

IN THE SUPREME COURT OF VICTORIA
AT MELBOURNE
COMMERCIAL COURT

REVISED

S ECI 2016 001242

FLASH LIGHTING COMPANY LIMITED
(COMPANY NO 1032783)

Plaintiff

v

YINAN ZHANG & ORS
(According to the attached Schedule)

Defendants

<u>JUDGE:</u>	HARGRAVE J
<u>WHERE HELD:</u>	Melbourne
<u>DATE OF HEARING:</u>	13 December 2016
<u>DATE OF RULING:</u>	13 December 2016 (ex tempore)

<u>APPEARANCES:</u>	<u>Counsel</u>	<u>Solicitors</u>
For the Plaintiff	Mr T Di Lallo	Baker & McKenzie
For the First Defendant	Mr W E M Lye	DLA Piper Australia
For the Second Defendant	Mr A Barraclough	Clayton Utz
For the Third, Fourth and Fifth Defendants	Mr C Juebner	MST Lawyers
For the Sixth Defendant	Ms C M Pierce	SBA Law

HIS HONOUR:

- 1 The plaintiff applies for a freezing order against the 1st defendant, Mr Zhang. The plaintiff alleges that Mr Zhang knowingly assisted in a breach of trust or fiduciary duty by U&D, when he caused U&D to pay \$29.2 million held by it on trust for the plaintiff to CJL, a company owned by Mr Zhang.
- 2 The affidavit material on behalf of both the principal of the plaintiff, Mr Xiao, and Mr Zhang is on information and belief through their instructing solicitors. There are unresolvable factual conflicts on that affidavit material.
- 3 The relevant legal principles to be applied in deciding whether or not to grant a freezing order under o 37A and the inherent jurisdiction of the court were summarised by J Forrest J in *Deputy Commissioner of Taxation v AES Services (Aust) Pty Ltd*:

First, that a freezing order, by its very nature, is a drastic remedy and a court must exercise a high degree of caution before taking a step which will interfere with a party's capacity to deal with his or her assets.

Second, the order is not designed to provide security for the applicant's claim. It is solely directed to preserving assets from being dissipated, thereby frustrating the court process.

Third, the applicant bears the onus both in satisfying the Court that the order should be continued and in satisfying the Court as to the amount which is to be the subject of the order.

Fourth, that an order can only be made on the basis of admissible evidence which supports the contentions made by the party seeking the order. Speculation and guesswork is no substitute for either the facts or inferences properly drawn from proved facts.

Fifth, that before such an order can be made it is necessary that the applicant establish –

- (a) an arguable case against the defendant; and
- (b) that there is a danger that the prospective judgment will be wholly or partly unsatisfied as a result of the defendant's actions in either removing the assets or disposing or dealing with them so as to diminish their value.

Sixth, the balance of convenience must favour the granting of the freezing order.

Seventh, that there is no set process determining the exact nature of an order. The order will be framed according to the circumstances of the case.

Eighth, the applicant must establish with some precision the value of prospective judgment. The order should not unnecessarily tie up a party's assets and property.

Finally, there may be discretionary considerations which militate against the granting of a freezing order, such as delay in bringing the application on before the court or a lack of candour in the materials placed before the court.¹

4 I turn to consider whether or not a good arguable case has been established. What follows is a brief summary of the essential facts. I have read and synthesised all the affidavit material and in reaching my conclusions do so on the basis of the evidence as a whole.

5 Mr Xiao and Mr Zhang have been friends for some years and have a family connection. Mr Zhang introduced Mr Xiao to a public company, Daton Group Australia, which has since changed its name to ANB. Both men, or entities associated with them at relevant times, held shares in Daton/ANB. Mr Xiao became the Chairman of directors and Mr Zhang was a director and the chief executive officer.

6 U&D was incorporated on 26 August 2011. It was the vehicle utilised for the purchase of EPC 818, a coal mining tenement, with a view to a joint venture arrangement between Daton/ANB and KQ, the defendant in related proceedings. At the time of incorporation, Daton/ANB held 60 per cent of U&D and the plaintiff held 40 per cent.

