IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

POPE INVESTMENTS LLC,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Civil Action No. 5171-VCP
	)	
BENDA PHARMACEUTICAL, INC., YIQING WAN, WEI XU, JUN TANG, Q.Y. MA and ERIC YU,	)	
	)	
Defendants.	)	
	)	

MEMORANDUM OPINION

Submitted: August 16, 2010
Decided: December 15, 2010

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David A. Dorey, Esquire, Elizabeth Sloan, Esquire, BLANK ROME LLP, Wilmington, Delaware; *Attorneys for Defendant Benda Pharmaceutical, Inc.*

PARSONS, Vice Chancellor.

This case originates out of a dispute between Plaintiff, Pope Investments LLC ("Pope"), an investment fund, and Defendants, a holding company whose assets are in China, Benda Pharmaceutical, Inc. ("Benda" or the "Company"), and its directors. Pope made an equity investment in Benda and subsequently injected additional capital in the form of a convertible note. Soon after Pope made these investments, however, the financial condition of Benda began to deteriorate significantly. Benda's management projected large profits while pitching the Company to investors, but instead they racked up big losses. As a result, when the note came due, Benda was unable to make payment on it.

Pope subsequently obtained a judgment from a New York court for the principal and interest due on the note. After having been granted that judgment, it filed this action which seeks, among other things, the appointment of a receiver to allow it to recover the amount of its judgment. While Pope also holds an equity interest in Benda, Pope asserts its claim for a receiver only in its capacity as a creditor.

In support of its request for the appointment of a receiver, Pope alleges that Benda is insolvent and that a receiver is necessary to protect the interests of creditors. For example, it alleges that the individual Defendants have made insider loans for the purpose of gaining preferred creditor status, engaged in commercial transactions that have wasted corporate assets, and failed to repay loans to Benda. Moreover, a third party bank creditor has obtained an execution order on one of Benda's core assets. Thus, Pope claims that the failure to appoint a receiver will result in a disorderly and inefficient liquidation of Benda.

For the reasons stated in this Memorandum Opinion, I conclude that although Pope has demonstrated that Benda is insolvent, it has not shown that special circumstances exist that warrant the appointment of a receiver. Accordingly, I deny Pope's application for a receiver.

I. BACKGROUND

A. The Parties

Plaintiff Pope is a Delaware limited liability company. It was founded by William P. Wells. Pope Asset Management LLC ("Pope Asset"), a Tennessee limited liability company, is the managing member of Pope. Pope and its principal, Wells, heavily focus their investments on China. In fact, approximately $400 million of the $680 million they have under management is invested in Chinese ventures.[1]

Defendant Benda is a publicly-traded Delaware corporation with its principal office in Wuhan, Hubei Province, People's Republic of China ("PRC"). It focuses on the research, discovery, and development of pharmaceuticals.[2] More specifically, it is engaged in research and development, the manufacture of chemicals used in pharmaceutical production, and the manufacture and distribution of drugs and medicines.[3] Benda was formed in November 2006 when Ever Leader Holdings Limited

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1 Defs.' Ans. Br. ("DAB") App. Ex. C, Dep. of William Wells ("Wells Dep."), 18-19. Similarly, Plaintiff's opening and reply briefs, filed on March 12, 2010 and March 25, 2010, are referred to as "POB" and "PRB," respectively.

2 POB App. Ex. C, Benda Pharmaceutical, Inc., Annual Report (Form 10-K) ("Benda 2008 10-K"), at 73 (Apr. 15, 2009).

3 DAB 12.

("Ever Leader"), a holding company incorporated under the laws of Hong Kong, combined with Applied Spectrum Technologies, Inc. ("AST"). AST then changed its name to Benda. Ever Leader is now a wholly-owned subsidiary of Benda.

Defendant Yiqing Wan is the Chief Executive Officer and Chairman of the Board of Directors of Benda.

Defendant Wei Xu is a director of Benda and is also Wan's wife.

Defendant Eric Yu was the Chief Financial Officer and a director of Benda during the time period relevant to this litigation until his resignation on September 21, 2009.

Defendants Jun Tang and Q.Y. Ma also are directors of Benda.

Hubei Tongi Benda Ebei Pharmaceutical Co., Ltd. ("Benda Ebei") is a Sino-Foreign Equity Joint Venture company incorporated under the laws of China. Ever Leader owns 95% of the issued and outstanding capital stock of Benda Ebei. Wan is the founder, president, and general manager of Benda Ebei and owns the remaining 5% of its stock.

Shenzen SiBiono GeneTech Co., Ltd. ("SiBiono") is a pharmaceutical company organized under the laws of China. Benda Ebei owns approximately 60.13% of SiBiono's issued and outstanding stock. Xu serves as chief executive officer and a director of SiBiono.

Yidu Benda Chemical Co., Ltd. ("Yidu Benda") and Jiangling Benda are Benda subsidiaries. Wan is chairman of the board of directors for each of these entities.

B. Facts

1. Relationship between Pope and Benda

This matter is before me as a result of a series of investments Pope made in Benda. In 2006, Wan and Xu were looking to raise $12 million of capital for Benda via a private placement memorandum to expand its business. Pope initially invested $4.15 million in 2006 in Benda's common stock and later purchased additional common stock. In March 2007, Pope agreed to loan Benda $5.52 million in the form of a convertible note that gave Pope the option to purchase additional common shares in Benda upon the loan's maturity in March of 2009.[4] Further, under a related agreement, Pope received warrants to acquire an additional 9.952 million Benda common shares at an exercise price of $0.555. Pope's stake now has risen to 21% of Benda's issued and outstanding shares,[5] but its beneficial ownership is or has been substantially higher.[6] Nevertheless, Pope is pursuing the pending application for a receiver solely in its capacity as a creditor, based on its March 2007 convertible note and the October 2009 New York State Court judgment it obtained against Benda pursuant to that note.

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4 *See* DAB 9. These facts appear to be undisputed.

