EASTERN CARIBBEAN SUPREME COURT
BRITISH VIRGIN ISLANDS

IN THE HIGH COURT OF JUSTICE
(COMMERCIAL DIVISION)

CLAIM NO. BVIHC (COM) 2017/0151

BETWEEN:-

(1) ZHAO LONG
[2] KUNLUN NEWCENTURY INVESTMENT HOLDINGS CO LTD

Claimants

-v-

[1] ENDUSHANTUM INVESTMENTS CO LTD
[2] JADE VALUE INVESTMENTS HOLDING CO LTD
[3 ZHONGZHI INVESTMENT HOLDING CO LTD
(4) SHARON WEI
[5 LUNAN PHARMACEUTICAL GROUP CORPORATION

Defendants

CLAIM NO. BVIHC 2017/0125

BETWEEN:-

[1] HENGDE CO (PTC) LTD
[2] ENDUSHANTUM INVESTMENTS CO LTD

Claimants

-v-

[1] ZHAO LONG
[2] LUNAN PHARMACEUTICAL GROUP CORPORATION

Defendants

Appearances:

Mr. Tom Lowe QC, with him Mr. John Crook of Walkers Hong Kong, Mr. Oliver Clifton, Ms. Tamara Cameron and Ms. Yegâne Güley of Walkers BVI for Zhao Long and Kunlun Newcentury Investment Holdings Co Ltd

Mr. Stephen Rubin QC, with him Ms Laure-Astrid Wigglesworth of Appleby (BVI) Ltd and Mr. Aaron Taylor for Lunan Pharmaceutical Group Corporation

Mr. Gilead Cooper QC, with him Mr. Jonathan Addo of Harneys for Hengde Co (PTC) Ltd, Endushantum Investments Co Ltd and Jade Value Investments Holding Co Ltd

Zhongzhi Investment Holding Co Ltd and Sharon Wei did not appear and were not represented

2021: March 10-12, 15-18, 22-25, 29 and 30
July 20

JUDGMENT

[1] **JACK, J [Ag.]**: This action concerns the ultimate beneficial ownership of 25.7 per cent of the shares in a large pharmaceutical business carried on in Linyi City in the Shandong Province of the People's Republic of China ("PRC"), Lunan Pharmaceutical Group Corporation ("Lunan"), the fifth defendant in action 2017/0151 and second defendant in action 2017/0125. The same issues arise in respect of shares of two associated companies.

[2] I shall use the following shorthand for the various other protagonists:

Berpu: Berpu Technology Co Ltd, a Hong Kong company, whose sole director and shareholder is Zhang Guimin, the current chairman of Lunan;
Better: Lunan Better Pharmaceutical Co Ltd, also transliterated as Lunan Beite Pharmaceutical Co Ltd, a PRC company established in 2003;
Biotech: Lunan New Times Biotech Co Ltd, also translated as Lunan New Age Biology, a PRC company;
Endushantum: Endushantum Investments Co Ltd, a BVI company, the first defendant in action 2017/0151 and second claimant in action 2017/0125;
Hengde: Hengde Co (PTC) Ltd, the first claimant in 2017/0125;
Hope: Lunan Hope Pharmaceutical Co Ltd, also transliterated as Lunan Houpe Pharmaceutical Co Ltd, a PRC company;
Jade Value: Jade Value Investments Ltd, a BVI company incorporated in 2015;
KWM: King & Wood Mallesons, formerly King & Wood, an international law firm, one of the leading commercial law firms in the PRC;
Kunlun BVI: Kunlun Newcentury Investment Holdings Co Ltd, a BVI company, the second claimant in action 2017/0151 with one issued share currently held by Ms. Zhao;
Kunlun US: Kunlun Properties Inc, a company incorporated in Minnesota in the United States of America, beneficially owned by Wang Jianping and Mrs. Wei;
Mr. Mu: Vincent Mu, Ms. Zhao's and Kunlun BVI's expert on PRC law;
Provision: Provision Investment Co Ltd, a Hong Kong company, whose sole director and shareholder is Zhang Guimin,

Shandong NT: Shandong New Times Pharmaceutical Co Ltd (sometimes referred to as Shandong New Age), a PRC company established in 2001;
Shenzhen Wanji: Shenzhen Wanji Pharmaceutical Group Co Ltd, a company incorporated in the PRC, which purchased Yantai Development in 2001;
Sitic: SITIC America Inc, a company incorporated in the United States of America;
Mr. Sun: Sun Jinqin, Yantai Development's nominee director of Lunan;
Wang Buqiang: Wang Buqiang, a director of Lunan who handed the finances and accounts; a long-standing colleague of Zhao snr;
Wang Jianping: Wang Jianping, a lawyer dual qualified in the PRC and the US, latterly the senior partner in China of KWM;
Wang Longai: a partner in the Beijing law firm, Jing Xuan, who represented Endushantum in the Linyi proceedings and Wang Buqiang in proceedings brought by him against Lunan;
Prof. Wang: Wang Yong, Lunan's expert on PRC law;
Mrs. Wei: Wei Ximmin, also known as Sharon Wei, Wang Jianping's wife, a US resident and citizen;
Yantai Development: Yantai Development Group Co Ltd, a company incorporated in the PRC; the holding company of Sitic;
Zhao snr: Zhao Zhiquan, the founder of Lunan;
Ms. Zhao: Zhao Long, the first claimant in action 2017/0151 and first defendant in action 2017/0125; the daughter and only child of Zhao snr;
Zhongzhi: Zhongzhi Investment Holding Co Ltd, a BVI company incorporated in 2015.

The facts

[3] A predecessor of Lunan was established in 1968 in Tancheng County in the Shandong Province of the PRC as a pharmaceutical company owned by the state. The business moved to Linyi City, also in the Shandong Province in 1985. Zhao snr joined the business in about 1983 after graduating as a pharmacist at the Shandong Chemical and Engineering Institute. As part of the liberalization of the Chinese economy which occurred in the 1980's, the local government in 1987 invited bids for a manager to take over the running of the business. It was effectively a part-privatization of the company, which was in poor condition. Zhao snr's bid was successful. He took over the management of the company and was instrumental in turning the business around. In a very real sense, he was the founder of what was later renamed as Lunan. In March 1994 there was a further restructuring of the company which left the state in control of about 35 per cent of the shares.

[4] Ms. Zhao is Zhao snr's only daughter. She was born in 1984.

[5] Wang Buqiang joined Lunan around the same time as Zhao snr. He worked in the finance department becoming the general manager of finances in 1987 and eventually a director of Lunan with responsibility for the finances.

[6] In the 1990's central government in the PRC offered tax advantages to Chinese companies which had foreign investors. The exact requirements to gain the tax advantages were not explored at trial. Nor was it clear at trial what the full extent of the tax advantages were, save that the foreign investor did not pay Chinese tax on any dividends from the Chinese company which were reinvested in the Chinese company. At any rate the tax advantages were sufficiently great to justify quite a lot of time and trouble being spent by Zhao snr on ensuring the tax benefits were retained.

[7] Zhao snr took advantage of this scheme in 1994 to obtain investment from an American company, Sitic. This was a wholly owned US subsidiary of Yantai Development, a Chinese company. Sitic appointed Mr. Sun as its nominated director of Lunan. Approval of this "Chinese-Foreign Joint Venture" was given by central government in 1995. Sitic held 25.7 per cent of Lunan's shares. It is the ultimate beneficial ownership of these shares now which is the central issue in the current litigation.

[8] It is common ground that relations between Zhao snr and Mr. Sun deteriorated, with major disagreements about Lunan's direction erupting in 2000. Eventually an agreement in principle was reached between Yantai Development and Lunan for Sitic to sell its shares to a buyer whom Zhao snr would identify.

[9] In January 2001 Zhao snr met Wang Jianping. Wang Jianping was born and bred in Shandong Province, though not in Linyi. He was admitted to the Chinese bar but then went to the United States where he completed his legal education at Harvard Law School and the University of St Louis. He was subsequently admitted to the bar in Missouri and practised in the United States as a sole practitioner. In 1998 he returned to China, where he became a partner in KWM. Latterly he was KWM's senior partner. His wife, Mrs. Wei,

remained in the United States. Wang Jianping and his wife owned a US company, Kunlun US. Its main asset was a small shopping mall in Illinois.

[10] Zhao snr needed a foreign investor to replace Sitic, if the tax advantages of the Chinese-Foreign Joint Venture legislation were to be retained. Wang Jianping was prepared to offer Kunlun US as a temporary vehicle to hold the Sitic shares in Lunan. He said — and I accept his evidence on this — that there would have been American tax implications for Mrs. Wei if Kunlun US, as a US incorporated and domiciled corporation, started to receive dividends from Lunan. Thus, Kunlun US could not hold the shares long-term.

[11] On 15th March 2001 Lunan and Kunlun US entered a share entrustment agreement ("the share entrustment agreement"). The intention behind the making of this agreement and its purpose and effect are key issues in this case.

[12] After reciting that Party A was Lunan, represented by Zhao snr, and Party B Kunlun US, represented by Mrs. Wei, it provided:

> "Article 1. Party A shall provide funding and entrust Party B to purchase under Party B's name 21 million shares of foreign shares in Lunan Pharmaceutical Group Corporation held by Sitic America, Inc. for the total price of RMB 75.6 million.
>
> Article 2. Party A undertakes to pay the amount used to purchase the shares at the time and in the manner specified under the Equity Transfer Agreement between Party B and Sitic America, Inc., and agrees that should Party A fail to pay the share purchase amount due to reasons attributable to Party A, which leads to damages incurred by Party B arising from default, Party A shall indemnify Party B for all losses incurred by Party B therefrom.
>
> Article 3. Party B agrees to accept Party A's entrustment to hold on Party A's behalf 21 million shares of foreign shares in Lunan Pharmaceutical Group Corporation purchased from Sitic America, Inc. using Party A's funds. Party B agrees to appoint a shareholding representative as per Party A's request, and exercise its shareholder's rights in Lunan Pharmaceutical Group Corporation on behalf of Party A in accordance with instructions issued by Party A from time to time, with the exception of the right to earnings.
>
> Article 4. Both parties agree that Party A shall be entitled to dispose of the said 21 million shares held under Party B's name or terminate this Agreement at any time,

to which Party B shall provide assistance, provided that Party A shall serve a one month prior notice on Party B.

Article 5. Party B shall not be entitled to any shareholder's rights and interests in the 21 million shares in question.

Article 6. Party A agrees to pay Party B an annual amount of RMB 80,000 as Party B's service fee.

Article 7. Both parties shall be obliged to keep the contents of this Agreement in absolute confidentiality. Each party shall be liable for all losses of the other arising from its failure to perform its confidentiality obligations.

Article 8. Any matters uncovered hereunder shall be resolved by both parties through good-faith negotiation."

The agreement was signed by Zhao snr and Mrs. Wei respectively.

[13] On 2nd April 2001 Sitic and Kunlun US entered a share transfer agreement by which Kunlun US purchased Sitic's shares in Lunan for RMB75.6 million (about US$12 million), payable in two instalments. Lunan's board approved the transfer by a resolution of 9th April 2001. On 16th April 2001 by an "Entrusted [*sic*] Payment Agreement", Lunan agreed to pay the first instalment of RMB37.8 million to Sitic. This was expressly on Kunlun US's behalf rather than on Lunan's behalf. On 25th April 2001 Lunan amended its Articles of Association to permit Kunlun US to be a shareholder. No mention was made in any of this documentation of the share entrustment agreement.

[14] On 18th May 2001 Lunan applied to central government in the PRC for approval of the share transfer agreement for the purposes of the Chinese-Foreign Joint Venture legislation. The transfer was approved on 30th May 2001. Again no issue of share entrustment was revealed.

[15] The same day Lunan transferred RMB37.8 million in two tranches to Kunlun US. The payment was entered in Lunan's books as a receivable from Kunlun US. Another of the key issues in the current case is what the true nature of this money transfer was. In particular, if this was Lunan purchasing its own shares from Sitic, did the PRC prohibitions

on companies purchasing their own shares apply? And if so, what was the effect a breach of those prohibitions?

[16] Kunlun US sent the money to Sitic who gave Kunlun US a receipt for it. On 1st June 2001 Lunan's internal accounts showed the first instalment of the purchase price being a receivable of Lunan's from Kunlun US. We know this, because Ms. Zhao took a photograph of the physical record (E/1851 with a translation on the following page) and a screen shot of the computer records (E/1871-1872), not from any documents disclosed by Lunan as part of its disclosure obligations.

[17] On 18th June 2001 Kunlun US gave Zhao snr the right to exercise all of Kunlun US's shareholder's rights in Lunan.

[18] Whilst this was going on, Yantai Development was in the process of being purchased by Shenzhen Wanji. Shenzhen Wanji was apparently under the impression that Yantai Development still owned the 25.7 per cent stake in Lunan. When it discovered the truth, it made a public announcement which was answered by two public declarations, each made by Wang Jianping in his capacity as legal counsel to Lunan. The first was on 23rd June 2001. The second on 29th July 2001 was in similar terms to the first and reads in translation:

> "On 25 July 2001, Yantai Hualian Development Group Co Ltd (hereinafter 'Yantai Development') issued an announcement regarding a dispute over the transfer of shares with Lunan Pharmaceutical Co Ltd. As engaged by Lunan Pharmaceutical Co Ltd, Mr. Wang Jianping of King Wood Law Firm hereby declares again that: Lunan Pharmaceutical Co Ltd has completed all legal procedures in relation to the transfer of shares regarding foreign shareholders, SITIC America Inc., transferring shares to Kunlun Property Co Ltd. Lunan Pharmaceutical Co Ltd has no further relationship with SITIC America Inc and Yantai. The announcement made by Yantai Development is not a fact and Lunan Pharmaceutical Co Ltd does not bear any consequences arising from such.
> Beijing, King Wood Law Firm, Wang Jianping 29 July 2001

[19] On 17th January 2002, Sitic commenced proceedings in the Shandong Province Higher People's Court to set the share transfer to Kunlun US aside.

[20] On 20th May 2002, the following agreement was made:

> "Party A: Shandong Linyi Engineering Machinery Factory [another company in the Lunan stable]
> Party B: US Kunlun Properties Inc.
> In view of
>
> 1) the transfer of 25.7% shares in [Lunan] held by [Sitic]. to Party B;
> 2) Lunan… made an advance payment for Party B to [Sitic] for the first installment of shares subscription amount as entrusted by Party B. Due to Party B's financial problem, Party B did not have sufficient capital to repay;
> 3) in view of Party A's intention to maintain the long term relationship with Party B, Party A is willing to make the advanced payment for Party B and Party B will repay Party A when Party B has sufficient funds.
>
> Upon the amicable negotiation between Party A and Party B, the following terms and conditions have been agreed:
>
> 1. Party A is willing to pay on behalf of Party B the outstanding Lunan… advance payment as soon as possible;
>
> 2. Party B should repay Party A the Lunan… advance payment made by Party A, and should bear the interests payment incurred according to rate charged for loan by similar bank between date of advance payment made by Party A and the actual date Party B made such repayment;
>
> 3. This agreement is governed by the law and jurisdiction of the People's Republic of China. Any disputes arising from the conclusion, interpretation and the performance of this agreement shall be settled through negotiation. If such negotiation fails, any of the parties shall have the rights to submit the dispute to Linyi Arbitration Committee for settlement…"

[21] On 16th May 2003, the Higher People's Court dismissed Sitic's action. Sitic appealed. By judgment of 20th October 2005 the Supreme People's Court dismissed the appeal. The balance of the purchase monies was then paid to Sitic.

[22] In the meantime, as shown in the relevant audit variation reports dated 25th December 2003, Lunan and Kunlun US had invested RMB 30 million and RMB 10 million respectively in Better and RMB 22.5 million and RMB 7.5 million respectively in Hope in each case as "paid in capital". These investments were approved by Lunan's board on 18th September 2003 as "Chinese-foreign equity joint ventures". A key issue in this case is who paid the

RMB 10 and 7.5 million invested by Kunlun US into Better and Hope respectively. Ms. Zhao's case is that her father used his accumulated salary and bonus to pay those monies. Lunan's case is that those monies came beneficially from Lunan itself.

[23] On 22nd September 2003 KWM had Endushantum incorporated in this Territory. Mrs. Wei was shown as the sole shareholder.

[24] On 10th November 2003 Kunlun US and Zhao snr entered an agreement ("the 2003 share transfer agreement"). By this Kunlun US agreed to transfer the Lunan shares and the shares in Endushantum to Zhao snr.

> "Party A: [Kunlun US] Legal representative: WEI Xinmin Nationality: USA
> Party B: [Zhao snr] Nationality: China
> Whereas Party A holds ~~22~~ 21 million foreign shares of Lunan… and intends to transfer the same, Party B is willing to accept the shares in its entirety.
> The Parties have reached agreement through amicable negotiations as follows:
> 1. The Parties agree that the transfer price shall be RMB ~~3.30~~ 3.67 per share, totaling RMB 77 million (or the equivalent in foreign currencies).
> 2. Party A agrees to transfer [Endushantum], a company incorporated by Party A in the British Virgin Islands, to Party B, at a price of RMB 9,000 for the transfer. Party B shall use the aforesaid foreign invested company as the transferee to accept the equity transferred by Party A. Party A shall ensure that the aforesaid company is transferred to Party B upon payment by Party B.
> 3. Payment shall be by installment. The first installment shall be 50% of the total transfer price, which shall be transferred to a bank account designated by Party A within 30 days from the Supreme People's Court's unfreezing of the equity held by Party A. The remainder should be paid to a bank account designated by Party A within 2 years from the receipt of the first installment.
> 4. The Parties agree that, upon signing of this agreement and Party A's receipt of the first installment paid by Party B, Party B shall automatically obtain the irrevocable full authorization of Party A to handle the formalities for the approval of the equity transfer and the equity change registration procedures. Party A shall assist Party B in handling all the procedures in respect of the equity transfer, and provide all the documents, information and certificates necessary for the approval formalities and sign all the documents necessary for completing the equity transfer. 5. The Parties agree that all the interests in respect of the transferred equity, including but not limited to the proceeds from the equity, as well as the other benefits arising from the equity interests, shall be owned by Party B as of the date of this Agreement.
> 6. Party A and Party B agree that Party B shall pay interest on the consideration to Party A from the signing date of this agreement at an annual interest rate of 6%, which shall be paid together with the consideration.

> 7. The Parties agree that this agreement shall be governed by the laws of the People's Republic of China.
> 8. The Parties agree that all disputes arising from the execution of this agreement shall be settled through amicable negotiations. Should negotiations fail, either party shall be entitled to apply to China International Economic and Trade Arbitration Commission for arbitration, the decision of which shall be final and binding on both Parties…"

[25] On 9th August 2004 Lunan retained KWM to advise generally. No reference is made to the Lunan shares held by Kunlun US. The following day Zhao snr retained KWM to advise in relation to Endushantum.

[26] On 26th October 2004 Kunlun BVI was incorporated. Zhao snr was named as the sole shareholder and director.

[27] On 1st November 2004 Kunlun US and Kunlun BVI made an equity transfer agreement ("the 2004 share transfer agreement") which modified the 2003 share transfer agreement. Kunlun BVI was substituted as the transferee for Zhao snr, so that the Lunan and Endushantum shares would be transferred to Kunlun BVI. Kunlun US would also transfer 7.5 million shares in Shandong NT (25 per cent of Shandong NT's shares) for RMB 8.25 million. The RMB 8.25 million was paid on 9th November 2004.

[28] On 12th May 2005 Hope paid a dividend of RM 2.375 per share, which meant a payment to Kunlun US of RMB 12.5 million. The same day, Hope by Board resolution increased its share capital by RMB 20 million to RMB 50 million. Lunan invested RMB 37.5 million and Kunlun US the RMB 12.5 million from the dividend paid to it by Hope that day.

[29] On 20th July 2005 Better declared a dividend of RMB 71.25 million to Lunan and RMB 23.75 million to Kunlun US. The dividend payable to Kunlun US was treated as reinvested in Better.

[30] On 29th October 2005, shortly after the Supreme People's Court's judgment was handed down, Better approved dividend payments to be made on 20th November 2005 of RMB 64.8 million to Lunan and RMB 21.6 million to Kunlun US. On 20th November 2005 Hope

also approved dividend payments of RMB 38.25 million to Lunan and RMB 12.75 million to Better.

[31] The RMB 21.6 million Better dividends and RMB 12.75 million Hope dividends payable to Kunlun UK were in fact paid on 2nd or 3rd December 2005 to Beijing Pingnuo Technologies, another company in the Lunan stable. On 5th December 2005, Beijing Pingnuo Technologies paid RMB 37.8 million to a subsidiary of Yantai Developments on Sitic's behalf. Kunlun US was shown in Hope's and Better's books as having been paid the dividends.

[32] On 6th December 2005 Kunlun US gave Kunlun BVI a receipt for RMB 38.5 million, being the first payment due under the 2003 and 2004 equity transfer agreements. Shortly afterwards Lunan paid KWM RMB 3.8 million approximately for KWM's work on the Sitic litigation.

