

COURTS OFFICE LIBRARY

IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION



Cause No. FSD: 796/2011

The Honourable Mr Justice Andrew J. Jones QC
In Open Court, 21st and 24th October 2011

IN THE MATTER OF Section 46 of the Companies Law (2010 Revision)
AND IN THE MATTER OF the Grand Court Rules, 1995, Order 102, rule 2(1)(b)

B E T W E E N:

ISRAEL OIL & GAS CORPORATION

Plaintiff

AND

(1) ISRAEL PETROLEUM COMPANY LIMITED

First Defendant

(2) INTERNATIONAL THREE CROWN PETROLEUM LLC

Second Defendants

Appearances: Ms Tina Asgarian of Ogier for the Plaintiff

Mr James Eldridge of Maples and Calder for the Defendants

JUDGMENT

Introduction

1. By its Originating Summons issued on 28th April 2011 (the "Originating Summons") Israel Oil & Gas Corporation ("IOG") seeks an order pursuant to section 46 of the Companies Law (2010 Revision) that the register of members of the First Defendant, Israel Petroleum Company Limited ("IPC"),

be rectified to give effect to a share transfer request made on 8th March 2011 (the "Share Transfer Request") together with such other ancillary relief as may be necessary for the purpose of giving effect to the rectification. It is admitted that IOG has no absolute right to have its proposed share transfer registered and that the IPC's directors are empowered under its articles of association to reject the Share Transfer Request if they bona fide consider it to be in the interests of the company to do so. The issue between the parties is whether or not the decision to reject the Share Transfer Request constituted a proper exercise by IPC's sole director of its discretionary power under the company's articles of association. Alternatively, the Defendants contend that the Share Transfer Request amounts to an improper "share splitting" exercise, such that the Originating Summons is inherently abusive.

Factual Background

2. IOG, is a company incorporated pursuant to the laws of the Province of Ontario and is a wholly owned subsidiary of Bontan Corporation Inc., ("Bontan"). The Bontan group's principal place of business is in Toronto, Canada and its chief executive officer is Mr Kam Shah ("Mr Shah"). IOG is the registered owner of 76.79% of the issued share capital of IPC. The other shareholders of IPC are the Second Defendant, International Three Crown Petroleum LLC ("ITC"), which holds 23.20% and JKP Petroleum Co Ltd ("JKP") which holds 0.01% of the issued share capital. Both ITC and JKP are companies incorporated in the State of Colorado and are wholly owned and controlled by Mr H. Howard Cooper ("Mr Cooper) who is a resident of Vail, Colorado, USA.
3. In 2009, ITC acquired an option to purchase the rights to certain licences and permits for the exploration of natural gas and oil in Israel (referred to as the "Concessions") from a company called Petromed Corporation. Shortly thereafter, ITC approached Bontan and proposed a joint venture agreement

whereby ITC and Bontan would acquire the rights to the Concessions. It was agreed between the parties that a new company would be incorporated as the vehicle for this venture and that it would hold the Concessions acquired pursuant to ITC's option agreement. Accordingly, on 12th November 2009, IPC was incorporated for this purpose pursuant to the Companies Law of the Cayman Islands.

4. The parties' agreement concerning their respective shareholdings and interest in IPC is recorded in the Contribution and Assignment Agreement dated as of 14 November 2009 and made between ITC, IOG, Bontan and Allied Ventures Incorporation ("Allied"), together IPC itself. Pursuant to the Contribution and Assignment Agreement it was agreed that IPC would issue 7500 shares to IOG, 2250 shares to ITC and 250 shares to Allied, representing a 75%, 22.5% and 2.5% equity interest in IPC respectively.
5. By a subsequent agreement dated 14th April 2010, it was agreed that Allied would be deemed never to have owned any interest in IPC and that its sharest would be re-allocated to ITC and IOG on a pro-rata basis. Allied played no further role in the events giving rise to this litigation. The result is that IOG and ITC would be the registered holders of 7,679 and 2,321 shares, representing 76.79% and 23.21% of the issued (voting) share capital respectively. In fact only 2,320 of ITC's shares were registered in its own name. One share was registered in the name of JKP. Whatever the reason for registering one share in the name of JKP, it has no bearing upon the issue which I have to decide in this case. It follows that IOG is the registered owner of sufficient shares to pass both an ordinary resolution (by a simple majority) or a special resolution (by a two-thirds majority).
6. At the same time as entering into the Contribution and Assignment Agreement, the parties also entered into a Stockholders Agreement which regulates the management of IPC and confers certain rights on its

