IN THE EASTERN CARIBBEAN SUPREME COURT
IN THE HIGH COURT OF JUSTICE
BRITISH VIRGIN ISLANDS

CLAIM NOS:BVIHCV 251 of 2008

BETWEEN:

ARAN VENTURES HOLDINGS LTD.

Claimant

And

D.B. ZWIRN SPECIAL OPPORTUNITIES FUND, LTD.

First Defendant

DBZ ARAN CHINA REAL ESTATE INVESTMENT CO. LTD.

Second Defendant

Appearances: Mr Paul Dennis of O'Neal Webster for the Claimant
Mr Timothy Harry and Ms Elizabeth Killeen of Maples and Calder for the Defendants

JUDGMENT

[2009: 15, 16 July; 30 July]

[Contract for services – express termination provisions on material default by contractor – whether material default – whether waiver by employer– joint venture agreement – whether terminated – whether Claimant entitled to accrued benefits –nature of benefits to which contractor entitled]

[1] The Claimant ('Aran') is a BVI registered company incorporated on 25 June 2004. There is no evidence as to its general line of business but there is no dispute that in 2005 it won a competitive bid to acquire land and build and operate the first five star hotel in the Haicang district of the city of Xiamen in south east China ('the hotel').

[2] As a basis for providing equity funds to build the hotel Aran entered into a joint venture agreement with the first Defendant ('DBZ'), a New York based hedge fund, on 1 April 2006. Although the second Defendant, a company incorporated in the BVI on 23 March 2006 and to which I will refer as 'JVCo', was party to the joint venture agreement, the main thrust of its provisions was to regulate the relationship between Aran and DBZ. I will refer to this agreement as 'the joint venture agreement'. JVCo was the entity through which, indirectly, the hotel was to be owned and the arrangement was that DBZ would hold 95% of the shares of JVCo, with Aran holding the remaining 5%.

[3] The purpose of the joint venture agreement was to govern the relationship of Aran and DBZ as partners in the hotel business but also, by its express terms, to govern the relationship of DBZ and Aran in their capacity as shareholders of JVCo. DBZ was to have a majority on the board of directors of JVCo. Construction of the hotel began in September 2007 and is still under way.

[4] The parties have fallen out. DBZ and JVCo say that Aran was in material breach of an agreement ('the AMSA') made, apparently, in early 2007, under which Aran was appointed by JVCo as an independent contractor to manage certain aspects of the hotel project on behalf of the joint venture and that in consequence of those breaches, JVCo was entitled to and did serve a valid notice of termination of the AMSA, as a result of which that agreement terminated on 2 February 2008. DBZ says that the termination of the AMSA caused the consequential termination of the joint venture agreement.

[5] Aran seeks declarations that the purported terminations by JVCo of the AMSA and by DBZ of the joint venture agreement were invalid. Aran denies that it was in material breach of the AMSA and says that if it was then at any rate some of those breaches were waived by JVCo. If it is wrong about that and if the AMSA and the joint venture agreement were terminated, Aran says that it is nevertheless entitled under the provisions of the joint venture agreement to be paid a substantial sum by way of its share of what it estimates will be the net profit on the eventual sale of the hotel. Aran's estimate is that when that

happens, it will be entitled to some US$5.7 million, although it accepts that that figure is not capable of ascertainment until the hotel has been sold. Aran also claims that JVCo has failed to pay its share of the fee to which it is entitled under clause 6 of the AMSA and says that the amount currently outstanding and unpaid, on the basis that the AMSA remains on foot, is some US$110,000. JVCo admits that Aran is entitled under the AMSA to a pro rated fee for the first part of the first quarter of 2008 in the sum of some US$6,000, covering the period from 1 January 2008 until 2 February 2008, when JVCo contends that the AMSA was terminated, but claims the right to set that off against some US$245,000 which JVCo counterclaims. The counterclaim is for expenses to which it says it was put as a result of certain of the alleged defaults which it relies upon in its notice of default.

[6] It is convenient to begin with the question whether Aran was in breach of the AMSA. Although, as I have said, the AMSA was not in fact concluded until early in January 2007, it is plain from monthly status reports provided to JVCo by Aran that Aran commenced acting on behalf of the joint venture by, at the latest, July 2006. The front sheet of the copy AMSA in the trial bundle bears a date of 29 December 2006 and states that it was 'Effective as of April 1, 2006'. No explanation was given at trial why the AMSA appears to have post dated Aran's acting on behalf of the joint venture, but none of the breaches relied upon pre-dated the execution of the AMSA and the point therefore appears to have no bearing on the issues which I have to decide.