[33] On 30th April 2006 Better approved the payment to Kunlun US of a dividend of RMB 41 million. Accounting records of 20th May 2006 show Better making dividend payments of RMB 123 million to Lunan and RMB 41 million to Kunlun US. The payment to Kunlun US is shown as RMB 37.8 million paid to Kunlun US, RMB 2.5 million shown as reinvested in Better and a service fee of RMB 700,000 payable to Kunlun US for Mrs. Wei's services. The RMB 37.8 million was in fact paid by Better to Shandong Linyi Engineering Machinery and the RMB 700,000 to Shandong Lichuang Techology Company Ltd, both Lunan companies.

[34] On 12th June 2006 Kunlun US gave receipts to Kunlun BVI confirming payments by Kunlun BVI totalling RMB 77 million to it pursuant to the second transfer agreement, the first payment having been made on 6th December 2005.

[35] In August 2006 Better, Hope and Shandong NT approved the transfer of their shares from Kunlun US to Endushantum. The Linyi government also approved the transfers. On 11th September 2006 Kunlun US and Endushantum agreed to transfer 12.5 million Better shares, 12.5 million Hope shares and 7.5 million Shandong NT shares to Endushantum

("the 2006 transfer agreement"). The transfer of the Lunan shares included in Art 6 a provision that after completion "Party B [Endushantum] shall be entitled to all the rights and assume all the obligations of Party A [Kunlun US] under the Articles of Association of [Lunan]." It otherwise makes no mention of Endushantum taking over any obligations of Kunlun US.

[36] The consideration for the transfer of Kunlun US's shares in Endushantum to Kunlun BVI was one dollar. On 1st October 2006 Endushantum paid RMB 12.5 million to Kunlun US for the Hope shares and the same amount for the Better shares.

[37] The mechanics of payment were set out in an undated memorandum, prepared by Wang Buqiang, he says in two tranches, the first in 2006, the second in 2007, entitled (in translation) "About Endushantum Investments":

> "I. The foreign shareholders of [Lunan, Hope, Better and Kunlun BVI] changed from [Kunlun US] to [Endushantum]. Endushantum is currently a wholly owned subsidiary of [Kunlun US]. After all the changes are completed, [Kunlun US] shall transfer Endushantum to [Kunlun BVI].
>
> II. In accordance with the equity transfer agreements signed respectively on 10 November 2003 and 1 November 2004, from the date of signing of this agreement, all interests related to the transfer of equity, including but not limited to equity income and other rights arising from this equity interest shall belong to [Kunlun BVI] of Party B.
>
> III. [Kunlun BVI] shall pay [Kunlun US] the following amounts:
>
> 1. The transfer price of 77 million Yuan for the 21 million foreign shares of [Lunan] and interest paid in installments.
>
> (1) 38.5 million Yuan had been paid by 6 December 2005. [Hope and Better] made profit distributions in November 2005, of which, [Hope's] allocation of 1.02 Yuan per share, which was an allocation of 12.75 million Yuan for foreign shares, and [Better's] allocation of 2.16 Yuan per share, which was an allocation of 21.6 million Yuan (a total of 34.35 million Yuan for foreign shares) should belong to [Kunlun BVI]. [Kunlun US] received 38.5 million Yuan (a payment receipt was issued for the receipt of the first installment of [Kunlun BVI's] payment of RMB 38.5 million Yuan for the transfer of [Lunan's] 21 million foreign shares). Of this amount, 37.8 million Yuan was paid to [Sitic] as an equity transfer payment, and [Kunlun US]; [Kunlun US] received the balance of 700,000 Yuan. The 4.15 million

Yuan paid in excess of the dividends was the proceeds from the company's operations of Lanling Chenxiang's stocks (total of 9,666,413.39 Yuan, of which 5,306,413.39 Yuan was included in [Hope's] 2005 investment income and 210,000 Yuan was used for personal incentives).

(2) The balance of 38.5 million Yuan was paid on 12 June 2006. On 30 April 2006, [Better]. passed a board resolution to carry out a profit distribution for the year of 2005 year. At 4.10 Yuan per share, 41 million Yuan that would be allocated to Kunlun should belong to [Kunlun BVI]. Of this amount, 2.5 million Yuan was reinvested in [Better] as a capital increase; 37.8 million Yuan of the 38.5 million Yuan ([Kunlun US] issued a payment receipt for the receipt of the second installment of [Kunlun BVI's] payment of RMB 38.5 million Yuan for the transfer of [Lunan's] 21 million foreign shares) was used to repay a prepayment of [Hope] under the entry of 'Other receivables – LinWang Jianpingg engineering machinery factory'. [Kunlun US] received the balance of 700,000 Yuan.

(3) The interest accrued under the agreement has not been paid yet. The specific amounts are as follows:

a) The interest accrued on the 38.5 million Yuan paid on 6 December 2005 is: 38,500,000 x 7,570,000 / 3,600,000 x 6% = 4,860,000 Yuan

b) The interest accrued on the balance of 38.5 million Yuan paid on 12 June 2006 is: 38,500,000 x 9,450,000 / 3,600,000 x 6% = 6,060,000 Yuan

a) + b) above = 10,920,000 Yuan

If the prepaid amount of 37.8 million on 30 May 2001 (which [Hope] entered under 'Ling engineering machinery factory') and the bank interest of 5.76% are used to calculate the interest until 12 June 2006, the accrued interest should be 37,800,000 x 18,390,000 / 3,600,000 x 5.76% = 11,120,000 Yuan. The result of the two calculations above was around 11 million Yuan, so the interest could be settled at 11 million Yuan.

2. The transfer price of 8.25 million Yuan for the 7.5 million foreign shares of [Kunlun BVI] and interest paid in installments. On 9 November 2004, [Kunlun US] issued a payment receipt for the receipt of [Kunlun BVI's] payment of RMB 8.25 million Yuan for the transfer of [Better's] 7.5 million foreign shares. The interest was exempted due to the short payment time and Party B's obligation to pay the funds for the equity transfer was fully completed.

3. Endushantum's shell transfer fee of 9000 Yuan (not yet paid).

IV. As of December 2006, the foreign shares originally owned by [Lunan, Hope, Better and Kunlun BVI] were transferred to the ownership of Endushantum.

> V. On 10 January 2007, [Kunlun BVI] and [Kunlun US] signed a trust agreement to entrust all the property under the name of Endushantum with [Kunlun BVI] as the beneficiary."

[38] The accuracy of this memorandum is shown by an analysis of the disclosure (such as it is) given by Lunan, as set out in para 71 of Ms. Zhao's witness statement of 23rd January 2019.

[39] On 11th October 2006 Lunan and Endushantum by board resolutions approved the sale of the Lunan shares from Kunlun US to Endushantum in the following terms:

> "1. To agree that the foreign shareholder of the company, [Kunlun US] will transfer all the 25.7% shares of the company to its wholly owned subsidiary, Endushantum…, and acknowledge all the terms of the share transfer agreement between the two parties;
> 2. To agree that Endushantum will undertake the relevant liabilities of a foreign investor, and act as the new foreign investor to continue performing the rights and obligations of a foreign shareholder;
> 3. To agree that a new Memorandum and Articles of Association of the company will be amended and issued according to the new amendment of Company Law enacted from 1 Jan 2006, and the new Memorandum and Articles of Association will be submitted to the relevant department of the government for approval and record."

Lunan rely on the reference to continuing "performing the rights and obligations of a foreign shareholder" for the argument that the obligations of in the share entrustment agreement were carried over to be observed by Endushantum.

[40] The transfer in accordance with the 2006 transfer agreement was approved by the PRC Ministry of Commerce on 8th December 2006.

[41] Thereafter, Endushantum held the following shares: 21 million (or 25.7 per cent) of Lunan shares; 12.5 million (or 25 per cent) of Hope shares; 12.5 million (or 25 per cent) of Better shares; 47.25 million (or 25 per cent) of Shandong NT shares; and 42.5 million (or 25 per cent) of Biotech shares. The other 75 per cent of Biotech's shares were held by Shandong NT.

[42] In December 2006 Endushantum transferred its Hope and Better shares to Shandong NT, whilst retaining its Lunan and Biotech shares.

[43] From 2007 onwards up to the death of Zhao snr there were various dividend payments made by all these various companies and various additional shares issued, but I do not need to set out the details.

[44] Zhao snr remained the sole director and shareholder of Kunlun BVI until 19th July 2011. Prior to that date, the "family tree" of legal title was simple: Zhao snr held 100 per cent of the shares in Kunlun BVI. Kunlun BVI held 100 per cent of the shares in Endushantum. Endushantum held 25.7 per cent of Lunan's shares and 25 per cent of the shares in Hope, Better, Biotech and Shandong NT.

[45] On 19th July 2011, Mrs. Wei, as sole director of Endushantum, declared the "Zhao Trust" in a document in Chinese signed (but not sealed) by Zhao snr on behalf of Kunlun BVI and Mrs. Wei on her own behalf. In translation it provides:

> "'I. This Trust shall be revocable. The Settlor shall have the right to notify the Trustee in writing of the revocation of the Trust at any time. The Trustee shall, within 30 days after receiving the notice of the revocation, handle the termination formalities and transfer all of the Trust Property to the Settlor or a third party designated by the Settlor. All costs incurred by the Trustee from the termination of the Trust and the transfer of the Trust Property to the Settlor or the third person designated by the Settlor shall be borne by the Settlor.
>
> II. At the time of the establishment of the Trust, the sole Beneficiary of this Trust is the Settlor, that is, [Kunlun BVI]. After the establishment of this Trust, the Settlor may designate other people as the Beneficiaries, but should notify the Trustee in writing.
>
> III. The Trust Property entrusted to the Trustee is Endushantum Investments Co Ltd and property under its name listed as follows [details of the shares in Lunan, Shandong NT, Hope, Better and Biotech are then given].
>
> IV. The Settlor has the following rights:
> 1) Determine the termination of the Trust;
> 2) Replace or add Beneficiaries;…
>
> VI. The Trustee has the following rights:
> 1) To charge remuneration…

2) In accordance with the intention of the Settlor, to exercise ownership rights to the Trust Property, including but not limited to participating and exercising voting rights at shareholder meetings as a shareholder.

VII. The Trustee has the following obligations:

1) To act and manage the Trust Property in good faith and to fulfil the duty of care;

2) Absent the Settlor's written permission, the Trustee shall not sell or transfer the Trust Property, or to create any security, pledge or any third party interest on the Trust Property;

3) Not to mingle Trust Property with her own property;

4) Keep confidential the Beneficiary's identity (except where the law, the government or the court so requests mandatorily)."

[46] The same day the shares in Endushantum were transferred to Mrs. Wei.

[47] Zhao snr had been diagnosed with cancer in 2002, however, he had been able to continue working regularly until November 2014, when his condition deteriorated and became terminal. Ms. Zhao, his daughter, flew back from university in the United States where she had been studying.

[48] On 8th November 2014 Zhao snr gave Ms. Zhao a share transfer in respect of the shares in Endushantum signed by Mrs. Wei. Shortly afterwards this was signed by Ms. Zhao. As a matter of BVI law this was a valid share transfer, regardless of whether the register of members was changed.

[49] The following day he gave Ms. Zhao a letter addressed to Mrs. Wei in the following terms (as translated):

"Dear Ms. Sharon Wei:

According to the Trust Agreement I have signed on behalf of [Kunlun BVI] with you on 19 July 2011, I have entrusted you to manage [Endushantum] and all of the property held under its name. In the Trust Deed we also agreed to transfer free of charge all the Trust Property to me or a third person designated by me, pursuant to my written instructions. Now I have decided to transfer [Endushantum] and all of the property it holds under its name to my daughter, Zhao Long… Please arrange the procedures for the transfer as soon as possible upon receipt of this letter.

[Signed by Zhao snr]
November 9, 2014

[Then handwritten by Zhao snr:] The assignee of the above transferred assets is specified to be my daughter only. The transferred assets shall not be deemed as common property of husband and wife.

[Signed by Zhao snr]
November 9, 2014

[50] There is an issue, to which I shall return, as to whether this document was shown to Mrs. Wei or Wang Jianping during Zhao snr's lifetime. Ms. Zhao's case is that on 10th November 2014 she travelled to Beijing from Linyi to give the share transfer and the 9th November letter of instruction to Wang Jianping on his wife's behalf. She says that she spotted a typo in the share transfer form and asked Wang Jianping to correct it and send her the amended transfer for re-execution.

[51] On 9th November 2014 Zhao snr also gave instructions in writing on behalf of Kunlun BVI addressed to Mrs. Wei authorising Ms. Zhao to exercise all its rights under the Zhao Trust. Ms. Zhao's case is that her father was in frequent telephone communication with Wang Jianping during this time, sometimes with her present.

[52] Zhao snr passed away on 14th November 2014. Zhang Guimin replaced him as chairman of Lunan and the various associated companies.

[53] After Zhao snr's death, Ms. Zhao says Wang Jianping and his wife visited her to express their condolences. In the course of the visit, Wang Jianping told her she needed to provide proof of address for the BVI registration agent to register the share transfer. This she did by sending a copy of the lease of her home in Minneapolis and various utility bills. Wang Jianping never sent her an amended transfer, nor was the original transfer registered.

[54] On 25th November 2014 Wang Jianping sent an email to Ms. Zhao saying in translation:

> "I trust you have returned to the States smoothly. Wang Buqiang called me today and said that he wished to get your authorization to vote in the general meeting of Lunan… This is not urgent. It is estimated that the general meeting of the company will be held in June of next year, before which time we do not see the necessity of a general meeting or any particular matter that may require one. Therefore, when you have considered well, you can send me a draft for me to have a look for you. If you plan to return to China during Christmas or New Year's, please let me know. It is probable that my thoughts on the restructuring of the company will be in shape and we can have a talk in person."

[55] On 29th December 2014 Wang Jianping sent Ms. Zhao a "draft plan for the overseas restructuring" as part of a proposed floating of Lunan on the Hong Kong Stock Exchange. Attached was a working paper. This referred to Ms. Zhao as "A". It discusses her "current equity status" and says that she holds 25 per cent of Lunan, Better, Hope and Shandong NT directly. Since Lunan held 75 per cent of Better's and Hope's shares, her "percentage of share[s] in these three companies are…" and he then calculates that 25 per cent of Lunan's 75 per cent share of those two companies means she holds 43.25 per cent of those companies (25 per cent directly, plus 18.25 per cent [25 per cent of 75 per cent] indirectly through Lunan). Lunan only held 35 per cent of Shandong NT, so her total share there was 33.75 per cent (25 per cent directly, plus 8.75 per cent [25 per cent of 35 per cent] indirectly).

[56] He then discusses the "share ratio of the three key persons for the continuous development of the listed company." He said (in translation):

> "There are three key persons: *Alpha* (operation), *Beta* (finance + reliable), and *Gamma* (political relations + legal relations + reliable). These three people should hold no less than 5 per cent of the listed company respectively. Therefore, they should respectively hold 8 per cent of the shares of the pre-IPO company after the overseas restructuring but before the introduction of strategic investment."

[57] Alpha was Zhang Guimin, Beta Wang Buqiang and Gamma Wang Jianping. Wang Jianping proposed setting up three trusts, one with Ms. Zhao as the sole beneficiary with 80 per cent of a holdco for Endushantum (in practice the holdco would be Kunlun BVI), another with 10 per cent of the holdco for Wang Buqiang and his children and a third

holding the remaining 10 per cent of the holdco for Wang Jianping himself and his children. (It is not clear what was to happen to Zhang Guimin, but it may be his interest would be held through a proposed separate managing holding company, which would hold 20 per cent of Endushantum.)

[58] In January 2015, when Ms. Zhao was visiting China, Wang Jianping arranged a meeting with two of his partners at KWM in Hong Kong. Wang Jianping suggested that, in order to keep Ms. Zhao's identity concealed in the event of a stock market listing for Lunan, they should set up a family trust with Ms. Zhao identified as "Ms. Wei's family". Ms. Zhao did not agree to the trust proposal. In any event any listing was at least five years away.

[59] In May 2015 Ms. Zhao graduated. Wang Jianping, Mrs. Wei, Wang Buqiang and Zhang Guimin all attended the graduation ceremony. Ms. Zhao says nothing was discussed at this time or subsequently about giving the three men an interest in the Lunan shares held by Endushantum.

[60] On 5th June 2015 Zhongzhi and Jade Value were incorporated. The directors and shareholders of the two companies were Wang Jianping, Wang Buqiang and Zhang Guimin.

[61] On 14th June 2016 Wang Buqiang prepared a proposal for the restructuring of Endushantum which referred to Ms. Zhao as "the actual controller of Endushantum". This proposal also included reference to the incentive plan for Lunan's management.

[62] On 1st August 2016 Ms. Zhao attended the board meeting of Lunan, she says in her capacity as beneficial owner of Endushantum. At the board meeting the setting up of an employee incentive plan was discussed, but no final decision was made.

[63] On 5th August 2015 Mrs. Wei transferred the two issued shares in Endushantum to Jade Value. The same day 44,998 new shares in Endushantum were issued to Jade Value and 5,000 to Zhongzhi. Ms. Zhao was not told of this.

[64] On 16th August 2016 Endushantum, on Mrs. Wei's instructions, paid Ms. Zhao $687,000. Ms. Zhao says that Wang Jianping and Wang Buqiang were aware of the payment. On 5th September 2016 Ms. Zhao paid Wang Jianping $8,800 described in the transfer as a "trust fee", although the explanation given her was that it was an "annual company maintenance fee".

[65] On 25th September 2016 Hengde was incorporated. Wang Jianping was the only director and shareholder.

[66] On 20th November 2016, Mrs. Wei as settlor executed a deed establishing the "Banyan Tree Trust". She appointed Hengde as trustee to manage the trust property, which comprised all the shares in Jade Value. The original beneficiaries of the trust were Ms. Zhao and Wang Jiaoming, the daughter of Mrs. Wei and Wang Jianping. Wang Jianping was the protector with a power to add and remove beneficiaries.

[67] In December 2016 Shandong NT purchased all the shares in Better and Hope from Endushantum and Lunan for RMB 115 million.

[68] On 15th February 2017 Mrs. Wei transferred the shares in her name in Jade Value to Hengde. (Mrs. Wei had earlier on 18th December 2016 executed an identical share transfer which does not appear to have been actioned. Nothing turns on the date.)

[69] By this time there was worsening tension between the directors of the board of Lunan. One faction ("the Guimin camp") comprised the chairman, Zhang Guimin, Zhu Bingfeng, Li Bing and Su Ruiqiang. The other ("the Zeping camp") comprised Zhang Zeping, Li Guangzhong and Wang Buqiang. The Zeping camp were dissatisfied with the direction in which Zhang Guimin was taking Lunan. They wanted to remove him as chairman. On 19th February 2017 they had approached Wang Jianping with a view to retaining him as their lawyer in the upcoming corporate battle.

[70] On 20th February 2017 there was a meeting in KWM's Beijing offices between Ms. Zhao and Wang Jianping, where Ms. Zhao learnt for the first time of the existence of the Banyan Tree Trust and its terms. She was given a copy of the trust deed. Wang Jianping wanted

her to sign a document to ensure that her interest in the trust would pass on her death to her (Ms. Zhao's) daughter, but Ms. Zhao refused.

[71] On 27th February 2017, Ms. Zhao sent Wang Jianping via WeChat a query about the relevance of Jade Value to Endushantum. Originally Wang Jianping said that Jade Value held all the shares in Endushantum, but then corrected that to say that Jade Value held 90 per cent, with 10 per cent held by a management company owned by himself, Wang Buqiang and Zhang Guimin. That management company was Zhongzhi.

[72] Ms. Zhao says that these revelations destroyed her confidence in Wang Jianping. She threated to sue Wang Jianping. In return Wang Jianping offered to resign as protector of the Banyan Tree Trust and appoint Ms. Zhao's mother as the protector. The following day, 28th February 2017, Ms. Zhao was sent a renunciation by Wang Jiaoming of her interest in the Banyan Tree Trust, purportedly dated 1st February 2017, but probably backdated from 27th or 28th February.

[73] On 27th February 2017, Ms. Zhao gave an instruction to Lunan stating that she was the only legitimate owner of Endushantum and Endushantum's property. She said: "I hereby entrust my mother to manage the dividend collection on my behalf. I no longer empower Sharon Wei to do so." Zhang Guimin sent this to the Finance Department with the instruction: "Please handle accordingly." Wang Buqiang saw this.[1]

[74] On 2nd March 2017 the Zeping camp gave notice of a meeting of the board of Lunan to discuss removing Zhang Guimin as chairman. Before they could hold the meeting, however, on 7th March 2017 Zhang Guimin purported to dismiss them as directors and took physical control of Lunan. The directors in the Zeping camp were forcibly removed from Lunan's premises in Linyi. Subsequently each camp purported to pass board resolutions removing the other side from office. These efforts were legally ineffective, because it was only a shareholders' resolution which would permit the removal of directors.

[1] Wang Buqiang, transcript, day 7, pp 58-59.