shareholders.¹ Pursuant to Clause 2(a) of the Stockholders' Agreement the management of IPC is vested in a single director. Clause 2(c)(i) provides that the initial director will be ITC (acting as a corporate director) and Clause 2(c)(i)(A) provides that the director shall not be removed from office other than for wilful misconduct which has a material adverse effect upon the business (as defined). By Clause 15, the Stockholders' Agreement is expressed to be governed by the laws of the State of Delaware.

7. In January 2011, Bontan and IOG commenced proceedings in the Economic Division of the Tel Aviv District Court, Civil Claim No6304-1-11 (the "Israeli Proceeding") against a number of defendants, including ITC and IPC who made an application to this Court for an order that all further proceedings on the Originating Summons be stayed on case management grounds until after the conclusion of the Israeli Proceeding. I rejected that application. However, in order to put the Originating Summons into context, it is necessary to have a general understanding of the Israeli Proceedings and for this purpose I think that it will be convenient for me to repeat the summary contained in my ruling dated 3rd October 2011 by which I dismissed the stay application.
8. The Israeli Proceeding originates from the fact that in January 2010 Petromed Corporation purported to rescind its agreement to assign the Concessions to IPC for reasons which are said to be connected with IPC's failure carry out critical seismic surveys. In March 2010 it was discovered that Petromed Corporation was negotiating to sell the Concessions to new investors. The dispute between Petromed Corporation and IPC was settled on terms that the new investors would take a majority interest in the Concessions in exchange for paying certain development costs incurred by IPC. The result was that IPC's economic interest in the Concessions was significantly diluted. At the

¹ The parties to the Stockholders' Agreement are expressed to be the same as the parties to the Contribution and Assignment Agreement.

same time, the Israeli Government published a directive to the effect that it would not approve the assignment of the Concessions to IPC and the new investors unless they were able to prove a collective “financial capability” in the sum of US\$100 million. It was a term of the settlement agreement that the new investors would provide IPC with a “financial umbrella”, in effect guaranteeing its share of the financial capability requirement (which was US\$14 million) until 30th November 2010. If IPC was unable to meet its financial commitment within this timeframe, it would be required to elect between losing its (approximately 14%) interest in the Concessions or paying a fine of US\$28 million to the new investors. IPC’s interest in the Concessions was held through a limited partnership called IPC Oil and Gas (Israel) LP (“the LP”), of which IPC was initially the sole limited partner and ITC was the general partner.

9. Then, on 13th October 2010, ITC caused IPC to enter into an agreement with the Ofers Brothers Group whereby it acquired half of IPC’s interest in the Concessions in consideration for providing finance up to US\$28 million, thus enabling IPC to meet the financial capability requirement by the 30th November 2010 deadline. As a result of this transaction Ofers Brother Group became a limited partner in the LP with a 50% interest. Furthermore, on 25th October 2010, ITC caused IPC to enter into a contract with Shaldieli Ltd, a public company whose shares are listed on the Israeli Stock Exchange, whereby IPC exchanged its partnership interest in the LP for 90% of the issued share capital of Shaldeili Ltd. The purpose of this transaction, according to ITC, is to give IPC the opportunity to raise finance through a public offering of shares. However, Bontan and IOG assert that both the Ofers and the Shaldeili transactions were done by ITC (in its capacity as IPC’s sole director) without their consent in breach of the terms of the Stockholders’ Agreement.

