IN THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

FSD No. 109 of 2014 (AJJ)

Before the Hon. Justice Andrew J. Jones QC
In Open Court, 6- 9, 12-16, 19 and 20 January 2015 and 6 March 2015

IN THE MATTER OF THE COMPANIES LAW (2013 REVISION)

AND IN THE MATTER OF ACORN INTERNATIONAL, INC

Appearances:

Ms. Catherine Newman, QC instructed by Mr Rupert Bell of Walkers for the Petitioner

Mr. Richard Sheldon QC and Ms. Hilary Stonefrost instructed by Ms. Anna Peccarino of Travers Thorp Alberga for the Minority Shareholders

Mr. Ross McDonough and Mr. Guy Cowan of Campbells for the Company

JUDGMENT

Introduction

1. On 29 September 2014, Acorn Composite Corporation (the "Petitioner") presented a contributory's winding up petition against Acorn International, Inc. ("the Company") on the just and equitable ground. On 14 October 2014 the Court directed that the petition be treated as an *inter partes* proceeding between the Petitioner and DY Capital, Inc. and SB Asia Investment Fund II LP (referred to as "the Minority Shareholders") and that the Company shall be treated as the subject-matter of the petition. On 24 November 2014, the Minority Shareholders presented a cross-petition. Both the petition and cross-petition necessarily plead that it would be just and equitable for the Court to make a winding up order, but both petitions ask the Court to exercise its jurisdiction under section 95(3) of the Companies Law to make orders for alternative relief. The trial therefore took the form of an adversarial proceeding in which the Company had no substantive role. On the first day of the trial, I allowed the petition to be amended so as to plead new facts and claim additional relief based upon matters which took place after its presentation.

The Company and the Parties

2. The Company was incorporated in the Cayman Islands on 20 December 2005 as a holding company for the purposes of acquiring a business which had originally been established in the People's Republic of China ("PRC") in 1998 by Mr Robert R. Roche ("Mr Roche") and Mr Don Dongjie Yang ("Mr Don Yang"). The original businesses were restructured in 2004 under a holding company called China DRTV, Inc and on 31 March 2006 the Company became the ultimate holding company when it issued shares to the existing shareholders of China DRTV, Inc in exchange for their shares in China DRTV, Inc., whereupon the Company's shares were listed on the New York Stock Exchange ("NYSE"). The Company is therefore the listing vehicle and holding company for a group operating in the PRC (the "Acorn Group").

3. The Acorn Group operates one of the PRC's largest TV direct sales businesses with a nationwide distribution network of 3,800 outlets and other direct sales platforms. Due to the prohibition on foreign investment in the direct sales business and restrictions or prohibitions on foreign ownership of companies that engage in internet related business, the Group's business is conducted through four companies incorporated in the PRC pursuant to a Variable Interest Entity structure. The intended overall effect of these contractual arrangements is that these companies (referred to as "the VIE Entities") are under the managerial control of the Company and the economic interest in them is attributable to the Company, with the result that the audited consolidated financial statements of the Company include both its subsidiaries and the VIE Entities and this is the basis upon which its shares are listed on the NYSE.

4. The Group is managed as a single economic entity under the direct control of the Company's board of directors, although it has been divided since mid-2012 into three operating divisions, referred to as Sections A, B and C. Section A comprises the Group's inbound and media sales business including media placement, the production of advertisements, program broadcasts, consumer phone orders and delivery. This included a traditional direct television sales business, known as "DRTV", which collapsed during 2014 as a result of regulatory changes. Section B comprises outbound and data sales business, including the Group's call centre, catalogue, text message and insurance business. Section C comprises sales of electronic learning products and fitness and health products. Mr Roche was in charge of Sections A and B until his removal as executive chairman of the Company on 26 August 2014. Mr Don Yang was in charge of Section C and, since Mr Roche's removal, has been in charge of all three Sections.

5. The Petitioner, is a company incorporated in Nevada, USA, which is owned and controlled by Mr Roche. His total beneficial ownership in the Company's shares held through the Petitioner and various other companies and trusts, determined in accordance

with the rules of the United States Securities and Exchange Commission ("the SEC"), is 46.24% as reflected in the Form 20-F filed in April 2014.

6. The Cross-Petitioners are SB Asia Investment Fund II LP ("SAIF") and DY Capital, Inc. SAIF is an investment fund which invested $43 million in the Company by subscribing for shares in 2005 and subsequently increased its investment [by buying an additional 501, 706 ADS shares in the market in 2008 . It now holds 26.72% of the issued share capital. SAIF is ultimately controlled by Mr Andrew Y. Yan ("Mr Andy Yan"). He became a director of the Company in April 2006 and continued to be a member of the board until 31 December 2014 when he retired by rotation and was not re-elected. DY Capital, Inc is a private investment holding company wholly owned by Mr Don Yang. It owns 7.88% of the issued share capital of the Company. Mr Don Yang also owns shares in his own name and indirectly through his minority shareholding in a company called Bireme Limited.

7. The beneficial ownership of Mr Roche and Mr Don Yang in the Company's shares, determined in accordance with the SEC rules, is 46.24% and 12.66% respectively. This includes their proportionate interest in the Company's shares held through Bireme Limited which is jointly owned by Mr Roche's wife ("Mrs. Roche") (87.7%) and by Mr Don Yang (12.3%). For the purposes of the SEC filing, Mr Don Yang's shareholding in Bireme Limited is treated as equating to a 2.97% beneficial interest in the Company's shares, but is does not give him any voting power because Mrs Roche is in a position to vote the whole of Bireme Limited's shareholding (which is 22.23% of the Company's issued share capital). The result is that Mr Roche and his wife have voting control over 49.21% of the Company's issued share capital. In addition, Mr Roche's evidence is that the Petition is supported by 14 individual shareholders, many of whom are members of his family, who collectively own a further 2.82% of the Company's issued share capital. On this basis Mr Roche has described himself as the "majority shareholder". As a practical matter, he is able to pass an ordinary resolution provided that he is not prevented from giving effective voting instructions in respect of those shares held in the form of American depository receipts/shares ("ADS").

8. This winding up proceeding has therefore taken the form of an adversarial action between the "Majority Shareholders" (meaning the various companies controlled by Mr Roche) on one side and the "Minority Shareholders" (meaning the companies controlled by Messrs Andy Yan and Don Yang) on the other side. The expression "Group of Four" is used to mean the four directors who support the Minority Shareholders, namely Mr Andy Yan, Mr Don Yang, Mr Gordon Wang and Mr Jing Wang. Together, the Group of Four control the Company's board of directors. The independent shareholders who have not participated in this proceeding represent only about 15% of the Company's issued share capital.

The Witnesses

Mr Robert W. Roche

9. Mr Roche is a US citizen who has been resident in Japan and China for about 30 years and has substantial business interests outside the Acorn Group. He is also a qualified lawyer. He has sworn a total of ten affidavits for the purposes of this proceeding and was cross-examined at length over a period of three days. He gave the impression of a larger than life character who is committed to the Acorn Group and its business and has a passionate belief in the merit of his own case. His evidence does tend to suggest that he is a domineering character who expects to get his own way, but I think that he is also capable of respecting those with whom he disagrees. He gave his evidence in a spontaneous, open manner. He was not evasive and I came to the conclusion that he is an honest witness whose evidence is generally reliable.

Mr William B. Liang

10. Mr William B. Liang ("Mr. Liang") has been an independent non-executive director of the Company since October 2010. He serves on the Company's audit and compensation committees and has never held any day to day managerial role. He is a Chinese national who speaks fluent English and holds an MBA degree from the University of Massachusetts. He has held executive and board positions with a number of well-known *Fortune 500* companies and is currently a member of the board of JP Morgan Futures Co. Ltd. Mr Liang is not a shareholder of the Company and I think that it is fair to say that he has no personal interest in the outcome of this proceeding. He gave evidence (via video-link) in a clear, concise and compelling manner and I formed the view he is an honest and reliable witness.