5 POB App. Ex. H, Benda Pharmaceutical, Inc., General Statement of Acquisition of Beneficial Ownership (Schedule 13D) (Feb. 16, 2010).

6 Pope filed a Schedule 13D in February 2010, listing its beneficial ownership of Benda at 51%. *Id*. at Item 5.

2. The current financial and operational conditions of Benda's business

While Benda is incorporated in Delaware, it essentially is a holding company with assets exclusively in China. All of Benda's revenue is generated by its subsidiaries and results from business related to generic drugs, active pharmaceutical ingredients, bulk chemicals, and Gendicine, a drug used to treat cancer.[7] According to Benda, Gendicine is the first commercially sold gene therapy drug approved by a government agency anywhere in the world.[8] Benda acquired ownership of Gendicine through its acquisition of SiBiono in April 2007 using funds Benda received from Pope in exchange for the promissory note, among other sources.

It is undisputed that the financial condition of Benda has deteriorated substantially in the last few years. For example, Benda's net income went from $3.7 million in both 2004 and 2005 to $2.7 million in 2006, a loss of $7.3 million in 2007, and a loss of almost $16 million in 2008. According to its most recent annual report, Benda had an accumulated deficiency of $16,047,561, a working capital deficiency of $18,857,300, and a net loss of $15,815,920, and burned through $810,116 of cash in 2008.[9] Through the third quarter of 2009, the Company had incurred an additional net loss of $2,825,707 and its working capital and accumulated deficits had increased, respectively, to $27,126,139 and $18,736,213.

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7 Benda 2008 10-K.

8 *Id*. at 24.

9 Benda 2008 10-K, at F-1.

The Company also has defaulted on a number of financial obligations. For instance, on October 14, 2009, Pope obtained summary judgment on the promissory note executed in 2007 for $5,520,000, plus interests and costs for a total of $6,503,154.53.[10] Another creditor who loaned money to Benda in the same private placement as Pope obtained a judgment against Benda of $674,251.65 on June 19, 2009.[11] Three other investors have filed Notices of Default relating to the same private placement transaction. In addition, SiBiono has defaulted on a loan from a Chinese bank in the amount of approximately $3.5 million, which resulted in entry of a judgment against it on November 23, 2008.[12] The land use rights at SiBiono's new production facility, which are critical to its ability to produce Gendicine, were pledged as collateral for that loan. Consequently, SiBiono (and therefore Benda) is at serious risk of losing those rights. Although Wan alleges that the bank orally has agreed to modify the payment schedule of this loan, he has produced no documentation to support his claim. Moreover, SiBiono's ability to re-finance its debt is complicated because its new plant will not be completed until at least March 2011 and it has not yet received the necessary government approvals to commence manufacturing Gendicine at that facility.[13]

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10 POB App. Ex. M.

11 *Id.* Ex. P.

12 POB App. Ex. B, Benda Pharmaceutical Inc., Quarterly Report (Form 10-Q) ("Benda Nov. 23, 2009 10-Q"), at F-21 (Nov. 23, 2009).

13 Pl.'s Ex. D, Dep. of Yiqing Wan ("Wan Dep."), 77-78. SiBiono's ability to complete this plant arguably is clouded by its inability to pay the contractors who

Benda has overdue financial obligations to a number of other entities as well. It owes $1.42 million to SiBiono's selling shareholders as a result of Benda's purchase of a 57% stake in SiBiono in April of 2007.[14] Those shareholders allegedly consented to being paid sometime in 2009, but have not yet received payment. Additionally, as part of Equity Transfer Agreements with Yaojin Wang and Huimin Zhang, Benda is obligated to redeem more than 2.2 million shares of Benda's common stock at an exercise price of $3.60 per share, which creates a current liability of approximately $7.3 million.[15] All told, the Company's current liabilities exceed $29 million.[16]

Lastly, Benda's auditor expressed serious concerns about the Company's finances. For example, in the 10-Q for the period ended September 30, 2009 its auditor stated:

> Currently, the Group [Benda and its subsidiaries] does not have the ability to substantially increase its loan indebtedness with any financial institution, nor can the Group provide any assurance it will be able to enter into any loan agreements in the future, or be able to raise funds through further issuance of debt or equity in the Group. Moreover, the Group presently has little additional resources with which to obtain or develop new operations.
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> These factors raise substantial doubt about the Group's ability to continue as a going concern. . . .

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are working on it, but Benda has produced evidence indicating that issue has been resolved, at least temporarily. *Id*.

14 Benda Nov. 23, 2009 10-Q, at F-7.

15 *Id.* at F-27.

16 Trial Transcript of Mar. 29, 2010 ("T. Tr.") at 199.

> While the Group is attempting to produce sufficient revenues, the Group's cash position may not be enough to support the Group's daily operations.[17]

Therefore, the Company clearly is in a precarious financial condition.

Compounding its financial problems is the fact that the Company also has had problems meeting significant regulatory deadlines. For example, Benda frequently has submitted filings to the SEC late and has incurred more than $2.5 million in penalties as a result.[18]

In addition, the Company has encountered significant operating difficulties. Most importantly, the Chinese State Food and Drug Administration rescinded SiBiono's Good Manufacturing Practice Certificate ("GMP Certificate") in April 2008, and SiBiono did not obtain final approval for the reinstatement of its GMP Certificate until July 2009.[19] Because a company needs a GMP Certificate to manufacture drugs in China, SiBiono could not produce Gendicine during the fifteen months it was without one.

Yidu Benda also has had difficulties. It had to close its plant and cease operations in mid-January 2007 because its waste and water system was not compliant with Chinese environmental standards. By the time of trial on March 29, 2010, Yidu Benda still had

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17 Benda Nov. 23, 2009 10-Q, at F-7.