7 KQ is a subsidiary of a Chinese state owned enterprise of which Mr Zhang's then wife, Ms Zhu, was a director in 2012.

8 The joint venture was facilitated by an equity transfer agreement dated 27 April 2012, under which Daton/ANB sold an 11 per cent interest in U&D to KQ, and the plaintiff sold its 40 per cent interest in U&D to KQ. Thus, on completion of the equity transfer agreement, KQ obtained control of U&D by a 51 per cent shareholding, with the remaining 49 per cent held by Daton.

9 Under the equity transfer agreement, the sale price for the plaintiff's 40 per cent

¹ [2009] VSC 418 [20] (citations omitted).

interest was \$51.6 million. Mr Zhang was well aware of that, as he facilitated the plaintiff's investment in U&D and the equity transfer agreement. At the time, Mr Zhang was a director and company secretary of U&D, a director and shareholder of CJI and a director of Daton.

10 On 17 August 2012, KQ gave an instruction to its bank to transfer the sum of \$70 million from its bank account to the bank account of U&D; with the added instruction to U&D that \$51.6 million of that \$70 million was to be paid to the plaintiff (the 'KQ instruction').

11 Following the receipt by U&D of the \$70 million, Mr Zhang arranged for the sum of \$22.4 million to be paid by U&D to the plaintiff in part payment of the \$51.6 million due to it under the equity transfer agreement. From that time, Mr Zhang knew that the unpaid balance due to the plaintiff under equity transfer agreement was \$29.2 million ('the \$29.2 million').

12 The KQ instruction had the effect that \$51.6 million of the \$70 million payment received by U&D was held by it on trust for the plaintiff ('the trust'). However, instead of arranging for U&D to pay the \$29.2 million to the plaintiff, Mr Zhang arranged for U&D to pay the \$29.2 million from the U&D account to CJI in two tranches – \$10 million on 27 August 2012 and \$19.2 million on 18 September 2012. The \$29.2 million has been used by Mr Zhang and his company, CJI, for its own purposes – known and unknown. It is unnecessary for the purposes of the application against Mr Zhang to consider the unknown purposes because, as appears below, Mr Zhang contends that the money was his to deal with as he saw fit and he thus acknowledges he dealt with it for his or CJI's benefit.

13 Mr Zhang alleges oral arrangements between him and Mr Xiao, in the terms set out in an affidavit sworn by his solicitor, Mr Leggatt, on 25 November 2016 as follows:

[In around August 2011] Mr Xiao and Mr Zhang then agreed to incorporate a new company called U&D Mining (Australia) Pty Ltd. The plan was that Mr Zhang and Mr Xiao would each invest approximately \$10,000,000 in this company to purchase EPC818 and Daton would invest the balance to purchase

the EPC 818 mining tenement. Each of Mr Xiao, Mr Zhang and Daton would then hold an interest in U&D and the sole asset of U&D, would be the mining tenement EPC818. Mr Zhang and Mr Xiao planned to sell their interest to an investor with enough capital and experience in coal mining so that Daton could establish a productive and profitable coal mine.

Mr Xiao and Mr Zhang agreed that Daton (with the permission of the Board) would invest approximately \$6,000,000 in U&D, but receive a 60% stake in U&D. Mr Zhang and Mr Xiao would then both invest approximately \$10,000,000 each, for the remaining stake in U&D.

As Mr Zhang and Mr Xiao had a long business relationship, Mr Zhang trusted him to honour *the agreement that Flash Lighting Company Limited, would hold 40% of U&D, but that 40% represented an investment whereby Mr Xiao and Mr Zhang had invested approximately \$10,000,000 each*. This decision was based on a relationship of trust, and the cultural understanding that Chinese business partners who invest in and operate the same business together operate on an expectation as to what they are going to receive from a deal.

At the time, Mr Zhang was the person handling the business negotiations. He regularly kept Mr Xiao informed by phone. Mr Xiao told Mr Zhang that he did not want to take an ongoing risk in relation to this investment and that he wanted to double his return on this investment.

On 21 November 2011, U&D entered into a sale and purchase agreement with Arch Coal and Houghton Investments, to acquire EPC818 for \$25,250,000. An approximate breakdown of the funding for this \$25,250,000 is as follows:

- (a) \$6,450,000 by Daton (some of that money was provided by Apollo Fertilizer Pty Ltd, which was a subsidiary of Daton);
- (b) \$9,230,000 by Mr Xiao;
- (c) \$9,640,000 by Mr Zhang, which includes money invested by other business partners.