Mr Andrew Y. Yan

11. Mr Andy Yan is a professional investment manager with many years' experience. He became a non-executive director of the Company in 2006 following SAIF's investment. When unable to attend in person, he was represented by Ms Lynda Lau who is a principal of SAIF and an employee of Mr Andy Yan's investment management business. He is a dominant character to whom Mr Don Yang deferred in connection with this proceeding. He swore four affidavits and was cross-examined at length. He speaks fluent English. He attempted to avoid appearing in Court on the grounds that he was too busy and finds it difficult to travel for medical reasons. I infer from the evidence that Mr Andy Yan has in fact played an important role in the events giving rise to the presentation of the Majority Shareholders' petition, but he attempted to distance himself from certain important decisions. I have formed the view that his evidence to the Court was carefully tailored to meet the needs of the Minority Shareholders' case and was not always truthful.

Mr Don Yang

12. Mr Don Yang is a Chinese citizen who does not speak English as his first language. He swore three affidavits in English and it then became apparent that he could not read and understand what he had sworn without the benefit of a translation. The Court was told that his affidavits were prepared in English, then translated into Chinese and that he then swore the English versions. Apart from failing to comply with the requirements of the rules, this process means that the written evidence does not reflect Mr Don Yang's own words. In the absence of any objection from counsel for the Petitioner, I admitted these affidavits in evidence on the basis that I should give no weight to the written evidence if and to the extent that it is inconsistent with his oral evidence. It would be unfair to draw an adverse inference from any inconsistency since the written evidence does not reflect his own words. On the other hand, whenever his written evidence conflicts with that of Mr Roche, I should prefer that of Mr Roche. However, during the course of hearing his oral evidence I did form the impression that Mr Don Yang was tending to hide behind the interpreter and understood English to a greater extent than he was willing to admit.

13. Even allowing for the fact that it may have been an unnerving experience for Mr Don Yang to give evidence in proceedings conducted in a foreign language in a foreign court, he was not an impressive witness. His oral evidence appeared to be rehearsed. He took every possible opportunity to repeat, often at some length, that he was acting in the best interests of the Company. His answers were often evasive. He hid behind the legal department in order to avoid responsibility for decisions which he must have made, albeit in consultation with Mr Andy Yan and other members of the Group of Four. He was willing to make allegations of misconduct against Mr Roche for which there is no evidence. I formed the view that Mr Don Yang is not a reliable witness and that, in general, where his evidence conflicts with that of Mr Roche, Mr Roche's evidence is to be preferred.

Mr Gordon Xiaogang Wang

14. For the purposes of the NYSE listing rules Mr Gordon Wang qualifies as an independent director of the Company but he is in fact a former executive whom Mr Liang described as having very close working and personal relationships with various senior officials of the company. Mr Roche described him as a thoughtful man but he was content to follow the lead of Mr Andy Yan and Mr Don Yang without offering any advice. He is not a shareholder and has no personal interest in the outcome of this litigation but he has adopted a partisan position and I formed the view that his evidence must be approached with caution.

15. I should also mention Mr Jing Wang, the fourth member of the Group of Four. He did not give evidence and, apart from being a consistent supporter of the Minority Shareholders, appears not to have played an active role in any of the relevant events.

The Acorn Group's financial condition

16. It is common ground that the Acorn Group has been facing serious commercial challenges as a result of which it has generated losses for a number of years. In order to put the evidence into context, it is relevant to record the headline figures extracted from the Company's audited consolidated financial statements for the years ended 31 December 2010 to 2013 and its management accounts and SEC filings for the first three quarters of 2014.

Consolidated Balance Sheet ($ in millions)

	2010	2011	2012	2013	2014(Q1)	2014 (Q2)	2014 (Q3)
Cash Reserves	91.70	111.20	91.00	82.60	67.00 9.70	51.80 9.70	42.00 9.70[1]
Total Assets	214.60	245.70	207.40	175.40	158.00	146.70	136.40
Total Liabilities	30.80	48.80	27.60	39.10	31.10	33.20	31.60
Net Asset Value	182.40	196.40	179.30	135.80	126.80	113.50	104.80

Consolidated Statement of Operations ($ in millions)

	2010	2011	2012	2013	2014 3 mths	2014 6 mths	2014 9 mths
Revenues Net	293.2	362.1	242.6	184.7	28.30	43.10	74.20
Net Income (loss)	(6.4)	5.1	(17.9)	(39.9)	(8.20)	(21.80)	(30.30)

17. To the extent that it is relevant to make findings about the reasons for the Acorn Group's declining financial condition, the most reliable evidence is contained in the statements filed with the SEC, each of which bears Mr Don Yang's certification that the information

[1] From Q1 2014 onwards the Group had restricted cash of $9.7 million.

fairly presents, in all material respects, the financial condition and results of the operations of the Company. This material reflects that the 2011 fiscal year represents a temporary upturn in what would otherwise have been a consistent and steady decline in sales and increasing losses, with a consequential erosion of the cash reserves. The Form 6-Ks (May 19, 2011 and March 20, 2012) reflect that mobile handsets sales were the largest contributor to revenues in 2011, primarily as a result of the introduction of an updated version of its bestselling model. The evidence is that the shelf life of this new product was limited and the decline in total sales resumed in 2012.

18. On January 1, 2014 new government regulations (referred to as the SAPPRFT Regulations) came into force and imposed limitations on the length and frequency of infomercials aired on satellite television channels in the PRC. The immediate impact was a significant reduction in airtime for infomercials promoting the Acorn Group's products. The Company's Form 6-K (May 27, 2014) reported a 63.8% decline in sales generated from the TV direct sales platform in Q1 2014 compared with the same period in the prior year. In its most recent Form 6-K (November 25, 2014) the Company stated that direct TV sales decreased 72.6% in Q3 2014 compared with the same period in the prior year, mainly due to the SAPPRFT Regulations. I accept Mr Roche's evidence that these regulations effectively destroyed what had been an important part of the Group's business. Electronic learning products, which is part of the Section C business managed by Mr Don Yang, was the largest product category of sales in the third quarter of 2014.

19. The overall financial picture is declining sales and continuing losses, financed from cash reserves which fell from $91.7 million as at 31 December 2010 to $51.9 million as at 30 September 2014 (including $9.7 million of restricted cash). On 29 September 2014 the Company's auditors issued a going concern warning, meaning that they would need to carry out procedures and obtain evidence to satisfy themselves that the Company would be able to carry on its business for at least another year. There is a measure of disagreement about how long the Acorn Group can sustain this level of losses without an injection of new capital and I shall return to this subject in paragraph 40 below.

20. It goes without saying that both Mr Don Yang, as CEO, and Mr Roche, as executive chairman until August 2014, must bear responsibility for the overall performance of the Acorn Group, not just the sections for which they were directly responsible. Mr Roche said that the declining financial performance and the cost cutting exercises which he carried out were bound to result in some loss of moral amongst the staff and, I think, some degree of tension amongst the management. However, I find it significant that the contemporary documentation does not reflect any serious disagreement between Mr Don Yang and Mr Roche and their respective management teams about the way forward. If

there had been any real clash, one would have expected it to result in discussion at board level, but the minutes of the meetings do not reflect any debate about competing business strategies.

21. A business plan entitled *Acorn Evolution* was developed for the Sections A and B businesses by Mr Roche and his management team during Q1 2014. The version of this document put in evidence is not dated but was probably produced in April 2014 because it reflects Q1 financial information. I am not concerned with the business merits of this plan. Mr Roche's evidence is that it was accepted or, at least, not rejected by the board. Mr Andy Yan was critical of this plan in his evidence to the Court, but that criticism is not reflected in contemporaneous documents. There was no opposing plan. None of the witnesses have suggested that this plan gave rise to any real debate, let alone an argument amongst senior management or members of the board.

22. The only expression of concern about Mr Roche's management of the Acorn Group's business, and section A and B in particular, is contained in Mr Don Yang's e-mail of 6 May 2014. It was written in Chinese and he took the trouble to ensure that it was properly translated. Mr Roche was cross-examined about this e-mail at length. He accepted that it reflects what Mr Don Yang genuinely believed at the time. Much of it constitutes criticism of organisational and personnel decisions made by Mr Roche and criticism of his management style, rather than disagreement with strategic business decisions.