18 Benda 2008 10-K, at F-25.

19 Benda Nov. 23, 2009 10-Q, at 6.

not received final approval of its production process and lacked the funds to ready its plant to resume production.[20]

Despite these problems, however, Benda's subsidiaries do exhibit signs that they may be able to continue as viable businesses. The Company was profitable in the period just before it raised capital from Pope in 2006.[21] Moreover, in the first nine months of 2009, Benda generated revenue of greater than $17 million and reported a gross profit of more than $7 million.[22] While Benda still lost money on an operating basis, now that SiBiono has regained its GMP Certificate, it is plausible that the Company may be able to return to profitability in the relatively near future.

3. Agreement with Dr. Peng

As part of its efforts to improve the performance of Benda and its subsidiaries, Pope entered into an agreement with Dr. Zhaohui Peng, the former Chief Executive Officer and Chairman, as well as a 30% stockholder, of SiBiono. As part of their arrangement, if Pope comes to control SiBiono, Peng has agreed to put some patents, which currently are the subject of litigation with SiBiono, into the "new" company in

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20 Wan Dep. 29-30.

21 POB App. Ex. G, Private Placement Memorandum Consolidated Balance Sheets, at 3.

22 Benda Nov. 23, 2009 10-Q, at F-2.

exchange for a revised equity ratio.[23] In addition, Peng would be restored to his former leadership role at SiBiono.

Peng has accused Benda of engaging in a number of improper transactions. Perhaps the most serious claim is that Wan sold Gendicine to Shen Hua, who was the sales director at SiBiono, at a discounted price.[24] Hua, according to Peng, then sold the drugs through his distribution company at an increased price, splitting the profits with Wan and Xu. Defendants generally do not contest that they have a distribution arrangement with Hua, but deny it was improper and that they received any portion of Hua's proceeds.[25]

4. Corporate Governance

Benda's corporate governance practices are open to question. Under the Investment Agreement between Pope and Benda, Pope is entitled to nominate a representative and to have that nominee elected to the Boards of Directors of Benda and its subsidiaries.[26] Pope has never had any such board representation, but the parties disagree as to whether Pope has been diligent in its efforts to have a board representative

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23 DAB App. Ex. O, E-mail from Angel Liu to Peng. The "revised equity ratio" has not been determined yet.

24 PRB App. Ex. X, Dep. of Dr. Zhaohui Peng ("Peng Dep."), 64-65.

25 Wan Dep. 161.

26 POB App. Ex. N, Investment Agreement, 25-26.

appointed.[27] Furthermore, three of the five members on the Board (Wan, Xu, and Yu) are insiders of the Company. And, Benda has not held a meeting of its stockholders to vote for new directors for more than five years. Indeed, its last stockholders meeting of any kind was in November 2006.[28]

C. Procedural History

On December 29, 2009, Pope filed a Complaint asserting both directly and derivatively that Defendants had breached their fiduciary duties to Pope, diverted corporate opportunities rightfully belonging to Benda, aided and abetted each others' breaches of fiduciary duty, and were liable for civil conspiracy. Count I of the Complaint seeks the appointment of a receiver to assume management of Benda's business affairs.

On January 22, 2010, I granted Plaintiff's motion to expedite proceedings regarding Count I and, on February 3, entered an Expedited Scheduling Order for Count I. On March 2, I denied Benda's Motion to Modify the Scheduling Order and granted, in part, Benda's Motion for a Protective Order by limiting discovery to information from January 1, 2008 to the present.

The parties then filed opening, answering, and reply briefs on Pope's Application for the Appointment of a Receiver (the "Application"). I conducted a trial on that

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[27] Pope has put forward four nominees, but none of them were nominated. Wan Dep. 60-65. Benda explains away two of these instances, noting that Pope suspended one of the nominations and that another nominee never followed up to meet with Wan. DAB 29.

[28] POB Ex. A, Aff. of William Wells ("Wells Aff."), ¶ 13; Wan Dep. 57.

Application on March 29, 2010. Both parties filed post-trial briefs on April 7. In addition, Pope moved on May 25 to supplement the record. In a Letter Opinion on July 26, 2010, I denied that motion and also overruled Benda's objections to several exhibits attached to Pope's post-trial brief. Benda filed a supplemental brief addressing those exhibits on August 17.

This Memorandum Opinion reflects my findings of fact and conclusions of law as to Pope's Application for the appointment of a receiver.

D. Parties' Contentions

Pope contends that Benda is insolvent and should have a receiver appointed for it under 8 *Del. C.* § 291, because the Company is unable to pay its debts as they come due in the ordinary course of business. Specifically, Pope claims that as a result of both its gaping working capital deficit and inability to obtain financing, Benda cannot pay its debts and other obligations without essentially liquidating its business.[29] Furthermore, Plaintiff alleges that Wan has misused corporate funds for personal gain and that Wan and Xu have engaged in self-interested transactions (*e.g.*, loans Xu made to Benda subsidiaries on allegedly preferential terms) that risk placing their interests ahead of Benda's shareholders and creditors. Pope argues that a receiver is necessary to protect the interests of creditors, whether such appointment results in the liquidation of Benda or its continuation as a going concern.

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[29] POB 21, 23.

By contrast, Defendants deny that the Company is insolvent and assert it merely has illiquid assets.[30] They also contend that the issue here does not involve a disagreement over the Company's insolvency so much as a dispute over the proper course of management. Defendants cite to Pope's own brief as demonstrating that the ongoing business is valuable[31] and further argue that Plaintiff's Application stems mainly from a disagreement over management—which is insufficient to warrant the appointment of a receiver. Furthermore, Defendants emphasize that the appointment of a receiver constitutes an extreme remedy and that Pope has failed to explore other available, but less drastic avenues for resolution. Those potential options include, among other things, using Pope's substantial ownership position to effect a change of management[32] or attempting to enforce Pope's judgment against Benda in China through Article 265 of the Civil Procedure Law of the People's Republic of China.[33]

II. ANALYSIS

A. Standard for a receiver

The key purpose of appointing a receiver under Delaware law is "to protect the rights of stockholders and creditors when a company has become insolvent."[34] The

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30 DAB 32.