[75] What then happened was that the Guimin camp continued to exercise day-to-day control of the business. In the current litigation, however, (until the reconciliation to which I shall come) Appleby took instructions from the Zeping camp. Lunan continued to pay the Zeping directors, notwithstanding that they were refused access to the premises or participation at board meetings.

[76] In early March 2017, both sides in the battle for control of Lunan took steps to seek Ms. Zhao's support in the forthcoming shareholder fights. Zhang Guimin introduced her to a woman called Zhao Xiaoai, but also known as Zhao Aili. He said she was a lawyer representing Lunan's supervisory board. (Some documents say Zhao Xiaoai was the board's legal representation, which may be different, but nothing turns on this.)

[77] On 8th March 2017, Ms. Zhao called (or purported to call) a shareholders' meeting. However, Mrs. Wei issued a declaration to Lunan's board stating that neither Ms. Zhao nor her mother were shareholders in Endushantum.

[78] On 9th March 2017 Zhao Xiaoai via WeChat showed Ms. Zhao a copy of the 2001 share entrustment agreement. This was the first time Ms. Zhao had seen it.

[79] On 10th March 2017, Lunan (probably on the Guimin camp's instructions) wrote to Mrs. Wei as follows:

> "Ms. Wei Sharon (Original Settlor): Lunan… entrusted 25.7% of the total shares to [Endushantum] for nominal shareholding. [Endushantum] signed a Trust Agreement with your company without the permission of Lunan Pharmaceutical, which in our opinion hurts our interest. We now demand you to immediately stop performing and terminate the Trust Agreement. We have engaged lawyers to take legal actions to pursue relevant liabilities."

[80] On 21st March 2017, Lunan (but on the Zeping camp's instructions) wrote to Mrs. Wei to say:

> "Considering the chaos in the Company and that the nature and ownership of the shares of [Endushantum] are still in controversy, in order to equally protect the interest of all shareholders and staff of the Company, the Company would like to

> maintain the current equity structure before the new Chairman and General Manager take control of the Company and order is restored. Please do not transfer your shares of the Company during this period."

[81] In early April 2017 Ms. Zhao went back to China. She and her husband, Wang Rui, arrived in Linyi on 3rd April. There she met Zhao Xiaoai for lunch, who subsequently allowed her to take various screenshots of documents off Lunan computers and an Excel spreadsheet. Ms. Zhao discovered that Zhao Xiaoai had broken into her father's desk in his office at Lunan (which had otherwise been left untouched after his death) on Zhang Guimin's instructions and found documents, including, it would seem, the 2001 share entrustment agreement. Ms. Zhao met Wang Buqiang on 7th April 2017 for dinner. I shall come back to this conversation. The following day, 8th April 2017, she again met Zhao Xiaoai. Relations broke down after Ms. Zhao indicated that she would not be supporting Zhang Guimin in the shareholder dispute. Zhao Xiaoai then refused Ms. Zhao further access to Lunan's computers.

[82] On 26th June 2017, Walkers, on Ms. Zhao's behalf, issued a stop notice in respect of shares in Endushantum. On 7th July 2017 Harneys, on Hengde's behalf, gave an undertaking to preserve the status quo. On 17th July 2017 Zhongzhi gave an undertaking to preserve the status quo of its 10 per cent shareholding in Endushantum. On 20th July 2017 Hengde and Endushantum issued the 2017/0125 proceedings which I am currently trying. These proceedings sought directions as regards the Banyan Tree Trust.

[83] On 18th August 2017 Hengde gave a further undertaking not to deal with shares held by Endushantum.

[84] On 21st August 2017 Ms. Zhao and Kunlun BVI issued the current proceedings under action number 2017/0151. I shall not give a full account of the procedural steps taken in the action. Issues of disclosure I shall deal with in a separate section. By order of 10th April 2017, this action was ordered to be heard together with Hengde's action. The trial was originally listed for hearing in April 2019, but that was adjourned and then adjourned again due to Covid, so it only came before me for hearing in March 2021.

[85] On 16th November 2017 Ms. Zhao was able to visit Lunan's premises again and take some further photographs of Lunan's records.

[86] On 23rd October 2019, the Zeping group of directors issued an open letter, complaining that Zhang Guimin had not obeyed a court order to reinstate them as active directors. Among numerous allegations of mismanagement was one of embezzling money:

> "At the beginning of this year, Zhang Guimin illegally transferred RMB 24,974 million[2] into the accounts of eight companies named after Zhang Guimin, including Shandong Guimin Pharmaceutical Sales Co Ltd (details of the 17 illegal transfers are attached below). These companies are basically newly established this year and have no business relationship with Lunan… Socially, it is public knowledge that a certain company in Linyi is laundering hundreds of millions of yuan for Zhang Guimin. Zhang Guimin is suspected of misappropriating huge amounts of money."

[87] Notwithstanding that letter, there appears to have been some kind of reconciliation. On 29th January 2020 Appleby (representing Lunan) told Walkers (representing Ms. Zhao) that they were taking instructions now from the Guimin directors.

[88] In the meantime on 5th December 2019, Lunan issued proceedings against Endushantum before the Intermediate People's Court of Linyi City. Whether this was before or after the reconciliation between the two camps of directors is not in evidence, but it is likely to be after the reconciliation. Although Lunan asked for the proceedings to be heard in private (as is possible in the PRC), the Linyi court did not grant this request. The trial was heard in open court on 7th February 2020. Zhang Guimin as chairman was the legal representative of Lunan. Two lawyers from the Shanghai Kingsway law firm, Wang Huaigang and Ceng Yan, appeared for Lunan. Mrs. Wei was the legal representative of Endushantum. Two lawyers from the Beijing Jing Xuan law firm, Wang Longhai and He Bei, appeared for Endushantum.

[2] The comma should probably be a decimal point.

[89] In its statement of claim, Lunan alleges that "[Kunlun US] and [Endushantum] signed an Agreement for Shareholding Rights Transfer on 11 September 2006. [Kunlun US] transferred its Entrusted Shareholding Interests to [Endushantum] to hold on its behalf. [Endushantum] promised to succeed all the rights and liabilities of Kunlun US based on the [Entrusted Shareholding Agreement]. On 11 October 2006 [Lunan's] Board of Directors passed a resolution and confirmed that variation."

[90] Endushantum admitted these averments in its defence. Importantly, it did not include in its list of documents submitted to the Linyi court the 2006 transfer agreement. That document was never before the Linyi court. Instead Endushantum conceded that it "enjoys all rights and assumes all obligations originally enjoyed and assumed by [Kunlun US] under the Agreement for Shareholding Entrustment." It simply asked for its annual fees. Further (despite this not being part of Lunan's case) Endushantum volunteered that it held shares in Shandong NT on the basis that Lunan funded the purchase. No mention was made of Zhao snr, Ms. Zhao or the litigation in the BVI. Nor were the issues raised in the current proceedings pleaded. No challenge was made to the jurisdiction of the Linyi court; instead Endushantum voluntarily submitted to the Chinese jurisdiction.

[91] Only Lunan raised an issue about the circumstances in which it acquired the shares and the application of article 149 of the **Company Law 1993**. On 8th January 2020 it served a document called "Opinions and explanations on the legal effect of the Entrusted Shareholding Agreement", which set out solely the arguments in favour of validity of the agreement.

[92] Judgment was delivered on 3rd April 2020. It is a public document. After the formal parts, it began:

> "Requests for litigation to this court were made by the plaintiff Lunan…
> 1. to confirm by the laws that the relationship of entrusted shareholding between the plaintiff and the defendant was released;
> 2. the costs of litigation for this case to be borne by the defendant.
>
> Facts and reasons: the plaintiff was originally named as Shandong Lunan Pharmaceutical Co Ltd, in April 2005, the name of the enterprise was changed to Lunan Pharmaceutical Group Corporation, upon verification and approval by the

administration authority for industry and commerce. On 15 March 2001, the plaintiff entered into an Agreement for Entrusted Shareholding [which was then set out]…

The defendant is a wholly owned subsidiary incorporated by [Kunlun US] in the British Virgin Islands in 2003. On 11 September 2006, an Agreement for Transfer of Equity Interest was entered into between [Kunlun US] and the defendant, [Kunlun US] transfer to the defendant the holding of equity held by it in trust for holding, the defendant undertook to succeed all of the powers and rights entitled by [Kunlun US] based on the Agreement and all of the obligations to be undertaken, the defendant shall be bound continuously by the Agreement.[3] On 11 October 2006, the board of directors of the plaintiff made board resolution, and made confirmation on such act of change. Afterwards, being an obligor of performance for such act of change, the plaintiff performed obligations and procedures for registration of change of equity interest. On 10 September 2019, Notice for Release of Entrusted Shareholding was served by the plaintiff to the defendant, notifying in writing the defendant of release of the relationship of entrusted shareholding, the defendant had also subsequently received the aforesaid notice. Until the date of this litigation initiated, the defendant had not made any confirmation on the act of exercise in respect of such right of release. The plaintiff is in the opinion that the defendant, being a successor of the outsider's rights and obligations as agreed by the Agreement, shall be bound by the Agreement. The exercise of such right of release of agreement by the defendant pursuant to the agreements of the Agreement is in compliant with the agreements of the contract and the requirements of the laws, request for confirmation is made therefore.

The defendant Endushantum Company advocated that:

1. The defendant recognized the existence of the relationship of entrusted shareholdings with the plaintiff.

2. The plaintiff shall pay to the defendant the service fees since the year of 2011. Commencing from the year of 2011, the plaintiff had not according to the agreements of the Agreement paid the service fee totalling 0.72 million.

3. The defendant would like to according to the agreements of the Agreement cooperate/coordinate with the plaintiff to release the Agreement for Entrusted Shareholding and to administrate the relevant change procedures for registration of industry and commerce. Upon the defendant's receipt of the notice of release by the plaintiff, clearly notifying the defendant of willing to cooperate/coordinate with the plaintiff to administrate the relevant change procedures for registration of

[3] The grammar has gone slightly wrong: this and the rest of the quotation is what is in the original translation. Although "held in trust" is used, this is not in the technical Chinese law sense. "Entrustment" would be a better translations: see below in the discussion on the Trust Law 2001.

industry and commerce, however provided that the plaintiff shall pay the service fees since the year of 2011. However the defendant had not made replied.

4. The defendant wished to release the relationship of equity interest holding on behalf of the plaintiff in the 25% of equity interest in [Shandong NT] as soon as possible.

…

According to the opinions of both of the litigant and the defendant, the focus issue disputed in this case is: the problem of recognition on whether the entrusted agreement involved is released or not. In the opinion of our court, the Agreement for Entrusted Shareholding entered into between the plaintiff and [Kunlun US] does not violate the mandatory requirement of the laws of our country, and shall be a valid agreement. And in the year of 2006 upon consent by the plaintiff, the transfer of the rights and obligations of such shareholding by [Kunlun US] to the defendant also does not violate the mandatory requirement of the laws of our country, such act of transfer shall be valid, and both of the plaintiff and the defendant shall performance subject to the agreements of the Agreement for Entrusted Shareholding. Agreement for Entrusted Shareholding provides both parties agree that Party A has the right to exercise disposal at any time against the equity interest of the 21 million shares held in the name of Party B or to release this Agreement, Party B must give cooperation/coordination. However, Party A must give written notice to Party B one month earlier. On 10 September 2019, Notice for Release of Entrusted Shareholding was served by the plaintiff to the defendant, notifying in writing the defendant of release of the relationship of entrusted shareholding, the defendant had also subsequently received the aforesaid notice. Therefore, the Agreement for Entrusted Shareholding involved shall be released at the time since the plaintiff's notice being served on the defendant, so the litigation request by the plaintiff for recognizing release of the relationship of entrusted shareholding between both parties shall be established, it is recognised by our court; the defendant advocates to request the plaintiff to pay fees for holding shares, howsoever, it clearly indicates counterclaim will not be initiated, this case will not trial.

Subject to the provisions under Article 161, Article 173.1(2) of the General Principles of Civil Law of the People's Republic of China and Article 88, Article 93(2), Article 96(1) under the Contract Law of the People's Republic of China, judgment is as follows:

It is recognized that the Agreement for Entrusted Shareholding entered into between the plaintiff Lunan Pharmaceutical Group Corporation and the defendant Endushantum Investments Co., Ltd. of the British Virgin Island is released.

419,800 dollars of case acceptance fee shall be assumed by the defendant Endushantum Investments Co Ltd of the British Virgin Island.

Where the verdict is dissatisfied, the plaintiff Lunan… may within fifteen days since the service date of the judgment, and the defendant [Endushantum] of the British

> Virgin Island may within thirty days since the service date of the judgment, submit petition of appeal to our court, and according to the number of persons of the counterparty produce duplicated copies. Appeal shall be held at the Supreme People's Court of Shangdong Province."

[93] No appeal was brought by either side. The existence of the judgment was not immediately disclosed to Ms. Zhao and Walkers. None of the documents generated in the proceedings were disclosed either. I shall discuss this breach of Lunan's and Endushantum's disclosure obligations as a separate issue. Appleby wrote in a letter of 10th February 2021 with admirable *sang froid*:

> "In the process of obtaining further documents from our client to prepare our further supplemental disclosure, we have been provided with a copy of a judgment of the Intermediate People's Court of Linyi City made on 3 April 2020. A copy of that judgment and our translation are enclosed. We are instructed that with effect from 5 February 2021 in respect of the Lunan shares, and from 9 February 2021 in respect of the shares in [Shandong NT] and [Biotech], Endushantum is no longer the registered owner of the disputed shares."

[94] The shares in Lunan and Shandong NT as well as those in Biotech are now held by two Hong Kong companies controlled by Zhang Guimin, Berpu and Provision, both incorporated on 5th January 2021.

The three bases of claim: (1) Burden of proof

[95] Three separate bases of claim are advanced on behalf of Ms. Zhao and Kunlun BVI, any of which, if made out, would entitle them to win.

[96] The first argument is founded on the burden of proof. As is put in their skeleton opening:

> "53. Zhao Long's claim is straightforward as against the present incumbent owners of the Endushantum Shares. She has *legal* title by virtue of an executed transfer of title in her favour before it was usurped by virtue of the executed transfer (see **Nilon Ltd v Royal Westminster Investments SA**[4]). She overcomes the presumption of ownership by the registered holders by exposing Sharon Wei's breach of trust and the knowing receipt of Jade Value and Zhongzhi.

[4] [2015] UKPC 2 at para [51].

> 54. Once she has shown them to be knowing recipients, Zhao Long has a better claim to title than Jade Value and Zhongzhi whose title is defeasible. Her title is of a pre-existing right to a proprietary legal title which prevails against them as the knowing recipients of the Zhao Trust as can be seen from **MacMillan Inc v Bishopsgate Investment Trust (No 3)**[5] where Millett J (see at p 990) spoke of 'superior claims'. A Class 1 type of pre-existing 'undestroyed proprietary base' which rests on an express trust trumps that of a Class 2 knowing recipient (see **Byers v Samba Financial Group**,[6] especially at para [46] and [52]).
>
> 55. Moreover, Zhao Long has a better claim to legal ownership than anyone else because she is the last person entitled to have legal title to the Endushantum shares. Once it is accepted that Jade Value and Zhongzhi became shareholders purely by usurpation and that they have to return the registered title (in the same way as a thief), the Zhao Long ought to benefit from the same presumptions of legal and beneficial ownership as any other owner (see **Chen v Ng**[7]). The burden of disproving that entitlement now falls on Lunan because Zhongzhi et al do not assert any right."

(2) Factual case on entrustment

[97] Ms. Zhao and Kunlun BVI put their second case in this way:

> "94. Lunan asserts title under [the] 'Share Entrustment Agreement' dated 15 March 2001… Lunan has no other factual basis for asserting title. The later discussions mean nothing unless Lunan can show that this was a valid agreement which was intended to remain in force.
>
> 95. The evidence as to [the] Share Entrustment Agreement is unsatisfactory in a number of respects and the preceding and subsequent circumstances do not support the existence of a long-term entrustment arrangement by which Lunan was to hold beneficial ownership in the Lunan Shares.

[98] The skeleton then recites Sitic's subscription of shares in Lunan and Zhao snr's falling out with Mr. Sun. It continues:

> "98. In order to replace Sitic as shareholder, someone had to agree to take over the foreign shares. To continue to benefit from the preferential tax regime the foreign shares had to be owned by a foreign entity. Such a share structure was specifically approved by the PRC authorities.

[5] [1995] 1 WLR 978.
[6] [2021] EWHC 60 (Ch).
[7] [2017] UKPC 27 at paras [40] to [42].

99. Kunlun US was identified after Zhao snr asked his friend, Wang Jianping, to help him find a foreign company as a business partner to take over Lunan's foreign shares from Sitic. It is also not in dispute that Lunan wanted Sitic to sell its foreign shares and was prepared to provide the funds to Kunlun US to buy the 21 million shares.

100. There is, however, disagreement as to the basis on which Lunan and Kunlun US was to act. Lunan's case is that Kunlun US was to act as Lunan's nominee and that it was 'buying' the shares once and for all. Ms. Zhao maintains that this was a temporary stop-gap arrangement to take advantage of the opportunity to get rid of Sitic whereby Lunan would lend funds and be repaid but that the trust owner was her father."

[99] The skeleton then put forward arguments against Lunan's position that the share entrustment agreement remained in force:

"103. First it involves Lunan engaging in sham ownership, a scheme whereby Lunan would falsely declare itself not to be the shareholder. If Lunan was truly the owner of the shares that was a fraud on the PRC tax authorities which was kept entirely secret and never mentioned until 2017. The blame for that cannot simply be laid at the doors of the deceased Zhao snr.

104. Secondly, if Lunan's case is correct, it has also engaged in a reduction of its own capital at a time when it was a relatively small company that could ill afford a reduction of RMB 77 million in capital. This was a clear violation of PRC company law and Wang Jianping would have known perfectly as a lawyer that this was unlawful, irrespective of the niceties of the principles of contractual invalidity.

105. Thirdly, Lunan's case also means that it lied to its shareholders, which included at the least present and former employees and their families.

a. Lunan's shareholders were not shown the foreign shares as an investment in any financial statements Lunan has disclosed. This remained the case long after Zhao snr died… [T]he foreign shares are… shown as capital.

b. They were also not shown a 100% holding in [Shandong NT] which held 100% in Lunan and Better.

106. Viewed in this way, the Share Entrustment Agreement is more plausibly seen as a temporary measure which was required by the need to replace a troublesome shareholder, Sitic, with a friendly shareholder, allowing the board room to return to its pre-Sitic state but with Lunan treating its funding as repayable, as indeed it did in its accounts. Zhao snr was the obvious person to perform that rôle for Lunan, controlling a foreign shareholder.

107. The Sitic payment needed to be urgently financed if Lunan was to keep the Lunan shares out of the hands of third parties. Lunan could do no more than provide bridging finance. Zhao snr and the Lunan Board would have appreciated that, if Lunan financed the initial payment, Zhao snr would eventually have to refinance the payment. A breathing space was ironically provided by the Sitic litigation after the payment was made."

(3) PRC law

[100] The third claim is based on PRC law. I consider various detailed points in the discussion of the expert evidence, but there are three main limbs to Ms. Zhao's case. Firstly, she alleges that the share entrustment agreement was unlawful, in that a company may not purchase its own shares. Secondly, even if the first share entrustment agreement was lawful, any proprietary rights Lunan may have had against Kunlun US, were lost when the shares were transferred to Kunlun BVI and Endushantum pursuant to the 2004 share transfer agreement. Thirdly, there was no breach of Zhao snr's duties as director and even if there were any breach it would only give rise to a personal claim which was barred by limitation.

[101] As to the first issue, Lunan says the purchase was lawful, because it was made through a nominee. Alternatively, it was lawful as a short-term measure. On the second issue the 2006 share transfer had the effect of carrying over the share entrustment arrangement in favour of Lunan. As to Its position on the third aspect of Ms. Zhao's case, Lunan pleads in its Re-Re-Amended Defence and Counterclaim as follows:

"14H Under the provisions of the 1999 and 2004 PRC [**Company Law**], it was provided (and similar provisions applied under Articles 148 to 150 of the 2006 PRC [**Company Law**]) that:

(1) Directors, supervisors and management personnel were to comply with the articles of association of the company and owed fiduciary duties towards the company, and they were not to use their duties and powers to seize personal interest for themselves or abuse their powers to receive or convert company assets (Article 159),

(2) Directors and management personnel were not to misappropriate company funds or use company funds to make loans to themselves or any others and were not to deposit company assets in a bank account opened in their names or that of their nominees or use company funds to provide guarantees for others (Article 60),

(3) Directors and management personnel were not to engage in similar business as the company's on their own or with others, or engage in any

> activity which damages [the] interests of the company and any income received by them in engaging in such business or activities belongs to the company. Directors and management personnel were not to enter into contracts with the company or carry out transactions with the company in violation of the provisions of the articles of association of the company or without the consent of the shareholders' meeting (Article 61).
>
> 14.I. In the premises, if as the Claimant avers (but which is denied), Zhao snr entered into any loan agreement with Lunan in 2001 or purported to apply dividends paid by Lunan or [Hope or Better] in respect of the Lunan shares in repayment of Lunan for the first Instalment in 2001 or, in making the Second Instalment in 2005, Zhao snr procured or was party to the transfer of the Lunan shares beneficially to Endushantum, where (a) in breach of Articles 59, 60 and/or 61 of the [**1999 Company Law**] and/or the [**2004 Company Law**] and/or (b) in breach of Article[s] 148, 149 and/or 150 of the [**2006 Company Law**] and/or in breach of his non-statutory fiduciary duties to Lunan…"

This is said to give rise to proprietary consequences.