23. I agree with Leading Counsel for the Petitioner that the most reliable evidence about the reasons for the Acorn Group's poor financial performance and the directors' strategies for turning it around is to be found in the quarterly SEC filings. The significance of these filings is that they constitute a series of contemporaneous, public statements about what the directors believed to be the reasons for the Company's financial performance in each successive quarter and about their intentions for the business going forward. There is no evidence of any debate or disagreement amongst the senior management or the directors about the content of any of these filings. In particular, plans relating to the e-commerce business are disclosed in these filings and the criticism made in Mr Don Yang's 6th May e-mail seems to be limited to the speed of implementation because the subsequent filings do not reflect any change of strategy. I draw the following conclusions from the evidence about the Group's financial performance and business plans. First, during the period from mid-2012 onwards, there was general agreement upon the need to develop a new business model and to do so quickly. Second, there was no disagreement between Mr Roche and Mr Don Yang or amongst the directors about the business strategy. They were not advancing different, conflicting business plans. To the extent that any criticism of Mr

Roche is expressed, it is directed more at his management style and the implementation of new strategies, such as e-commerce, about which there was fundamental agreement. Third, there is no contemporaneous evidence tending to suggest that the Group of Four, or any of them, believed that the Company's poor financial performance was attributable to any mismanagement on the part of Mr Roche. For these reasons, I infer that the allegations of mismanagement levelled against Mr Roche have been contrived as an *ex post facto* justification for the actions taken by the Group of Four to remove Mr Roche from office as executive chairman.

The events leading up to the presentation of the Petition

The e-Surer Proposal – 20th August Board Meeting

24. On 20 August 2014 Mr Roche presented the board of directors with a proposal to make a convertible loan of Rmb 20 million ($3.1 million) to Shanghai e-Surer Financial Services Co Ltd ("e-Surer") secured by a 51% equity interest in one of its subsidiaries. The subsidiary holds a national insurance agency license which enables it to sell insurance products throughout the PRC. Mr Roche's evidence is that his management team had been working on the transaction for 18 months and that he regarded it as a "fantastic idea". He said that the terms had been agreed in principle on 19 August when the Company was given a 48 hours exclusivity period in which to conclude the transaction, failing which e-Surer would turn to a competitor. The merits of this transaction are not relevant to the issues which the Court has to decide, but what happened at the board meeting on 20 August 2014 triggered the events which gave rise to the presentation of the Petition.

25. Notice of the board meeting was sent out by the Company's legal department on 19 August, initially without any supporting documents. A summary of the transaction was sent later in the day. The meeting took place the following morning via teleconference. Mr Roche, Mr Don Yang, Mr Andy Yan and Mr Gordon Wang participated in person. Mr Jing Wang was represented by an alternate. Only Mr Liang was unable to participate. Eight other people were present on the call, including members of the management team responsible for negotiating the proposed transaction, members of the legal department, the CFO, Ms Lynda Lau and Mr Vincent Lin, a lawyer from O'Melveny & Myers LLP who acted as secretary of the meeting and took the minutes.

26. The proposal was rejected. Only Mr Roche voted in favour. He admits having become angry and using foul language. He said that anger got the better of him because, so far as he was concerned, everybody failed the board-member test that day, not because they disagreed with him but because they had failed to give proper consideration to the proposal. Mr Andy Yan's evidence is that he did read the proposal and thought that the

valuation put on e-Surer was absurd. He summarised his view of it in an e-mail written the same day.

27. A few days after this board meeting, on 25 August, an important conversation took place between Mr Roche and Mr Gordon Wang in which Mr Roche delivered a warning that he might use his voting power to change the composition of the board. The Majority Shareholders have sufficient votes to pass an ordinary resolution which is all that is required under the Company's articles of association to remove or elect directors. Mr Roche's written evidence about his conversation with Mr Gordon Wang is that -

> "I also emphasised that Shareholders were entitled to provide input on key strategic decisions being taken by the Board, and if Shareholders did not agree with the approach being taken by the Board on matters of significance regarding the Company's future, and the Board was not prepared to listen to its Shareholders, then it was conceivable that changes to the Board might need to be considered by the Company in a general meeting." (Mr Roche's second affidavit at paragraph 44).

Mr Gordon Wang related this conversation to Mr Don Yang who must have passed it on to Mr Andy Yan.

Mr Roche's removal from office – the 26th August Board Meeting

28. A board meeting was convened by an e-mail notice transmitted by a member of the legal department at 9.27am on 26 August 2014, notwithstanding that a regular board meeting had been scheduled to take place on the following day since 1 July 2014. The meeting was set to take place by teleconference at 1.00pm on the same day. The notice did not contain any agenda. Mr Roche's request for an agenda went unanswered. Mr Roche's evidence is that he suspected that something nefarious was about to happen and decided that it would be futile to attend the meeting.

29. The Group of Four were all present (on line) in person. Mr Liang was unable to attend. In Mr Roche's absence, Mr Don Yang acted as chairman of the meeting and, as usual, Mr Vincent Lin acted as secretary of the meeting. Mr Don Yang proposed that Mr Roche be removed as executive chairman on the grounds that the Company's business had deteriorated significantly since the fourth quarter of 2012 and that Mr Roche, as the person directing the Company's business in this period, was unable to take any effective measures to improve the situation and had refused to take the advice of other directors and management. Mr Andy Yan added that Mr Roche had been distracted by his other business interests and was not able to devote his full time to the Company's business. Mr Gordon Wang and Mr Jing Wang criticised his management approach. In summary, the minutes record that Mr Roche was removed from office because of the Company's declining financial results and his poor management performance since 2012. There was

no suggestion that he had been guilty of any form of misconduct or breach of fiduciary duty. This allegation was to come later. Nevertheless, in spite of the fact that he continued to be a director of the Company, Mr Roche was forbidden from entering the Company's premises, forbidden from talking to the staff and his e-mail was cut off. Initially, the Company put out a false press statement to the effect that Mr Roche had decided to "step down" as executive chairman. Only later was an accurate statement filed with the SEC.

Mr Roche's attempts to convene an EGM

30. Having realised, shortly before the 26th August meeting took place, that the Group of Four intended to remove him as executive chairman, Mr Roche took steps whilst still executive chairman to convene an EGM for the purpose of proposing resolutions to change the composition of the board. Later the same day Mr Don Yang sent an email to the shareholders stating that there were technical deficiencies with the notice circulated by Mr Roche and that the proposed EGM would not proceed.

31. On 27 August 2014 the long-scheduled board meeting took place. One of the agenda items was the date for the Company's AGM, which it was anticipated would take place on 24 October 2014 in accordance with the usual timetable. The Group of Four claimed that they did not know how much time was required in order to convene the AGM, despite the presence of the Company's in-house legal counsel who set out the relevant timing. They resolved to defer the decision to another day.

32. On 28 August 2014 Mr Roche requested that an EGM be convened to deal with the business set out in the notice sent by him on 26 August 2014. On 1 September 2014 Mr Don Yang stated in an email addressed to the board that Mr Roche's original notice was technically deficient in that it failed to state the time and place of the meeting. He chose not to waive these defects or convene a meeting himself at the request of the Majority Shareholders. He also stated in this e-mail that Mr Roche could consider using his voting rights to appoint additional directors at the AGM which would be held later in the year. In fact, the Group of Four had no intention of allowing the Majority Shareholders to exercise their voting rights in this way. They subsequently refused to allow any such resolutions to be included in the agenda for the AGM.

33. On 4 September 2014 the Majority Shareholders' attorneys wrote to the board requesting that an EGM be convened to explain the justification for Mr Roche's removal as executive chairman; to allow the shareholders to vote on the resolution to reconstitute the composition of the board; and to vote on a special resolution to amend the Company's articles of association to allow shareholders holding in aggregate no less than 30% of the

Company's issued shares to convene an EGM unilaterally. A board meeting took place the following day when Mr Don Yang proposed the establishment of a special committee to look into the question of when to hold the AGM. It was resolved by the Group of Four with Messrs Roche and Liang voting against, to establish a committee comprising Mr Don Yang, Mr Gordon Wang and Ms Xiaojing Li. There is no evidence that this committee ever met.

34. Mr Liang then sought to convene a board meeting, on 3 days' notice, to take place on 10 September at which the board would make a decision about convening an EGM. However, on 8 September 2014 the Group of Four themselves convened yet another board meeting to take place on 9 September 2014, the day before the meeting convened by Mr Liang. The Group of Four voted against convening an EGM and against Mr Roche's proposal to hold the AGM on 8 October 2014.

