IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION
Mr Justice Andrew J. Jones QC
In Open Court, 18th December 2009

CAUSE NO. FSD 26 OF 2009

IN THE MATTER OF SECTIONS 86 AND 87 OF THE COMPANIES LAW (2009 REVISION)

AND IN THE MATTER OF ORIENT PETROLEUM INTERNATIONAL INC.

Appearances: Ms. Sandy Corbett, Walkers on behalf of the Company

JUDGEMENT

1. Orient Petroleum International Inc ("OPII") appears to carry on a substantial oil and gas exploration business in Pakistan. It was incorporated in the British Virgin Islands on 29 December 2004 and was 'transferred by way of continuation' to the Cayman Islands with effect from 24 November 2009. Shortly thereafter, on 4 December 2009 OPII presented a petition under Section 86 of the Companies Law (2009 Revision) for an order sanctioning a scheme of arrangement between the company and its shareholders. OPII now applies by its *ex parte* summons for an order that a scheme meeting of shareholders be convened and held in Geneva, Switzerland on 6 January 2010. The Petition and *ex parte* summons is supported by an affidavit sworn by Rustom B. Kanga who describes himself as "a director and the secretary" of OPII and gives his address as an office building in Geneva. He does not disclose his professional qualifications or business background and experience. Nor does he disclose what, if any, executive management role he performs within the OPII Group. However, he does asset that he is "intimately acquainted the affairs of [OPII]".

2. In my judgment this Petition is not supported by credible evidence and must be dismissed. Having carefully read Mr Kanga's affidavit and its exhibits, the true commercial purpose of this proposed scheme of arrangement remains wholly unclear to me. As pleaded (Petition §15), its object is "to alter the present corporate structure of [OPII] and Ocean Pakistan [Ltd] such that

[OPII] and Ocean Pakistan [Ltd] amalgamate … and [OPII] is dissolved without winding up and its separate legal existence shall cease for all purposes". Mr Kanga's affidavit (§12) states that Ocean Pakistan Ltd (which I shall refer to as "Ocean Pakistan") was incorporated in Delaware in 1995 under the name 'UMC Pakistan Corporation'. It subsequently changed its name and was transferred by way of continuation and became registered as a Cayman Islands company with effect from 7 December 2000. If the scheme of arrangement is approved (and any necessary orders are made under Section 87), OPII will cease to exist and its business, undertaking and assets will be merged with that of Ocean Pakistan, its wholly owned (dormant) subsidiary.

3. One would expect to find a full explanation of the underlying commercial rationale for the amalgamation set out in an explanatory memorandum as required by GCR O.102, r.20(4)(e) which provides that the Petitioner must prepare and submit to the Court as part of the supporting evidence "a draft explanatory memorandum or proxy statement which provides the shareholders or creditors with all the information reasonably necessary to enable them to make an informed decision about the merits of the proposed scheme". The draft *Explanatory Statement* (Exhibit "RBK-4") patently fails to meet this criteria. The *Rationale for the Scheme of Arrangement* is set out in §4 on page 7. In summary, the Court is told that "The primary reason for the transaction is to bring cost effectiveness and efficiency to both companies, simplifying the overall group structure such that it can benefit from a combined and stronger past profile for winning new concession agreements, creating a more tax efficient single entity and rationalising the operating, administration, and maintenance costs of the companies." It goes on to identify certain expected benefits in sub-paragraphs (a) to (e). It is important to put these statements into context. OPII appears to be a substantial oil and gas exploration company whose draft balance sheet reflects an NAV of about $157 million as at 30 September 2009 (Exhibit "RBK-5"). In contrast, Ocean Pakistan is said by Mr Kanga to be "dormant". Its draft balance sheet as at 30 November 2009 (also Exhibit "RBK-5") reflects that it is now a shell company with no assets and no liabilities. (The fact that it has a nominal credit balance of $73 on its bank account is immaterial). No proper financial statements have been produced and there is no other evidence from which I can glean any information about its trading history. Against this factual background, the draft *Explanatory Statement* makes the following assertions (in Part II, §4)