10. The Israeli Proceeding was commenced by IOG and its parent company against, inter alia, Shaldieli Ltd, IPC, ITC and Mr. Howard Cooper, by which they claim (i) a declaration that the Shaldeili transaction was void because it was concluded without their consent in breach of the Stockholders Agreement; (ii) an order that ITC be removed as director of IPC and general partner of the LP; ² (iii) consequential orders unwinding the Shaldeili transaction and compensating Bontan and IOG for their losses alleged to have been suffered; and (iv) orders compensating them for losses said to have been suffered as a result of the settlement agreement with Petromed Corporation and the agreement with Ofers Brothers Group. Put simply, the defence put forward by Mr. Howard Cooper on behalf of both ITC and IPC is that the Shaldeili transaction was in the interests of IPC; that Bontan/IOG's consent was not required on a true construction of the Stockholders' Agreement; and that they knew about and did not object to the Ofers Brothers Group transaction. Mr. Cooper has also counterclaimed in the names of IPC and ITC asserting that Bontan/IOG are in breach of their funding obligations under the Contribution and Assignment Agreement, as a result of which it is alleged that IOG is not entitled to retain its shareholding in IPC. It is not disputed that the shares in IPC were properly issued to and registered in the name of IOG pursuant to the Contribution and Assignment Agreement, but the Tel Aviv Court is asked to declare that the allotment of shares to IOG is void as a result of the subsequent breach. The evidence is that the trial of the Israeli Proceeding is not likely to take place until the end of 2012 or the beginning of 2013.

The Share Transfer Request

11. IOG's evidence (contained in Mr Shah's affidavit) is that it wishes to convene an extraordinary general meeting of IPC, but its articles of

² Bontan and IOG are seeking to enforce their contractual right under the Stockholders' Agreement to have ITC removed as the single director of IPC on the ground that it is guilty of willful misconduct which has materially and adversely affected the company's business (As defined) within the meaning of Clause 2(c)(i)(A).

association do not provide any means by which a shareholder may requisition or convene a general meeting, with the result that the default provision contained Section 61 of the Companies Law must apply. The material part of the section states that "... in default of any regulations as to the persons to summon meetings, three members shall be competent to summon the same...". Whilst IPC does have three members, IOG proceeded on the assumption that ITC would not co-operate. Therefore, on 8th March 2011 IOG sent its Share Transfer Request by which it sought to transfer 750 shares to Bontam (its parent company) and 750 shares to 1843343 Ontario Inc (another wholly owned subsidiary of Bontan). By splitting the shareholding in this way, the requirement of Section 61 is met without altering the ultimate beneficial ownership or control of IPC. It may be said that, today, the Bontan group owns in 76.79% of the issued (voting) share capital of IPC and that it will continue to do so if the Share Transfer Request is implemented. It may also be said that implementation of the Share Transfer Request will have no impact upon the managerial control of IPC because it is accepted that the two transferees must agree to be bound by the terms of the Stockholder Agreement. The only effect of implementing the Share Transfer Request is that three Bontan group companies holding 7,500 shares in total will be entitled to convene an extraordinary general meeting, whereas one Bontan group company holding 7,500 shares alone is not entitled to do so.

12. The shareholders of Cayman Islands incorporated companies are entitled to deal with their shares freely and transfer them to whomsoever they please, save to the extent that their rights are expressly curtailed by the provisions of the company's articles of association. In this case IOG's right to transfer its shares is curtailed by Article 9 of IPC's articles of association, which states as follows –

"The Directors may in their absolute discretion decline to register any transfer of shares without assigning any reason therefore. If the Directors refuse to register a transfer they shall notify the transferee within two calendar months of such refusal."

13. Clause 5 of the Stockholders' Agreement provides that:

"No stockholder shall sell, assign, transfer, give, pledge, encumber or in any way dispose of (collectively a "transfer"), any Shares, or enter into an agreement to Transfer any Shares, without the Director's prior written consent, which consent may not be unreasonably withheld, and unless (a) such Stockholder has complied with the provisions of this Section 5, and (b) the transferee of any such Shares has agreed to be bound by the terms of the, and become a party to this Agreement."