31 *Id*. at 34 (citing POB 32-33).

32 Defs.' Post-Tr. Br. 3.

33 *Id*. at 2.

34 1 R. Franklin Balotti & Jesse A. Finkelstein, *The Delaware Law of Corporations and Business Organizations* § 11.1, at 11-2 (3d ed. 1998).

appointment of a receiver "lies within the sole discretion of the [c]ourt."[35] Under Delaware General Corporation Law ("DGCL") § 291, the court may appoint a receiver for an insolvent corporation upon application by any creditor or stockholder. The appointment of a receiver is appropriate only if the company is insolvent[36] and there exist "special circumstances" where "some real beneficial purpose will be served."[37] Accordingly, the court will appoint a receiver only if the company is insolvent and exigent circumstances warrant such relief.[38]

There are two bases upon which a court can find an entity to be insolvent. One is if an entity's liabilities exceed its assets.[39] The other is if an entity is unable to pay its obligations as they come due in the ordinary course of business.[40] In either case,

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35 *Banet v. Fonds de Regulation et de Controle Café Cacao*, 2009 WL 529207, at *3 (Del. Ch. Feb. 18, 2009) (citing *Acro Extrusion Corp. v. Cunningham*, 801 A.2d 345, 347 (Del. 2002)).

36 8 *Del. C.* § 291.

37 *Banet*, 2009 WL 529207, at *3 (citing *Prod. Res. Gp., LLC v. NCT Gp.*, 863 A.2d 772, 784 (Del. Ch. 2004)).

38 *Id*. (citing *Drob v. Nat'l Mem. Park*, 41 A.2d 589 (Del. Ch. 1945) (receiver should never be appointed except under special circumstances of great exigency); *Prod. Res.*, 863 A.2d at 785 (appointing receiver when it was necessary to protect the company's creditors); *Noble v. Eur. Mtg. & Inv. Corp.*, 165 A. 157 (Del. Ch. 1933) (holding that a bare showing of insolvency alone will not result in appointment of a receiver)).

39 *Id*. (citing *Prod. Res.*, 863 A.2d at 782 (quoting *Siple v. S&K Plumbing & Heating, Inc.*, 1982 WL 8789, at *2 (Del. Ch. Apr. 13, 1982) ("a deficiency of assets below liabilities with no reasonable prospect that the business can be successfully continued in the face thereof" warrants a finding of insolvency)).

40 *Id*.

"insolvency is a jurisdictional fact, proof of which must be clear, convincing, and free from doubt. If there is any doubt as to the insolvency of the corporation, a receiver should not be appointed."[41]

B. Insolvency

1. Assets versus liabilities

The first step in this Court's analysis of Pope's Application for appointment of a receiver is to determine whether Benda is insolvent. Pope does not contend that the Company is insolvent under the first test of whether liabilities exceed assets. In fact, Benda's most recent balance sheet indicates that its assets exceed liabilities by about $18 million.[42] Many of those assets, however, consist of real estate and manufacturing equipment which is relatively illiquid and used by Benda's operating subsidiaries.

2. Inability to pay its obligations as they come due in the ordinary course of business

The second way Pope could prove Benda is insolvent is by showing that the Company is unable to pay its obligations as they come due in the ordinary course of business. Pope asserts that Benda is insolvent under this theory for several reasons. First, as mentioned in the Facts, Benda has a working capital deficit of over $27 million. Working capital, which is defined as current assets minus current liabilities,[43] is a

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41 *Kenny v. Allerton Corp.*, 151 A. 257 (Del. Ch. 1930); *Banks v. Cristina Copper Mines, Inc.*, 99 A.2d 504, 505 (Del. Ch. 1953).

42 Benda Nov. 23, 2009 10-Q, at F-1; POB App. Ex. K, Dep. of Philip Kempisty, 220-22.

43 BLACK'S LAW DICTIONARY 222 (8th ed. 2004).

measure of liquidity. Thus, Pope argues that Benda is insolvent because it does not have enough short-term assets to satisfy its short-term liabilities and that such a deficit has persisted at Benda for a long period of time. Second, Pope argues that the evidence shows Benda cannot raise capital by issuing new debt or selling new equity interests and, therefore, cannot use either of those mechanisms to pay its debts in the ordinary course of its capital-intensive business to avoid insolvency.[44]

Benda largely does not dispute the vast extent of its debts. At trial, Benda admitted current liabilities of approximately $29.5 million. This number included: (1) $9.7 million of accounts payable; (2) $7.3 million owed to former shareholders of SiBiono; (3) $7.2 million owed to long-term convertible promissory note holders (which includes the amount owed to Pope); (4) $3 million owed to Ping An Bank; and (5) $1.4 million owed to a former shareholder of SiBiono, though Defendants allege this obligation has been satisfied.[45] Pope alleges these debts are all past due. Furthermore, Benda admittedly does not have sufficient liquidity to pay off these obligations. Therefore, to defeat a finding of insolvency, Benda must demonstrate some other means by which it can pay off these debts in the ordinary course of business.

Benda proffered two plausible arguments for meeting this requirement. First, there is a possibility that, if necessary, it could sell some of its illiquid, long term assets,

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44 POB 21.

45 T. Tr. at 194-200.

which consist of property, plant, and equipment.[46] Second, Benda suggests that it might be able to raise additional capital. Having carefully considered the record, I find both of these arguments unpersuasive.

Benda's argument that it might be able to sell assets to satisfy its debts poses the question whether it is appropriate to find a company that is in a line of business requiring large capital investment to be insolvent merely because most of its assets are illiquid. Defendants urge the Court to answer that question in the negative. As they note, this would put companies whose businesses are capital intensive, such as a real estate investment trust (or REIT), in constant peril of being placed under a receiver if they become technically insolvent as a result of temporary periods of illiquidity.