   (a) "[OPII] and Ocean Pakistan are in the same line of business and their amalgamation will therefore cause a consolidation of their activities and business of [OPII] and Ocean Pakistan into one entity and therefore enable it to harness and optimise the synergies of two companies;"

   (b) "the proposed amalgamation would result in cost reduction and value creation, facilitate expansion and growth of the business by strengthening management and finances,

reduction in administrative and overhead expenses, a large asset base, effective financial planning and thus facilitating the business to be carried on more advantageously, economically and profitably due to unified management and control;"

(c) "the amalgamated entity shall provide strategic and competitive advantage. The proposed amalgamation is in line with current global trends to achieve size, scale, integration and greater financial strength and flexibility. The consolidated entity is likely to achieve higher long terms financial returns than could be achieved individually by [OPII] and Ocean Pakistan". (Given that Ocean Pacific is a dormant shell company with no assets, this statement is patently absurd)

(d) "the proposed amalgamation would allow greater tax effectiveness in Pakistan; and"

(e) "[OPII] and Ocean Pakistan have both successfully honoured significant capital commitments under their respective concession agreements with the Government of Pakistan over past many years and enjoy a good profile in the country. The amalgamated entity would, in the near future, be able to bid more successfully for new concession areas through a combined, stronger profile, synergized expertise and resources. "

4. On the basis of the evidence put before the Court (and intended to be made available to the creditors) these assertions do not make any commercial sense whatsoever. Indeed, they appear to be complete nonsense.

5. The evidence before Court does not include any group structure chart. Except for the bare statement that OPII is engaged in the oil and gas exploration, there is no meaningful description of OPII's business. Its audited consolidated financial statements have not been put in evidence. There is no description of Ocean Pakistan's trading history; no evidence about why or when it ceased to carry on business and became dormant; and its financial statements have not been produced in evidence.

6. Exhibit "RBK-5" comprises a draft balance sheet for Ocean Pakistan as at 30 November 2009 and a draft consolidated balance sheet for OPII as at 30 September 2009. Both documents are unsigned drafts. Neither document can be characterised as a set of financial statements. There are no profit and loss accounts; no statements about the accounting principles adopted; no comparative figures for the prior year/period; and no explanatory footnote disclosure. In the case of OPII's so-called "consolidated balance sheet", it does not even identify the subsidiaries with which its financial statements have been consolidated. At best, these draft balance sheets fail to provide the reader with the financial information reasonably necessary to make an informed decision about the merits of the proposed scheme of arrangement, as asserted in *Explanatory Statement* or otherwise. In my judgment these draft balance sheets lead to the conclusion that §4 of Part II of the *Explanatory Statement* is false, which in turn leads to the conclusion that the underlying commercial purpose of this scheme of arrangement is being misrepresented to the Court.

7. Ocean Pakistan's draft balance sheet simply reflects that it had become a shell company as at 30 November 2009. It reflects that OPII has subscribed capital of $96,319 and that this capital has been all but wiped out by accumulated losses (described as negative retained earnings) of $296,246. The draft balance sheet reflects that the company has no assets and no liabilities, except for a nominal $73 in cash.

8. OPII's draft consolidated balance sheet purports to reflect the company's financial position as 30 September 2009. The word "consolidated" implies that its balance sheet has been consolidated with that of Ocean Pakistan and its other subsidiaries. Whether or not it actually has any other subsidiaries is not disclosed. The fact that the two balance sheet dates are different inevitably raises a "red flag" in my mind. Whether or not this fact has any significance is impossible to know. I think that I am being asked to infer that Ocean Pakistan's financial position as at 30 November was the same as it was on 30 September, but then one wonders why the Court was not provided with a draft as at 30 September. OPII's draft balance sheet reflects total assets of about $193m and total liabilities of about $36m, resulting in an NAV of about $157m. The "non-current liabilities" are described as a "security deposit" of $247,000 and "deferred liabilities" of about $23m. How this liability arose and why it is properly characterised as "deferred" should be explained in the footnotes to OPII's audited financial statements, but this document has not been disclosed to the Court. OPII is said to have retained earnings of $157m but, in the absence of any profit and loss accounts, it is impossible to know whether it is currently trading at a profit or loss. The draft balance sheet also reflects that OPII has a share capital of $1,000, (which is consistent with the Petition, as verified in §11 of Mr Kanga's affidavit). However, neither the draft balance sheet nor Mr Kanga's affidavit contains any clue about the way in which OPII's activities have actually been financed. Finally, I note that OPII's draft consolidated balance sheet includes cash and bank balances of about $44m. By definition, this includes the $73 belonging to Ocean Pakistan. If Ocean Pakistan is in fact OPII's only subsidiary, it follows that its stand-alone balance sheet will look exactly the same as its consolidated balance sheet. They will be literally identical because the figures are given to the nearest '000. Whether Ocean Pakistan has a credit balance or an overdraft of $73 on its bank account makes no difference because the amount is too small to impact upon OPII's consolidated balance sheet at all.