14. On 8th March 2011 Mr. Shah sent the following email to Mr. Cooper:

"Dear Howard:

Attached is a share transfer form by our wholly owned subsidiary, Israel Oil & Gas Corporation, for transfer of 750 IPC shares to Bontan itself and 750 IPC shares to our other wholly owned subsidiary, 1843343 ONTARIO INC., together with supporting board resolutions of Bontan and each subsidiary. Under our Stockholders Agreement, this is a transfer exempted from the right of first refusal provisions as both subsidiaries are, of course, under Bontan's common control. Per the Stockholders Agreement, I have also attached an opinion from Messerli & Kramer P.A to the effect that the US Securities Act is inapplicable to the share transfers. Kindly confirm receipt of our transfer request and please forward an updated register of members, and related supporting resolutions, to document our share transfers.

Thanks much for your prompt attention to this matter.

Very truly yours,

Kam Shah"

15. On 11th March 2011 Mr Cooper replied as follows:

"Hello Kam:

Your email of March 8 attaches purported share transfers from Israel Oil & gas Corporation to Bontan Corp, and a company you describe as owned by Bontan Corp., and requests that International Three Crown Petroleum LLC ("ITC"), as sole director of Israel Petroleum Company Limited ("IPC") forward "updated" register of shares reflecting these transfers. Your email does not indicate the purpose of these transfers. Accordingly, ITC does not have sufficient information on which to base a decision whether to approve the proposed share transfers. As you know, ITC's approval is required under Section 5(a) of the Stockholders Agreement and Article 9

of the Articles of Association. In light of the current disputes between the parties, ITC cannot approve the transfers without such information. Accordingly, please advise the purpose of the proposed transactions and confirm that the transfers will not have any effect on the issues in dispute between the parties."

Best Regards

H. Howard Cooper."

16. More than a month later, on 25th April 2011, Mr. Shah replied to this email, setting out the reasons for the Share Transfer Request:

"Hi Howard:

As you know, on March 8, we requested that you update the register of IPC to reflect a transfer of shares that we made in IPC. To date, you have failed to do so and instead, have unreasonably withheld ITC's consent to the transfer on the grounds that we have not indicated the purpose of the transfer. Specifically, you noted in your March 11 email to me that because of the current disputes between the parties, you would not approve the transfer without such information and that you were also requiring us to confirm that the transfer will not have any effect on the issues in dispute between the parties.

I can confirm to you that we wish to transfer these shares for the purpose of calling a meeting to discuss both the management of the company as well as other administrative matters relating to the day to day running of the Company, for example, the manner in which the audit of the company's accounts will be conducted pursuant to Article 70 of the Articles of Association. I do not think we are required to make any statement to you as to what impact, if any, this will have on the litigation. We have made a legitimate request to transfer shares for a legitimate purpose and your refusal to register the transfer can be for no reasonable purpose.

As such, we expect that you will take all actions necessary to honor and register the transfer. If you do not do so by Wednesday, April 27, 2011, we will have no other option than to institute legal action to ensure that the this transfer be honored.

Regards

Kam."

17. Having considered the reasons for the Share Transfer Request, Mr. Cooper replied on the following day:

"Kam:

In regard to your below request that ITC approve the share transfer, Article 9 of the Articles of Association of the company provides that "The Directors may in their absolute discretion decline to register any transfer of shares without

assigning any reason therefore." ITC is within its rights under the Articles and Cayman law to refuse to register the transfer without giving a reason.

Further, Bontan is in continuing and substantial default of its obligations under the Contribution Agreement and Stockholders Agreement and has no legal basis for invoking provisions of the Stockholders Agreement for any purpose. In this regard, I call your attention to the fact that ITC has now had to advance to IPC Cayman another approximately \$222,000 to pay a cash call from the Operator for initial costs relating to preparation for the appraisal well. ITC has advanced approximately \$1,900,000 to IPC Cayman to keep it viable because of Bontan's failure to fund, and IPC Cayman has another approximately \$2,000,000 in outstanding liabilities that it has not been able to pay because of Bontan's failure to fund. As you know, it is ITC's position that Bontan has no legal entitlement to ownership of any shares in IPC Cayman in view of its manifest failure to perform its obligations, let alone the right to transfer any shares to a third party.