[7] Aran's primary obligations under the AMSA were set out in clauses 2 and 3 as follows:

Clause 2,

> "ENGAGEMENT OF THE SERVICER
>
> The Investor [that is to say, JVCo] hereby appoints the Manager [that is to say, Aran] as an independent contractor to provide the services with respect to the Assets as further described in Section 3 ("Services"). The Manager hereby accepts the above appointment and shall perform the Services in accordance with

professional standards of care and practice ordinary for a reasonably prudent management servicer administering similar assets management in the PRC.

In performing its obligations under this Agreement, the Manager shall at all times act in good faith and in the best interests of the Investor with respect to the Assets and, using its best efforts, shall carry out all of its obligations under this Agreement in accordance with customary commercial standards and consistent with the Manager's duties to the Investor hereunder."

(I should say that 'Assets' is to have the meaning assigned to the word in the joint venture Agreement, that is to say, 'a portfolio of hotels and other investments')

"3. THE SERVICES

3.1 The Manager agrees to source, identify, provide due diligence services with respect to, and assist the Investor in, the acquisition of Assets and to provide advisory, consultation, disposition and management services for Assets to allow the Investor to achieve the expeditious operation, management and disposal of such Assets in a manner which maximizes within the time frame established by the Investor the net present value of the proceeds derived from the Assets while minimizing the risks associated therewith.

3.2 In the event that the Manager identifies any assets that it believes are appropriate for purchase by the Investor, the Manager shall submit to the Investor a proposal for such acquisition (which proposal shall be accompanied by an investment package in the form set forth in Exhibit A). By way of clarification but not by way of limitation, always subject in all events to the Limitations on Authority, the Manager's duties shall include, but not be limited to, the following:

(a) The Manager shall engage a reputable law firm approved by the Investor, at the expense of the Investor, to provide legal services

to the Investor with respect to the Assets which it owns or proposes to acquire, including, without limitation, subject to receiving the prior written consent of the Investor for the particular action to the extent such consent is required based on the Limitations on authority and pursuant to Section 5.1 of the Joint Venture Agreement, prosecution of legal actions, filing and prosecution of claims in bankruptcy proceedings, or the timely filing of tax petitions where appropriate;

(b) as necessary or advisable, the Manager shall engage other professionals approved by the Investor, at the expense of the Investor, to carry out the services in connection with the management of Assets;

(c) if the Investor shall so request, the Manager shall contract with unaffiliated licensed brokers, as necessary, to identify and negotiate with prospective third-party sellers of any Asset and prospective purchasers of any Asset, on terms approved by the Investor and at the Investor's expense;

(d) if the Investor so requests, the Manger shall assist the Investor in preparing materials for presentation to and negotiating with third-party lenders for the financing or refinancing of a portfolio of Assets (or any subset thereof or any individual Asset) acquired, or to be acquired, by the Investor and shall assist in concluding such financing and refinancing arrangements subject to approval thereof by the Investor. In so doing, the Manager shall prepare all reasonable reports relating to the Assets required to obtain third-party financing of the Assets and to comply with the requirements of any financing documents for the Investor's financing of the Assets. If the Investor shall so request, the Manager shall take

reasonable action required to be taken under any financing documents for the Investor's financing of the Assets, including, without limitation, reporting and notice obligations in order for the Investor to comply in all respects with the provisions of such documents; and

(e) subject to the provisions of Section 11.5 of this Agreement, the Manager shall, at the Investor's request and at the Investor's expense, assist the Investor or its agent in making all filings and registration with the competent authority necessary from time to time to record the ownership, right or interest of an Asset by the Investor.

3.3 The Investor, as owner of the Assets, hereby grants to the Manager the authority to administer and manage the Asset and the proceeds and other incomes generated from the administration and management of the Assets thereof in accordance with this Agreement and, subject to the limitations, restrictions, obligations and other terms and conditions hereof, full power and authority, acting alone as the Investor's authorized representative, to do any and all things in connection with such servicing, management and administration of the Assets. With respect to the assets in each Investment Pool, the Manager shall:

(a) collect rent and other income generated from the Assets, if any;

(b) maintain and keep information in relation to the Assets which shall include but not be limited to any documents, agreements and correspondence in relation to the Assets and make certain that all documentation in relation to the Assets in the possession of the Manager is kept in a way that the files for each Asset can be clearly distinguished from each other and from the files relating to

other documentation and correspondence relating to other assets owned by or serviced or administered by the Manager;

(c) ensure that all staff members of the Manager responsible for the servicing, management and administration of the Assets shall be familiar with the Assets and each of the real property; and

(d) check and make necessary maintenance of the Assets, including but not limited to paying governmental charges and taxes, and maintaining water and electricity supply, facilities and insurances for such Assets.

3.4 The Manager shall cooperate with and provide such assistance as is reasonably required by the Investor from time to tome in connection with the purpose of this Agreement, including, without limitation, providing the Investor or any third-party service providers designated by the Investor with assistance in valuing assets, completing and filing tax returns and preparing annual reports, including assistance with the preparation of any financial statements to be included therewith."