[102] It is common ground that the relations initially between Kunlun US and Lunan and latterly between Endushantum on the one hand and Lunan on the other were governed by the law of the PRC: see para 111 of Lunan's closing. I shall therefore not consider the position in English or BVI law.

Limitation

[103] Mr. Rubin QC made various submissions about limitation and the rules of pleading. In **Comodo Holdings Ltd v Renaissance Ventures Ltd**,[8] I commented on section 6 of the **Statute of Frauds Amendment Act 1828**,[9] also known as Lord Tenterden's Act, which required fraudulent representations as to creditworthiness to be in writing, were they to be actionable. I held:

> "40. Provisions such as the 1828 Act are treated as procedural matters governed by the *lexi fori*: see **Dicey, Morris & Collins on the Conflict of Laws**[10] rule 19 and the discussion at para 7-027f; and **Leroux v Browne**[11]**,** applying the **Statute**

[8] [2019] ECSCJ No 272 (decision of 25th July 2019) at para [40].
[9] 9 Geo IV c 14.
[10] 15th Ed (2012).
[11] (1852) 12 CB 801, approved in Maddison v Alderson (1883) 8 App Cas 467 at 474, Morris v Baron & Co [1918] AC 1 at 15 and Irvani v G & H Montage GmbH [1990] 1 WLR 667.

> **of Frauds 1677**[12] to a contract made in France and governed by French law. Statutes of Limitation were also treated as part of the *lex fori*.[13] (In England, but not here, this has now been modified by the **Foreign Limitation Periods Act 1984**.)
> …
> 44. The defendants have not pleaded any reliance on the 1828 Act. However, the Civil Procedure Rules 2000… only requires the pleading of facts: see CPR 8.7, 8.7A and 10.5. The failure to plead issues of law, such as the effect of the 1828 Act, does not in my judgment therefore waive the point."

[104] The same necessarily applies to the **Limitation Act 1960**. A party can rely on it without it having been pleaded. It is this Act, rather than any PRC legislation, which governs limitation.

[105] If (contrary to this view) the PRC limitation period did apply, then the period of limitation was two years until 2017, when the limitation period was extended to three years: see para 16 of Mr. Mu's report.

[106] In fact, however, on the facts as I shall find them, no issue of limitation in fact arises.

The appropriate approach to evidence

[107] All counsel were content that when considering the witness evidence in the case, I should apply the approach which I set out in my recent judgment in **IsZo Capital LP v Nam Tai Properties Inc**:[14]

> "[75] I shall discuss the individual witnesses shortly. However, I first remind myself of the limitations of the assessment of the demeanour of witnesses. As Leggatt LJ (as he then was) said in **R (SS (Sri Lanka)) v Secretary of State for the Home Department**:[15]
>
> > '36. …[I]t has increasingly been recognised that it is usually unreliable and often dangerous to draw a conclusion from a witness's demeanour as to the likelihood that the witness is telling the truth. The reasons for this

[12] 29 Car II c 3.
[13] See Dicey at para 7-055ff.
[14] [2021] ECSCJ No 478, BVIHC (COM) 2020/0165) (3rd March 2021).
[15] [2018] EWCA Civ 1391.

were explained by MacKenna J in words which Lord Devlin later adopted in their entirety and Lord Bingham quoted with approval:[16]

> "I question whether the respect given to our findings of fact based on the demeanour of the witnesses is always deserved. I doubt my own ability, and sometimes that of other judges, to discern from a witness's demeanour, or the tone of his voice, whether he is telling the truth. He speaks hesitantly. Is that the mark of a cautious man, whose statements are for that reason to be respected, or is he taking time to fabricate? Is the emphatic witness putting on an act to deceive me, or is he speaking from the fullness of his heart, knowing that he is right? Is he likely to be more truthful if he looks me straight in the face than if he casts his eyes on the ground perhaps from shyness or a natural timidity? For my part I rely on these considerations as little as I can help."

37. The reasons for distrusting reliance on demeanour are magnified where the witness is of a different nationality from the judge and is either speaking English as a foreign language or is giving evidence through an interpreter. Scrutton LJ once said that he had "never yet seen a witness giving evidence through an interpreter as to whom I could decide whether he was telling the truth or not."[17] In his seminal essay on "The Judge as Juror" Lord Bingham observed:

> "If a Turk shows signs of anger when accused of lying, is that to be interpreted as the bluster of a man caught out in deceit or the reaction of an honest man to an insult? If a Greek, similarly challenged, becomes rhetorical and voluble and offers to swear the truth of what he has said on the lives of his children, what (if any) significance should be attached to that? If a Japanese witness, accused of forging a document, becomes sullen, resentful and hostile, does this suggest that he has done so or that he has not? I can only ask these questions. I cannot answer them. And if the answer is given that it all depends on the impression made by the particular witness in the particular case that is in my view no answer. The enigma usually remains. *To rely on demeanour is in most cases to attach importance to deviations from a norm when there is in truth no norm*. (Leggatt J's emphasis)'

[76] This warning echoes the earlier observation of the judge, sitting at first instance, in **Gestmin SGPS SA v Crédit Suisse (UK) Ltd**,[18] where he said:

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[16] "Discretion" (1973) 9 Irish Jurist (New Series) 1 at p 10, quoted in Devlin, The Judge (Oxford, 1979) at p 63 and Bingham, "The Judge as Juror: The Judicial Determination of Factual Issues" (1985) 38 Current Legal Problems 1 (reprinted in Bingham, The Business of Judging (Oxford, 2000) at p 9).

[17] Compania Naviera Martiartu v Royal Exchange Assurance Corp (1922) 13 Ll L Rep 83 at p 97.

[18] [2013] EWHC 3560 (Comm) at para [22].

> '[T]he best approach for a judge to adopt in the trial of a commercial case is… to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose — though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth.'

[77] Now this is not a binding rule. On the contrary, as the English Court of Appeal held in **Kogan v Martin**:[19]

> 'We start by recalling that the judge read Leggatt J's statements in **Gestmin v Credit Suisse** and **Blue v Ashley**[20] as an "admonition" against placing any reliance at all on the recollections of witnesses. We consider that to have been a serious error in the present case for a number of reasons… **Gestmin** is not to be taken as laying down any general principle for the assessment of evidence. It is one of a line of distinguished judicial observations that emphasise the fallibility of human memory and the need to assess witness evidence in its proper place alongside contemporaneous documentary evidence and evidence upon which undoubted or probable reliance can be placed… But a proper awareness of the fallibility of memory does not relieve judges of the task of making findings of fact based upon *all* of the evidence. Heuristics or mental short cuts are no substitute for this essential judicial function. In particular, where a party's sworn evidence is disbelieved, the court must say why that is; it cannot simply ignore the evidence.'

[78] An oft-cited summary of the appropriate approach (albeit in the context of fraud rather than improper motive) is that of Robert Goff LJ in **Armagas Ltd v Mundogas SA (The Ocean Frost)**:[21]

> 'Speaking from my own experience, I have found it essential in cases of fraud, when considering the credibility of witnesses, always to test their veracity by reference to the objective facts proved independently of their testimony, in particular by reference to the documents in the case, and

[19] [2019] EWCA Civ 1645, [2020] FSR 3 at para [88].
[20] [2017] EWHC 1928 (Comm) at paras [65]-[69].
[21] [1985] 1 Lloyd's Rep 1 at p 57.

> also to pay particular regard to their motives and to the overall probabilities. It is frequently very difficult to tell whether a witness is telling the truth or not; and where there is a conflict of evidence such as there was in the present case, reference to the objective facts and documents, to the witnesses' motives, and to the overall probabilities, can be of very great assistance to a judge in ascertaining the truth.'"

[108] I proceeded to remind myself that I needed to take a holistic view of the evidence. I give myself the same reminder in this case.

Wisniewski inferences

[109] I can in appropriate cases draw inferences of fact from a party's failure to call witnesses — a **Wisniewski** inference.[22] Brook LJ gave the following guidance:

> "(1) In certain circumstances a court may be entitled to draw adverse inferences from the absence or silence of a witness who might be expected to have material evidence to give on an issue in an action.
>
> (2) If a court is willing to draw such inferences they may go to strengthen the evidence adduced on that issue by the other party or to weaken the evidence, if any, adduced by the party who might reasonably have been expected to call the witness.
>
> (3) There must, however, have been some evidence, however weak, adduced by the former on the matter in question before the court is entitled to draw the desired inference: in other words, there must be a case to answer on that issue.
>
> (4) If the reason for the witness's absence or silence satisfies the court then no such adverse inference may be drawn. If, on the other hand, there is some credible explanation given, even if it is not wholly satisfactory, the potentially detrimental effect of his/her absence or silence may be reduced or nullified."

Adverse inferences from disclosure inadequacies.

[110] I turn first to the question of what adverse inferences I can properly draw from the deficiencies in Lunan's and Endushantum's disclosure. These comprise firstly the deliberate decision not timeously to disclose any documents in the Linyi proceedings and secondly general failings in Lunan's disclosure. In relation to this second limb, particular

[22] See Wisniewski v Central Manchester Health Authority [1998] PIQR P324, [1998] 1 Lloyd's Rep (Med) 223.

reliance is placed on an alleged failure by Lunan to comply with the order of Wallbank J of 17th February 2021, who ordered *inter alia* that Lunan produce a "complete set of the accounting ledgers for Zhao snr, Kunlun US, Kunlun BVI, Endushantum, [Sitic] and the corresponding entries in the general ledger and bank ledgers."

[111] As to the witnesses of fact who could give evidence about disclosure, I heard from Ms. Zhao on her and Kunlun BVI's behalves. Wang Jianping gave evidence on behalf of Hengde, Endushantum and Jade Value. Mrs. Wei had served a witness statement agreeing with her husband's evidence, but was not called. Wang Buqiang, Zhang Zeping and Li Guangzhong gave evidence on Lunan's behalf. It will be recalled they were in the Zeping camp of directors. No one from the Guimin camp gave evidence to me. Because Wang Buqiang, Zhang Zeping and Li Guangzhong had been excluded from physical access to Lunan's premises, they were unable to give evidence about the complaints made in relation to Lunan's disclosure. In consequence there was no one who could be cross-examined about any deficiencies in Lunan's disclosure.

[112] In **Matthews & Malek on Disclosure**,[23] the learned authors discussed what adverse inferences might be drawn from disclosure failures in the following terms:

> "Where a party has failed to provide proper disclosure or has destroyed documents, without there necessarily being any breach of an order or disclosure obligations, it is open to the court to draw adverse inferences at trial in relation to the absence of documents. Where the destruction of documents has occurred prior to litigation and not in breach of an order, it will rarely be appropriate to draw an adverse inference in the absence of evidence of deliberate spoliation in anticipation of litigation. If the court considers that the absence of documents is deliberate, then the court may take that into consideration in assessing the credibility generally of the person in default. Thus the inference may be drawn that the deliberate destruction demonstrates a consciousness of the weakness of the party's cause in general, and from that consciousness may be inferred the fact itself of the cause's lack of truth and merit. The second main inference is that the specific document is unfavourable to the cause of the party who has destroyed it. It has been held that for the latter inference to be drawn there must be some evidence of the contents of the destroyed document, although this may be too stringent and inflexible a test. Furthermore, negative inferences can be drawn in

[23] 5th Ed (2016) at para 17.38 (citations omitted).

relation to those issues which specifically relate to the categories of documents a party has failed to disclose in breach of his disclosure obligations."

[113] Thus it can be seen there are two separate evidential consequences. Firstly, the Court is entitled to take the failure to provide proper disclosure into account in determining credibility. Here there can be no automatic inferences drawn. The Court will look at the nature of the breach in considering what weight to attach to the breach of the disclosure duty. Searching with insufficient diligence is less likely deleteriously to affect a party's or a witness's credit than a deliberate failure to disclose. The Court will have to take an overall view when it balances all the evidence in the case.

[114] Secondly, the Court may make a finding of fact based on the non-production of a document. Mr. Rubin QC submitted, citing **Shawe-Lincoln v Neelakandan**:[24] "Whether it is appropriate to draw an inference at all and, if so, the precise nature and extent of such an inference will depend on the particular circumstances of each case." **Shawe-Lincoln** was a case of alleged medical negligence, where the general practitioner failed timeously to send the claimant patient to hospital. Lloyd-Jones J at para [12] explained:

> "[Counsel for the claimant] submits further that, while the burden clearly lies and remains on the claimant to prove on the balance of probabilities that the breach caused the injury suffered, the defendant, by his breach of duty in failing to cause him to be admitted to hospital at the appropriate time, has, in effect, deprived the claimant of the medical records of the progress of his condition and that this fact has hindered the presentation of the present claim. Here he relies on **Keefe v The Isle of Man Steam Packet Company Limited**.[25] That was a deafness claim by Mr. Keefe's widow against his former employers. The Department of Employment Code of Practice required employers to measure noise in their premises and if it was over a certain level, to take steps to reduce the noise or to provide ear protectors. At trial in the County Court there was no engineering evidence of noise levels in the ships in which Mr. Keefe had served. The judge found that the employers had failed to make noise assessments in breach of duty. The judge also found that Mr. Keefe was exposed to excessive levels of noise, sometimes in excess of the limit prescribed in the Code of Conduct. However the claim was dismissed because Mrs. Keefe had failed to prove that her husband was exposed to excessive levels for periods in excess of 8 hours with any regularity. The Court of Appeal reversed the decision. Longmore LJ referred to the judge's failure to

[24] [2012] EWHC 1150 (QB) at para 82 (Lloyd-Jones J).
[25] [2010] EWCA Civ 683.

give any weight to 'the potent additional consideration that any difficulty of proof for the claimant has been caused by the defendant's breach of duty in failing to take any measurements.' He continued:

> '19. If it is a defendant's duty to measure noise levels in places where his employees work and he does not do so, it hardly lies in his mouth to assert that the noise levels were not, in fact, excessive. In such circumstances the court should judge a claimant's evidence benevolently and the defendant's evidence critically. If a defendant fails to call witnesses at his disposal who could have evidence relevant to an issue in the case, that defendant runs the risk of relevant adverse findings see **British Railways Board v Herrington**.[26] Similarly a defendant who has, in breach of duty, made it difficult or impossible for a claimant to adduce relevant evidence must run the risk of adverse factual findings. To my mind this is just such a case.
>
> 20. This has been accepted law since **Armory v Delamirie**[27] the famous case in which a chimney sweep found a jewel in a chimney and left it with a pawnbroker for valuation. The pawnbroker, in breach of duty, failed to return it and could not be heard, when sued, to assert that the chimney sweep could not prove its value. The court awarded the highest sum realistically possible. A bailee's duty towards his bailor is, of course, different from an employer's duty to his employee but breach of the latter duty is not necessarily less serious than breach of the former.
>
> 21. The fact that the judge gave no (or virtually no) weight to this breach of duty coupled with my serious reservations about the reasons why he rejected the claimant's evidence persuades me that his judgment cannot stand and that, in the absence of a plausible competing cause of the claimant's hearing loss, this court should substitute the conclusion (to which he ought to have come) namely that the probability was that the claimant's loss of hearing was caused by excessive noise while employed on the defendant's vessels.'"

[115] I agree with Mr. Rubin QC that what inferences stand to be drawn is fact-sensitive. I also remind myself that it is necessary to take care as to what inferences should properly be drawn, even from a deliberate failure to produce documents. The situation is analogous to

[26] [1972] AC 877 at 930G.
[27] (1721) 1 Strange 505.

the case of witness who tells lies, where it is necessary to give a **Lucas** direction.[28] I explained this in **Comodo Holdings Ltd v Renaissance Ventures Ltd**,[29] as follows:

> "These [the elements of a **Lucas** direction] are of course usually given in criminal trials in the instructions to jurors, but (subject to the different burden of proof) apply equally to civil trials. I therefore direct myself as follows. Before I can use a lie to prove the contrary, I must be satisfied on balance of probability of the following. Firstly, the lie must be proved or admitted. Secondly, the lie must be deliberate and must not have arisen through confusion or mistake. Thirdly, it must not be told for a reason unconnected with the witness's liability (for example, through fear the truth would not be believed, to protect another, or for some reason advanced on behalf of the witness). If I am satisfied all three elements are made out, then I may use the lie as some support for the other side's case. A warning often given to juries is that witnesses sometimes seek to bolster a truthful case by telling stupid lies. I give myself the same warning."

The second limb of non-disclosure

[116] Mr. Lowe QC makes the following submissions in relation to the second limb, the alleged breaches of Wallbank J's order. (I shall omit most of the bundle references.)

> "86. The Supplemental Disclosure ordered by Wallbank J was not produced until 5 March 2021 shortly before the trial. Instead, of producing the relevant material what was produced by the plainly rushed supplemental disclosure (then in untranslated form) contained notable gaps. In particular, Lunan omitted to disclose any documents dealing with bonuses pre-2004. There is simply no evidence regarding Zhao snr's remuneration in the form of bonuses and wages prior to 2004 and how funds to his credit were used.
>
> 87. No ledger account at all has been disclosed. It is plain that a running ledger was kept for Zhao snr, an extract of which for the period between June to December 2004 clearly shows its existence. It is clear that if Lunan's system was capable of being used to print out ledgers for defined date ranges that a ledger for the relevant period in 2003 could have been but has not been produced. That would be so even if there no entries for that period. This cannot be checked for the sole reason that Lunan has failed to comply with the disclosure order.
>
> 88. Wang Buqiang admitted to having a further ledger for Zhao snr on his 'personal' computer at Lunan which has also not been disclosed. In his oral

[28] See R v Lucas [1981] QB 720.
[29] [2019] ECSCJ No 272, BVIHC (COM) 2013/0045 (25th July 2019) at para [263].

evidence Wang Buqiang said that he created and maintained an additional 'proxy ledger':[30]

> 'Q. And you kept those — you kept the records of all the bonuses, did you, on your computer, which we can't see?
> A. I transferred all the balance of the bonuses payable, or due to Mr. Zhao, to a separate ledger I kind of proxy-managed on his behalf.
> Q. When did you do that transfer?
> A. Approximately 2008.
> Q. When — so there's another ledger, proxy ledger, you say?
> A. Yes.'

89. All that is available, apart from the 'three column account' extracts are Zhao Long's computer screen shots of searches made without which there would have been very little information. Although the search appears to have been set the relevant date range between 01.01.2000 and 31.12.2012, it does not follow that the output from that search in would have thrown up the results for 2003. For example, Wang Buqiang agreed that school fees and other personal expenses were paid from the ledger, but the search produced no results for such transactions. The legal fees shown in H/189 also did not appear on the search despite the fact that the fees are plainly in the ledger. In any event, Lunan failed to give the relevant discovery.

90. It can be inferred that, had there been full disclosure and it had dated back to the most relevant period, it was very likely to have shown substantial receipts for Zhao snr in 2003. Annex 1 Table 1 to these submissions shows some of the bonuses from disclosed records. It is evident that there are other gaps such as in 2005 and 2006. Those ledgers ought to have shown more detail in relation to Zhao snr given the movement of Hope and Better dividends through Lunan's accounts evidenced by Wang Buqiang's memorandum (see further below).

91. The fact there are ordinary 'salary' entries for 2004 but none for 2001-2003 also begs the question what happened to his salary prior to 2004. One would expect to see a record of Zhao snr's salary from the earliest period of the ledger prior to 2004. No other hard copy information has been produced to enable Zhao Long to determine what was available to her father in the year 2003. No board minutes or other contractual information dealing with wages or bonuses were disclosed, although there is ample evidence that such material should exist. Wang Buqiang told Zhao Long specifically that the bonuses were set out in board minutes.

92. Whilst nothing at all for the most relevant period (2003) has been produced, it should be inferred (from what has been disclosed for 2004) that Zhao snr had substantial wages and bonuses available to him in 2003 when the shares for Hope and Better were financed.

[30] Transcript, day 6 p 27.

> a. The additional disclosure for the six months ending 31 December 2004 alone shows that Zhao snr was entitled to bonuses in excess of RMB11.26 million ('accumulated total for current year').
> b. Wang Buqiang claimed that the bonuses were calculated by reference to a government formula but no documents pertaining to that were produced. He gave no reason for saying that there had been a fundamental difference in the periods before and after 31 December 2004.
> c. The extract from Zhao snr's ledger at H/189 includes an entry stating that the Board resolved to credit Zhao snr with RMB 7,156,200. The board resolution has never been disclosed. Zhao snr was debited with 'annual salary' of RMB 6,314,960 in June 2004. His credit for the year was RMB 11.26 million. Some hard copy vouchers were produced for the 2004 bonuses but not all.
> d. On 16 August 2007 Zhao snr contributed part of annual salary (RMB3,830,712 contributed as company funds recorded). The same amount was 'returned' to Zhao snr on 27 December 2007.
> e. Wang Buqiang admitted to Zhao Long in 2017 that Zhao snr was entitled to substantial bonuses in the 'tens of millions' (see the transcript)."