Few courts have dealt with this issue. One such case, *Sill v. Kentucky Coal & Timber Development Co.*,[47] involved a defendant entity whose primary asset was land, the assessed value of which exceeded its outstanding liabilities. Nevertheless, the court refused to dismiss the plaintiff's application for a receiver, finding that even if an entity's ordinary course of business involves holding primarily illiquid assets, it still could be insolvent under certain circumstances.[48] The *Sill* court's reasoning appears to remain sound today. Indeed, the prong of the insolvency analysis that focuses on a company's ability to pay its debts as they come due would be redundant if it only applied to

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46 DRB 32.

47 97 A. 617 (Del. Ch. 1916).

48 *See id*.

companies whose assets were less than their liabilities. In some circumstances, therefore, it may be appropriate to find an entity to be insolvent, despite its holding highly valuable illiquid assets.

Furthermore, Benda's situation clearly differs from that of a REIT. One core mission of a REIT is to buy and sell properties to generate a return for its investors. Therefore, if a REIT had to sell some real estate to meet its liabilities, such a transaction probably would be within the ordinary course of its business as REITs frequently engage in purchasing and disposing of real estate assets. By contrast, according to Benda's own description, its subsidiaries are in the business of researching, developing, and manufacturing pharmaceuticals. As Defendants note, this business is particularly capital intensive—especially at the outset as both the research and development process and the property, plant, and equipment necessary to manufacture drugs require tremendous capital expenditures. While significant upfront capital investment in the pharmaceutical industry is to be expected, however, the disposal of core assets likely would not be considered to be within the ordinary course of a pharmaceutical company's business. Moreover, Benda has not shown that it could pay off its creditors in the near term by selling only non-core, long-term assets.

Even if Benda is unable to meet its current obligations through the sale of assets in the ordinary course of its business, there is another way it might be able to achieve that objective: a capital raise. Pope points to Defendants' own public disclosures, however, as evidence that Benda could not raise the necessary capital for its business by selling equity

or taking on new debt.[49] In their answering brief, Defendants describe a number of efforts Benda has made to obtain financing,[50] but they failed to prove that any of those efforts is likely to succeed. The most definite plan Defendants presented involved an investor who allegedly offered to buy out Pope for approximately 70 cents on the dollar, thereby reducing Benda's debt.[51] But, this potential transaction would not avoid the insolvency problem. First, it is not clear that a formal offer was or is on the table. Moreover, even if it was, Pope has no obligation to accept a discount on its debt, as the alleged transaction contemplates. Second, the potential injection of capital Defendants described would eliminate only a portion of the debts Benda owes. Thus, Defendants have failed to show the existence of a definite and adequate plan for curing Benda's apparent insolvency and, as a result, I conclude that Benda is insolvent for purposes of 8 *Del. C.* § 291, because it is unable to pay its debts in the ordinary course of business.

C. Exigent Circumstances

Although Pope has met its burden of proof in showing that Benda is insolvent, "even if insolvency is shown, the appointment of a receiver does not follow automatically."[52] Indeed, "a receiver will never be appointed except under special circumstances of great exigency when some real beneficial purpose will be served

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49 Benda Nov. 23, 2009 10-Q, at F-7.

50 DAB 35.

51 T. Tr. at 189-91.

52 *Keystone Fuel Oil, Inc. v. Del-Way Petroleum, Co.*, 1977 WL 2572, at *578 (Del. Ch. June 16, 1977).

thereby."[53] Therefore, Pope must demonstrate how the appointment of a receiver is likely to protect Benda's creditors—that is, it must show that some benefit that such an appointment would produce or some harm it could avoid.

In *Keystone*, the plaintiff-creditor, who had obtained a money judgment against the defendant, sought the appointment of a receiver so that the receiver could liquidate the defendant's assets and pay Keystone's judgment. In declining to appoint a receiver, the court characterized the question of whether the defendant was, in fact, insolvent as being relatively close because of a disagreement as to the true value of its assets and liabilities.[54] The plaintiff's failure to demonstrate a risk of fraud or the dissipation of assets further weakened the case for a receiver.[55] The court, therefore, implied that at least where an entity's insolvency was the subject of considerable doubt, a plaintiff must make a strong showing of exigent circumstances, such as by proving fraud on the part of the defendant.

The court's analysis in *Production Resources* is also instructive. There, another judgment creditor plaintiff sought appointment of a receiver. The defendant relied on *Keystone* for the proposition that appointing a receiver was inappropriate if a creditor was merely attempting to collect on a corporate debt. The court rejected that argument and noted that the cases underpinning the *Keystone* decision actually dealt with the

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53 *Id*. at 577.

54 *Id*.

55 *Id*.

appointment of receivers for solvent companies.[56] In such situations, "presumably a creditor can protect its rights in the normal course by pursuing an action for breach of contract or other remedies. In other words, solvency removes the core justification for appointing a receiver under § 291."[57] Furthermore, the court in *Production Resources* observed that *Keystone* "simply emphasizes the discretionary nature of the § 291 remedy and the reality that this court should not lightly undertake to substitute a statutory receiver for the board of directors of an insolvent company."[58] Based on the discretionary and extraordinary nature of relief sought, one factor I consider important in evaluating Pope's Application for appointment of a receiver is whether there are other less drastic remedies by which it might achieve its objectives.

1. Has Pope adequately explored alternative remedies?

Benda alleges that Pope has failed to explore two possible avenues to achieve its aims and, therefore, should not be afforded the extraordinary remedy of a receiver. First, it alleges that Pope could have pursued its claims through corporate action based on its large equity position. Second, it alleges that Pope could seek to satisfy its judgments directly by attaching Benda's assets in China. After reviewing these contentions and the related evidence, I am not persuaded that Defendants have shown clearly that Pope's

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56 *Prod. Res. Gp., L.L.C. v. NCT Gp., Inc.*, 863 A.2d 772, 785 (Del. Ch. 2004).