35. On 10 September 2014 the meeting convened by Mr Liang duly took place but none of the Group of Four attended. Mr Roche and Mr Liang passed resolutions convening an EGM for 14 October 2014 to consider Mr Roche's proposals to reconstitute the board and amend the articles. Later that day, Mr Don Yang emailed Mr Roche stating that he was calling an urgent board meeting at 10pm that evening to deal with what he described as "the invalid board meeting". At the 10pm meeting, the Group of Four expressed the view that the resolutions passed at the earlier meeting were invalid.

36. On 11 September 2014 Mr Roche convened a further board meeting to take place on 16 September 2014, attaching an agenda, asking that the board could approve the resolutions passed at the 10 September 2014 meeting or convene an EGM to consider the proposed resolutions on a different date or convene an AGM at which his resolutions could be considered. At the board meeting on 16 September 2014 the Group of Four refused to approve the resolutions passed at the 10 September 2014 meeting and refused to convene an EGM. Mr Don Yang said that, given an AGM would be held soon, there was no need to convene an EGM, which was a thoroughly disingenuous statement because he had no intention of allowing Mr Roche to put forward his proposed resolutions at any meeting.

The Investment Proposal - the 26th September Board Meeting

37. On 25 September 2014 the Company's in-house legal counsel sent an e-mail to the directors stating that some members of the board had been approached by external investors seeking to invest in the Company. It went on to say that Mr Don Yang would like to hold a board meeting on the following day to discuss the proposal, instruct external legal counsel and to authorise the legal department to liaise with the external lawyers in connection with the preparation of the legal documents. The following morning, about three hours before the meeting, a 40 page written presentation was

circulated to the directors. It is written in a highly adversarial style, without any input from the CFO except that the document contains figures supplied by the finance department. It set out a proposal by which the Hina Group[2] and Keywise Group[3] would each subscribe $20 million for preferred shares. It was proposed that they would be given seats on the board and veto rights over certain (unspecified) matters. This proposal would have the effect of diluting the interests of the existing shareholders and depriving the Majority Shareholders of their ability to pass an ordinary resolution.

38. Neither Mr Roche nor the audit committee had any prior knowledge of the Investment Proposal. Mr Don Yang said that discussions had been taking place with the Hina Group since the first quarter of 2014 about the possibility of investing in one of the Acorn Group subsidiaries or VIE entities, but Mr Andy Yan said that the proposal to invest in the Company came from the Hina and Keywise Groups in September 2014. Mr Roche complained about the lack of notice and asked that the meeting be re-scheduled for 30 September. He also wrote to Mr Gordon Wang asking for his view about the proposal. He received replies from both Mr Don Yang and Mr Gordon Wang to the effect that the purpose of the meeting was limited to "introducing" the Investment Proposal to the board and that the directors would not be asked to make any final decision until the legal documentation had been prepared. The board meeting took place via teleconference on 26 September. All the directors were present (on line) except for Mr Andy Yan who was represented by Ms Lynda Lau and Mr Jing Wang who was represented by Mr Gordon Wang. Resolutions were passed (with Mr Roche and Mr Liang voting against) to instruct external counsel to advise in connection with the proposed terms and to authorise the in-house counsel to liaise with them in connection with negotiating the terms and preparation of the documentation.

39. Immediately after the meeting, Mr Liang sent an e-mail expressing the view that "issuance of new stock as the first course of action for raising cash makes very little sense. It should be the last resort, as it dilutes equity of all shareholders". He suggested that debt financing secured against receivables and other assets and preferred stock financing should be explored actively because it can serve to raise cash while avoiding diluting shareholder interest and control. The Acorn Group's recorded NAV at the material time was $104.8 million. There is evidence that both Mr Roche and Mr Andy Yan then considered that the market value of certain assets was materially higher than the book value. On the following day, Mr Roche sent the directors a very lengthy e-mail in which he set out his concerns about the lack of financial information and the absence of any reason for an expedited approval process without consulting the shareholders. He accused the Group of Four of acting for an improper purpose. He said "the [Investment]

[2] The Hina Group is one of the PRC's leading investment banking and private equity firms.
[3] The Keywise Group is headquartered in Hong Kong and carries on an asset management business.

Proposal appears to be nothing more than a crude attempt to significantly dilute the existing equity holders, and entrench the position of the Group of Four going forward". He urged the board to convene a shareholders' meeting to consider the proposal and asked for a reply by 2.00pm (Beijing time) on 29 September. He did not receive a response and the Petition was presented almost immediately after the expiry of this deadline.

40. The Minority Shareholders' case is that the Company was then in urgent need of finance. Its financial condition at the material time is reflected in the management accounts for the quarter ended 30 September 2014, the highlights of which are set out in the tables at paragraph 16 above. It is perfectly clear that steps needed to be taken, and were in fact being taken, to change the business model and reverse the continuing losses, but there is no evidence from which to infer that a cash injection was urgently required at that time, such that the board needed to make a decision on the Investment Proposal on a few days' notice. There was no liquidity crisis. As at 30 September 2014 the Acorn Group's total cash reserve was $51.7 million (of which $42.0 million was unrestricted) and its recorded NAV was $104.8 million. The Houlihan Lokey Report states "According to Company's management's estimates, the Company will run out of cash in late 2015 if status quo is maintained".[4] No witness suggested that the Group was likely to run out of cash in less than a year.

41. In spite of what was said in the e-mails about "introducing" the Investment Proposal to the board and making no final decision at the meeting, Mr Liang's evidence (which I accept) is that the way in which Mr Don Yang opened the discussion gave the clear impression that a final decision was to be made. Indeed, the terms of the resolution actually passed does suggest that a decision had already been made by the Group of Four. Mr Liang's evidence is that they were not prepared to consider alternatives. He said –

> "May I add sir, the fundamental opposition that I had with this dilution or investment plan was that there were other financing alternatives that are more effective that would affect less the company's financial state – financial position and the performance and would not cause as much disturbance or destabilization in the equity structure of the company. I proposed debt as one of the alternatives, but Don Yang and Andy Yan just flatly turned it down. Just would not even consider any other proposal."
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> He went on to say -
>
> "The financing alternative that I proposed in terms of financing with debt, I think I stated in my e-mail, certainly did to all the board members, was a non-convertible preferred stock. It is, in

[4] During the course of the board meeting on 26 September 2014, the Company's outside lawyers advised that a financial adviser's report should be obtained. Houlihan Lokey (China) Limited, was retained and issued a report dated 8 October 2014.

effect, a perpetual debt even though it's called non-convertible preferred stock. It's a common practice for companies in similar situations – in situations that have a need for cash. If you go to this alternative, it's a low cost financing method, it's a low cost debt – in effect, debt financing method without diluting the shareholding structure of the company, therefore, avoiding any destabilizing effects to the company".

I conclude that the Investment Proposal was put forward in September 2014 by the Group of Four for the improper purpose of attempting to dilute the Majority Shareholders' voting power and to do so prior to the AGM which had to be held by the end of the year.

Decisions made in relation to the Company's AGM

42. The Company is required to hold an AGM once in each calendar year. Historically, these meetings had always been held in October. In order to comply with the NYSE Listing Rules, notice of the AGM must be given to all shareholders, including ADS holders, not less than 40 days prior to the meeting. At a board meeting held on 27 October 2014, the Group of Four voted to hold the AGM on 31 December 2014, being the last possible day. Although Mr Andy Yan said that he supported this decision because he thought it was in the interests of the shareholders, he also said that he wanted to remain a director for as long as possible and I conclude that this was the real reason why the date was chosen.

43. In spite of what Mr Don Yang had said at the 16 September board meeting, the Group of Four refused to allow Mr Roche's proposed resolutions to be put on the agenda which was restricted to the re-election of Mr Andy Yan and Mr Gordon Wang as directors, the re-election of Deloitte as auditors and any other business which might properly come before the meeting. On 4 November the Majority Shareholders' attorneys (Walkers) wrote to the Company's attorneys requesting, inter alia, that the board reconsider its decision to exclude the Majority Shareholders' proposed resolutions from the agenda. This letter was ignored. The restrictive agenda was clearly designed to prevent the Majority Shareholders from voting on resolutions to reconstitute the board and amend the articles.