[117] I agree with all these points. It is apparent from the screenshots taken by Ms. Zhao at Lunan's premises in 2017 that there were more documents than Lunan has disclosed. Since Lunan have called no one to explain the gaps in Lunan's disclosure, in my judgment it is open to me to draw adverse inferences of fact against Lunan. I have to take a holistic view of all the evidence before deciding whether to draw such an inference, however there is in my judgment a basis for inferring, as Mr. Lowe QC invites me to, that Zhao snr used his wages and bonuses to fund the subscription payments made by Lunan to Hope and Better between 23rd and 26th December 2003 in return for 25% of equity in each then held for him by Kunlun US.

[118] I am reinforced in my view that an inference is capable of being properly drawn by my view of Lunan's failure to disclose the Linyi proceedings. This latter failing clearly shows that Lunan attached no weight to its obligation to produce relevant documents and was perfectly willing to suppress inconvenient documents until it decided it was in its interests to disclose them.

[119] Whether I should or should not draw the inference is one that requires me to consider all the evidence in the case, so I shall return to this point.

The first limb: Wang Jianping

[120] Mr. Rubin QC rightly made no attempt to defend the late disclosure of the Linyi proceedings. The decision by Wang Jianping, Mrs. Wei and the directing minds of Lunan not to disclose the existence of the Linyi proceedings and the documents connected therewith was a deliberate breach of their disclosure obligations to the Court.

[121] The only witness from whom I heard to explain the late disclosure of the Linyi proceedings was Wang Jianping. He is in many ways a remarkable man. After admission to the Chinese bar, he attended Harvard Law School, where he obtained an LLM. He received a JD from St Louis University and was then admitted to the Missouri bar. I think I can take judicial notice of the fact that the Harvard Law School is one of the leading law schools in the United States and admits students of commensurate quality. Equally, his ability to master two very different systems of law shows him to be an exceptionally skilled lawyer. Of course my ability to assess his ability as a lawyer as he was giving evidence was limited. However, when a legal issue was mentioned, he showed an impressive grasp of the relevant law. For example, he knew the precise issues of US tax law which would potentially affect his wife, if Kunlun US kept the shareholding in Lunan long-term. Equally, he was able to explain the differences between professional rules of conduct in America and the PRC when I asked him whether it was appropriate for Lunan's lawyers to speak to him directly in the course of the Linyi litigation.

[122] One matter I should mention is that Wang Jianping gave his evidence in Chinese. Mr. Lowe QC had expected him to give his evidence in English. Wang Jianping explained, however, that his English was rusty and that he preferred to give his evidence through an interpreter. I entirely understand his position. I was admitted to the German bar from 2000 to 2014 and spoke German to a high standard. Nonetheless I, like Wang Jianping, would be nervous giving evidence in a case involving nine-figure sums in a language which I was no longer speaking on a daily basis. I draw no adverse inference from his giving evidence in Chinese.

[123] Although it is more difficult to assess a witness's character when he gives evidence through an interpreter, there were occasional flashes of wit and humour. I find that Wang Jianping has qualities of charm and charisma.

[124] His explanation for not disclosing the Linyi proceedings starts at para 19 of his witness statement. He says Endushantum received the summons to attend the Linyi Intermediate People's Court on 19th December 2019. He and his wife decided to appoint Wang Longai of Beijing Jing Xuan Law Firm to represent Endushantum in the litigation. He then said:

> "21. Around this time (I cannot recall the exact date), Ms. Wei received a telephone call from Lunan's lawyer, Mr. Wang Huaigang, who began to speak to her in a threatening manner about not disclosing the existence of the Linyi Proceedings. Ms. Wei informed Lunan's lawyer that it was better to speak to me about this and passed her mobile to me to continue the conversation. I was told that under no circumstances should I disclose anything about the Linyi Proceedings to anyone, that Ms. Wei and I were bound by confidentiality obligations arising out of the Share Entrustment Agreement, and that were I to reveal this information, Ms. Wei or I would be sued in the PRC. As a PRC citizen and resident, I was not prepared to take the risk of legal proceedings being brought against me or my wife, and I therefore felt compelled to comply with the instruction given."

[125] He says he raised the issue of the BVI proceedings with Endushantum's Chinese lawyers, but they "advised… that the BVI proceedings were not relevant and should not be raised." He does not explain why. He says Endushantum received the Linyi judgment on 26th April 2020, but says: "I did not take any steps in response to it. I felt extremely uncomfortable about the whole situation and decided that if the shares were to be transferred, this should be done by Lunan or the Court." In June 2020, he says Zhao Fenglin, one of the judges in the Linyi proceedings, approached his wife to tell her to complete the share transfer. (Mrs. Wei did not give evidence of this, which is accordingly hearsay.)

[126] I do not accept this evidence about the Linyi proceedings given by Wang Jianping. Firstly, the existence of share entrustment agreement was already in the public domain. Hengde and Endushantum had already disclosed it in the 2017/0125 action in this Court. Any damage to Lunan had already occurred.

[127] Secondly, there is no documentary evidence whatsoever to support the allegation of threats. It must be recalled that Wang Jianping was the senior partner of KWM, a major law firm in China. It is second nature for lawyers like him to keep some documentary record of significant happenings. It would be normal for him to have Wang Longai write to Wang Huaigang (a) to complain that the latter's threats were completely inappropriate and (b) to ensure that there was a contemporaneous record of the threats having been made. There is no evidence from Wang Longai, either oral or documentary, to corroborate what Wang Jianping says. Yet no reason is advanced for not obtaining evidence from Wang Longai.

[128] Thirdly, it is apparent that Ms. Zhao's case was never put before the Linyi Court. I asked Wang Jianping about this.[31]

> "THE COURT: In these proceedings here in the BVI Ms. Zhao is putting forward quite a detailed case as to why she is entitled to the Lunan shares or at least the beneficial ownership of the Lunan shares. None of that was put before the Linyi Court; is that correct?
> THE WITNESS: Yes.
> THE COURT: Why not?
> THE WITNESS: That's because my lawyer told me the party involved in the Linyi Proceedings was Endushantum, and it has, so who are, who were those shareholders behind other (unclear) has legal thing to do with the Linyi Proceedings.
> THE COURT: …Mr. Wang Longhai from the Jing Xuan Law Firm, he swore all the documents in the BVI Proceedings, did he?
> THE WITNESS: No. I told him about the background, but I didn't submit all the documents to him.
> THE COURT: And did you ask him for a written opinion as to what you ought to do? It's just obviously there are some damaging allegations being made against you now. Did you ask him to set out in writing why he was giving the advice he was giving you?
> THE WITNESS: I don't have such a written opinion available, but if that's needed I can ask him to write such an opinion in writing."

[129] Ms. Zhao's case was allowed to go by default. A careful lawyer, like Wang Jianping, would in my judgment ensure that there was a record of why such a major (and on its face surprising) step was being taken, if it were legitimate. There is a complete absence of

[31] Transcript, day 6, pp 54-55.

evidence to corroborate Wang Jianping's reasons for taking this very exceptional course. Wang Jianping's suggestion that "if that's needed," he "can ask [Wang Longai] to write such an opinion in writing" is not worthy of credence in a lawyer of Wang Jianping's standing. Obtaining an opinion should have been done (assuming the making of admissions was legitimate) *before* the defence to the Linyi proceedings was served. Not even an *ex post facto* opinion has been obtained to provide some justification for what Wang Jianping did in the Linyi proceedings.

[130] Fourthly, the obvious recourse in response to any threat by Lunan's lawyers was to raise the matter with the Linyi Court and ask them to confirm that there could be no issue with disclosure of the Linyi proceedings to Endushantum's BVI lawyers. Wang Jianping accepted[32] that "the Linyi Court didn't make any ruling on the disclosure. It was Lunan's lawyer who cautioned us against it." Of course, Lunan was as much in breach of its obligations to this Court as Endushantum, so one would have thought the Linyi Court would have indicated that there was no impediment to either Endushantum or Lunan complying with their obligations here in this Territory.

[131] Fifthly, Wang Jianping rose to become the senior partner of a major law firm. He would not have achieved that degree of professional success without a degree of toughness and resilience. In evidence he was disdainful of Wang Huaigang and the Shanghai Kingsway law firm, which he evidently thought was not a patch on KWM. That attitude is inconsistent with his case that he was trembling at the idea of him and his wife being sued by them for breach of confidence.

[132] The failure timeously to disclose the Linyi proceedings was a grievous interference with the proper administration of justice by this Court and I find that it was intended to be such. It shows in my judgment a complete absence of integrity on the part of Wang Jianping, his wife and those in the Guimin camp at Lunan. It may well be a criminal contempt of Court as well,[33] but I have not heard full argument on this. It leads me to have severe doubts about the truth and reliability of Wang Jianping's evidence to the Court.

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[32] Transcript, day 5, p 24.

[33] See Matthews & Malek on Disclosure (5th Ed, 2016) at para 7.31ff.

[133] Mr. Cooper QC submitted that Wang Jianping never stood to gain from the position he adopted in this litigation. "At no stage have [Wang Jianping and Mrs. Wei] ever claimed to be anything other than trustees or nominees for someone else. Nor has it been explained how the Banyan Tree Trust was supposed to benefit them personally, or why it would be to their advantage if the court were to hold that Lunan, rather than Zhao Long, is the true beneficial owner. That part of Zhao Long's case is simply not understood." I do not accept this. Firstly, Wang Jiaoming, the daughter of Wang Jianping and Mrs. Wei, was until her renunciation a beneficiary of the Banyan Tree Trust. Further as protector of that trust Wang Jianping had the power to appoint and remove beneficiaries. Secondly, he contemplated personal gain for himself under the 29th December 2014 plan. Thirdly, he is, or at least seems to be, beneficially interested in Zhongzhi.

[134] I should add that Mr. Lowe QC put some reliance on the fact that Wang Longhai from the Jing Xuan Law Firm had also represented Wang Buqiang in the litigation by him against Lunan which settled in 2019. There are reasons to be suspicious of this sharing of legal representation, but I find there is insufficient evidence to draw any conclusions about why this occurred or as to whether any inferences should be drawn.

The Linyi judgment and its effect

[135] It is convenient at this point to consider the legal effect of the Linyi judgment. Mr. Rubin QC argues that the judgment should be recognised at common law. He relies on rule 42(2) of **Dicey, Morris & Collins on the Conflict of Laws**,[34] which provides:

> "A foreign judgment given by the court of a foreign country with jurisdiction to give that judgment in accordance with the principles set out in Rules 43 to 46, which is not impeachable under any of Rules 49 to 54 and which is final and conclusive on the merits, is entitled to recognition at common law and may be relied on in proceedings in [here, the BVI]."

[136] However, this is in my judgment subject to the general rule that the Court will not recognise fraudulent or collusive judgments. In this regard, **Spencer Bower & Handley on Res Judicata** says:[35]

[34] 15th Ed (2018) at para 14R-20.
[35] 5th Ed (2019) at para 17.10.

> "Collusion is play-acting by litigants for a common purpose involving the pretense of a contest. The 'play' is generally 'foul play', but need not be. There is a distinction between fraud and collusion although their effect is the same."

[137] The leading case is **Earl of Bandon v Becher**.[36] There a decree had been obtained from the equity side of the Irish Court of Exchequer, whereby the life tenant of some land managed to defraud the infant tenants in tail. Lord Bougham, sitting in the House of Lords, stated the law as follows:[37]

> "It is said that the whole of these proceedings spring from a decree of the Court of Exchequer in Ireland, and that that decree being pronounced by a Court of competent jurisdiction, upon parties legally before it, cannot now be questioned in another Court of co-ordinate jurisdiction; but, if brought into dispute at all, should be brought into dispute in the Court where it was originally pronounced. I agree generally to the proposition, but I must add to it this one qualification, that you may at all times, in a Court of competent jurisdiction, —competent as to the subject-matter of the suit itself,— where you appear as an actor, object to a decree made in another Court, upon which decree your adversary relies; and you may, either as actor or defender, object to the validity of that decree, provided it was pronounced through fraud, contrivance, or covin of any description, or not in a real suit; or if pronounced in a real and substantial suit, between parties who were really not in contest with each other. That it is undeniably true that the Court of Chancery has no right to review a decree of the Court of Exchequer; that nothing but a Court of Appeal can give redress if such decree is erroneous, is clear, and indeed nothing can be more true than such a proposition; but it is equally true, that if the decree has been obtained by fraud it shall avail nothing for or against the parties affected by it, to the prosecution of a claim, or to the defence of a right. These two propositions are undeniably true; they are recognised in practice, they are independent of each other, and they stand well together. That was the rule stated as deduced from all the authorities in a case which, having been decided in the Court of Arches, was subsequently the subject of discussion in another Court. The question was, whether the judgment of the Court of Arches was conclusive and binding on all other Courts, not Courts where that judgment was before them on appeal. Mr. Solicitor-general Wedderburn, in his excellent argument in that case, thus summed up the effect of all the authorities:[38] —'A sentence is a judicial determination of a cause agitated between real parties, upon which a real interest has been settled;—in order to make a sentence there must be a real interest, a real argument, a real prosecution, a real defence, a real decision. Of all these requisites not one takes place in the case of a fraudulent and collusive suit; there is no Judge, but a person invested with the ensigns of a judicial office, is

[36] (1835) 3 Cl & Fin 479.
[37] At pp 510-511.
[38] The Duchess of Kingston's Case (1776) 2 Smith's LC (13th Ed) 644, 20 Howell's State Trials 355 at pp 478-9.

> misemployed in listening to a fictitious cause proposed to him; there is no party litigating, there is no party defendant, no real interest brought into question.' On the whole, I am of opinion that this case falls within the rule there stated, and which I quote from Mr. Wedderburn's statement because of the aptness of the expressions. It is not an irregularity, it is not an error which is here complained of, but it is that the whole proceeding is collusive and fraudulent; that it cannot therefore be treated as a judicial proceeding, but may be passed by as availing nothing to the party who sets it up."

[138] In my judgment, the Linyi proceedings give rise to a clear case of a collusive judgment. Endushantum conceded its liability, when, as it knew full well, there were arguable defences. Wang Jianping was extremely well-qualified in company and trust law (indeed, probably as well-qualified, if not better qualified, as the two experts in this case). I find as a fact that he knew there were not just arguable, but in truth strong, defences to Lunan's claims. The 2006 share transfer agreement was not put before the Linyi court. The Linyi court was misled as to the terms of that agreement. Nothing was said to the Linyi court about the pending BVI proceedings, or of the interest of Ms. Zhao in the matter. As a result the Linyi court was seriously misled. There was also a breach of Hengde's undertaking. These were, I find, all deliberate decisions made in order to spirit the Lunan shares away from Endushantum.

[139] The secrecy Wang Jianping and Lunan showed in relation to the Linyi proceedings vis-à-vis this Court is a classic indicator of impropriety.

[140] Mr. Rubin QC at para 233.6 of his closing submissions says:

> "the Linyi judgment is a valid and subsisting judgment of the PRC Court. Unless and until set aside, Lunan is entitle[d] to the property (being company shares sited in the PRC) to which that Court held it entitled. If the Claimant seeks to undo the effect of that judgment, she can take the appropriate steps before the PRC Court. This Court, with respect, is not competent to undo that judgment."

[141] He is, of course, right that this Court cannot set aside the Linyi judgment. However, in accordance with the **Bandon v Becher** decision, it is possible to consider it as a proceeding which cannot determine any rights as between Endushantum and Lunan. I do so hold.

[142] It will be recalled that the Linyi court decided that:

> "the Agreement for Entrusted Shareholding entered into between the plaintiff and [Kunlun US] does not violate the mandatory requirement of the laws of our country, and shall be a valid agreement. And in the year of 2006 upon consent by the plaintiff, the transfer of the rights and obligations of such shareholding by [Kunlun US] to the defendant also does not violate the mandatory requirement of the laws of our country, such act of transfer shall be valid, and both of the plaintiff and the defendant shall performance subject to the agreements of the Agreement for Entrusted Shareholding."

[143] The court gives no reason for saying the original 2001 share entrustment agreement was valid. Given that no argument to the contrary was addressed to it, the weight to be given to this holding of the Linyi court is in my judgment negligible. Further, as a matter of principle, because the Linyi court was not determining a real dispute, its legal reasoning is not binding or even persuasive. Moreover, a decision in respect of the 2001 agreement was not necessary to its decision. This is because Endushantum conceded that the 2006 transfer agreement created an entrustment relationship. That would have created a fresh obligation regardless of the validity of the 2001 entrustment. (The analogous situation in English law would be where Endushantum considered it had a moral obligation to Lunan in respect of shares and in 2006 voluntarily made a declaration of trust of the shares in favour of Lunan. No consideration would be required.)

The witnesses of fact

[144] I turn then to the witnesses of fact. As I have said, Ms. Zhao gave evidence on behalf of herself and Kunlun BVI. She was their only witness. Wang Jianping was called for Hengde, Endushantum and Jade Value and was their only witness. A three-paragraph witness statement was made by Mrs. Wei and served on those three companies' behalves, but she was not called, so her witness statement was not admissible. Lunan called Wang Buqiang, Zhang Zeping and Li Guangzhong. Lunan called no one from the Guimin side of Lunan.

[145] Ms. Zhao was clearly a very intelligent woman. She studied law in the PRC and did an internship at KWM, although she was never called to the Chinese bar. She went to the United States for post-graduate legal studies. I found her generally a witness of truth.

However, she was a young woman in the early part of this century and had little direct knowledge of events at that time. When matters became tense in 2017, she took to recording conversations on her mobile phone. Her evidence to me was that those to whom she spoke knew she was recording them. She said this was on the basis that her mobile phone would be on the table at which they were sitting. I am doubtful that there was any proper consent by her interlocutors to the making of the recording. However, no issue arose of excluding the evidence under section 125 of the **Evidence Act 2006**.[39]

[146] I have already commented on Wang Jianping's evidence.

Wang Buqiang

[147] Wang Buqiang had direct knowledge of many of the events in issue. He had a hand in the drafting of the 2001 share entrustment agreement. He also saw the 2003 equity transfer agreement in favour of Zhao snr. He says that he thought Zhao snr would hold the Endushantum shares as nominee for Lunan.

[148] In his first witness statement, he says:

> "47. The transfer to Endushantum pursuant an agreement dated 11 September 2006 was approved at a meeting of the board of Lunan, which was recorded in a board resolution dated 11 October 2006. Para 2 of the resolution recorded the fact that Endushantum would assume the rights and obligations of Kunlun Properties US. Lunan's intention in approving the transfers to Endushantum was that Endushantum would hold the Shares (as well as the shares in the other Lunan group companies) as its nominee.
>
> 48. On 9 August 2006 the boards of Lunan Better and Lunan Hope approved transfers of their shares from Kunlun Properties US to Endushantum pursuant to agreements of the same date."

[149] In 2007 he saw the Zhao Trust document. He says:

> "51. Kunlun [BVI] was Mr. Zhao's company and I understood the Mr. Zhao intended to benefit personally from this arrangement. Mr. Zhao told me to keep the document secret. I thought was Mr. Zhao was proposing was unlawful and

[39] No 15 of 2006, Laws of the Virgin Islands.

> inconsistent with Lunan's rights, but I was his subordinate and thought I had to what he said.
>
> 52. After 2007, Mr. Zhao personally drew the dividends for himself due on the Shares and tax refunds of re-investment many times. A screenshot of some entries on Mr. Zhao's account with Lunan has been disclosed by Zhao Long in these proceedings. I do not know how she obtained that screenshot. It shows the credit to the account of dividends and the use of the proceeds for Mr. Zhao's own personal expenses. These included personal investments by Mr. Zhao, personal expenses (such as Zhao Long's wedding fees) and an annual payment to Wang Jianping to manage the 'trust' (after 2007).
>
> 53. In November 2010 Kunlun Properties US transferred its shares in Endushantum to Kunlun [BVI]. I suspected this was a breach of the nominee arrangement, but I continued to keep quiet at Mr. Zhao's request."

[150] He denied that after Zhao snr's death he asked Wang Jianping to get Ms. Zhao's authorisation to vote the Lunan shares held by Endushantum, as Wang Jianping recorded in his email to Ms. Zhao of 25th November 2014. Wang Jianping had no reason to invent this instruction from Wang Buqiang. Wang Buqiang's denial is improbable against this contemporaneous documentation.

[151] It will be recalled that a very substantial dividend payment was made to Ms. Zhao in 2016. This must ultimately have been known to Wang Buqiang, as the finance director. He also saw Ms. Zhao's instruction of 24th February 2017, which the chairman had told him to action. At no time did he raise the propriety of this or of the dividend payment with Ms. Zhao in his recorded conversations with her.