But even if the Stockholders Agreement could be invoked by Bontan, ITC has no obligation under the agreement to approve this transfer. As I previously indicated to you, in view of the litigation between the parties, and ITC's concern that the purported transfers are intended to prejudice ITC's legal claims, it was entirely reasonable for ITC to request confirmation from Bontan that the transfers would not be used in any manner to change Bontan's legal position in the litigation. Further, it was entirely reasonable for ITC to request the reason for the transfer, appearing as it has in the midst of the ongoing litigation, and frankly our suspicions are borne out by your refusal to give a reason.

It should also be noted that Section 5(a) of the Stockholder's Agreement provides that, "No Stockholder shall....transfer....any shares....without the Director's prior written consent, which consent may not be unreasonably withheld..." Bontan did not seek ITC's prior consent as required but rather attempted to effect the transfer without our prior written consent as required by the agreement. The question of consent does not even arise in these circumstances, since the procedure prescribed in the agreement was not followed.

ITC declines your request to approve the purported transfers.

Howard"

The issue which I have to decide is whether the decision reflected in this e-mail constitutes a bona fide exercise of the discretionary power contained in Article 9 of IPC's articles of association, made in the interests of the company.

The Applicable Law

18. It is common ground that, as a matter of law, the discretionary power contained in Article 9 must be exercised by ITC bona fide for the purpose for which it is given the power and that it must be exercised in the interests of IPC. The test was formulated by the English Court of Appeal in *Re Smith & Fawcett Ltd* [1942] 1 Ch 304, per Lord Greene MR (at page 306) in the following way:

"[The directors] must exercise their discretion bona fide in what they consider - not what a court may consider - is in the interests of the company, and not for any collateral purpose. They must have regard to those considerations, and those considerations only, which the articles on their true construction permit them to take into consideration, and in construing the relevant provisions in the articles it is to be borne in mind that one of the normal rights of a shareholder is the right to deal freely with his property and to transfer it to whomsoever he pleases."

19. The Stockholders Agreement is to be construed in accordance with the law of the State of Delaware. I have the benefit of an affidavit of foreign law sworn by Mr C. Stephen Bigler and filed on behalf of IOG. He is a lawyer admitted to the Bar of Delaware who has been in practice for some 27 years and his explanation of the law is unchallenged.³ He summarises the applicable legal principles in the following way:

"8. Several Delaware decisions have considered whether a party to a contract was "unreasonable" in withholding its consent under the contract under language similar to that in Section 5 of the Agreement. Generally, a party whose consent is required may properly withhold consent to a transaction when the decision is made for a legitimate business purpose

9. In determining whether withholding consent is "reasonable," the Delaware courts have looked to the contractual implied covenant of good faith and fair dealing in determining whether consent was unreasonably withheld. Delaware law incorporates an implied covenant of good faith and fair dealing into every contract. The covenant "requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the contract."

³ Counsel for the Defendants rightly points out that, in paragraphs 14-18 of his affidavit, Mr Bigler has strayed from the role of an independent expert and sought to act as an advocate for the Plaintiff. These paragraphs must be disregarded but their inclusion does not detract from the weight which should be attached to the rest of his evidence.

20. It is also common ground that, for the purposes of this case, there is no material distinction between the applicable Cayman Islands and Delaware law. As a matter of Cayman Islands law ITC owes a fiduciary duty to the company and must exercise its power under Article 9 bona fide and not for any collateral purpose. Counsel are agreed that the covenant of good faith and fair dealing implied into the Stockholders' Agreement by Delaware law essentially leads to the same conclusion. Similarly, they are agreed that the requirement to exercise the Article 9 power "in the interests of IPC" is indistinguishable from the requirement to exercise the contractual right under Clause 5 "for a legitimate business purpose of IPC".
21. Before turning to apply these principles to the facts of this case, I should add that the burden of proof rests upon the Plaintiff. In spite of what IOG's counsel said in paragraph 17 of her written submissions, I think she conceded that the burden of proof rests upon her client to persuade the Court that ITC did not exercise its discretionary power bona fide in the interests of the company. As Lord Hoffman said in *Village Cay Marina Ltd v- Acland* [1998] 2 BCLC 327 at page 335, "The directors are prima facie assumed to have been acting in good faith and the onus of proving the contrary is upon the person who challenges their decision".