44. About two thirds of the shares in respect of which the Majority Shareholders have voting control are held in the form of ADS issued by Citibank N.A. pursuant to a deposit agreement. The evidence is that, under the terms of the deposit agreement, Citibank could only be required to vote on the instructions of ADS holders in respect of matters which are on the agenda and could not be required to issue a discretionary proxy to any ADS holder, thus enabling it to vote on any unscheduled business which might be raised at the meeting. However, Citibank was perfectly willing to appoint an ADS holder as proxy (as indicated on its standard voting instruction form) but would only do so in this case if the deposit agreement was amended. By a letter dated 7 November 2014, Walkers asked the

Company to agree to the necessary amendment which would have taken effect for the benefit of all ADS holders, not just the Majority Shareholders. No response having been received, Mr Roche then sought to convene another board meeting to be held on 11 November for the purpose of approving the amendment. The Company's in-house counsel claimed that not all the directors could attend and the matter was eventually considered at a meeting on 25 November, by which time the Notice of Meeting had already been published. The Group of Four refused to authorise the amendment. Mr Don Yang expressed the opinion that it would not be rational to amend the deposit agreement for a variety of reasons which I consider to be spurious. The true reason was to prevent Mr Roche from voting all of the Majority Shareholders' shares on the unscheduled business which the Group of Four planned to raise at the AGM without any prior notice.

45. The AGM duly took place on 31 December 2014. Mr Don Yang presided as chairman of the meeting. The resolutions to re-elect Mr Andy Yan and Mr Gordon Wang as directors were defeated because the Majority Shareholders were able to vote their registered shares and instruct Citibank to vote their shares held in ADS form. The auditors were re-elected. Mr Don Yang then allowed Ms Lynda Lau (acting on behalf of SAIF) to propose, by way of unscheduled business, the election of four additional directors – Mr Charlie Ban and herself as representatives of SAIF and Mr Sun Xiaodi and Mr Lu Liang who are supposedly independent directors. Mr Roche's attempt to adjourn or reconvene the meeting so that the ADS holders could give voting instructions to Citibank was rejected. Given that Citibank was bound to abstain and that Mr Roche could only cast votes in respect of the Majority Shareholders' registered shares (which represents about one third of their total shareholding), the resolutions proposed by SAIF were passed. The Group of Four had deliberately disenfranchised the ADS holders in order to maintain their control of the Company's board of directors.

Did the Group of Four act in breach of duty?

The legal principles

46. The Petitioner's case turns on establishing that the Group of Four acted in breach of duty in connection with the decision to remove Mr Roche from office; the subsequent decision to delay the AGM; the decision not to allow the Majority Shareholders' proposed resolutions to be put to the shareholders, either at an EGM or at the AGM; and the decision to propose the election of new directors by means of unscheduled business at the AGM. It is not in dispute that the Company's board of directors has the power to make these decisions and that the onus is on the Petitioner to prove that they did not exercise their powers *bona fide* and for a proper purpose.

47. The duty to act in good faith concerns the actual subjective motivation of the directors in question. As Lord Green M.R. put it in a well-known passage in *Re Smith & Fawcett Ltd* [1942] Ch. 304 at 306 –

> "The principles to be applied in cases where the articles of a company confer a discretion on directors …. are, for present purposes, free from doubt. They must exercise their discretion bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose."

I was also referred to *Regentcrest Plc –v- Cohen* [2001] 2 B.C.L.C. 80 in which Jonathan Parker J. summarised the law in this way at paragraph 120 –

> "The duty imposed on directors to act bona fide in the interests of the company is a subjective one (see Palmer's Company Law para. 8.508). The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind. No doubt, where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company's interest; but that does not detract from the subjective nature of the test."

48. The directors must exercise their powers for the purposes for which they are conferred. This principle is stated in Hollington's *Shareholder' Rights* (7th Edition) at paragraph 4.48 in the following way -

> "Directors are fiduciaries, and it is a well-established principle of equity that powers of a fiduciary nature must be exercised for their proper purposes. This duty overlaps with the duty of good faith. It may be found that directors have exercised their powers for improper purposes even if they acted in what they honestly believed were the best interests of the company and did not act for the advantage of one section of shareholders over the other: *Smith v Ampol* [1974] A.C. 821; *Regentcrest Plc v. Cohen* [2001] 2 B.C.L. 80 at [123]. Furthermore, whilst it remains a question of fact as to what was the purpose of the directors at the time they exercised the power, this is not just a question of the subjective state of mind of the directors at the time and there is more room for an objective assessment of the realities of the of the transaction and its substantial "purpose" by the court."

49. In this case, Messrs Andy Yan, Don Yang and Gordon Wang insist that their decision to remove Mr Roche from office was made for proper business purposes, namely his failure to turnaround the financial condition of the Company resulting from his mismanagement. Mr Roche says that his removal from office was simply motivated by a desire on the part of the Group of Four to retain managerial control and prevent the Majority Shareholders from exercising their right to vote on the removal and/or election of directors. Where there is a dispute about the purposes for which a decision was made, the Court is entitled to look at the situation objectively in order to ascertain whether the purpose relied upon

was the true purpose. I remind myself of Lord Wilberforce's statement in the opinion of the Privy Council in *Smith v. Ampol* [1974] A.C. 821, at page 832f-g –

> " .. when a dispute arises whether directors of a company made a particular decision for one purpose or for another, or whether, there being more than one purpose, one or another purpose was the substantial or primary purpose, the court, in their lordships' opinion, is entitled to look at the situation objectively in order to estimate how critical or pressing, or substantial or, per contra, insubstantial an alleged requirement may have been. If it requires that a particular requirement, though real, was not urgent, or critical, at the relevant time, it may have reason to doubt, or discount, the assertions of individuals that they acted solely in order to deal with it, particularly when the action they took was unusual or even extreme…"

The real reasons for removing Mr Roche from office and preventing the Majority Shareholders from putting their proposed resolutions to a general meeting of the Company's shareholders

50. If the Group of Four's true motivation for removing Mr Roche from office had arisen in connection with managerial decisions which they believed had caused or contributed to the Company's declining financial condition, there would have been no urgency to deal with the matter on the 26th August. At the very least, they could have waited until the next day at the board meeting which had been scheduled since the beginning of July. If their stated motivations were genuine, one would think that they would want to hear Mr Roche's explanations for the Company's financial condition and his proposals for turning it around. Instead, they proceeded with the meeting on 3 hours' notice in spite of being told that he could not attend. The absence of an agenda and the failure to respond to Mr Roche's enquiry about the reasons for the meeting also point to the conclusion that the Group of Four intended to take him by surprise. The Company's financial condition had been declining for some years and the need to change its business model had been recognised for a long time. If the Group of Four genuinely believed that Mr Don Yang would do a better job and ought to be in charge of all of Sections A, B and C, it might be expected that Mr Andy Yan would have expressed his concerns directly to Mr Roche. In fact, the evidence is that not long before the 26th August board meeting, Mr Andy Yan was considering the possibility of removing Mr Don Yang from his role as CEO.

51. If the Group of Four had come to the conclusion that Mr Roche should be removed because of his mismanagement, one might have expected that there would have been some prior disagreement about his managerial decisions or some prior discussion about his performance. In fact the evidence suggests that there was a consensus about the need for a new business model and no real disagreement about any important strategic decisions except in relation to the e-Surer proposal. Mr Don Yang's critical 6th May e-mail is directed at Mr Roche's organisational decisions and management style rather than expressing disagreement with strategic business decisions. This e-mail did not give rise to

any critical discussion at the board meeting held two weeks later. The evidence leads me to the conclusion that the decision to remove Mr Roche from office arose out of his conversation with Mr Gordon Wang and the realisation on the part of Messrs Don Yang and Andy Yan that he was considering the possibility of convening an EGM for the purpose of voting them off the board. It is significant that article 57 of the Company's articles of association confers upon the chairman of the board the power to convene an extraordinary meeting of its shareholders. Therefore, removing him from the office of chairman was an effective means of preventing the Majority Shareholders from having an opportunity to vote on resolutions to remove the Group of Four from office as directors. This was the real reason for their decision to remove him as executive chairman.

52. Mr Andy Yan admitted as much in response to a question from the Court. He said –

> "Q. Was the removal of Mr Roche as executive chairman an emergency matter?
> A. Yes, it is.
> Q. What was the emergency?
> A. Because, otherwise, he will remove us, and we – at the time, we believed if the company – if Mr Roche continued to control the – if he have absolute control of the company, then the company will die".