[8] Clause 2 imposes upon Aran a duty to provide the services set out in clause 3 of the AMSA and to 'perform' the services in accordance with professional standards of care and practice ordinary for a reasonably prudent management servicer administering similar asset management in the PRC. The services described in clause 3.1, which effectively summarizes the services more extensively set out in the following sub-clauses are the sourcing, identification, provision of due diligence services with respect to and assisting JVCo in the acquisition of hotels; and the provision of advisory, consultation, disposition and management services for acquired hotels; in order to allow JVCo to achieve 'expeditious' operation, management and disposal of hotels in a manner which maximizes the net present value of the proceeds derived from the hotels while minimizing the risks associated therewith.

[9] The difficulty with all of this is that it is premised on a business plan involving the acquisition and disposal of hotels, not the building of a hotel from the ground up. Furthermore, under an agreement made in April 2007 between HJX and HJS, HJS assumed wide project management responsibilities for the construction of the hotel. Mr Harry says, rightly, that some force must be given to the AMSA even if the background against which it was entered into is different from the background envisaged by its express terms and I agree with that. The problem is that the mis-match makes it extremely difficult to be sure that any particular act or omission involves a breach of the AMSA unless the breach or omission relied upon can be set against a contractual obligation in specific terms. Further, in the absence of any expert evidence as to the professional standards of care and practice ordinary for a reasonably prudent management servicer administering similar asset management in the PRC it is difficult, unless a breach can be positively identified as a matter of language, to know whether a complaint about a matter not addressed in express terms falls below that standard. It is for the defendants to establish the existence of a contractual term which they seek to rely upon and then to prove its breach.

[10] The relevant parts of the provisions of the AMSA relied upon by JVCo in its amended defence as justifying service of its notice of default are, in addition to clauses 2 and 3(2)(b), already set out above, the following:

Clause 5.1

> "Neither the Manager nor any of its Affiliates shall have the authority, without obtaining the prior written approval of the Investor, to:
>
> (a) enter into a binding commitment to sell, transfer, finance, pledge or hypothecate such Assets;
>
> (b) incur any costs on behalf of the Investor with respect to an Asset in excess of any amounts incurred for (i) legal expenses in connection with the legal due

diligence and acquisition of any Assets, (ii) any amounts incurred for information reports provided in connection with any Assets, except in accordance with clause (f) below, and (iii) accounting and audit fees for reports and audits as described in Section 8.2 hereof"

'Clause 8.2

"Reports; Audit

(a) The Manager shall be available for and participate in weekly telephone conferences with the Investor ("Weekly Meeting") during which the parties will discuss and review existing and potential business opportunities of Investments, acquisition or disposition of Assets that the Manager is in the process of sourcing and market developments related thereto, among other things. The Manager shall, at the request of the Investor, participate in credit meetings to discuss the merits of pursuing potential transactions involving the Investor. In addition, for every month, the Manager shall prepare and deliver to the Investor a pipeline report and a report with respect to the prior month ("Monthly Report"). In addition, the Manager will promptly provide the Investor with a copy of any third-party report received by Manager which contains information that Manager reasonably believes is material with respect to any of the Assets and any other information with respect to any such Asset that is reasonably requested by the Investor. In addition, the Manager shall promptly notify the Investor of all material developments regarding any of the Asset of which the Manager has actual knowledge, without waiting for the Weekly Meeting or the Monthly Report."

[11] JVCo's notice of default was in the following terms:

> "02 January 2008
>
> Dear Sirs
>
> Asset Management Services Agreement ("AMSA")
>
> Pursuant to section 12.1 of the AMSA, we hereby give you notice that each of the following events has caused you to be in default of your obligations in material respect under the AMSA and/or in material adverse breach of your covenants under the AMSA:
>
> (1) you finalizing and causing Howard Johnson Hotel (Xiamen) Co Ltd to enter into, for and on behalf of us, major contracts with third parties, including contracts with general contractors, quantity surveyors, LV designers and supervision firms without our knowledge or approval;
>
> (2) you causing Howard Johnson Hotel (Xiamen) Co Ltd to enter into a finance contract, for and on behalf of us, with Xiamen Haicang Investment Co Ltd without our knowledge or approval;
>
> (3) your instruction to the management of Shanghai Howard Johnson Hotel to produce the project chop despite our disagreement;
>
> (4) your failure to produce the status report since February 2007;
>
> (5) your failure to follow our instruction to instruct the management of Shanghai Howard Johnson Hotel on requirements regarding internal control procedures; and
>
> (6) your failure to provide project information accurately to us, including your failure to disclose to us in the relevant finance model an additional land improvement fee of at least RMB 7 million and land idling fee of at least RMB 3.5 million.
>
> Should you fail to rectify any of the above defaults and breaches within 30 days from service of this letter, we ill be entitled (and intend) to terminate the AMSA.
>
> Yours faithfully
> For and on behalf of
> DBZ Aran China Real Estate Investment Company Limited
>
> By:_____
>
> Name: Christopher T. Suan
>
> Position: Director"