[152] It was suggested to Wang Buqiang in cross-examination that, after the falling out with the Guimin camp, he must have discussed with Wang Jianping matters like Ms. Zhao's entitlement to the shares:[40]

> "Q. And I suggest that what happened after 2017 is that there was a huge amount of debate about the ownership of the disputed shares, wasn't there?
> A. No, there wasn't any debate.
> Q. Well, I am going to suggest to you that there has been many occasions when you have discussed the facts of this case with Wang Jianping.
> A. No.

[40] Transcript, day 7, pp 55-56.

> Q. Well, have you ever discussed it with him?
> A. No, we have never discussed this matter.
> Q. Well, I am suggesting that's untrue. You have discussed with Mr. Wang Jianping, with whom you remain friendly, his own recollection of the facts surrounding the ownership of these shares, haven't you?
> A. No, we have never discussed that."

[153] This denial by Wang Buqiang is, in my judgment, inherently unlikely.

[154] Wang Buqiang raised an issue about chops. These are a form of seal often used in China for certifying documents. It was suggested that the fact that some documents were sealed with a particular chop showed that Zhao snr was acting in his capacity of legal representative of Lunan when executing the document concerned. Although a lot of time was spent at trial on this issue, the evidence in my judgment is not such that any such conclusion can be drawn. Firstly, it is common ground that there was nothing inherent in the chop which cast light on this. The ideograms which the chop reproduced when it was used to seal a document referred solely to Zhao snr, not to any capacity in which he used the chop. Secondly, Ms. Zhao said that her father liked chops on aesthetic and cultural grounds. His use of them does not therefore necessarily mean he had a commercial purpose in using them. Thirdly, there is no supporting evidence for Wang Buqiang's testimony that he kept this chop in the finance department for application to documents on Zhao snr's instructions. Moreover his evidence about chops was adduced at a late stage and there are doubts (which I will have to determine) about the reliability of Wang Buqiang's evidence. Overall the evidence about this chop is in my judgment inconclusive.

Zhang Zeping

[155] Zhang Zeping joined what became Lunan in 1976. He was on the manufacturing side of the business and rose to become a director in 1991. The original purchase of shares from Sitic he described in this way in his witness statement:

> "14. Mr. Zhao told me that Sitic's shares would be acquired by Kunlun [US], using Lunan's funds. Kunlun Properties US would hold the shares on behalf of Lunan as its nominee. Mr. Zhao said that this would be good for production and avoid further conflict. As Kunlun Properties US was a foreign company Lunan would continue to enjoy favourable tax treatment given to foreign/local joint ventures.

> 15. Mr. Zhao said that Kunlun Properties US was owned by Lunan's legal advisor, Wang Jianping and his wife Sharon Wei. I met Mr. Wang before at Lunan's office but did not know him well. I never discussed the proposed arrangement with him. I did not know his wife, Sharon Wei but had heard of her.
>
> 16. I recall Mr. Zhao showing me the nominee agreement that he had signed for Lunan and that Mr. Wang had signed for Kunlun Properties US."

[156] There are a number of difficulties with this. Firstly, the 2001 share entrustment agreement was not signed by Wang Jianping, it was signed by Mrs. Wei, which raises a doubt as to whether he actually saw it. Secondly, Wang Jianping's evidence was that Kunlun US was to have only temporary involvement. See the following extracts from Wang Jianping's cross-examination:

> "A. Well, as you can tell from my witness statement, while Kunlun US was holding the foreign shares for Lunan, we made it very clear to the management we would only be willing to do so temporarily, and it is expected — it's expected that Lunan could identify a possible investor as soon as possible, or we can devise a structure for Lunan to hold its own foreign shares."[41]
>
> "Q I suggest that what you really advised him of was that you couldn't have this arrangement on a long-term basis because of the rules about companies purchasing and financing purchases of their own shares.
> A. Well, actually my suggestion was that Kunlun US could temporarily do this from money, funds, provided by Lunan, as it says in this translation, and we only would like to do it on a temporary basis on trust for Lunan, because we didn't want to be a shareholder of Lunan. Once Lunan could find a better investor, we would quickly just transfer the shares."[42]
>
> "Q. And that [clause 3 of the share entrustment agreement] was not, I suggest to you, intended to change the condition that you'd put in that this would be a strictly temporary arrangement, was it?
> A. No. No.
> Q. Yes. You were not trying to encourage Lunan to view this as a long-term arrangement, were you?
> A. No.
> Q. So the idea was that you expected Lunan to assign these rights to a suitable purchaser as soon as possible?
> A. Yes.

[41] Transcript, day 4, p 42.
[42] Transcript, day 5, p 41.

> Q. And as soon as that happened, the whole arrangement, the Entrustment Arrangement would fall away, wouldn't it, because someone else would have paid Lunan for the shares or paid Lunan back for the shares?
> A. Yes.
> Q. Yes. And the reason that didn't happen was because SITIC challenged the validity of the transaction in 2001? There couldn't be a sale while that challenge was on foot, could there?
> A. Yes, we had to wait for the ruling from Court so as to continue with the sale."[43]

[157] Wang Jianping's evidence that the share entrustment was to be temporary is in accordance with Ms. Zhao's case. He explained — in my judgment, on this point convincingly — that the entrustment could not be long-term because of the tax implications for his wife. Yet, Zhang Zeping says nothing about the short-term nature of the entrustment.

[158] Later, when discussing the board resolution of 11th October 2006 approving the transfer of shares from Kunlun US to Endushantum, there was the following exchange between Mr. Lowe QC and Zhang Zeping:[44]

> "A. So at that board meeting, it was decided that Kunlun US shall transfer its shares to its subsidiary of Endushantum and then Endushantum shall continue to hold the shares of the foreign investor shares as the nominee on behalf of Lunan Pharmaceuticals. As it was a very important matter, so I do remember that event.
> Q. Well, it doesn't say in Resolution 2 that it is going to hold the shares, Endushantum, on behalf of Lunan, does it?
> A. So during the board meeting, it was adopted that Endushantum shall succeed the Kunlun US to hold the shares and Endushantum shall continue holding the share of Lunan's foreign investor share on behalf of Lunan Company and Endushantum shall follow the instructions from Lunan to act.
> Q. Why doesn't it say all that in the Resolution that you signed. If that's really true, why doesn't it say that?
> A. We did have discussions on that matter during board meetings, namely, that Endushantum shall hold the shares on behalf of Lunan. As to why it was not immortalised in the Resolution, it was beyond my knowledge.
> Q. Is it possible that what Mr. Zhang said to you is that Endushantum would follow instructions from the Board on how to behave as a shareholder?
> A. Mr. Zhang or Zhao?
> Q. Mr. Zhao sorry, Mr. Zhao.
> A. If you look at Resolution Article 2, it is agreed: 'Endushantum will undertake the relevant liabilities of a foreign investor, and act as a new foreign investor to

[43] Transcript, day 5, pp 50-51.
[44] Transcript, day 7, pp 84-86.

> continue performing the rights and obligations of a foreign shareholder.' And, you know, Kunlun US as the foreign investor already had the rights and obligations to hold the Lunan shares on behalf of Lunan and follow instructions from Lunan as well. We did have discussions that Endushantum, as the subsidiary of Kunlun US, shall continue performing rights and obligations and later holding the shares on behalf of Lunan.
> Q. I am going to suggest to you that that isn't what you actually remember at all. You don't really know what the difference was between instructions to behave in a certain way and instructions to hold as owner, do you?
> A. I did attend the board meeting and it was a very important matter, therefore, recollection of that event has been very clear in my mind.
> Q. And it's the first time in 2019 that you set out that recollection, wasn't it? You have never before said this about the 2006 meeting, any of this?
> A. No. That meeting did happen back in 2006. It represent an important format of the history of the Company of Lunan. I, therefore, do have recollections of the event. As [I] explain at the very, very beginning that I tend to remember very important matters."

[159] This is in contrast to Li Guangzhong's testimony about the same meeting, where the cross-examination proceeded:

> "Q. A lot of these events, and you have told us you retired, you started at Lunan in 1976, didn't you?
> A. Yes.
> Q. And you must have gone to many, many board meetings before you retired?
> A. Yes.
> Q. And it must be very difficult to recall particular discussions without notes or minutes which record those discussions, correct?
> A. That could be true, but for important matters I do recall.
> …
> Q.[Taken to the board resolution of 11th October 2006.] Presumably the Board Resolution says what the Board Resolution says and you now have no recollection of any particular words that were said at that board meeting, do you, apart from what is in that document?
> A. That's right."[45]

[160] Thus, contrary to Zhang Zeping's testimony, Li Guangzhong is saying that nothing particularly memorable was said at the board meeting. (Li Guangzhong otherwise gives little relevant evidence.)

[45] Transcript, day 7, pp 92-94.

Mrs. Wei and Zhang Guimin

[161] I did not hear evidence from either Mrs. Wei or Zhang Guimin (although the former served a witness statement). No explanation was given for the failure to call either of them.

The experts on PRC law

[162] I heard from two experts on PRC law, Mr. Mu for the claimants and Prof. Wang for Lunan. Both were very well qualified, but from very different backgrounds. Mr. Mu is a practising lawyer with the firm of Llinks. In his early days he had experience as a transactional lawyer dealing with company law matters, but he has primarily been a litigator with expertise in cross-border commercial matters. Latterly he has specialised in international commercial arbitration. He has an LLB, LLM and a PhD in law. Prof. Wang by contrast is a distinguished academic. He too has a PhD in law. He is a professor and the director of the Institute of Commercial Law at the China University of Political Science and Law. He has been a Fulbright scholar at both Georgetown University and Columbia University in the United States. He was a visiting scholar at the University of Oxford. He does a limited amount of work in Court, but this appears to be in unusual "sensational" cases, he said. He also has some transactional experience.

[163] I shall say at once that I prefer the evidence of Mr. Mu to that of Prof. Wang. Firstly, as we shall see, over the whole of the period with which we are concerned the law of the PRC was in a state of rapid development. The **Company Law 2005** made major changes to the **Company Law 1993**. Likewise in property law, the **Real Rights Law 2007** ("**RRL**") made major changes to the pre-existing **General Principles of Civil Law 1986** ("**GPCL**"). Mr. Mu's report gives a very detailed account of the way in which the law has changed. Prof. Wang's report does not. For example, Mr. Mu discusses extensively the way in which proprietary remedies have been extended in paras 149 to 177, whereas Prof. Wang merely discusses the matter in one paragraph, para 26 of his report.

[164] Secondly and related to this, due to the rapid development of the law, a practitioner may have a better understanding of how the courts would *actually* decide cases at any given time than a theoretician, whose evidence will concentrate more on how the courts at any

given time *should* decide cases. For example, Mr. Mu was able to explain how courts in practice attach different weights to precedents of other PRC courts.

[165] Thirdly, Prof. Wang has in some respects taken less care than Mr. Mu in the preparation of his opinion. At para 30 of the joint experts' memorandum, Prof. Wang says that he agrees with Mr. Mu's paras 149 to 177, but then sought to backtrack on that when he came to give evidence before me. Further in para 26 of Prof. Wang's report he cites the wrong article number. There are other examples, such as his failure in his report to refer to the Judicial **Interpretation III on the Company Law** in relation to nominee shareholder agreements; his making of (incorrect) assumptions of fact; and his evidence about the retrospectivity of legislation in the PRC. Further, Prof. Wang has not engaged fully with the contrary arguments which can be made to his views, so his opinions are not balanced.

[166] Fourthly, Mr. Mu gave his evidence more convincingly. Prof. Wang had a tendency to give long answers and to argue the case for Lunan, whereas Mr. Mu gave short answers, whether the answers were helpful to Ms. Zhao's case or not.

[167] Lastly, as we shall see, on the substantive questions Mr. Mu's opinions were in my judgment more consistent with the legislative and judicial source materials than Prof. Wang's.

[168] In reaching my conclusions on the expert evidence, (although I am necessarily jumping ahead to the next parts of this judgment) I have taken a holistic view of the evidence. The second and fourth points above are of less weight. The last point is of the greatest weight. Indeed, on most issues this last point is of definitive weight. Where matters are more finely balanced I have had to weigh all these points, but since all the points I have outlined weigh in favour of Mr. Mu's evidence being preferred the balancing exercise is in fact all one way.

The Chinese legal system and retrospectivity

[169] Mr. Mu sets out in his report a general overview of the relevant sources of Chinese law. I did not understand Prof. Wang to dispute much of this account. The PRC has a civil law system, based in part on German law, but with many other influences, including to an

extent the common law. It is not codified. The primary source of law is legislation. The National People's Congress ("the NPC") is the supreme law giver, but in practice legislation is made by a permanent committee of NPC members, the NPC Standing Committee.

[170] As well as passing legislation, the NPC Standing Committee issues formal "Interpretations". Interpretations are binding interpretations of legislation, which the Committee issues from time to time to clarify any ambiguities in existing legislation. They are a form of legislation.

[171] The Supreme People's Court ("the SPC") is the highest court in the PRC. Mr. Mu was not sure how many appeals it hears a year, but it is of the order of thousands, if not tens of thousands. China does not have a general system of *stare decisis*. Nonetheless, decisions of the SPC are a source of law. There are two types of SPC decision. Firstly, the SPC publish in its *Bulletin* what are expressly described as "guiding decisions". Lower courts are under an obligation to follow these decisions. Secondly, weight is given by lower courts to other decisions of the SPC, even if they are not formally binding in the way a guiding decision is. (Decisions of intermediate appeal courts and other lower courts are also given some weight, though less weight than is given to non-guiding decisions of the SPC.)

[172] In many civil law systems, one important source of law is academic opinion — *la doctrine* in France, *die Rechtslehre* in Germany. Neither expert suggested that in the PRC academic opinion had a similar status. Indeed, because the law in the PRC has been developing very rapidly as its economy has grown, there may be less opportunity for the academic systematisation possible in a fully codified system. At any rate it was not suggested that Prof. Wang's views should have a special status because he is an academic.

[173] An additional source of law in the PRC is the power of the SPC to issue "judicial interpretations". These are described by Mr. Mu as follows:

"9. Interpretations with general effect are also made judicially by the [SPC] when dealing with issues of law arising in legal proceedings. These interpretations are generally called 'judicial interpretations' even though given outside court proceedings. The SPC is entitled to give judicial interpretations on specific issues concerning the application of laws in trial work pursuant to [and he sets out the legislation]. Article 5 of the **Provisions of the Supreme People's Court on Judicial Interpretation** provides that judicial interpretation shall have legal effect generally, i.e. not confined to a particular case. These interpretations are issued in the same way as legislation outside any court proceeding and thus are also unlike opinions given by judicial bodies in common law courts.

10. When an interpretation is given by the SPC on a particular law, then the interpretation of that law may or may not be applied 'retrospectively'. Unless specific provision is made for a judicial interpretation to have retrospective effect the approach is generally in my view as follows:

(a) First, it is an important principle of PRC law that laws are not altered retrospectively. It is normally apparent from the national law provision itself as well as by the SPC interpretations that laws are not retrospective. The SPC interpretations are generally carefully worded to limit the retrospective effect.

(b) Secondly, an interpretation that explains an existing law will necessarily be retrospective to that extent but will not generally relate to any law that predates the existing law. When it is intended to be understood as having that limited retrospective effect, the interpretation can be seen as declaratory of the meaning of an earlier PRC law.

(c) Thirdly, when the existing law that is explained in an interpretation is the same as the earlier provision it may also assist in the interpretation of the earlier provision. For example, an interpretation on company law given in 2010 in relation to the meaning to be given to the **2005 Company Law** can be extended to interpret the identical provisions in the **1993 Company Law**."

[174] In cross-examination, Prof. Wang was taken to para 10 and asked if he agreed with it. He said:[46] "I agree with that."

[175] Notwithstanding that acceptance, Prof. Wang argued that it was legitimate to apply retrospectivity much further than this, so as to be able to interpret earlier legislation, such as the **Company Law 1993**, in the light of later legislation, such as the **Company Law 2005**. A little earlier in his cross-examination, there were these exchanges:[47]

[46] Transcript, day 10, page 5 7.
[47] Transcript, day 10, pp 55-57

"Q. Article 149 [of the **Company Law 1993**]. It didn't allow, for example, the distribution of shares to an employee as an incentive as an exception to the rule in Article 149, the prohibition.

A. You are correct. Article 149 of the **1993 Company Law** have no such stipulations, same as [article 143, item 3 of the **Company Law 2005**]. But I want to give two point. One point is to prove one is an intention, one is a purpose, that is the first one. The second one involve a very important legal issue, is that the 2005 of the Chinese **Company Law** applied in this case, in fact, it happened in 2001. I provided the Court interpretation one People's Supreme Court **Interpretation of Company**, the first one. And Article 2 provided that if a case lodged with the People Court and the judge can't find any specific provisions of the prevailing law at that time, and the reference can be made to the new law. So follow this logic and you can see the 2005 can apply in this case, even [if] the case happened in 2001.

And I can give — another supporting is that and you provided that (Chinese spoken) that is a Ninth National Conference of the People Court, **Work of the Commercial and Civil Law Trial**. The first, Article 1, they gave a ruling for the Chinese **Civil Code**, especially the first part of the general provision of the Civil Code. Can the new law, Chinese **Civil Code** applied to the past event? And the People's Supreme Court say that if the case is lodged with the People, and then you can find a specific provision and the new law can apply them by the reference.

The second standard is that to try to find the conductors. Does the conductors has continuity? If the conductor, namely, in this case is entrustment, if the conductor continue to the present time, then so it is a continuity and so the new law also in its process of continuity and the new law also can apply in the conductor happen before. So that is a — it is standard expressed stipulated by People Supreme Court and it is also a legal doctrine. And so you say you ask me to read Article 149 of the **1993 Chinese Company Law** and yes, I pay attention, but the conclusion is that it is different."

[176] I make of course full allowance for language difficulties. However, I do not understand a great deal of this. The document from the Ninth National Conference is not listed among the attachments to Prof. Wang's report at page 25 of the report. It is not entirely clear if Prof. Wang is saying that there was an actual case where the 2005 legislation was applied to facts from 2001 or if he is giving his opinion on the current case (although I suspect the latter). I can see that there may be issues as to how the principles (b) and (c) in Mr. Mu's para 10 operate in particular cases. However, what Prof. Wang describes would appear to be pure general retrospectivity. If setting up an employee incentive share plan was unlawful and of no effect under the 1993 legislation, it is difficult to see how it could become retrospectively effective as a result of the 2005 legislation. By contrast, what Mr.

Mu says in para 10 (with which, it will be recalled, Prof. Wang said he agreed) seems perfectly workable and sensible.

[177] The statement in **Provisions of the Supreme People's Court on Issues Relating to Company Law** that "prior to the implementation of the company law, and where there are no specific provisions of the prevailing laws and regulations and judicial interpretations, reference may be made to the relevant provisions of the company law" can be read consistently with Mr. Mu's para 10.

[178] Similarly, I note what Mr. Mu says in para 19 of his report, which Prof. Wang does not answer:

> "19. I understand that Lunan relies on Article 106 of the **RRL** in relation to matters which occurred before October 2007. The **RRL** does not have a retrospective effect. Article 247 of **RRL** provides that "[t]he Law shall come into effect as of 1 October 2007". The **Annotation on the Real Rights Law** of the People's Republic of China state:
>
> > 'In general, the question of retrospectivity of a law concerns as to whether the law at issue can be applied to the circumstances taking place before the law in question took effect. Where the law at issue can be applied [to such circumstances], it has a retrospective effect; where it cannot be applied, it doesn't have retrospectivity... Non-retrospectivity is one of the important principles of legislation in our country; the **RRL** is of no exception. Law should be non-retrospective because it protects rights and maintains order. This is particularly the case for **RRL**. The proprietary relationships established prior to [the **RRL** becoming effective] should remain stable; whether such relationships are in keeping with the **RRL** should not be a matter of concern. Only in this way can the property acquired in a lawful manner be protected... It is conducive to correctly understand the validity of the **RRL** by noting that the **RRL** is non-retrospective."

[179] I prefer Mr. Mu's opinion on retrospectivity.

Article 149 of the Company Law 1993

[180] Article 149 of the **Company Law 1993** provides:

> ""A company may not purchase its own shares, except in the case of share cancellation for the purpose of reducing the company's capital, or in the case of

merger with another company holding shares of the company. Upon repurchase of its shares pursuant to the previous paragraph, the company shall cancel such shares within 10 days, and carry out amendment registration in accordance with the relevant national statutes or administrative regulations, and shall make a public announcement. The company may not accept its own shares as the collateral under a security arrangement.

It was replaced in similar terms by article 142 of the **Company Law 2005**.

[181] I clarified with Mr. Mu the difference in view between him and Prof. Wang:[48]

> "THE COURT: I mean, Mr. Mu, the difference between you and Prof. Wang really amount[s] to this, that when one is looking at Article 149 which prohibits, sorry, prohibits Lunan from buying its own shares, you say that that also prohibits Lunan buying its own shares through a nominee like Kunlun US?
> THE WITNESS: Yes.
> THE COURT: Whereas Prof. Wang says no because Kunlun US is there as the registered shareholder, there's no breach of Article 149.
> THE WITNESS: Yes, according to Article 24 of the [Judicial] **Interpretation III on Company Law,** Lunan should be regarded as the actual contributor according to the substance III. So if Lunan holds those shares through Kunlun US that would be regarded [as] a company holding its own shares, and that is prohibited by 149 of the Company Law. That is my submission."