57 *Id*.

58 *Id*. at 786.

efforts as to either of these alternative remedies have been so deficient that they support denying Pope relief.

Preliminarily, I note that one factor Pope relies upon as supporting its request for a receiver involves various deficiencies in Benda's corporate governance practices. The most egregious examples are Benda's alleged failure to nominate a designee of Pope to serve on its Board of Directors as is required by the Investment Agreement[59] and Benda's failure to hold an annual meeting of stockholders for the election of directors for several years.[60] Pope labels these problems as "[m]alfeasance"[61] and suggests they would support appointment of a receiver. But, that argument lacks merit.

As to the failure to nominate Pope's designees to the Benda Board, Pope easily could have enforced its rights in that regard by complaining to Benda about it and, if necessary, filing an action for breach of contract or, possibly, even a summary proceeding under 8 *Del. C.* § 225. There is no evidence, however, that Pope ever took any of these actions.

Similarly, Pope's complaint about the failure of Benda to hold an annual meeting rings hollow. Under § 211 of the DGCL,[62] this Court may summarily order a meeting to be held upon the application of any stockholder, such as Pope, if the Company failed to

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59 *See supra* note 26 and accompanying text.

60 *See supra* note 28 and accompanying text.

61 POB 17-19.

62 8 *Del. C.* § 211(c).

hold an annual meeting for a period of more than 13 months. Yet, Pope never pursued such an action or even notified Benda about its concern over the lack of an annual meeting. In these circumstances, I accord no weight to Pope's complaints about Benda's corporate governance practices in terms of a putative justification for imposing the remedy of a receiver here.

While Pope cannot make affirmative use of the alleged governance deficiencies at this point, I do not find that its failure to take remedial actions as outlined above or to file its Application for a receiver or take other actions in its capacity as a creditor or shareholder of Benda to pursue its claims of mismanagement and malfeasance more quickly provide a basis for denying its Application altogether on grounds of laches or otherwise. Rather, they effectively neutralize Pope's criticisms of Defendants' corporate governance practices.

Next, Benda argues that Pope should seek to enforce its judgment by less drastic means through the Chinese court system. The pursuit of any remedy in China presumably is fraught with challenges. Pope has submitted a letter from Chaoying (Charles) Li, a Chinese lawyer in Beijing, stating that Pope is "unable to sue one or all of [Benda's subsidiaries in China]" because it does not hold a direct interest in any of them.[63] Pope holds such interests indirectly through the Delaware holding company, Benda. Li further states that Pope is likely to be unable to enforce any judgments in

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[63] Pl.'s Post-Tr. Br. ("PPTB") Ex. A, Letter from Chaoying (Charles) Li to Court. Similarly, Defendants' Post-Trial Brief is referred to as DPTB.

China until the PRC has "concluded and acceded to by international treaty reciprocity of enforcing judgments of each country."[64]

Benda "generally agrees with Mr. Li's recitation of the difficulties in executing on a United States judgment against assets in China," but makes a couple of distinctions.[65] Benda has submitted a letter from Ren Lifeng, a lawyer in Shenzen, where SiBiono is located. His letter states that it might be possible, though difficult, for Pope to execute on its judgment from a United States court in China:

> Under Article 265 of the Civil Procedure Law of the PRC, when a legally effective ruling or decision made by a foreign court requires recognition and enforcement by a people's court in the PRC, a party concerned **may apply directly to a competent intermediate people's court for recognition and enforcement**.
>
> Thus, even in the absence of relevant treaties between the PRC and the United States of America . . . **Pope may directly apply to a competent PRC court for recognition and enforcement of a effective judgment made by a U.S. court against Benda**.[66]

Lifeng acknowledges, however, that he is "not aware of any collection efforts, successful or otherwise, in the non-marital context being pursued under this provision."[67]

Based on Pope's extensive investment activity in China, I infer that it recognizes the legal uncertainties involved with such investments. Thus, I am not inclined to allow

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64 *Id*.

65 DPTB 2.

66 DPTB Ex. 1, Letter from Ren Lifeng to Court (emphasis added).

67 *Id*.

Pope to use those uncertainties to shortcut the normal procedural safeguards against the improvident appointment of a receiver. Because a receiver constitutes extraordinary relief, it might make sense to require Pope to pursue a less drastic remedy that might allow it to collect on its judgment while allowing Benda to continue operations, before seeking a receiver. The record indicates, however, that a more direct remedy probably is not realistic. In the circumstances of this case, therefore, I find that Pope should not be penalized for not trying to execute on its judgment in China. By the same token, however, I also hold that the difficulties of enforcing such a judgment in China do not represent a special circumstance favoring appointment of a receiver.

2. Is a receiver necessary to ensure equal treatment for Benda's creditors by avoiding conflicted transactions or preventing certain creditors from executing on judgments?

a. Insider loans

Pope questions the propriety of a loan made by Xu to Ever Leader in the amount of approximately $1 million. Pope speculates that this loan is meant to allow Defendants to foreclose quickly upon assets of SiBiono and thereby deprive Benda's other creditors of some protection.[68] In support of this argument, Pope notes that the stated purpose of this loan as being for daily operations is unusual because Ever Leader is a holding company and not an operating company. Moreover, Pope argues that loans made by Xu and reflected in Benda's documents, such as one listed in Benda's November 23, 2009

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[68] T. Tr. at 38-39.

10-Q in the amount of $967,999, appear to have been paid off while debts to outsiders, such as Pope, remain unpaid.[69]

In response, Defendants offer plausible explanations for the purpose of the disputed loan to Ever Leader. Defendants claim that it was made to pay for their audit and legal fees.[70] Wan also testified that China's foreign currency control measures make it challenging to make payments to U.S. professionals and that the loan was meant to accelerate these payments.[71] More importantly, Defendants have represented to this Court that no repayment of the loan has been made and Xu will be repaid "last."[72]

While I am unable to make a final determination, both as to whether these loans were properly made and whether there were any improper repayments, I rely on Defendants' assertions that the challenged loans have not been and will not be repaid until after all other creditors have been paid. As a result, at this early stage of the proceedings, I am not persuaded that Pope has met the significant threshold of proving these insider loans involved any impropriety or represent a special or exigent circumstance justifying the appointment of a receiver.