[12] I shall deal with these complaints as they came to be particularized in JVCo's amended defence. Before I do that, however, I should say that when the case came on for hearing I was asked by each party to give permission for amendments to be made to its pleadings. In the case of JVCo's defence, these amounted to reliance upon additional clauses of the AMSA as justifying the allegation that facts already relied upon amounted to material breaches of the AMSA and to the addition to allegations that Aran had 'caused' certain entities to enter into contracts an alternative allegation that Aran had 'permitted' them to enter into such contracts. Aran's amendment was to add a defence of waiver in respect of four alleged breaches of the AMSA set out in paragraph 12.3 of the JVCo's defence.

[13] Before going any further I should first identify some of the other entities who played a part in the matters which gave rise to these proceedings. The entity which actually held the land on which the hotel is being constructed is a Chinese company called Howard Johnson Hotel (Xiamen) Limited ('HJX'). It is an indirect but wholly owned subsidiary of JVCo. Apart from the fact that a director and one-third owner of Aran (a Mr Wilburt Chang ('Mr Chang')) is a director of HJX (something not relied upon in JVCo's pleadings) Aran is wholly unconnected with HJX. Another company which figures in the story is Howard Johnson Shanghai Hotel Management Company Limited ('HJS'). This company was contracted at some stage by a subsidiary of JVCo to provide certain project management services to HJX. A further player in the story is a Chinese company called Xiamen Haicang Investment Co Ltd ('Haitou'). Haitou seems to have been a government run entity charged with the development of the region within which the hotel is situated and acted as funder to HJX in the project, using money which Haitou itself borrowed from Industrial and Commercial Bank of China ('ICBC').

[14] JVCo's first pleaded complaint is that without its knowledge or consent, as required by clause 5.(1)(a) of the AMSA , Aran 'caused or permitted' HJX to enter into an 'agency agreement' with Haitou in March 2007 for the provision of funding finance to HJX under which Haitou would charge a fee of 2%. This was said to have been against the best interests of JVCo and thus a breach of clause 2 of the AMSA and to have amounted to a

'material development' within the meaning of clause 8.2 which should have been disclosed by Aran to JVCo. Although there is no specifically pleaded allegation that the 'material development' was not in fact disclosed, it is, in my judgment, implicit in the wording of the amended paragraph 12.2 of the amended defence.

[15] It emerged from the evidence of Mr Tseng Hung Yan ('Mr Tseng'), a director of DBZwirn Asia Partners Limited ('DBZ Asia'), described as an affiliate of DBZwirn LLP and investment adviser to DBZ, that the burden of this complaint was that the agreement contained no cap on the interest rate payable thereunder; that the sum upon which the 2% fee was to be levied was imperfectly defined and that if DBZ Asia had had anything to do with the matter the fee would have been reduced to 1.5% and that the agreement was defective because it left it unclear as to the amount of the principal sum by reference to which the 2% fee was to be calculated. In response, Aran said that the agency agreement of March 2007 was a mere replacement for an earlier such agreement of May 2006, of which the DBZ parties had (as they admitted) been fully aware before entering into any relationship with Aran and that in that earlier agreement the fee had been not 2% but 3%. Mr Tseng explained that the reason for there being any 'fee' at all was because the agreement between ICBC and Haitou was that Haitou would not charge HJX with an interest at a rate higher than Haitou had to pay to ICBC. The 'fee' was a supposedly acceptable way to get round this prohibition.

[16] In his evidence for Aran, Mr Michael Bock ('Mr Bock'), who was Aran's only witness, said that he had had a fleeting glance of a draft of this 'agency agreement' and had made some oral suggestions for amendments via HJS during the period while it was being negotiated. But he said that he was not involved in the conclusion of this agreement and had not been aware that it had been finalised until some time after the event. He said that he had been asking for a copy of the document as executed, but had not been supplied with one. But Mr Bock accepted that he should have informed JVCo about the negotiations and that JVCo might have wished to have its own input before it was finalized.