Completion of the transaction occurred on 10 February 2012, where the acquisition by Daton was announced to the ASX. The interest was officially transferred by Arch on 20 February 2012 to U&D.

...

Whilst pursuant to the Equity Transfer Agreement, the sum of \$51,600,000 was owing to FLC, it was well understood and obvious to both Mr Xiao and Mr Zhang, that the amount of \$51,600,000 was not money that was going to be received only by Mr Xiao's interests. As stated above, Mr Zhang and Mr Xiao had both invested similar amounts in U&D to purchase EPC818. Mr Xiao had appointed Mr Zhang to represent his interests in relation to the transaction and Mr Xiao had instructed Mr Zhang that he wished to double his money.

As Mr Xiao had only invested \$9,200,000 in U&D in late 2011/early 2012, he told Mr Zhang that he was delighted to realise that investment for a significant profit in such a short time. They agreed that of the \$51,600,000 that had been paid for FLC's interest in U&D, \$22,400,000 would be paid to Mr Xiao and

\$29,200,000 would be paid to Mr Zhang. This allocation of the sale price, reflected their mutual investment of similar amounts, but also the fact that Mr Zhang had sourced the opportunity, found a buyer and brought it to realisation.

As to the amount paid by KQ to ANB, Mr Zhang and Mr Xiao also received a benefit as they were majority shareholders of ANB. That money was used to fund the continued business operations of ANB.²

14 In support of the alleged oral agreement or understanding, Mr Zhang contends that if money was in fact outstanding to the plaintiff under the equity transfer agreement, the amount of that outstanding debt, or the fact of it, would have been disclosed in the Daton annual reports, and there is no such mention. For the reasons expressed in argument, I do not accept that contention. The annual reports concerned Daton's investment in U&D and thus EPC 818, in circumstances where it held 60 per cent, and then 49 per cent, of the shares in U&D. It was not relevant for the Daton annual reports to comment upon or make reference to any monies outstanding under the equity transfer agreement by which the plaintiff's 40 per cent interest in U&D was sold to KQ.

15 Mr Zhang relies also on the plaintiff's delay in bringing his claim or making any demand for the outstanding \$29.2 million to support his alleged oral agreement. However, I am satisfied that, if the explanations given on behalf of Mr Xiao in the affidavits sworn by his solicitor Mr Lucarelli are accepted, these explanations for delay are objectively credible. Further, they are supported in some measure by expert evidence as to Chinese business and cultural practices.

16 The court is thus placed in a position where there is a direct clash of affidavits sworn on information and belief which cannot be resolved on an interlocutory application. In these circumstances, in considering whether a good arguable case has been established, it is appropriate for the court to give primary weight to such contemporaneous documents as are in evidence.

17 In my opinion the plaintiff's case is, if accepted at trial, a good arguable case for the

² Affidavit of David Thomas Leggatt, sworn 25 November 2016, [20]–[25], [38]–[40] (emphasis added).

relief sought. It is supported by two key contemporaneous documents, being the equity transfer agreement and the KQ instruction. On the other hand, there is not one contemporaneous document presently before the court which supports Mr Zhang's allegations of oral agreement to share the \$51.6 million between himself and the plaintiff. That position may change at trial, but I can only rule on the basis of the information before me as it presently stands.

18 Taking the evidence as a whole, I am satisfied that a good arguable case for knowing assistance in a breach of trust has been established.

19 I turn to consider the next element: whether there is a danger that Mr Zhang as a prospective judgment debtor will act so that any judgment against him will be partly or wholly unsatisfied as a result of him dealing with his assets. In that regard there is no specific evidence against Mr Zhang that he is planning to deal with his assets for that purpose, although there is evidence that other defendants who are persons or companies associated with him, who received or may have received some of the \$29.2 million, are dealing with assets. I have reserved my judgment on matters concerning other defendants. It is, however, unnecessary to take those matters into account in determining that there is a risk of dissipation if the freezing orders sought against Mr Zhang are not made.

20 In my opinion, the good arguable case which has been established for knowing assistance in a breach of trust by U&D will, if proved at trial, establish dishonesty by Mr Zhang. In such circumstances, where a good arguable case has been established which itself involves actions which may be described as dishonest or immoral, the court can infer a risk of dissipation to defeat a potential judgment.