ITC's reasons for rejecting the Share Transfer Request

22. Mr Cooper's reasons for rejecting the Share Transfer Request were set out in his e-mail of 26th April which I have recited in paragraph 14 above. It is said that, in substance, he made three points, namely that (1) IOG had "no legal entitlement to ownership of any shares in IPC ... let alone the right to transfer any shares"; (2) he was concerned that any share transfer might "prejudice ITC's legal claims in the Israeli proceedings"; and (3) because the prescribed procedure under Clause 5 of the Stockholders' Agreement had not been observed. When considering the reasons which Mr Cooper gave for his decision, I bear in mind two important points. First, I should not fall into the trap of analysing each and every word of his e-mail in an attempt to extrapolate a free standing reason from every comment or statement. Instead, I should read it as a whole and seek to identify the overall reason given for his decision. Second, in determining what was his overall reason, I should have regard to the evidence as a whole and not confine myself to the content of the 26th April e-mail. Mr Cooper elaborated upon his reasons at some length in paragraphs 10-15 of his affidavit, which was sworn some four months later in opposition to the Originating Summons. In particular, he explained that the reference to

prejudicing ITC's claims in the Israeli Proceeding should not be read literally and that he was of course referring to the counterclaims made by both ITC and IPC. Ms Asgarian suggests that I need look no further than the e-mails which say, in effect, that ITC was acting in its own interests rather than the interests of the company and for this reason alone I should find in favour of the Plaintiff. I reject this proposition for the reasons given by the Privy Council in *Village Cay Marina Ltd -v- Acland*.

23. This was a similar case in which the company's director refused to register a share transfer for reasons set out in a letter to the transferor. It was said that the reason given in this letter was a bad one and that the director was not entitled to enlarge upon his reasons, as he had done, in his evidence to the court. Having exercised his discretion for an improper purpose, it was said that he could not exercise it again for a proper purpose. The Privy Council rejected this argument and held that the trial judge was entitled to take into account not only the terms of the director's letter but also the evidence of his reasons given at trial. Lord Hoffman said (at page 337g) "In general however [their Lordships] do not think that there is any rule of law by which the directors are confined to the reasons they have given. Of course as an evidential matter they may have difficulty in persuading the court that their refusal was based upon reasons which they did not mention, but the question for the judge in the end is whether at the time they believed in good faith that the refusal of registration was in the interests of the company". Furthermore, Mr Cooper's affidavit stands as unchallenged evidence. Before making the order for directions for trial, I specifically invited Ms Asgarian to consider whether or not she wished to cross-examine Mr Cooper. Having taken time to consider the matter, she decided not to ask me to make an order for cross-examination. In these circumstances I think that it would be quite wrong for me "look no further than the e-mails", thereby attaching little or no weight to the explanations given in his affidavit.
24. Having made these observations, I turn to consider Mr Cooper's stated reasons for his decision, as they are identified by counsel for the Plaintiff. Arguably, the first identified reason is not a rationale one. IOG must be regarded as a shareholder unless and until ITC succeeds in rectifying the share register on the basis of an order the Tel Aviv Court to the effect that the original issue of shares be set aside by reason of IOG's breach of the Contribution and Assignment Agreement. It ought to have been obvious to Mr Cooper that the transferees could obtain no better title than the transferor. The third identified reason appears to be highly technical. By Clause 5(a) of the Shareholders' Agreement IOG is not entitled to transfer the shares without the *prior* written consent of

ITC (as director), such consent not to be unreasonably withheld. However, executed share transfers were included as part of the Share Transfer Request submitted to ITC and it is said that the failure to comply strictly with Clause 5(a) was one of the reasons why Mr Cooper rejected the request. I would not expect a director, acting in good faith, to concern himself with this point. Whether the Share Transfer Request included drafts or executed share transfer forms, it could and should have been treated as a valid request for the purposes of both Clause 5(a) and Article 9. However, these two criticisms of Mr Cooper's reasoning do not lead me to conclude that he was failing to act in good faith in the interests of the company for a legitimate business purpose.