[182] Article 52 of the **Contract Law 1999** deals with illegality and article 58 with the consequences of a breach of, *inter alia*, article 52. They provide:

> "Article 52
> In any one of the following situations, a contract shall be without effect:
> (1) one party concludes the contract through the use of fraudulent or coercive means, causing detriment to the interests of the State;
> (2) the contract involves a malicious conspiracy which is detrimental to the interests of the State, a collective or a third party;
> (3) illegal intentions are concealed beneath an appearance of legality;
> (4) there is detriment to social and public interests; or
> (5) the mandatory provisions of laws and administrative regulations are violated.
>
> Article 58
> After a contract has been declared invalid or revoked, all property obtained by reason of the said contract shall be returned; where the property cannot be returned or there is no need to return it, compensation shall be paid on the basis of

[48] Transcript, day 9, p 15.

> the depreciated value of the property. A party that is at fault is liable to compensate the other party for its resulting losses, and where both parties are at fault, then each party shall bear the relevant liability respectively."

[183] Prof. Wang's view at para 18.9 of the experts' joint memorandum is this:

> "In the case at hand, the Shareholding Entrustment Agreement between… Lunan and Kunlun US does not reduce the capital of Lunan since… Lunan has subscribed and contributed the shares. Accordingly, such entrustment agreement neither violate the principle of capital maintenance nor weaking the interests of creditors. Also, because the shareholders of Lunan know [that] Kunlun US is a nominee shareholder while… Lunan is the actual capital contributor and the Shareholding Entrustment Agreement intends to resolve the problems of reconstructure [*sic*] rather than improperly control the company, such entrustment agreement does not violate the equal treatment among shareholders and the control right over the company. In summary, the Shareholding Entrustment Agreement between Lunan and Kunlun US causes no damage to the public interests or national interests."

[184] I cannot accept the majority of this. Article 1 of the entrustment agreement provides that "[Lunan] shall provide funding and entrust [Kunlun US] to purchase under [Kunlun US's] name 21 million shares of foreign shares in Lunan… held by Sitic… for the total price of RMB 75.6 million." This is in my judgment a paradigm case of a reduction in capital. Prior to the purchase of the shares from Sitic, Lunan had RMB 75.6 million, which it did not have after the purchase. The payment to Sitic of that money necessarily weakens the position of creditors of Lunan, because Lunan had that much less money to pay its other creditors.

[185] It is also not true as a matter of fact that shareholders of Lunan knew that Kunlun US was a nominee shareholder. It is common ground that the existence of the share entrustment agreement was a closely guarded secret, which only came to light after Zhao snr's desk was broken into in 2017. Prof. Wang appears to have just made an assumption that Lunan's shareholders knew about the alleged nominee arrangement.

[186] At para 18.10 of the memorandum, Prof. Wang says:

> "Besides, according to Article 97 of the **Company Law 2005**, the company shall prepare a registry of shareholders and the shareholders recorded in such registry may claim to and exercise the shareholder's rights. That is, the nominee rather than the principal would be recorded as the shareholder of the company due to the

nominee agreement and the above article. In other words, it is the nominee that holds the shares instead of the principal. Therefore, even if the shares are held on behalf of the same company, there is no violation of Article 143 of the company Law 2005 and the nominee agreement should be valid."

[187] Prof. Wang was cross-examined on this.[49] He was taken to the SPC's **Interpretation of Company Law III**.

"Q. And you see this deals with the realistic needs to prohibit shareholders from withdrawing capital contribution?
A. Yes, I see it.
Q. Okay. And it provides that: 'The company carries the realistic and expected benefits of many members of the society and the company's capital is the blood of the company. Therefore, whether the capital is sufficient or not is related to the realisation of the interest of many parties, withdrawal [of] capital contribution by shareholders from the company undermines the maintenance of capital and causes damage to many parties concerned.'

And then it deals with the various forms of damage, doesn't it? For example, damage to the interest of the company. The company is different from a partnership which emphasises capital contribution… [W]ithdrawing capital contribution is a huge shock to the inherent characteristics of the company. And then there is another heading: 'Impairs the equity of other shareholders.' Another heading: 'Damages the interest of creditors: (4) 'Creates an illusion that the capital is sufficient for potential creditors of the company. Damages the interest of the investors with whom they deal in reliance on the company's creditor and undermines the security of transactions.'

Then the final paragraph on this translation says: 'For the whole society since the company is important parties and social transactions, if this kind of phenomenon happens frequently, company's ability to perform contracts reduces debts and liabilities with external parties cannot be timely and appropriately fulfilled. Trade security and economic order would be undermined to a great degree. As such the behaviour of withdrawing capital contribution by shareholders must be restricted, therefore, improving the system of civil law identification and accountability for capital contribution withdrawal by shareholders is of great significance to protect the rights and interest of the company, other shareholders, creditors, investors protect the security of transaction and establish a fair and honest...'

First of all, that's correct, isn't it, that's a correct translation of what is said in that part of the SPC's **Interpretation of Company Law, number III**, isn't it?
A. Yes, it is correct. It is the correct English translation.
Q. And in the last paragraph I read to you, the SPC is emphasising that it's important to improve the system of civil law identification and accountability for capital contribution, isn't it?
A. Yes, I see it.

[49] Transcript, day 10, pp 25-30.

Q. And that obviously suggest that the SPC is focused on the substance of a transaction and doesn't expect civil law to be unable to identify people who, for example, hide behind the nominee agreement?
A. Yes. You raise a very important concept and that is substantial transactions, what is the substance, what is the nature of the transactions? But also identify what is the nature of the transactions in legal practice –
Q. …The SPC is emphasising, isn't it, that it expects civil law to be able to identify when something has happened to affect the position about capital maintenance?
A. Yes, yes. There are people called to try such cases and they need to identify what is a substantial transaction, no problem.
Q. And this is obviously — I don't mean to get you into the debate, but this is obviously relevant, isn't it, to the question of substance over form in this context?
A. Yes. We try to find the substance when the judge is deciding that —
[There is then an intervention by Mr. Rubin QC, before the cross-examination continues.]
Q. Article 24 of the **Judicial Interpretation number III** specifically identifies Article 52 of the contract law, doesn't it?
A. Yes.
Q. Again, suggesting that the Supreme Court is concerned with the substance of the transaction than the substance of a holding of shares, not the nominal registered owner.
A. Yes.
Q. Okay. You haven't referred to these particular texts in your report or when you deal with the question of form over substance, have you?
A. Yes, I do some things in my report related to this question.
Q. Yes. But in relation to the particular text we read out, which you agree support the idea of substance over form, you haven't actually referred to those in your report, have you?
A. I provided some case and they are related to this point."

[188] The case to which the Professor refers is **China Nuclear Energy Industry Corp v Huatai United Securities Co Ltd**.[50] Prof. Wang was cross-examined on this as follows:[51]

"Q. The investor in the company, there was a shareholder in the company called Huacheng who had not paid the capital contribution, that's correct, isn't it?
A. Yes.
Q. And so Huacheng held shares in Huatai and China Nuclear; is that right, Huacheng held shares in Huatai? And China Nuclear was also a creditor of Huacheng, wasn't it?
A. Yes, it is a creditor of Huacheng.
Q. And Huatai tried to enforce its rights as creditor of Huacheng by obtaining back its own shares which hadn't been properly paid?
A. Yes, he want to enforce his — yes.

[50] (2016) J02MZ No. 7351 (Beijing Second Intermediate People's Court).
[51] Transcript, day 10, pp 47-50.

Q. So China Nuclear and Huatai were competing for these shares in trying to enforce their rights as creditors?
A. That is right.
Q. And they made an arrangement, a settlement, which resulted in China Nuclear holding the Huatai shares for Huatai. That was the entrustment, wasn't it?
A. Yes, that is the arrangement.
Q. Yes. And so the only way that Huatai could get paid its capital contribution was by getting back the shares and selling them?
A. Yes.
Q. So that the whole purpose was a short-term fix that Huatai could get back its shares and sell them, wasn't it?
A. Yes, Huatai realised its rights, yes, under the regiment set by People's Court.
Q. Yes. And then if you go to page 133, we can see in the paragraph beginning: 'Nuclear Energy claimed that the Equity Holding Agreement and the Agreement for Transfer of Equity held upon Entrustment were invalid on the grounds that Huatai may not hold its own shares.' And the Court answered that by saying: 'It is easy to see, based on the facts of this case...' So this was a, first of all, a case that turned on its facts, correct?
A. Yes, Nuclear Energy Industry claim, yes.
Q. Yes. And Huatai did not intend to hold its own equity. And then it goes on to say it didn't formally hold its own entity. Huatai entered into the agreement and the agreement for entrustment only for the purpose of acquiring the proceeds from the equity in order to offset the loss resulting from Huacheng's false capital contribution. Do you see that?
A. Yes, I see.
Q. And the 'arrangement was done for the purpose of protecting the legal rights and interest of its own shareholders, and creditors. As a result, the Court does not accept this claim of Nuclear Energy.' So it dismissed the argument about capital infringing the capital maintenance role for those reasons, didn't it?
A. Yes, correct.
Q. And, in particular, the purpose wasn't to take away capital but to recover the capital that hadn't been paid, that's correct, isn't it?
A. Yes, correct.
Q. And on that basis, the Court then deals with, upholds the Entrustment Agreement because of those special facts?
A. Yes, but what is a more important for the legal analysis by the People's Court in its decision and you can find that the Judge say after they give an explanation as what you say just now and the People Court Judge give a more explanation for his ground for his decision. That is they have no purpose to violate the legal, the principle of capital maintenance. And so the sentence is they do not do harm to the company's creditor."

[189] I asked Prof. Wang about the differences between his and Mr. Mu's views.[52]

[52] Transcript, day 10, pp 42-43.

"THE COURT: As I understand it, Prof. Wang, it is common ground between you and Mr. Mu that it wouldn't have been possible for Lunan here to buy the shares from Sitic directly because that would be a straight case of a company purchasing its own shares. But are you saying that if a company like Lunan purchases the shares through a company like Kunlun US, that that is not caught by the ban on a company buying its own shares?
THE WITNESS: Yes. The case, this case, Lunan case is very, very special and people call the judge, if they try this case, they would have paid more and more attention on it's a special form. That is holding company's own shares via entrustment. And I will explain why the holding company own share via entrustment, what is the substantial difference with the director holding the company's own share. And from the purpose, from the form, from the balance sheet, from the resulter and they are all different. And so that is why this case is very special. But Mr. Mu provided a case just focused on directing holding companies own share. So I don't think it's a point and so that is a very important point and I hope, Judge, My Lord, you need to pay more attention on this difference.

[190] Prof. Wang was asked by counsel why this was a special case. The exchanges went:[53]

Q. And I think paragraph 18.9 and 18.12 [of your report] you deal with the specific facts of the case as you see them, don't you?
A. Yes.
Q. Okay. And that's why you say this is a special case because of the specific fact; is that right?
A. Yes, it is very special.
Q. So I would like to examine the facts with you, if I might… The Lunan Entrustment Agreement was concluded in 2001. And the facts you deal with, for example,… you see on the 6th of March '94 the Lunan Company was re-organised. And then on 12th of April 2005, it was transformed into a private owned enterprise and renamed Lunan Pharmaceutical Group. You don't deal with any facts there that relate to the period between 1994 and 2005 in that paragraph, so I don't think this paragraph helps you to understand the purpose of the entrustment, does it?
A. But the key factor here is that Lunan Company was in the process of reconstruction and transformation just like other state owner enterprise. State owner enterprise come into transformation, come into reconstruction and from the state owner enterprise to private owned enterprise. And usually the transformation and the reconstruction is very long in terms of process. And so Lunan in this process and the fund and the shareholdings this case involved in how to allocate this fund and suspending. And so I think all this, I think, is a very key factor and so it could be have a inference on the decisions…
[I]f you have want to make employee-ownership arrangement and it is exceptions, it is included in 142. And so it is possible that a very special, in very

[53] Transcript, day 10, pp 51-57.

> special circumstances, this suspended of fund to (unclear) entrustment. And it is very close with item 3 employee-ownership arrangement in Article 142. And so if you want more evidence to prove that, then I think Lunan can apply that Article 142 to item 3 to renew its contract valid and if he can get the valid contract, and it should have been regarded as valid.
>
> So that is a very important and because in my legal practice experience and I also deal with some standard owned [*sic* in the transcript: "state-owned" is probably intended] enterprise in the transformation in the reconstruction and I find that because of some shortcoming of Chinese **Company Law**, that is for the standard owned transformation. And our company systems lack a very important tool that is a treasury, the treasury share and we have no treasure share. So this lack cannot resolve the urgent need for the transformation and the construction for the standard owned enterprise and mainly standard owned enterprise adopt such as entrustment contract to holding companies shares and to realise the same functions and so that is why I think if the evidence is correct, then we can say its purpose is legal."

[191] It does not seem to me that this explanation has very much connection with the events of 2000 and 2001, where the purpose of obtaining the transfer of shares from Sitic was to remove from the share register a shareholder with whom Zhao snr had fallen out. That has nothing to do with a transformation from "state owner enterprise to private owned enterprise", as Prof. Wang seems to have understood was occurring.

[192] As to what constituted an "ordinary" case, as opposed to a "special" case, Mr. Lowe QC referred me to **Guangxi Dibo Mining Group Co Ltd v Zhejian Hailidde New Material Co Ltd**.[54] Hailidde had agreed to subscribe for shares in Dibo, but Dibo had by a side agreement agreed to compensate Hailidde for the cost of the shares in return for Hailidde not exercising any shareholder's rights. The Higher People's Court of Zhejian Province held that the side agreement was invalid. "[Dibo's] repurchase of [Hailidde's] equity interest by Dibo… reduce[s] the company's capital in the disguised name of compensation for losses by signing an Acknowledgement… for the purpose of circumventing mandatory legal provisions." It then refers to the "Company Capital Maintenance Principle" and to article 142 of the **Company Law 2005**. The Court held that the entrustment agreement was void. I find as a matter of Chinese law that this is the ordinary consequence of a share entrustment agreement which breaches the capital maintenance principle.

[54] (2017) Zhe Min Zhong No 875.

[193] In my judgment, the view of Mr. Mu is to be preferred to that of Prof. Wang on the question as to whether a purchase by a company of its own shares is permissible, if the purchase is made through a nominee. Prof. Wang's view would render the "company capital maintenance principle" nugatory, if it could be so easily bypassed. I do not understand why Lunan's case is "very, very special". On the contrary the share entrustment agreement is a straightforward purchase from a third party by a company of its own shares through a nominee.

[194] It is also difficult to reconcile Prof. Wang's views in para 44 of his report with para 50 of the joint memorandum. At para 50 of the latter he accepts that the SPC adopts the "substance theory" of nominee agreements, by which the principal is to be "recognised as the real shareholder". (See also the joint memorandum at para 46.) But at para 44 of his report, he says that, because the nominee is registered as the shareholder, "it is the nominee that purchases and holds the shares instead of the principal. Therefore, even if the shares are held on behalf of the same company, there is no violation of Article 142 of the **Company Law**."

[195] The significance of the Linyi judgment I have considered separately.

[196] In my judgment, the share entrustment agreement was unlawful, because it breached article 149 of the **Company Law 1999**.

The consequences of unlawfulness

[197] I turn then to the consequences of the unlawfulness of the share entrustment agreement. Mr. Mu said that in this case the shares held by Kunlun US could not revert to Lunan. He explained the effect of a finding that a contract was void as follows:[55]

> "Actually in Article 58 of the **Contract Law** there are three sentences. The first sentence says, if a contract is held null and void the assets acquired under the contract should be returned. This is the first sentence. And the second sentence is that, if the assets cannot be returned, or is not appropriate to be returned, then the party should use compensation instead of return of the assets. And the third sentence is, the first sentence here, you just mentioned, the loss resulting from an

[55] Transcript, day 9, pp 39-40.

> invalid contract should be compensated by each party based on its fault. So back to your question, whether it's always the case that the principal should be compensated, it's not always the case. It depends on whether there's a fault by the nominee.
> Q. But the — what happens is that the Court, the Court has to decide whether it can return the shares to the actual contributor. That's the first decision.
> A. That is the first sentence I just mentioned.
> Q. That's right. That's Article 58. So in this case there would be nothing wrong with the Court returning these shares to Lunan provided it declares itself as the registered holder?
> A. No, I don't think so. I don't think so, because like I just said, according to the second sentence in Article 58 of the **Contract Law**, if the subject matter cannot be returned or is not appropriate to be returned, then it should not be returned, and we need to understand what does it mean that it cannot be returned. I think one of the reason[s] the Court relies on is that returning the subject matter, whether returning the subject matter would violate the law. I think that is the rationale the Supreme Court adopted in [the] **Chinachem** case. It is because that in the first place the Chinachem, a foreign investor, is prohibited by Chinese law to invest in [a] Chinese Bank, so the subject matter, the shares cannot be returned to Chinachem. I think the same rule, analysis, is also applicable to this case in our hands, the Lunan case."

[198] In the **Chinachem** case,[56] a foreign investor, Chinachem, had bought shares in a Chinese bank which were held by a Chinese nominee, SME, under an entrustment agreement. Under PRC law foreigners were not permitted to hold shares in Chinese banks without various Government approvals, which had not been given. The SPC held that the entrustment agreement was void. The nominee had to return the monies advanced by Chinachem for the shares. In addition, fault was allocated between the principal and the nominee under the last limb of article 58, so that SME had to pay 40 per cent of the value of the shares and dividends to the principal by way of compensation. The shares remained with the nominee, who became the full legal owner of them.

[199] I accept Mr. Mu's evidence that, if the share entrustment agreement fell foul of article 149 of the **Company Law 1999**, then the Court would refuse to order the shares to be transferred to the principal. That would be to do precisely what the legislature decided should not happen — the acquisition by a company of its own shares.

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[56] Chinachem Financial Services Ltd v China Small and Medium-sized Enterprise Investment Co Ltd (2002) Min Si Zhong Zi No 30.

[200] What remedy the Court would give Lunan, if it held that the share entrustment agreement with Kunlun US was void, is not entirely clear. Mr. Mu suggested that there would be no remedy granted at all. This is the one point on which I am doubtful of Mr. Mu's view. **Chinachem** suggests that Kunlun US would have to repay the monies lent for the purchase from Sitic. In addition, it may be that the provision in article 58 of the **Contract Law 1999** that "where the property cannot be returned or there is no need to return it, compensation shall be paid on the basis of the depreciated value of the property" should apply. This would mean that Kunlun US had to reimburse Lunan for the value of the shares which Kunlun US were unable to transfer to Lunan. Such a restitutionary remedy would foster the legislative objective of maintaining the capital of the company whose shares were in issue. Refusing any remedy, as Mr. Mu suggests, would mean that Lunan lost irrevocably RMB 77.6 million of its shareholders' capital.

[201] I do not, however, need to determine this issue. Firstly, any claim under article 58 would be a personal claim against Kunlun US and is long barred by limitation. Secondly and in any event, the way in which the dividend payments were accounted for means that the loan to Kunlun US was in fact repaid. Thirdly, Lunan would have no proprietary claim against Kunlun US, because giving them the shares would offend the capital maintenance doctrine. Therefore (even if tracing were available, which on Mr. Mu's evidence it was not) there would be no property held by Kunlun US which Lunan could trace to Endushantum.

[202] An alternative justification for the legality of the share entrustment agreement was argued on Lunan's behalf. It was suggested that it was a temporary measure, which was justified as being part of a company reconstruction. There are difficulties both as a matter of Chinese law and on the facts with this argument. Firstly, an exception for company reconstructions would undermine the capital maintenance rule. Company reconstructions often occur against a background of financial distress. An exception of this type would allow the purchase of company's own shares at a time when the need for capital maintenance might be at its greatest. I reject the proposition that this reflects Chinese company law. I do, however, accept that the point is and was arguable. Thus, Wang Jianping would have been able defend the purchase of the Lunan shares from Sitic on this basis, had the need to defend the transaction arisen. Secondly, on the facts, this view of

the law would favour Ms. Zhao's case that her father needed to step in, because Kunlun US (and subsequently Endushantum) could not as a matter of Chinese law hold the Lunan shares for Lunan long-term. Lunan's case is that the share entrustment agreement with Kunlun US was rolled over into a share entrustment agreement with Kunlun BVI. Yet that would scarcely be a temporary fix. On the contrary, it would be a long-term holding, which could not fall under an exception (if such an exception existed) for temporary reconstruction purposes.