Mr Don Yang took the same position. I do not believe their explanation of the emergency. If they were concerned about management decisions taken or proposed to be taken – the e-Surer proposal for example – it was open to the Group of Four to remove him from his executive role without removing him as chairman. To my mind, the Group of Four's subsequent actions point to the conclusion that the purpose of removing him from office was simply to prevent him from convening an EGM and preserve their own control of the Company which was not a valid exercise of their powers.

53. I do not accept Mr Don Yang's evidence about his reasons for disenfranchising the ADS holders. He described the decision to introduce the unscheduled business as a legal procedure decided upon in advance of the meeting in consultation with the Company's legal department. During the course of his cross-examination he said that the procedure had actually been decided upon *before* the Notice of Meeting was issued on 24 November, the inference being that they deliberately left the election of the four new directors off the agenda so that the resolutions could be introduced at the meeting without any risk of the Majority Shareholders being able to vote more than about one third of their shares. Counsel came back to this point in re-examination. Mr Don Yang was referred to his previous evidence and asked again about the timing of his consultation with the lawyers. He said –

> "Q. Your answer is 'The answer is that I consulted our in-house lawyer what is the legal procedure.'

A. Yeah
Q. You say, 'I would imagine that they have consulted OMM and given me the answer.' And then His Lordship asked, 'Did you decide upon the legal procedure before you issued the notice of the meeting on the 24th of November?'
A. Of course, it was before November the 24th.
Q. And what did you – what was the legal procedure that you decided upon?
"A. Just to proceed according to the agenda just like other years.
"Q. And before the 24th of November when you issued the notice, did you decide the legal procedure which included the unscheduled proposal?
A. Yes."

Mr Andy Yan tried to distance himself from this decision. He accepted that information about the proposed new directors should have been disclosed in advance of the meeting and said that he did not know why this was not done. I do not believe this evidence. My conclusion is that the Group of Four's decisions to restrict the agenda and to refuse to amend the deposit agreement were not a bona fide exercise of their powers made for any proper purpose. These decisions were simply part of a strategy to disenfranchise the Majority Shareholders and thereby enable the Minority Shareholders to retain control of the Company's board of directors.

54. The way in which the Group of Four manipulated the AGM so as to prevent the Majority Shareholders from putting forward their own resolutions and prevent them from voting all of their shares against their own resolutions was not a bona fide exercise of the powers conferred upon them. It was an improper exercise of their powers for the purpose of maintaining the Minority Shareholders' control of the Company.

The Minority Shareholders' Cross-Petition

55. The Minority Shareholders' argue that the Court can make a winding up order on the just and equitable grounds on the Cross-Petition by reason of their justifiable loss of confidence due to serious mismanagement of the Company's affairs by Mr Roche. I now turn to deal with the matters relied upon in support of their case.

The legitimate expectations of the Minority Shareholders

56. It is asserted that what is now the Acorn Group's business was originally formed and has been continued on the basis of an understanding that Mr Don Yang would be CEO and/or hold a key management role and be a director so long so as the business continues and that Mr Roche has breached an obligation to permit him to continue in these roles. In my judgment, this argument is unsustainable. It is also asserted that SAIF invested in the Company on the basis of understandings that Mr Don Yang would continue to have a key management role or serve as CEO. The evidence leads to the conclusion that no such understanding existed.

57. It is agreed that the business was co-founded by Mr Don Yang and Mr Roche in 1998, although the Company itself was not incorporated until December 2005 and only became the top holding company of the Acorn Group on 31 March 2006. Originally, in 1998, Mr Don Yang was the CEO and Mr Roche was chairman of the predecessor company, but for a very long period from 1999 to 2010 the CEO and chairman of the Acorn Group was Mr James Yujun Hu ("Mr Hu"). Throughout this period Mr Don Yang did have a senior managerial role, but he could not have had any expectation of fulfilling the role actually fulfilled by Mr Hu. Mr Andy Yan's written evidence is that SAIF's initial investment of $35 million was made in January 2005 on the clear understanding that Mr Don Yang would be CEO or that he would remain as the key member of the management team. No such understanding could have existed because Mr Hu was the CEO at that time and I accept Mr Roche's evidence that Mr Hu was the decision maker. This conclusion is consistent with what Mr Andy Yan said in his oral evidence when he described having had a recent discussion with Mr Roche about replacing Mr Don Yang as CEO. My overall impression of Mr Andy Yan's evidence is that he would not have hesitated to replace Mr Don Yang as CEO if he had thought it would be in SAIF's financial interest to do so.

58. It is significant that the Company was incorporated during Mr Hu's tenure as CEO and, following its incorporation, he became CEO of the Company itself. Its articles of association provide that all directors, save for the CEO during his term of office, shall retire by rotation every three years. Since Mr Don Yang was not CEO at the time these articles were adopted in July 2006, I find it difficult to understand how it can be said that there could have been any legitimate expectation that he would continue as a director indefinitely. Mr Don Yang's appointment as CEO in place of Mr Hu coincided with the Company's initial public offering of shares listed on the NYSE. I find it difficult to see how it can be said that Mr Don Yang should have an entrenched position as CEO when no such disclosure was made in the SEC filings. I accept Mr Roche's evidence that there was no agreement or understanding in 2010 (or at any earlier date) that Mr Don Yang would be entitled to remain in office indefinitely. Indeed, Mr Don Yang admitted in evidence that he did *not* have any right to be CEO forever.

Mismanagement and lack of probity on the part of Mr Roche

59. The second ground in the Cross-Petition is an assertion that the Minority Shareholders lack confidence in Mr Roche's conduct of the business because of his serious mismanagement and lack of probity. Their case is put under four heads. First, it is said that the business of Sections A and B collapsed as a result of Mr Roche's mismanagement. Second, that Mr Roche engaged unsuitable and unqualified people in senior positions because they are his friends. Third, that he acted improperly in

connection with certain related party transactions. Fourth, that he mishandled the e-Surer transaction. I have already dealt with the first of these allegations. The contemporaneous evidence leads to the conclusion that the Group of Four did not believe that the Company's poor financial performance generally, and the collapse of the Section A and B businesses in particular, was attributable to mismanagement on Mr Roche's part. The allegation is contrived. I will deal briefly with the second point, although Mr Sheldon appeared to attach little significance to it. He does rely upon the third point which I shall deal with in more detail. The only significance of the e-Surer proposal is that it triggered the events leading to the petition.

Related party transactions

60. The allegation upon which most reliance has been placed concerns the way in which Mr Roche handled certain transactions between Acorn Group companies and counterparties in which he has an ownership interest. The Company's articles of association provide that directors may be interested in contracts made by the Company provided that their interest has been disclosed. Such contracts require the approval of the audit committee and have to be disclosed in SEC filings. The case against Mr Roche is based principally upon transactions with Dreamstart (Hong Kong) Ltd ("Dreamstart") and China Branding Group Ltd ("CBG"). It is not disputed that Mr Roche's interest in these two companies was fully disclosed. He had a 20% shareholding in Dreamstart and a 7.6% interest in CBG. Nor is it disputed that the original transactions with both Dreamstart and CBG were approved in advance by the audit committee.

61. The initial contract with Dreamstart was a Software Trial Agreement made on 21 March 2014 by which Dreamstart contracted to supply call centre software to an Acorn Group company for a three month trial period in consideration for a licence fee, the amount of which was geared to the number of users. There was also a separate contract with an affiliate for the supply of related computer hardware. It is not disputed that these contracts were approved in advance by the audit committee. As it turned out, the trial was thought to be successful and the Acorn Group continued to use and pay for the software (for an increased number of users) on a monthly basis after the end of the trial period pending the negotiation and conclusion of a long term contract, but this continuation was not approved by the audit committee. Assuming that Mr Roche's failure to obtain audit committee approval for a continuation of the contract (prior to its expiry on 30 June) was a breach of the Company's rules, I regard the Minority Shareholders' assertion that it constituted misconduct and a breach of fiduciary duty as contrived. The allegation was raised for the first time only after Mr Roche had been removed as executive chairman.