[17] There was no evidence that Aran was in any position to cause HJX to do anything at all, let alone enter into a funding agreement and it was unclear to me how Aran could be said to have 'permitted' HJX to enter into a contract unless it had the power to prevent it from doing so. There was no evidence that it had. It does not follow from the fact that Mr Chang was a director of Aran as well as being a director of HJX that Aran controlled HJX. It was not pleaded and there was no evidence that Aran was or acted as agent for HJX. This part of the complaint therefore fails on the facts. It also seems to me that even if that were not so, it could not constitute a breach of clause 5.1(a) of the AMSA, which on its terms covers agreements entered into by Aran, presumably as agent for the relevant Asset holding entity, of the type there mentioned. Aran was not party to the agency agreement. It does seem to me, though, that the re-negotiation, if that is the correct way to describe it, of the agency agreement was a material development within the meaning of clause 8.2(a) and within the plain scope of Aran's duties under clause 3 of the AMSA. I therefore hold that Aran's failure to draw the attention of JVCo to it was a breach of clause 8.2(a) of the AMSA.

[18] For what it is worth, I hold that the failure of Aran to inform JVCo about the renegotiation of the agency agreement constituted a breach of clause 2 of the AMSA as well as of clause 8.2(a), because the failure to carry out the 8.2(a) obligation self evidently also amounted to a breach of the obligation placed upon Aran by the AMSA to carry out its duties thereunder in the best interests of JVCo. I should say that in the course of his submissions Mr Harry appeared to rely upon the words '[Aran] shall at all times act in good faith and in the best interests of [DBZ Aran]' where they appear in clause 2 of the AMSA as though they gave rise to stand alone duties of good faith and loyalty. They do not. The words are preceded by the words 'In performing its obligations under this Agreement . . .', which make clear that they qualify duties to be gathered from other terms of the agreement and are not self standing obligations.

[19] The question is whether the breaches thus identified were breaches of obligations 'in a material respect' within the meaning of clause 12 of the AMSA. Authority was cited by Mr Harry upon the meaning of the word 'material' in similar contractual circumstances, but I do

not think that cases decided on other contracts entered into in different circumstances assist me in the construction of the AMSA. I would prefer to read 'material' as meaning 'not immaterial' and in my judgment the failure to notify JVCo about the pendency of negotiations about this obviously important agreement was a breach of the AMSA in a material respect.

[20] The next batch of complaints was that between February and September 2007 Aran 'caused or permitted' HKX to enter into four particular contracts (in one case, by accepting a tender offer). This fact was said to amount to breaches of clauses 5.1(b) and 2 of the AMSA, to have been done without the approval required by clause 3.2(b) and to have involved non-disclosure of a material development within the meaning of clause 8.2(a). It is obvious for the same reasons that I have set out in paragraph [17] above, that Aran cannot have 'caused or permitted' HJX to enter into any contracts. The allegations that this was done without approval or consent as required by clause 5.1(b) (which is in any event unconnected with the complaint made) or clause 3(2)(b) (ditto) therefore fall away with the main body of the complaint.

[21] Mr Bock's evidence was that he had no knowledge that the first three of these contracts had been entered into until after the event. He said that in any event these were not financial contracts and that they were not within the scope of Aran's responsibilities under the AMSA. In my judgment, he was correct to say so. I accept his evidence that he had no knowledge of these contracts until after they had been executed and in my judgment JVCo fails to prove that Aran had any duty to find out about them. The non-disclosure complaint therefore fails in respect of these three contracts. As for the fourth, it was unclear to me at what stage Mr Bock knew about the acceptance of the general contractor tender, but for similar reasons I do not consider that the AMSA imposed upon Aran any duty to report to JVCo on construction matters of this sort. Matters of that sort were the clear responsibility of HJS under an agreement entered into between HJS and HJX in April 2007, which made specific provision for supervision of construction matters. I do not believe, therefore, that Aran was in breach of clause 8.2 in not disclosing these matters. I should add that by amendment Aran pleaded that the alleged breach of causing or

permitting HJX to enter into these contracts was waived by JVCo. Since I have held that no such breach was committed, I do not need to consider the validity of the waiver point.

[22] Next, JVCo complains that in breach of clause 2 of the AMSA Aran instructed the management of HJS in October 2007 to procure a project chop over JVCo's objection, on the grounds that Aran had failed, despite the requests of JVCo, to implement adequate controls for its use. It was common ground that a project chop is a potentially dangerous instrument unless adequate controls are in place for its use. Mr Bock's evidence was that he had understood that he had instructions from JVCo to arrange for the acquisition by HJS of a project chop and that he gave oral instructions for that to be done, but he accepted that he was mistaken in that belief. He also accepted that it was not until November 2007 that he devised and put an internal control system in place. Mr Pan, who was the other witness for the defendants, gave evidence that it was DBZ Asia who installed the internal controls, not Aran. He also said that the chop was recovered from HJS by DBZ Asia some time in August 2007 (despite the pleaded date of October 2007) and that in the meantime it had not been used to the detriment of the project. Mr Harry, in his closing submissions for the defendants, said it had never been used.