25. I conclude that the overall reason for refusing to register the transfers was that Mr Cooper believed (as stated in paragraph 15.1 of his affidavit) that IOG's Share Transfer Request was intended as a tactical manoeuvre to undermine the Israeli Proceeding and to protect its own position in that litigation. I think that it was perfectly legitimate for Mr Cooper to ask IOG to explain the purpose of the transaction and to seek confirmation that the proposed transfers would not have any effect upon the issues in dispute between the parties. Whilst it might be said that a refusal to register the transfers for the sole purpose of preventing IOG from ever convening a general meeting of the company for any purpose whatsoever could not be regarded as a bona fide exercise of the director's discretion in the interests of the company, I think that Mr Cooper was entitled to ask why IOG wants to convene a meeting at this time. Having asked the question, he was bound to have regard to the answer. The answer given by Mr Shah was evasive. In his e-mail of 25th April, Mr Shah simply said that the purpose of the meeting was "to discuss both the management of the company as well as other administrative matters relating to the day to day running of the Company, for example the manner in which the audit will be conducted." In the real world extraordinary general meetings are convened for the purpose of passing special resolutions, not simply for the purpose of "discussing day to day management and administrative matters". Given the fact that the parties were then engaged in litigation, Mr Cooper cannot be criticised for believing that he was not being told the whole story by Mr Shah. It subsequently became clear that IOG in fact wants to convene an extraordinary general meeting for the purpose of passing a resolution to remove ITC as IPC's sole director. On the basis of the information presented to Mr Cooper in the circumstances as they existed on 26th April 2011, it seems to me that it was not unreasonable or irrational for him to form the belief that IOG was engaged in a tactical exercise intended to undermine or complicate the Israeli Proceeding in some way. He says that he did not believe that it would be in the interests of the company to

allow IOG to act in this way. It should be remembered that IOG and Bontan are asking the Tel Aviv Court to make an order, based upon their rights under the Shareholders' Agreement⁴, that ITC be removed as a director IPC, for which purpose it must establish that ITC is guilty of wilful misconduct materially and adversely affecting the company's business (as defined).⁵ Having regard to the evidence as a whole including Mr Cooper's affidavit, in my judgment the Plaintiff has not proved that ITC failed to act in good faith in the interests of the company by rejecting the Share Transfer Request.

The practice of "share splitting"

26. Finally, (although it is not strictly necessary that I do so), I will address the argument advanced by the Defendants' counsel that "share splitting" for the purpose of meeting the requirements of section 61 is an inherently abusive practice which should not be permitted by the Court. This argument is based upon the decision of the Hong Kong Court of Appeal in *Re PCCW Ltd* [2009] 3 HKC 292 (CAA (HK)). The case concerned the privatisation of Pacific Century CyberWorks Ltd and involved an application to the court to sanction a scheme of arrangement pursuant to section 166 of the Hong Kong Companies Ordinance, Cap.32 which is the equivalent of section 86 of the Cayman Islands Companies Law (2010 Revision). These legislative provisions empower the court to sanction an arrangement or compromise between a company and its shareholders or creditors if it has been approved by a majority in number of the shareholders/creditors holding seventy-five percent of the shares/debt by value. The effect of the court's sanction is that the scheme of arrangement is made binding upon those who dissent or abstain from the vote. There was evidence that shareholdings owned by two supporters of PCCW Ltd's scheme of arrangement had been "split" by transferring single shares to hundreds of individuals prior to the court meeting for the sole purpose of ensuring that the majority in number would be achieved and/or boosting the margin by which it was achieved. In the event, the majority by number would not have been achieved but for this share manipulation exercise. The Court of Appeal reversed the trial judge's decision to sanction the scheme, but it did not do so on the basis that the manipulative practices had invalidated the vote. It was held that when the

⁴ Bontan is a party to the Stockholders' Agreement even though it is not a shareholder of IPC.