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69 Benda Nov. 23, 2009 10-Q, at F-26.

70 *Id*. at 226.

71 Pl.'s Ex. PP, Mar. 26, 2010 Trial Dep. of Yiqing Wan ("Wan T. Dep."), 39-40.

72 *Id*. at 41.

b. Receivables and loans owed by Wan or entities controlled by Wan

Pope argues that another instance of exigent circumstances warranting appointment of a receiver exists in the form of improper loans or accommodations given to Wan or his affiliates. Pope presented evidence that Wan and Hubei Benda Science and Technology Co., Ltd. ("HB Science"), controlled by Wan, owe Benda subsidiaries over $2.9 million in outstanding debts pursuant to loans made to HB Science by these Benda entities.[73] Pope also questions an outstanding receivable of $107,000 owed to SiBiono by Shenzen Qingyi.[74] Further, Pope alleges that Wan has misused corporate funds by causing Benda Ebei to loan him $439,000 for personal expenses on "traveling trips."[75]

By and large, Wan does not dispute these obligations but says they all resulted from proper transactions. The justifications he offers for these "loans" include that they represent, in part: (1) reimbursement for business expenses in lieu of a salary; (2) capital credits that have been mislabeled as loans; and (3) a misunderstanding as a result of poor financial record keeping.[76] According to Benda, these "loans" primarily related to non-cash expenses and so did not involve "money in the pocket, walking out of the company."[77] Defendants also argue that these outstanding amounts pertain to

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73 Benda Nov. 23, 2009 10-Q, at F-26.

74 PRB App. Ex. KK, Asset Assessment Report of SiBiono dated Apr. 20, 2009.

75 *Id*. at 9; Wan Dep. 127-28.

76 Wan T. Dep. 49-60.

77 T. Tr. at 227.

transactions that occurred before January 1, 2008, and, therefore, are irrelevant. The fact that I limited discovery to matters that occurred after that date, however, does not mean, that anything that happened before then is necessarily irrelevant. The loans to HB Science, for example, apparently remain due and outstanding today and, if collected, could help alleviate some of Benda's financial problems. The fact that Wan, who is on both sides of the disputed loans, may have caused Benda not to pursue them also provides some support for Pope's Application. But that support is limited because the "loans" were made more than two years before Pope filed its Application.

These allegations of improper insider loans are serious and might warrant relief at a later stage after a trial on all of Pope's claims, most of which are not before me on the Application. Those claims include breach of fiduciary duty, waste of corporate assets, diversion of corporate opportunities, and civil conspiracy. The allegations regarding $439,000 in personal expenses, for example, raise a red flag and suggest the possibility of a misuse of corporate funds. On the abbreviated record presented as to Count I, however, these and other allegations of wrongdoing have not been proven conclusively as Defendants have adduced at least some probative and contrary evidence. If Pope succeeds in the trial of Counts II to VI in establishing liability on one or more of those additional claims, there then may be sufficient exigent circumstances to lead to the appointment of a receiver.[78]

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[78] *See Carlson v. Hallinan*, 925 A.2d 506 (Del. Ch. 2006).

c. Distribution of Gendicine at cut rate prices

Pope alleges, based on the testimony of Peng, that Benda has been making illicit profits at Benda's expense by selling Gendicine at cut rate prices. Under their agreement, SiBiono sells Gendicine to Hua, a former marketing director at SiBiono, who then resells the drug at a higher price through a third party entity.[79] At trial, Pope produced a document which purports to prove this.[80] Pope also alleges, based on the testimony of Peng, that Hua, Wan, and Xu split the profits of this distribution arrangement.[81]

Defendants first rebut these allegations by attacking Peng's credibility on several grounds. First, Peng was previously CEO of SiBiono and stands to regain an active role if Pope is successful.[82] Second, Peng is in litigation with SiBiono over control of certain patents and has agreed with Pope to settle these claims (presumably in a manner favorable to himself and Pope) if Pope gains control of SiBiono.[83] Third, even Wells has stated that he has doubts about Peng's credibility.[84] It is premature at this preliminary stage to make a final determination as to Peng's credibility. Nevertheless, Defendants' arguments raise legitimate questions about Peng's reliability and, when combined with

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79 Peng Dep. 67.

80 T. Ex. KK.

81 Peng Dep. 67.

82 *Id*. at 33.

83 *Id*. at 23-26, 28-31, and 35-36.

84 Wells Dep. 134.

his inability to produce much evidence to corroborate his claims, cause me to give them little weight at this stage.

Moreover, regardless of Peng's credibility, Defendants deny that Wan and Xu share in the profits of the SiBiono-Hua distribution agreement and also defend the propriety of the relationship with Hua. They assert that such a relationship is a necessity because "in China . . . SiBiono can't sell [Gendicine] directly. You have to go through [people like Hua]. So these guys get expenses, and so forth . . . . That is where the price difference is."[85] Therefore, according to Benda, the price difference is nothing more than a markup related to the sale and distribution of Gendicine.