[23] Although there is no doubt that Mr Bock did indeed agree to design project chop usage guidelines by 25 September 2007, it is not clear to me that Aran had any obligation under the AMSA to do so or that whatever part Aran may have played in the acquisition by HJS of the chop was a breach of clause 2 of the AMSA and I accordingly hold that these breaches of the AMSA are not made out.

[24] JVCo next complains that Aran failed, in breach of clause 2 of the agreement, to instruct the management of HJS in relation to the implementation of internal control procedures, in particular procedures regarding 'document' approval and project monitoring. I do not know what is meant by 'document approval', but in circumstances where HJS was contracted as project manager for the hotel construction under the agreement referred to earlier and which contained express provisions for the obtaining by HJS of all necessary legal documents and detailed provisions as to project management, it seems to me wholly

artificial, even if the language of the AMSA was sufficient to impose the pleaded obligations upon Aran, which in my judgment it is not, to suggest that it had any duty in this respect whatsoever. This complaint therefore fails.

[25] The next breach relied upon by JVCo is Aran's admitted failure to provide monthly reports between February and September 2007. The reports resumed only in October 2007. While there is certainly room for argument, in the light of the terms of clauses 2 and 3 of the AMSA, about what topics such monthly reports should have dealt with, to fail to produce any reports at all was, in my judgment, a clear breach of clause 8.2 of the AMSA and it seems to me that it is a breach 'in a material respect'. In his closing submissions Mr Dennis relied upon the 'resumption' of the obligation to provide monthly reports as 'curing' the earlier omissions, but I cannot accept this submission. Neither in his pleadings nor in his closing submissions did Mr Dennis suggest that these breaches had been waived and in my judgment he was correct not to do so.

[26] The final specific breach relied upon by JVCo is that Aran failed to provide it with accurate project information by failing to disclose to JVCo [sc. a liability for] land improvement fees for civil defence facilities of RMB7 million and a land idling fee of RMB3.5 million. This failure is alleged to have been a breach of clauses 2, 3 and 8 of the AMSA and to have resulted in HJS incurring a service fee of RMB850,000 in arranging for the waiver of the land idling fee by the Xiamen authorities.

[27] The evidence about these matters was not particularly clear. So far as the land improvement fees were concerned, Mr Pan's evidence was that JVCo knew that a RMB20 million land improvement fee was included in the original Haitou agency agreement (in fact the document gives a figure of RMB20.420 million). He said that at some stage, precisely when was unclear, JVCo had been given to understand that in addition to the RMB20 million or so there was a further liability of some RMB7 million to reimburse Haitou for civil defence works carried out in relation to the project. He said that Aran was asked to include this additional sum in the project's financial model. By some time in October/November 2007 JVCo had learnt, from HJX and HJS, but not from Aran, that the

civil defence costs (which have not yet been paid) were part of the originally stipulated RMB20.420 million, which was confirmed to JVCo by Haitou. His complaint was that Aran had failed to provide JVCo with accurate information, that is to say, the true position over the amount of the land improvement fee and that this caused confusion in the preparation of JVCo's financial projections.

[28] Mr Bock, for Aran, confirmed that the original agency agreement stipulated for a land improvement payment of some RMB20 million, but said that when Haitou was asked for receipts to back the claim, it was able to substantiate only RMB14 million of land improvement payments.

[29] A status report prepared by Aran and dated November 2007 appears, more or less, to confirm this account. In it Aran says that when it asked Haitou in January of 2007 to substantiate RMB20 million worth of land improvements, it could not vouch for more than RMB14 million. The project budget was accordingly reduced to RMB14 million. Some time shortly before November 2007, Haitou came up with an additional RMB6 (not 7) million as referable to civil defence costs incurred. The November status report confirmed that if this expenditure could be substantiated, the result would be an additional RMB6 million to pay over and above the RMB14 million that Haitou had already substantiated, but the overall position would remain the same as set out in the agency agreement.

[30] I think that there may have been some confusion in Mr Pan's evidence when he said that he thought the RMB7 million was an addition to the RMB20 million contained in the agency agreement (I think that he may have been muddling the position up with an addition to the RMB14 million which Haitou had been able to substantiate), but the essence of his evidence was that it was not until October/November that JVCo learned the true position and then not from Aran. What Mr Bock did not say in terms was that Aran itself had ever communicated any of this information to JVCo although he did 'suggest' that he had told DBZ Aran about it 'before' a meeting of 5 November 2007 at which JVCo claims that it learnt of these matters from HJC. What is noticeable is that none of the status reports before that of November 2007 makes any mention of any of these matters and I accept Mr

Pan's evidence that JVCo did not obtain a true picture as to the quantum of the land improvement payment until October/December 2007 and then from HJX and HJS, and not from Aran.

