegation to be "*wholly unmeritorious and that it would be an abuse of the process of this Court for such an insubstantial allegation to be further pursued*". [10]

Termination fee was improper and designed to poison rival bids

The merger agreement for the Teamsport Proposal included a termination provision such that a fee would be payable to the Teamsport Consortium in certain circumstances including where eHi abandoned the privatisation to pursue another offer. Ctrip alleged that this was a 'poison pill' which served to deter eHi from accepting any rival bids.

The Judge found that, "*the termination fee was a rational and apparently standard commercial clause designed to compensate the Consortium for the risk that a subsequent better bid was accepted… This allegation was on its face clearly unsustainable*". [11]

Improper motivation to investigate the CDH transaction

At the 10 April 2018 Board meeting, the Chairman proposed that the Board should authorise the investigation of a transaction by which Ocean Link purportedly gained control of certain shares in eHi held by CDH. It was this transaction that underpinned Ctrip's assertion that it had sufficient votes to block the Teamsport Proposal at an EGM. The Chairman considered that the transaction was *prima facie* contrary to the provisions of an Investors Rights Agreement between parties including Ctrip and eHi. Ctrip alleged that the investigation was not in the interests of the eHi.

The Judge noted that, "*…I found it ironic that Ctrip asserted the right of one bidding team to acquire shares to enable it to block an opposing bid while simultaneously complaining that the Company could not validly seek to respond to such manoeuvres.*" [12] The Judge stated, "*…this allegation is wholly unmeritorious and that it would be an abuse of the process of this Court for such an insubstantial allegation to be further pursued.*" [13]

Conclusion

The concluding paragraph of the judgment reflects the Court's view of Ctrip's conduct in filing a winding-up petition in the circumstances of this case:

"*The complaints of misconduct are unsustainable in the sense that it seems clear at this stage that they are factually incapable of proof and unmeritorious. In addition, the main purpose of the Petition is quite obviously to advance the rival bid supported by the Petitioner, not to advance the class interests of the shareholders the Petitioner is supposed to be representing.*"

Ctrip's application to restrain the Board from taking steps to proceed with a merger proposal where: (i) it had been reviewed and recommended by an independent Special Committee; and (ii) it was reviewed and adopted at two separate meetings of the Board, was roundly criticised by the Court in strong terms.

This decision of the Grand Court shows that it will act decisively to dismiss a patently abusive winding-up petition, especially in circumstances where a minority shareholder has an ulterior motive and is acting in its own self-interests rather than in the interest of all shareholders.

10 Paragraph 32
11 Paragraph 33
12 Paragraph 35
13 Paragraph 36

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