While the evidence as to whether the relationship with Hua is appropriate and fair to Benda's stockholders is inconclusive, Benda's explanation that SiBiono needed a third party distributor does not appear unreasonable. At the same time, it is possible that Pope ultimately may be able to show that Wan and Xu improperly have been splitting profits from the venture with Hua in derogation of the rights of Benda and Pope. Given the serious questions about Peng's credibility and the less than compelling nature of the other evidence Pope presented, however, I find its showing as to the transactions with Hua insufficient to constitute exigent circumstances that would warrant appointing a receiver.

d. Threat of seizure by the Chinese bank, Ping An

Pope also alleges that the value of Benda is at risk of a precipitous decline because of the threat that Ping An could decide to seize SiBiono's new plant at any time. SiBiono

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[85] T. Tr. at 231.

is critical to the value of Benda and if such an asset were sold at a fire sale price in a foreclosure proceeding, there is a high probability that creditors will recover less than they would if SiBiono's assets were disposed of in an orderly fashion. Although Benda claims that it has reached an oral agreement with the bank, it has no documentation to buttress this claim.[86] It is also true, however, that Ping An obtained the judgment against SiBiono over two years ago and there is no evidence suggesting that Ping An is likely to attempt to execute on its judgment in the near future. Furthermore, Ping An's forbearance in the face of SiBiono's default supports an inference that it sees some hope that SiBiono will be able to turn around its business and return to profitability. The fact that SiBiono recently obtained reinstatement of its GMP Certificate further supports such an inference.

For all of these reasons, I am not persuaded that the Ping An obligation or the other matters Pope has raised constitute exigent circumstances that necessitate the appointment of a receiver. Moreover, it is possible that the uncertainty that might ensue from such an appointment might spur Ping An to seek immediate execution which might cripple SiBiono and thus seriously impair the value of Benda.

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[86] T. Tr. at 187.

D. Would the Appointment of a Receiver Serve a Beneficial Purpose?

Even if exigent circumstances did exist, the appointment of a receiver is only justified if it would serve a "beneficial purpose."[87] Pope asserts that appointment would yield two principal benefits: salvaging the Company and ensuring its creditors receive equal treatment. These potential benefits, however, must be weighed against the likelihood of harm that might occur if an appointment causes the Company's creditors to panic and trigger an immediate liquidation.

After careful review of the record, I am not convinced that creditors have been treated unfairly. As discussed *supra* Part II.C.1.a, I base this conclusion, in part, on Defendants' representations that the insider loans have not been paid off preferentially and will be repaid only after all other creditors have been paid. The primary additional creditor allegedly receiving preferential payments is the construction company working on SiBiono's new facility.[88] Benda claims that the challenged agreement called for the construction company to have been paid as of July 30, 2010.[89] Based on the importance of the new plant to SiBiono's (and, therefore, Benda's) prospects of success, such a payment schedule reasonably could be the result of a good faith business judgment, because it seems designed to allow SiBiono to generate revenue by getting the plant up

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87 *Banet v. Fonds de Regulation et de Controle Café Cacao*, 2009 WL 529207, at *3 (Del. Ch. Feb. 18, 2009) (citing *Prod. Res. Gp., LLC v. NCT Gp.*, 863 A.2d 772, 784 (Del. Ch. 2004)).

88 T. Tr. at 168-69.

89 *Id*.

and running as soon as possible. Because Pope has not adduced sufficient evidence at this point to demonstrate that he is likely to succeed in proving that certain major creditors are receiving improper preferences, these complaints do not justify appointing a receiver.

Pope also argues that a receiver would be able to change the management course of the Company and thus salvage greater value. This argument is fraught with difficulty, however. First, it is not clear to what extent the actions taken by a receiver appointed to oversee a Delaware holding company with respect to an operating subsidiary in China would be respected under Chinese law. Therefore, such an appointment ultimately might be ineffectual. Second, by arguing that a receiver might be able to extract greater value from Benda through a change in management, Pope tacitly acknowledges that Benda has certain attributes which conceivably are valuable. This weighs against the appointment because of the Court's reluctance to second guess a company's board of directors' business judgment.

Finally, while it is possible that a receiver may be able to make positive changes to management or ensure equal treatment of creditors, I consider it at least as likely that such appointment will trigger the liquidation of the Company. One would expect, for example, that appointment of a receiver might constitute an event of default under one or more material loans or contracts of Benda's subsidiaries. Thus, the creditors of Benda and its subsidiaries might rush to execute on their claims, thereby extinguishing any prospects the Company might have had for a successful turnaround. Because of this possibility, there is a serious risk that appointing a receiver will do more harm than good.

In summary, while I find that the Company is insolvent, I am not persuaded either that exigent circumstances exist here or that the appointment of a receiver will serve a beneficial purpose. Therefore, I deny Pope's Application.[90] Section 291 grants this Court broad discretion when deciding whether to appoint a receiver. Pope has raised a number of serious allegations that might well warrant the relief it currently seeks here under Count I after the Court conducts a full trial on the merits of the other five counts in its Complaint. This decision, therefore, is without prejudice to that possibility.

III. CONCLUSION

For the reasons stated, Pope's Application for the appointment of a receiver is denied.

IT IS SO ORDERED.

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[90] Benda also contends that Pope's Application should be denied under the doctrine of laches, even if the appointment of a receiver otherwise seemed appropriate. In asserting a laches defense, Benda has the burden of persuasion as to two requisite conditions: (1) that the plaintiff waited an unreasonable length of time before bringing its suit; and (2) that the delay unfairly prejudices the defendant. *Hudak v. Procek*, 806 A.2d 140, 153 (Del. 2002) (citing *Fike v. Ruger*, 752 A.2d 112, 113 (Del. 2000)). "What constitutes unreasonable delay and prejudice are questions of fact that depend upon the totality of the circumstances." *Id*. (citing *Hudak v. Procek*, 727 A.2d 841, 843 (Del. 1999) (quoting *Federal United Corp. v. Havender*, 11 A.2d 331, 343 (Del. 1940))).

Under the facts of this case, I conclude that Benda has failed to meet its burden. First, the record shows that Pope acted in a reasonably timely way to protect its rights. The promissory note was not due until March 28, 2009. In May 2009, Pope brought suit on the note and, in October 2009, it obtained a judgment on it. Pope filed this suit in December 2009. Second, there is no evidence that any delay by Pope prejudiced the position of Benda. Accordingly, I reject Defendants' laches defense as to Count I.