[31] Mr Pan also gave evidence on the land idling fee. He said that JVCo was not told about this potential liability by Aran. He said that JVCo had discovered its existence in November 2007 from HJX and/or HJS, who told JVCo that they had informed Aran about the liability some months earlier. Although Mr Bock said in evidence that Aran had brought the existence of this potential liability to the attention of DBZ Aran, he also said that DBZ Aran 'should have known about it'. He gave no specific evidence as to when Aran had told DBZ about this matter and I prefer the evidence of Mr Pan that it was never reported to them by Aran.

[32] It seems to me that each of these two matters amounted to serious breaches of clause 8.2(a) of the AMSA and were within the scope of Aran's duties as set out in paragraphs 2 and 3 of the AMSA.

[33] In his skeleton argument for Aran, Mr Dennis says that this and other breaches (other than the breach of the obligation to produce monthly status reports), if breaches they were, had clearly been waived well before the notice of default was served on 2 January 2008. When the hearing began Mr Harry drew attention to the fact that waiver was not pleaded and he consented to my giving Mr Dennis permission to amend to allege it. The only amendment made in consequence by Mr Dennis was an amendment to his reply to the allegations in paragraph 12.3 of the defence dealing with the four contracts which it was said that Aran had caused or permitted HJC to enter into and which I have dealt with in paragraph [20] above. In these circumstances, it seems to me that it would be wrong for me to permit Aran to rely upon a defence of waiver or affirmation in respect of the other matters of complaint. Although it is true that JVCo did continue to treat the AMSA as in force for some time after matters had come to a head late summer of 2007, I think that it would be wrong without a much fuller examination of the alternatives open to JVCo to

conclude that its conduct between then and 2 January 2008 amounted to an unequivocal affirmation of the AMSA, such as to waive any breaches of it.

[34] Although the matters in respect of which I have found Aran to have been in breach of the AMSA were incapable of being remedied, in my judgment they were sufficient to justify service of JVCo's notice of default on 2 January 2008 and to justify JVCo in treating the AMSA in having terminated as of 1 February 2008.

[35] I now turn to the claim by DBZ that the joint venture agreement has been terminated. Clause 17 of the joint venture agreement was in the following terms:

> "17 Consequences of an Event of Default
>
> 17.1 In the event of the occurrence of an Event of Default, the non-defaulting party shall provide the other party (the "Defaulting Party") with written notice setting forth the nature of such Event of Default, and the Defaulting Party shall have thirty (30) days to cure such Event of Default by either party.
>
> 17.2 If the Defaulting Party fails to cure the Event of Default within the foregoing time period, the other party may terminate this Agreement by written notice, which termination shall be effective upon receipt of the notice."

[36] For present purposes, the relevant event of default was defined by clause 1.1 of the joint venture agreement as follows:

> "Event of Default"
> the occurrence of any of the following events shall constitute an "Event of Default" by an Investor:
> ….

(iii) the termination of the Asset Management Service Agreement;"

....

[37] The joint venture agreement contains no definition of the expression 'Asset Management Service Agreement' and indeed no such agreement was entered into by any of the parties until 3 January 2007, when the AMSA was executed. But no point was taken as to this and the case proceeded on the footing that the AMSA was the Asset Management Service Agreement referred to in the joint venture agreement. The face of the AMSA expresses it to be effective as of April 1, 2006, with the object, no doubt, of linking it to the joint venture agreement despite the fact that it was executed some nine months later.

[38] It will thus be seen that termination of the AMSA had the consequential effect of entitling the innocent party to terminate the joint venture agreement. Since I have held that the AMSA was validly terminated as of 1 February 2008, it follows that DBZ was entitled to serve a notice of default and that if the default remained unremedied for 30 days, then DBZ could serve written notice terminating the joint venture agreement. DBZ served a 30 day notice of default on 28 February 2008 relying on the termination of the AMSA. That event of default not having been capable of remedy, DBZ was entitled to serve a notice of termination. However, no such notice of termination is in evidence before me, so that Aran is entitled to a declaration that the joint venture agreement remains on foot.

[39] Aran also makes a claim in respect of clause 14.1 of the joint venture agreement. Clause 14.1 is in the following terms:

"14. Distributions

14.1 The Investors hereby agree to procure that the cash flow generated by each Investment Pool will be distributed by the Company on a monthly basis as follows:

14.1.1 Firstly, in meeting payments for settling (a) third party expenses incurred in the due diligence, closing, servicing, management,

marking and collection of the Assets for such Investment Pool, including travel, legal, accounting, other professional fees, organizational and legal expenses incurred in connection with the formation of the Business, hedging transactions incurred by members of the Company, which expenses shall have been mutually approved by the Management Group and the Company; and (b) the Servicing Fee (as such term is defined in the Asset Management Agreement).