⁵ Whether or not IOG can remove ITC as a director simply by passing an ordinary resolution pursuant to Article 62 of its articles of association without reference to the terms of Clause 5(a) of the Stockholders' Agreement is a question of law which does not arise on this Originating Summons and has not been addressed by counsel.

court comes to the conclusion that a material number of votes have been influenced by manipulative practices, it cannot accord the majority its usual weight for the purposes of deciding whether or not to sanction the scheme. If the overall picture is distorted by vote manipulation, the court should not take the decision of the majority at face value.⁶ The factual circumstances of *Re PCCW Ltd* are of course wholly different from the present case but, as Hon. Rogers VP observed, “the underlying objection to share splitting (and other manipulative practices) is the frustration of the legislative intent of the dual majority requirements” of the statute. In my judgment it cannot be said that that IOG’s proposed share splitting exercise is objectionable for this reason. Arguably, it is actually necessary in order to give effect to the legislative intent of section 61.

27. Whether or not a share splitting exercise done for the purpose of meeting the requirements of a provision of the Companies Law should be regarded as objectionable depends upon (a) the purpose of the statutory provision in question and (b) the intended effect of the alleged manipulation. The purpose of section 166 of the Hong Kong Companies Ordinance and section 86 of the Cayman Islands Companies Law is to impose a dual majority test. If either a majority in number or a majority in value is not achieved, the court has no jurisdiction to sanction a proposed scheme of arrangement. Furthermore, the size of the majorities may influence the way in which the court exercises its discretion. The purpose of this legislation to vary the normal principle of majority (by value) rule in circumstances where the court has power to override the contractual rights of the minority by imposing a scheme of arrangement upon them. The dual majority test is intended to achieve a form of minority protection. If it is acceptable for a company to collude with one or more of its shareholders prior to fixing the record date for the court meeting, it can guarantee that the majority in number will always be achieved. The result is that the dual majority test effectively ceases to exist and the statutory mechanism for protecting the minority is rendered nugatory. In the case of *Re PCCW Ltd* the share splitting exercise was objectionable because it was intended to achieve exactly this result.

28. Applying this test, I must first ask myself what is the purpose of the section 61. On its true construction, the purpose of section 61 is simply to regulate the way in which general meetings will be convened and conducted to the extent that such matters are not dealt with in the company’s articles of association. One of its purposes is to *enable* a


⁶ Per Hon. Lam J. at paragraphs 151-3.

minimum number of shareholders to convene a general meeting. It is one of a number of sections designed to protect a company's members as against its management. One of the purposes of section 61 is to *enable* a general meeting to be convened by a minimum number of members as a means of bringing management to account. Its purpose is not to *prevent* general meetings from being convened as means of frustrating the majority's ability to pass resolutions. It must then consider the intended effect of Bontan's proposed share splitting proposal. As I have already said, it was intended to *enable* Bontan to convene an extraordinary general meeting which is not inconsistent with the purpose of section 61. In principle it would be wholly unobjectionable for either of IOG or ITC to split their shareholdings in order to meet the requirement of section 61. However, the fact that it is not objectionable in principle for the members of IPC to split their shareholdings for the purpose of enabling them to convene general meetings in reliance upon the provisions of section 61, does not necessarily lead to the conclusion that ITC must have acted in bad faith by refusing to register the particular transfers in question.

Conclusion

29. In my judgment, the Plaintiff has not proved that ITC acted in bad faith for some collateral purpose. I therefore dismiss the Plaintiff's claim and give judgment for the Defendants with costs to be taxed if not agreed.

Dated this 24th day of October 2011


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