62. Having regard to the fact that the original contract had been approved and that the management team considered the trial to have been successful, I find it difficult to understand on what basis the audit committee could have disapproved of a temporary continuation, pending the negotiation of a long term contract. This point was put to Mr Andy Yan, whose answer was to criticise the audit committee's original decision. It was also put to Mr Gordon Wang, who is a member of the audit committee and had actually approved the original transaction. His evidence to the Court was that the price was outrageous compared with the industry norm and that the Dreamstart transaction is a prime example of Mr Roche's mismanagement. I do not accept this evidence as truthful. If he had honestly held this belief, one might have expected him to have said so at the 20 August board meeting, but there is no record of him having mentioned this matter at all. Nor does his affidavit (sworn just 10 days before he was cross-examined) reveal any hint that he held this belief. Instead, his affidavit merely makes the point that he had sought further information and states that "Therefore there was no formal approval of the extension contract".

63. The initial transaction with CBG took place in June 2012 when the Company made an equity investment of $1 million, representing 8.75% of its issued share capital. Mr Roche was a pre-existing shareholder and the Company's investment reduced his percentage interest from 10% to 7.6%. The Company's legal department reported that "We have conducted legal and financial due diligence and found no issue" and the audit committee approved the transaction. Having acquired an ownership interest in CBG, the Company entered into various transactions with CBG and its subsidiaries. The Company has an 8.75% participation in a $250,000 shareholder loan, which is now in default. Three other transactions with CBG were approved at an audit committee meeting held on 22 May 2014, including a contract with a CBG subsidiary called Mupin (Shanghai) Technology Co Ltd. CBG rented office space from the Company and there was an agreement by which CBG would provide certain support and advisory services to the Company. Mr Roche agreed that rent owing to the Company could be set off against service charges and royalties owing by the Company.

64. The principal complaint against Mr Roche concerns a transaction relating to "Maggie Q". CBG had an agreement with a celebrity professionally known as Maggie Q pursuant to which it was licensed to use her image for advertising purposes for a 15 month period expiring in November 2013. The Company paid CBG for the use of Maggie Q's image, although it did not enter into a formal written sub-license agreement. In August 2014, without obtaining the prior approval of the audit committee, Mr Roche agreed with CBG that the Company would pay for continuing to use Maggie Q's image during the period after CBG's written license agreement had expired. As I understand it, the suggestion is that he acted improperly by insisting that the Company pay CBG, when it might have

avoided payment or paid Maggie Q directly. There is no evidence that Maggie Q had complained about the continued use of her image which suggests that Mr Roche's stated belief that CBG still had the right to use it was not unreasonable.

65. There is no contemporaneous evidence that any member of the board ever expressed any concern about any related party transactions. The subject was not even mentioned at the 26th August board meeting. Nor is there any evidence to support Mr Andy Yan's statement made in cross-examination that he had had concerns about related party transactions dating from 2013. This evidence appears to be opportunistic and false. Even if it can be said that Mr Roche failed to comply with the Company's rules in connection with the extension of the Dreamstart contract or in any way relating to CBG, neither Mr Gordon Wang nor Mr Don Yang nor Mr Andy Yan expressed any concern and I do not accept that they genuinely believe that Mr Roche is guilty of any misconduct in this regard. These complaints have been contrived as an *ex post facto* justification for removing him as executive chairman.

The engagement of Mr Jacob Fisch and Mr Jeffrey Glickman

66. I have reached the same conclusion in respect of the complaints now made about Mr Roche's decisions to engage the services of Mr Jacob Fisch ("Mr Fisch") and Mr Jeffrey Glickman ("Mr Glickman"). It is not disputed that, as executive chairman, Mr Roche had authority to engage managers or consultants without the board's approval. It is not disputed that Mr Glickman is an internationally recognised marketing consultant. Mr Roche employed him with effect from 1 November 2013, initially for a period of six months, to evaluate and improve scripts used by the staff in order processing centres, review the media sales platforms and create and implement sales strategies. Mr Fisch is a lawyer whom Mr Roche first met in connection with the Company's IPO. Mr Fisch was also employed as a senior executive of Li & Fung Limited, the world's largest export trading company where he led a task force on e-commerce in the PRC. In May 2014 he was retained on a consultancy basis for a short period. There must be scope for legitimate disagreement about the merits of engaging these gentlemen, but Mr Don Yang's allegation that Mr Roche is guilty of mismanagement by engaging his "friends" lacks credibility. Mr Glickman had been working for six months by the time Mr Don Yang wrote his 6th May e-mail. It does not mention his name, let alone allege that his engagement was improper in some way.

Conclusions

67. The allegations made in the Cross Petition have not been proved. The evidence falls way short of establishing that the Minority Shareholders have justifiably lost all confidence and trust in Mr Roche's management of the Company's affairs, or sections A and B in particular, so as to justify making a winding up order. It follows that the jurisdiction to grant alternative relief on the Cross Petition is not engaged (see *Camulos Partners Offshore Limited v. Kathrein and Company* [2010] (1) CILR 303).

Conclusions in respect of the Majority Shareholders' Petition

Case for a winding up order made out

68. It is a fundamental principle of the Companies Law that a company should ultimately be controlled by its shareholders, who are its owners and have the right to appoint and remove its directors. Whilst the management of the Company's affairs is vested in its board of directors in the usual way, the right to remove and elect members of the board is vested in the shareholders who may exercise their right by means of an ordinary resolution passed at a duly convened general meeting. I have found that the Group of Four directors acted in bad faith and exercised their powers, both in connection with Mr Roche's removal from office and in connection with the AGM and the related refusal to convene an EGM, for an improper purpose. The Petitioner's loss of confidence and trust that the Group of Four (and those elected at the AGM) will conduct the affairs of the Company in good faith is justifiable. The manner in which they dealt with the AGM and their refusal to convene an EGM demonstrates a refusal to recognise the Majority Shareholders' right to vote their shares on resolutions which could properly be placed before the Company in general meeting. For these reasons I conclude that it would be just and equitable to make a winding up order, with the result that the jurisdiction to make an order for alternative relief is engaged.

Alternative remedies

69. Both the Petition and Cross Petition necessarily plead that the Petitioners are entitled to winding up orders, but both sides opened their respective cases on the basis that they would not actually ask the Court to put the Company into liquidation. However, this was not the way in which Mr Sheldon finally put his clients' case in his closing submissions. Rightly anticipating that I would dismiss his clients' Cross Petition and, on the assumption that I am satisfied that the Petitioner has proved its case, he went on to submit that I should indeed make a winding up order on the Amended Petition and reject the claim for alternative relief. The justification for proceeding in this way is that an order convening an EGM will not result in finality. The key individuals – Messrs Roche, Don

Yang and Andy Yan – have clearly lost all confidence and trust in each other and, as Mr Sheldon put it, the battle will go on if I simply make an order for an EGM, especially if it results in SAIF having no representation on the board. His submission is that the only way of achieving finality is to make a winding up order or a buy-out order, but the latter would necessarily result in another round of litigation for the purpose of determining the fair price, about which there would be a good deal of scope for argument.

70. In the circumstances of this case, a winding up order would likely result in one or more of the parties being bought out. Since the Company is a holding company whose only business is to own subsidiaries – in fact intermediate holding companies – the Court would direct that its business be carried on for the benefit of the liquidation and the underlying operating companies and business divisions would continue to be managed as they are today, with the liquidators performing a high level supervisory role in place of the board. The liquidators would be directed to instruct Houlihan Lokey or some other investment bankers to seek buyers for the entire business as a going concern. Both the Majority and Minority Shareholders would have the opportunity to buy the business, possibly in conjunction with BlueFocus Communication Group Company Limited ("BlueFocus") which has made an offer to buy a 49.9% interest at a price which is about three times the Company's current market valuation. In the particular circumstances of this case, a winding up order can be viewed as a mechanism through which the battle between the parties is brought to an end in a way which enables one side, or conceivably both sides, to achieve an exit at a fair price which might well be substantially higher than the price at which the Company's shares are currently being traded on the NYSE. For this reason, it may be said that a winding up order would be positively beneficial for the independent shareholders. However, I have come to the conclusion that it would be wrong to exercise the Court's discretion in the manner suggested by Mr Sheldon even though it might ultimately produce a commercially acceptable result for all concerned.