21 In *Patterson v BTR Engineering (Aust) Limited*,³ Gleeson CJ (then a member of the Court of Appeal in New South Wales) gave reasons for dismissing an appeal against the continuation of an injunction freezing a defendant's assets. The trial judge had made

³ (1989) 18 NSWLR 319.

the order on the basis of the risk of dissipation of assets arising from the underlying circumstances of the case, which involved a good arguable case of dishonesty. Gleeson CJ agreed that the necessary danger or risk of dissipation arose from those underlying facts.

22 In dismissing a contention that it was necessary to establish a likelihood of dissipation on the balance of probabilities, Gleeson CJ stated that such a requirement was:

too inflexible. It is not difficult to imagine situations in which justice and equity would require the granting of an injunction to prevent dissipation of assets pending the hearing of an action even though the risk of such dissipation may be assessed as being somewhat less probable than not.⁴

23 Gleeson CJ agreed with the trial judge that:

the nature of the scheme in which, *on the evidence to date*, the [defendant] appears to have engaged, is such that it is reasonable to infer that he is not the sort of person who would, unless restrained, preserve his assets intact so that they might be available to his judgment creditor.⁵

24 I turn to consider the balance of convenience. What course will carry the lesser risk of injustice? Mr Zhang puts forward no evidence of his assets or of any prejudice if a freezing order is made. On the other hand, the evidence in this case indicates that Mr Zhang is a Chinese national who is either not a permanent resident of Australia or resides between Australia and China and has the capacity to spend all his time in China if he chooses. In my opinion, the balance of convenience clearly supports a freezing order on the usual terms and with the usual protections.

25 In this regard also Mr Zhang relied upon the delay in the making of the claim. In *Choice Planning Pty Ltd & Ors v Mider@Franklin Street Pty Ltd & Ors*,⁶ I stated that mere delay is not fatal to an application for an interlocutory injunction, including for a freezing order: 'For delay to be a decisive factor there must be both unreasonable delay and substantial prejudice to the defendant or third parties so that it becomes

⁴ *Patterson v BTR Engineering (Aust) Limited* (1989) 18 NSWLR 319, 325.

⁵ *Ibid* 325-6 (emphasis added).

⁶ [2015] VSC 59.

practically unjust to grant the remedy sought'.⁷ I am not satisfied that this is such a case. On the evidence as it presently stands, it would appear that Mr Zhang is a successful businessman in China and in Australia. He has put forward no evidence as to his assets. Any freezing order will be subject to the usual exceptions enabling Mr Zhang to pay his reasonable legal expenses of this proceeding, to discharge debts already incurred bona fide and hereafter incurred in the ordinary course of business, and to pay his reasonable living expenses.

26 The question arises as to the strength of the plaintiff's undertaking as to damages in case it should turn out that a freezing order should not have been made. As indicated in oral argument, given the foreign status of the plaintiff, I agree that the undertaking should be appropriately secured. On that basis I will hear from counsel for Mr Zhang as to the appropriate form and amount of security to be imposed.

27 I will also hear from counsel as to the form of orders otherwise, including the limit to be inserted, the form of the usual exceptions to which I have already referred and as to any ancillary orders which may be sought.

⁷ *Choice Planning Pty Ltd & Ors v Mider@Franklin Street Pty Ltd & Ors* [2015] VSC 59 [12] (citation omitted).

SCHEDULE OF PARTIES

S ECI 2016 001242

BETWEEN:

FLASH LIGHTING COMPANY LIMITED (COMPANY NO. 1032783)	Plaintiff
- and -	
YINAN ZHANG	First Defendant
U&D MINING INDUSTRY (AUSTRALIA) PTY LTD	Second Defendant
WEI KUN PTY LTD (ACN 154 149 416) (In its own right and as trustee for the Zhu Family Trust)	Third Defendant
YI KUN PTY LTD (ACN 161 368 921) (In its own right and as trustee for The Wei Family Trust)	Fourth Defendant
YI WEI AUSTRALIA PTY LTD (ACN 165 552 367) (In its own right and as trustee for the Kun Family Trust)	Fifth Defendant
AUSTRALIA WALES FINANCIAL MANAGEMENT PTY LTD (ACN 166 542 276)	Sixth Defendant