Breach of a director's duties

[203] Lunan says that Zhao snr in any event broke his duties as a director of Lunan. Under the **Company Law 1993** a director's duties were as follows:

> "Article 59
> A director, supervisor, or the general manager shall abide by the articles of association, faithfully perform their duties, and safeguard the interests of the company, and may not abuse their positions and authorities at the company for private gain. A director, supervisor, or the general manager may not abuse their authorities by accepting bribes or generating other illegal income, and may not convert company property.
>
> Article 60
> A director or the general manager may not misappropriate company funds or loan company funds to other people. A director or the general manager may not deposit company assets into an account in his own name or in any other individual's name. A director or the general manager may not give company assets as security for the debt of a shareholder or any other individual.
>
> Article 61
> A director or the general manager may not engage in the same business as the company in which he serves as a director or the general manager either for his own account or for any other person's account, or engage in any activity detrimental to company interests. If a director or the general manager engages in any of the above mentioned business or activity, any income so derived shall be turned over to the company. Unless otherwise provided in the articles of association or otherwise agreed by the shareholders' committee, a director or the general manager may not execute any contract or engage in any transaction with the company.
>
> Article 62

> Unless required by law or consented to by the shareholders' committee, a director, supervisor, or the general manager may not disclose the company's confidential information.
>
> Article 63
> If a director, supervisor or the general manager causes detriment to the company while performing his duties in violation of any national statute, administrative regulation or the articles of association, he shall be liable for the loss so caused."

[204] This list does not include an express ban on the making of loans to directors. An express prohibition was first introduced in the **Company Law 2005**. Article 116 of this law provides:

> "A company shall not provide loans to its directors, supervisors or senior management personnel directly or through its subsidiaries."

[205] Prof. Wang argued this provision had retrospective effect, but for the reasons I have already set out I do not accept that retrospectivity is so far-reaching in Chinese law. Mr. Mu did not consider article 61 went so far as to prohibit loans to directors and I accept that view. However, it is not relevant. Lunan's case is that any lending was to Kunlun US, not to Zhao snr. Ms. Zhao's case is that the money was repaid. Moreover, even if there was a wrongful loan to Zhao snr, the legal consequences were limited, as the next section of this judgment discusses.

[206] No other breaches of duty are made out. No evidence was adduced that the Article 59 duties of a director are as stringent as those in **Phipps v Boardman**[57] in English law. If Zhao snr used his own money for the purchase of Hope and Better and then used the dividends paid by those companies to obtain ultimate beneficial ownership of the Lunan shares, then there would be, I find, no breach of Article 59.

[207] Likewise, there is no breach of Article 60. This does not, on the evidence which I have accepted, prevent a company lending money to a director, but in any event the money was lent to Kunlun US. It was money from the Hope and Better dividends which repaid the loan. There was no competing with Lunan under Article 61, nor any contract entered

[57] [1967] 2 AC 46 (House of Lords)

between Zhao snr and Lunan in relation to the Lunan shares held first by Kunlun US and then by Endushantum.

The consequences of a breach of duty by a director

[208] If (contrary to what I have found) Zhao snr broke his duties as a director, then Lunan's claims against him would have been primarily personal claims. Mr. Mu in his report explained the property law consequences as follows:

> "151. Prior to the introduction of Article 106 of the **RRL**, the only more or less general rights of recovery were those expressed in Article 61 of the **GPCL** and Article 58 of the **Contract Law**.
>
> 152. The **GPCL** makes it clear that a party must 'return' 'property' 'acquired as a result of a "civil act" which is void' (i.e. under Article 58 of the **GPCL**) or subsequently declared void or rescinded by a court (see Article 59 of the **GPCL**) to 'the party who suffers the loss' presumably, the owner (see Paragraph 1 of Article 61, the **GPCL**). A person 'suffers loss' within Article 61 because he has given up his property as a result of consent which is defective by virtue of either Articles 58 or 59 of the **GPCL**. Article 61 is aimed at reversing the results of that person's defective consent to that transfer of property. It is not concerned with the consent to the onward transfer of someone who does not suffer loss. It also does not extend to substitute goods or money (see below).
> …
> 155. Article 58 clearly contemplates cases when property cannot be returned but does not state in what circumstances that will be the case. However, Article 58 relates to 'property obtained by reason of the said contract'. This means that the right cannot extend to money (which is not treated as 'property') or to substituted goods (see below).
>
> 156. One circumstance when property could not be returned prior to the introduction of the **RRL**, was when the property had been sold. The **GPCL** did not have a general doctrine of good faith purchase but the doctrine was recognised in case law...
>
> 158. It is clear that Article 106 of the **RRL** has potential application to disposals by nominees under share entrustment agreements. Paragraph 1 of Article 25 of the Judicial **Interpretation III on the Company Law** provides that 'where a nominal shareholder transfers, pledges or otherwise disposes of the shares registered under his or her name, and the actual capital contributor requests the court to rule that the disposal of shares is invalid, citing that himself or herself is actually entitled to the shares, the People's Court may deal with the case with reference to the provisions of Article 106 of the **Real Rights Law**.'
> …

> 161. It is generally not possible in the PRC to claim the substitute product of property from persons other than a wrongdoer. That was so under the **GPCL** and the **Contract Law**. It also remains true under Article 106 of the **RRL**. A remedy is available against the wrongdoer for the wrong committed. However, that is very different to extending the right in Article 106 of the **RRL** to converted property.
> …
> 165. A person's ownership of shares includes right to receive dividends and bonus shares from those shares. A transfer of shares carries with it those rights. If the original owner makes a claim to recover shares from a nominal shareholder, the dividends may well have been spent. The claim can to the extent of the dividend only be a personal claim for unjust enrichment against the nominal shareholder. Neither Article 61 of the **GPCL**, Article 58 of the **Contract Law** or Article 106 of the RRL would have the consequence that anything purchased with the dividends would have to be turned over as well."

[209] If a loan was (contrary to what I have held) unlawful, Lunan would not have under the general law a proprietary claim to the shares. Instead Lunan would potentially have a more specific claim under article 404 of the **1993 Company Law**. This provides: "Any property obtained by the agent in the course of handling delegated affairs shall be passed on to the principal." Mr Mu accepted[58] that if a director was "acting on the company's business to buy the shares for the company's benefit, then he would have to hand those shares over to the company if asked".

[210] However, whether a director was acting on behalf of the company was, he said, more nuanced.[59]

> "Q. If a legal representative purchases shares in his capacity as legal representative and director for the company, with a view to the shares being for that company, he holds those shares for the company, doesn't he?
> A. That is not necessarily true. Like I just explained, the legal representative act on behalf of the company, then his activity, his behaviour could be considered as the company's behaviour. But it's not always easy to determine whether the legal representative is acting on behalf of the company or on behalf of his own. So we have to distinguish those two circumstances. Can you guess that the legal representative purchase certain shares? That is just too vague to make a conclusion because we have been looking to the relevant fact to see whether it's (unclear) or on behalf of the company.
> Q. Okay. I understand what you're saying but if the conclusion was that he was acting on the company's business to buy the shares for the company's benefit,

[58] Transcript, day 8, p 67.
[59] Transcript, day 8, pp 75-76.

then he would have to hand those shares over to the company if asked, wouldn't he?
A. That assumption in place, yes."

[211] Mr. Mu accepted that, if Zhao snr was the owner of the Lunan shares under an entrustment arrangement, then he was under a duty to disclose that fact to Lunan's board: see transcript, day 8, p 70. However, a failure to disclose would not give Lunan any claim to the shares themselves.

[212] If I find that Zhao snr used his own money to buy the Hope and Better shares, then in my judgment his use of the dividends from Hope and Better to pay off the loan from Lunan to Kunlun US was lawful. Even if there were some breach of his director's duties, that would not give rise to a proprietary claim by Lunan. Any personal claims are barred by limitation.

Trust and entrustment in Chinese law

[213] Both experts were agreed that Chinese law recognises the concept of a trust. However, they agree that this is a narrower concept than in English law. In particular, Chinese law draws a distinction between a trust and an entrustment. At para 11.1 of their joint memorandum they said:

> "(a) A trust relationship usually involves three parties, namely the settlor, the trustee and the beneficiary; an entrustment usually involves only two parties, namely the principal and the trustee;
> (b) Under a trust the trust property shall be independent from other property of the settlor; under an entrustment, the entrusted property shall still belong to the principal;
> (c) Under a trust, the disposal of trust property shall be decided by the trustee, and the trustor has no right to intervene; under an entrustment, the trustee shall act in accordance with the instructions of the principal."

[214] This difference is significant, because the legal consequences of a breach of trust and a breach of an entrustment agreement are not necessarily the same. Prof. Wang at paras 50 and 51 of his report deals with the consequences of a director breaching (what we would describe as) his fiduciary duties. He says:

> "If article 149 [of the **2005 Company Law**, which replaced articles 60 and 61 of the **1993 Company Law**] is violated, the income should belong to the company, and if it causes losses to the company, and the director shall be liable for compensation. Regarding the impact on the property rights of the company, transferees and recipients, it should be considered that there is a constructive trust behind the right of attribution of [company monies paid into the director's own account]. Therefore, if the director has engaged in a transaction that violates his fiduciary duty, he should be regarded as a trustee. As the beneficiary of the trust, the trust property is an improper profit of the directors, so the company can pursue the trust property. If the transferee of the transaction is a *bona fide* third party and has acquired company property, the director shall be liable for damages; if the transferee is not in good faith, the company may require it to return the obtained company property."

[215] The **Trust Law 2001** provides, so far as material:

> "Article 2
> Trust in this Law refers to the act in which the trustor, on the basis of confidence on the trustee, entrusts certain property rights it owns to the trustee and the trustee manages or disposes of the property rights in its own name in accordance with the intentions of the trustor and for the benefit of the beneficiary or for specific purposes.
>
> Article 7
> To establish a trust, there must be certain trust properties and the properties must be properties lawfully owned by the trustor. Property in this Law includes lawful property rights.

[216] Prof. Wang's description of a constructive trust of course sounds very familiar to an English Chancery lawyer. However, Mr. Mu denies that it represents Chinese law. Prof. Wang cites no Chinese authority for his proposition. The legislation, which I have set out as quoted in Prof. Wang's report, does not provide for a constructive trust. There is no remedy given in any PRC legislation identified by the experts which imposes a remedial (or constructive) trust. There is no case law supporting the existence of a constructive trust in these, or indeed any other, circumstances. The **Trust Law** only refers to trusts which are established by the settlor, not to trusts imposed as a matter of law. Indeed, as set out above, proprietary remedies in the PRC are quite limited.

[217] Mr. Mu said that there was a concept in the PRC of, what he translated as, a "constructed trust". But this was a trust (in the technical Chinese sense agreed by both experts in their

joint memorandum) which was created by conduct rather than by express words. It was not a trust imposed as a matter of law regardless of the parties' actual wishes or intentions, in the way an English law constructive trust is.

[218] Mr. Mu says:

> "The actual capital contributor… has no claim under Article 106 of the **RRL** to new shares acquired by the fiduciary with the proceeds of sale or buys using a dividend obtained from the entrusted shares. That is because irrespective of the claim against the person of the fiduciary, there is no claim to the new property itself under Article 106. Against the nominee the principal can only obtain damages for loss of the shares and extended relief but does so for breach of the duties owed by the agent and not under Article 106."

[219] I prefer Mr. Mu's view that there is no ability to trace assets acquired in breach of a director's duties, save to the limited extent outlined above.

Conclusions on (3) PRC law

[220] Accordingly, I conclude that the share entrustment agreement was invalid as a matter of PRC law. Even if (contrary to this view) a temporary share entrustment agreement was lawful, it was terminated on repayment of the loan made by Lunan to Kunlun US. Lunan has no proprietary claim arising from the share entrustment agreement which it could assert against Endushantum.

Conclusions on (2) the claimants' factual case on entrustment

[221] Lunan puts its case this way in closing:

> "17. [Ms. Zhao's] case is that the opportunity to purchase this extremely valuable parcel of shares was effectively gifted by the company to its Chairman in his personal capacity through a loan from Lunan, which then repaid itself from dividends on those shares, not only without any written record or formal approval but directly contrary to the one agreement that was executed in writing (that is, the Share Nominee Agreement between Lunan and Kunlun US).
>
> 18. The inherently more likely explanation is that Zhao Snr was behaving perfectly properly in 2001 and established Lunan as the party entitled to the Shares. The Shares were purchased by Lunan, and held by its nominee so as to avoid any issues that might arise from direct ownership. Further, in 2006 as at the time of the original purchases, all the individuals involved knew of and agreed the

> structure, but, as time went on Zhao came to want these shares for himself and his family (and maybe persuaded himself they were his). In any event, shortly before his death, he sought to exploit his position to appropriate these shares from his company by purporting to direct the transfer of Endushantum to his daughter."

[222] I have to stand back and view the evidence holistically in order to decide which side's case to accept.

[223] The best starting point in my judgment is to note that it was only in 2017 that doubts were cast on Ms. Zhao's ultimate beneficial ownership of the shares in Lunan. Once relations between the Guimin camp and the Zeping camp broke down, each side sought to woo Ms. Zhao. That is only explicable on the basis that she was the ultimate beneficial owner of the shares. It is noticeable that it is only when she refused to align herself with either camp that issues as to her ownership were raised.

[224] As Mr. Lowe QC rightly points out, there is no documentary evidence, apart from the share entrustment agreement itself, to show that Lunan ever had any beneficial ownership of the disputed shares. All the other documentary evidence is to the contrary. The original accounting in Lunan's books for the two tranches of monies which Lunan advanced to Sitic for the share purchase was as a receivable from Kunlun US. Lunan's case necessarily involves the assertion that Lunan deliberately concealed from the PRC authorities and its own shareholders the true position for years. Lunan's accounts misrepresented its financial position, because it did not show the disputed shares as assets.

[225] The declarations of the Zhao Trust and the Banyan Tree Trust respectively are inexplicable, if Endushantum in fact held no assets beneficially. There would be no purpose creating these trusts, if Endushantum held the Lunan and Shangdong NT shares as nominee for Lunan.

[226] Likewise Wang Jianping's "draft plan for the overseas restructuring" of 29th December 2014 is a nonsense, if Lunan beneficially owned all the shares held by Endushantum. Indeed, on Lunan's case in the current action, the only logical interpretation of the draft plan is that Wang Jianping was feathering his own nest (as Gamma) as well as Wang

Buqiang's nest (as Beta), in both cases at Lunan's expense. That would, on Lunan's case in these proceedings, have been quite wrongful on the parts of Wang Jianping and Wang Buqiang. Further the transfers of Endushantum shares to Hengde and Jade Value must have been posited on Endushantum actually having some value.

[227] For the reasons I have given, I accept Wang Jianping's evidence that the purchase of the Lunan shares by Kunlun US was always intended as a temporary measure. I see nothing objectionable in Zhao snr deciding to purchase shares in Hope and Better himself, provided of course that he was using his own money for the purchase. In turn there is nothing objectionable in using Hope and Better dividends to pay off the loan made by Lunan to Kunlun US, so that he could hold the disputed shares beneficially. It was better for Lunan that he should own them rather than some other third party, where difficulties similar to those which arose with Sitic and Mr. Sun might reoccur.

[228] I do not accept the evidence of Wang Buqiang and Zhang Zeping that a further share entrustment agreement was discussed and approved at the board meeting of Lunan on 11th October 2006. There is nothing in the Board resolution or the terms of the 2006 share transfer agreement which supports this. Li Guangzhong does not support the existence of such a discussion. Wang Buqiang's evidence was that, when he discovered the terms of the Zhao Trust, he felt he had to go along with Zhao snr's wishes. This does not explain why after Zhao snr's death he continued to act on the basis that Ms. Zhao continued to be the beneficial owner of the Lunan shares.

[229] I have already set out aspects of the evidence of both Wang Buqiang and Zhang Zeping. I found them unsatisfactory witnesses and I do not accept their evidence on matters which are in dispute.

[230] Likewise, save to the limited extent indicated, I do not accept that Wang Jianping was a witness of truth. Despite his eminence as a lawyer, I regret to say that his evidence and actions show in my judgment a complete absence of integrity. I can place no reliance on his evidence insofar as it is in dispute.

[231] I find on balance of probability that Mrs. Wei knew all the relevant facts which I have found. As can be seen from the undisputed facts which I have set out in the first section of this judgment, she had a major rôle in the administration of the whole off-shore set up of companies, from Kunlun US, to Kunlun BVI, Endushantum, Jade Value and Zhongzhi and signed many of the key documents. I find as a fact that she knew of Zhao snr's beneficial ownership and subsequently Ms. Zhao's.

[232] Even if (contrary to my view) the evidence were not so clear, this would be an appropriate case to draw **Wisniewski** inferences against Mrs. Wei.

[233] Zhang Guimin was Zhao snr's right-hand man and anointed successor as chairman of Lunan. I find as a fact that he knew of Zhao snr's ultimate beneficial ownership of the disputed shares and subsequently Ms. Zhao's ultimate beneficial ownership. Zhang Guimin was as close to Zhao snr as Wang Buqiang. It is inherently unlikely that proposals like Wang Jianping's 29th December 2014 plan could be drawn up without his knowledge as chairman of Lunan. His actions in having Zhao Xiaoai attempt to bring Ms. Zhao into the Guimin camp are only explicable if he thought she was the ultimate beneficial ownership of the disputed shares.

[234] Whether he knew about the initial share entrustment agreement, is unclear. I cannot make any finding about that. It is possible he knew nothing about it. It does not, however, make any difference to my findings.

[235] As with Mrs. Wei, I would, were it necessary, draw **Wisniewski** inferences in respect of him.

[236] I find as a fact that Ms. Zhao did show Zhao snr's letter of 9th November 2014 to Wang Jianping on 10th November 2014 and that this letter was discussed with Mrs. Wei. I find that it was a valid instruction under the terms of the Zhao Trust.

[237] I turn to the question: how were the shares paid for? We know from Wang Buqiang's memorandum that Hope and Better paid RMB 38.5 million by 6th December 2005 to Kunlun US, which was treated as a payment by Kunlun BVI. That money went to Sitic as

the second instalment of the sale price due from Kunlun US to Sitic. Another payment of RMB 38.5 million was made on 12th June 2006 in the same way, as a payment by Hope and Better notionally to Kunlun US, but in fact accounted for as a repayment to Linjiang Engineering, another Lunan company.

[238] This leads to a factual question: did Zhao snr own shares beneficially in Hope and Better? We know from the 25th December 2003 audit validation report that Kunlun US was treated as having invested RMB 10 million and RMB 7.5 million in Better and Hope respectively. These are admittedly substantial sums, but Zhao snr was in the years after 2003 receiving substantial sums in bonuses and salary. Lunan have called no witness to explain the absence of documentation from 2003. This is of a piece with their failure timeously to disclose the Linyi proceedings. The willingness of Wang Jianping and Wang Buqiang up to 2017 to accept that first Zhao snr and then his daughter were entitled beneficially to the disputed shares is consistent with Zhao snr having used his retained salary and bonuses to pay for the Hope and Better shares.

[239] Looking at these matters holistically, I find on balance of probability that Zhao snr did pay for Kunlun US's shares in Hope and Better. Once the loan from Lunan to Kunlun US was repaid from the Hope and Better dividends, Zhao snr was, I find, the ultimate beneficial owner of the Lunan shares and the other shares held by Kunlun US. He remained the ultimate beneficial owner subsequently when all the Kunlun US shares were transferred to Endushantum. It has never been suggested that any different result could apply to the shares held by Endushantum in Shandong NT and Biotech.

Conclusion as to (1) burden of proof

[240] I turn then to Ms. Zhao's case on the burden of proof. I accept that she had legal title to the original two shares in Endushantum, by virtue of the executed transfer of title in her favour: **Nilon Ltd v Royal Westminster Investments SA**.[60] She is presumed to have both legal and beneficial title: **Chen v Ng**.[61] None of the defendants have in my judgment discharged the burden of disproving that.

[60] [2015] UKPC 2 at para [51].
[61] [2017] UKPC 27 at paras [40] to [42].

[241] The transfer of the two shares in Endushantum to Jade Value and the issuance 44,998 new shares in Endushantum to Jade Value and 5,000 new shares to Zhongzhi were on this basis egregious breaches of trust. Jade Value and Zhongzhi were knowing recipients. I find as a fact that Wang Jianping, Mrs. Wei and Zhang Guimin knew the truth. Ms. Zhao and Kunlun BVI are entitled to the transfer back of all those shares.

[242] It is not necessary to go further than that for Ms. Zhao to establish her case. However, if it were necessary, I would accept Mr. Lowe QC's submission that her title is of a pre-existing right to a proprietary legal title which prevails against them as the knowing recipients of the Zhao Trust: **MacMillan Inc v Bishopsgate Investment Trust (No 3)**[62] and that a Class 1 type of pre-existing 'undestroyed proprietary base' based on an express trust trumps that of a Class 2 knowing recipient: **Byers v Samba Financial Group**.[63]

Final conclusion

[243] It follows that Ms. Zhao and Kunlun BVI succeed on each of the three bases on which they argued this matter. I will hear counsel on what consequential directions I should give. In particular, there is likely to be a live issue whether this Court has jurisdiction to make determinations in relation to the Lunan, Shandong NT and Biotech shares currently held by Berpu and Provision and, if it does, what directions I should give.

Adrian Jack
Commercial Court Judge [Ag.]

By the Court

Registrar

[62] [1995] 1 WLR 978.
[63] [2021] EWHC 60 (Ch).