71. I accept Ms Newman's submission that it would be wrong to make a winding up order on the Petition because it is unnecessary and would be a disproportionate way in which to remedy the wrong which has been done to the Majority Shareholders. Whether or not a winding up order is an appropriate remedy must depend on the basis upon which the Court comes to the conclusion that the jurisdiction is engaged. In this case the jurisdiction is engaged because the Petitioner has justifiably lost all confidence and trust in the Company's directors who have acted in bad faith and exercised their powers for the improper purpose of disenfranchising the Majority Shareholders so as to perpetuate the Minority Shareholders' control of the board. It is not necessary to make a winding up order to remedy this wrong. This complaint is capable of being remedied by an order that a meeting of the shareholders be convened for the purpose of considering and, if thought fit, passing the resolutions which Mr Roche has been attempting to put forward on behalf

of the Majority Shareholders and I do not consider that the pursuit of this particular remedy is unreasonable in any way.

72. I have also concluded that it would be unjust in the circumstances of this case to exercise the Court's discretion by imposing upon the Petitioner (and the Majority Shareholders) a remedy which they are not seeking. Although Mr Sheldon puts the case in terms of bringing the battle to an end and achieving a corporate divorce, it amounts to an argument that the Majority Shareholders should not be allowed to take control of the Company (which will be the result of ordering an EGM) without giving the Minority Shareholders an exit. In this regard it is necessary to consider the positions of SAIF and D.Y. Capital, Inc. (Mr Don Yang's company) separately.

73. SAIF is one of many investment funds managed by Mr Andy Yan's investment management business. Its investment in the Acorn Group is one of about 200 private equity investments made by his managed funds. He rejected the Petitioner's buy-out offer because he considered the price to be inadequate notwithstanding that it represented a premium over the market price. Mr Andy Yan made this decision in the knowledge that the daily trading volume of the Company's shares is so low that it would be practically impossible for SAIF to sell its 26.72% stake in the market. SAIF did not invest in the Company on the basis that it would be a controlling shareholder and there is no evidence from which to infer that its ability to realise its investment will be adversely affected in any way if the Court orders an EGM which results in the Majority Shareholders' nominees constituting a majority of the board. Furthermore, Mr Andy Yan has introduced the Acorn Group to BlueFocus[5] which has offered to buy up to 49.9% of the Company's issued share capital at a price of $6 per share which is almost three times the current market price. It therefore appears that SAIF has a potential buyer. Mr Andy Yan indicated that he would be happy to sell at this price.

74. The position of D.Y Capital Inc is wholly different. It is Mr Don Yang's personal investment holding company. He participated with Mr Roche in founding the business and, unlike Mr Roche, has always worked fulltime in the business in a senior management role. The Petitioner has made a comprehensive offer to Mr Don Yang which goes beyond buying out his shareholding at the same price as that offered to SAIF. On the assumption that the board has been reconstituted and that Mr Don Yang will cease to be employed by the Acorn Group, Mr Roche is offering to take all reasonable steps to encourage the new directors to approve a severance payment of $750,000 and approve

[5] Mr Andy Yan's evidence is that BlueFocus is the largest internet media company in the PRC and has a market capitalization in the region of $30 billion.

the sale of two business units to him for a nominal consideration. Mr Roche described this package as a "soft landing". The Court has been told that the offer will remain open for a reasonable time after the Court has delivered its judgment. It is also relevant to make the point that Mr Don Yang also has the opportunity to sell his shares to BlueFocus at a much higher price.

75. Having dismissed their Cross Petition, the Minority Shareholders are not entitled to any remedy of their own and I do not consider that the remedy sought by the Petitioner in paragraph 14 of the prayer for relief in the Amended Petition will impact upon them in a way which would be unreasonable or unfair, subject to two qualifications. First, there must have been some understanding that SAIF should be represented on the Company's board so long as it remains as a substantial shareholder. The mere fact that Mr Andy Yan has acted in breach of duty should not deprive SAIF of its representation. The Court has a broad discretion which enables me to make an order for an EGM to be convened on the basis that the removal of Ms Lynda Lau will not be included in the notice of meeting. Second, if and when Mr Don Yang is removed from office as a director and CEO of the Company, it seems to me that there must be some expectation arising in the ordinary course of business that he will be offered a severance package which includes an offer to buy his shareholding. By the time this judgment is delivered and the Court's order has been perfected, he will have had at least six weeks in which to consider the Petitioner's offer. If it is accepted and he resigns as a director, his removal from office will not be included in the notice of meeting. If he does not resign, I will grant the relief sought by the Petitioner on its undertaking to leave its offer open for a period of six weeks from the date upon which the Court's order is made.

Order that an EGM be convened

76. For these reasons I will make an order under section 95(3) of the Companies Law for the regulation of the Company's business by directing that an EGM be convened for the purposes of considering and, if thought fit, passing (a) ordinary resolutions to remove Mr Don Yang, Mr Jing Wang, Mr Charlie Ban, Mr Sun Xiaodi and Mr Lu Liang as directors, (b) ordinary resolutions to appoint Mr David Leung, Mr Cosimo Borrelli and Mr David Naphtali as directors and (c) a special resolution to amend the Company's articles of association to allow shareholders who together hold not less than 30% of the issued shares to convene an extraordinary meeting unilaterally. I intend that a draft notice of meeting will be annexed to the Court's order. The order will include all necessary directions relating to the manner in which the EGM will be convened and conducted, including the time and place of the meeting and the identity of the persons who will act as chairman and secretary of the meeting. Biographical information about the proposed new

directors should be disclosed with the notice of meeting. In the absence of agreement between the parties, I will hear counsel in chambers for the purpose of settling the terms of the order.

Injunction restraining the Company from pursuing the Investment Proposal without shareholder approval

77. I have concluded that the Group of Four did not act bona fide in connection with the Investment Proposal and that their purpose was to dilute the Majority Shareholders' voting power. There is no evidence that any further steps have been taken towards its implementation or that the Hina Group and Keywise Group would still be prepared to make any investment, but for the avoidance of doubt I am prepared to make an order in terms of paragraph 15 of the prayer for relief in the Amended Petition.

Ancillary relief under paragraphs 8 and 16 of the prayer for relief in the Amended Petition

78. The Petitioner made an application at the commencement of the trial for an interlocutory injunction requiring the Company to deliver up the financial chops and the legal representative chops of each of the VIE Entities to an independent custodian on the basis that there is a real risk that the outgoing directors will not recognise the result of a Court ordered EGM. Whilst they are probably not in a position to frustrate the immediate enforcement of the Court's order, they are in a position to frustrate its ultimate purpose and effect. A Court ordered general meeting can be held with or without the cooperation of the Minority Shareholders and the Company's existing directors. The resolutions passed at the meeting will take effect as a matter of Cayman Islands law and the necessary filings can be made with the Registrar of Companies and the SEC without the cooperation of the outgoing directors. However, the ultimate purpose and effect of such an order is that the Company's affairs should be controlled by a board of directors who have been elected at a properly organised general meeting of the Company at which all its registered shareholders and ADS holders have been able to participate and cast their votes. As a practical matter, Mr Don Yang is in a position to impede the incoming directors, in particular by abusing his position as the majority shareholder of the VIE Entities and failing to take the steps necessary to transfer the shares to new nominees, appoint new legal representatives and ensure that their chops are available to the Company's management.

79. Having heard argument on the Petitioner's summons at the commencement of the trial on the basis of disputed affidavit evidence, I adjourned the application for further argument at the end of the trial, when I would have had the benefit of oral evidence. Mr Don Yang assured the Court that he would comply with whatever order is made and I have decided

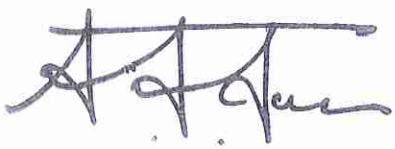
that I should give him the benefit of the doubt by not making any pre-emptive order. The Petitioner will have liberty to apply for orders under paragraphs 8 and 16 of the prayer for relief in the Amended Petition.

Costs

80. Subject to any further submissions which counsel may wish to make, I propose to make the usual order under CWR Order 24, rule 8 that the Minority Shareholders pay the Petitioner's costs of the Petition (including the costs of the amendment and the summons issued on 5 January 2015) and costs of the Cross Petition, such costs to be taxed if not agreed. There will be no order in respect of the Company's own costs.

Orders accordingly.

DATED this 6th day of March 2015



The Hon. Justice Andrew J. Jones QC
JUDGE OF THE GRAND COURT