14.1.2 Secondly, in paying the Preferred Return to be paid to members of the Investment Pool rate according to their share of the Investment Pool on amounts included in clause 14.1.1 above and clause 14.1.3 below, calculated from the month such amounts were contributed to the month as of which such calculation is being made.

14.1.3 Thirdly, in returning any capital contributed by the members of the Investment Company (including amounts contributed which were used to pay expenses), pro rata in accordance with their respective percentage interests in the Investment Pool.

14.1.4 Fourthly, for any "fully resolved" Investment Pool where there were insufficient funds for the full payment to be made under clause 14.1.1 through 14.1.3 above (an "Investment Pool Shortfall"), cash flow will next be used to satisfy the Investment Pool Shortfall consistent with the priorities listed above until the Investment Pool Shortfall has been satisfied. An Investment Pool will be deemed "fully resolved" on the earlier of (i) the date on which the capital attributable to Assets remaining in the Investment Pool (whether by way of return of capital or write off of investments) is 10% or less of the total capital attributable to

Assets originally invested in the Investment Pool; and (ii) the fourth anniversary of the expiration or termination date of the related Investment Year, or such other date as may be mutually agreed by all members of the Company.

14.1.5 Fifth, in paying 80% to the members of the Company, pro rata, in accordance with their respective percentage shareholdings in the Company, and 20% to the Management Group until the aggregate of the amounts returned pursuant to clause 14.1.2 above and this clause 14.1.5 equals to a 20% internal rate of return on total capital contributed.

14.1.6 Finally, in paying 75% to the members of the Company, pro rata in accordance with their respective shareholding therein, and 25% to the Management Group."

[40] 'Investment pool' was defined by clause 1.1 of the joint venture agreement as follows:

> "Investment Pool"
> means all the Assets and other investments acquired in a given calendar year, provided that the 2006 Investment Pool shall represent all Assets acquired prior to December 31, 2007;"

[41] Aran claims that it is entitled to a declaration that whether or not the joint venture agreement is determined upon sale of the hotel it will be entitled to a substantial percentage of the net proceeds of sale. This contention is misconceived. Clause 14 of the joint venture agreement deals with distributions of monthly revenue from the hotel once it is operational. It gives no entitlement to the underlying asset or its proceeds of sale. If and when the hotel generates income, then Aran will be entitled to a share in accordance with the provisions of clause 14 and whether or not the joint venture agreement has been

terminated. This follows, in my judgment, from the provisions of clause 18.3 of the joint venture agreement:

> "18.3 On termination of this Agreement for whatever reason all rights and obligations of the parties will cease to have effect except that termination will not affect the accrued rights and obligations of the parties under this Agreement at the date of termination or the continued existence and validity of the rights and obligations of the parties under Clauses 1, 19 and 21 to 25."

[42] The joint venture agreement is, as I have said, a shareholders agreement. Accordingly, it seems to me that when JVCo receives income from the present hotel project, Aran will be entitled as a member of JVCo to distributions in accordance with the terms of clause 14 whether the joint venture agreement is terminated or not. Of course, if the joint venture agreement is terminated, then DBZ is free to invest in future projects through different vehicles free from any obligation to Aran. If the present hotel is sold, then Aran's share of the net proceeds will come to it via its standing as a 5% shareholder in JVCo. But in my judgment Aran is entitled to the benefit of clause 14 so long as JVCo owns (indirectly) the hotel and insofar as the hotel generates net income.

[43] Aran also claims management fees pursuant to the AMSA on the footing that it remains on foot. Since I have held that it does not, Aran is entitled (subject to verification of the calculation) only to the prorated sum of US$6,239 admitted as due in paragraph 16 of JVCo's defence and counterclaim.

[44] Finally, JVCo makes a counterclaim. First, it claims to recover money it has paid to a firm of quantity surveyors to supervise the work of another firm said to have been appointed by Aran and which, it is alleged, was incompetent. There was no evidence to support am allegation that Aran had appointed any firm of quantity surveyors. No evidence has been led to establish the bald allegation in paragraph 22 of the counterclaim and I reject this aspect of it accordingly. Secondly, JVCo claims RMB850,000 which it says it paid HJS to

lobby Haitou to waive a land idling fee (said to have been in the sum of RMB7 million, as against the figure of RMB3.5 million put upon it in the evidence). No reason is given why Aran is under any liability to reimburse JVCo for this payment and I reject this claim also. Finally, JVCo claims sums paid or claimed by a PRC company which JVCo says it employed to provide onsite services and management to the hotel. No evidence has been led to establish any liability on the part of Aran to reimburse these costs to JVCo and this counterclaim also must be rejected.

Edward Bannister

Commercial Court Judge

30 July 2009