9. This financial state of affairs begs a series of questions and provides no answers whatsoever. By no stretch of the imagination does this evidence begin to justify any of the assertions made in §4 of the *Explanatory Statement.* These assertions are not supported by credible evidence. To the extent that any relevant evidence has been produced to the Court, it is largely inconsistent with

the *Explanatory Statement.* The discrepancies between the assertions made and the supporting evidence is so blatant that a detailed analysis is not necessary. I mention a few obvious examples. It is asserted that "simplifying the overall group structure" is a primary reason for the amalgamation. I do not believe this assertion. Assuming that Mr Kanga's evidence is true and that Ocean Pakistan is a dormant company with no assets and no liabilities, the cheapest, easiest and normal method eliminating it from the group structure is to have it struck off the register. Mr Kanga's affidavit does not explain why he is adopting the elaborate and expensive exercise of amalgamating the parent into its subsidiary, when he could equally well "simplify the overall group structure" by striking the subsidiary it off the register. Presumably, he has some reason for wanting to eliminate the parent rather than the subsidiary, but this important result is not explained in the evidence. It is also asserted that a beneficial commercial result of amalgamation is that OPII "can benefit from a combined and stronger past profile for winning new concessions and agreements". This assertion is not supported by any credible evidence. All the Court knows about Ocean Pakistan's past profile is that it was incorporated in Delaware in 1998 and has been registered in the Cayman Islands since 2000; it is now dormant, but I do not know for how long – Counsel suggested that it has been dormant for "years" but this is not apparent from the evidence; but I do know that it must have done some business at some stage in the past because it has accumulated losses of $96,246. On any view, this evidence does not support the assertion that OPII "can benefit from a combined and stronger past profile for winning new concessions and agreements".

10. It is also asserted that another reason for the amalgamation is "creating a more tax efficient single entity" and that "the amalgamation would allow greater tax effectiveness in Pakistan". In the absence of any proper financial statements, I have no means of knowing whether or not OPII is currently generating taxable profits or allowable losses. Nothing about its tax position, whether in Pakistan or elsewhere, is disclosed. Furthermore, I have no evidence from which to infer that the amalgamation can have any possible impact upon OPII's tax position at all. I can speculate that Ocean Pakistan's accumulated loss of $96,246 might be taken into account for the purposes of determining OPII's income tax liability. Given that Ocean Pakistan is a wholly owned subsidiary, I can also speculate that this result will occur (or has already occurred) in any event, whether or not there is an amalgamation. During the course of her submissions Counsel said that OPII may have obtained tax advice from PricewaterhouseCoopers, but this fact is not referred to in Mr Kanga's affidavit or any of its exhibits. There is no evidence to support this assertion and Counsel was not in a position to explain to me whatever advice may have been given. Suffice it to

say that there is absolutely no evidence to support the assertion made in the *Explanatory Statement* about tax benefits.

11. It is also asserted that an amalgamation "would result in cost reduction and value creation". On the basis of the draft balances sheets and in the absence of any proper financial statements or any analysis of OPII's business and Ocean Pakistan's "past profile", this assertion appears to be patent nonsense. Given that Ocean Pacific is dormant, and may have been dormant for many years, it will have no costs at all except for the fees necessary to keep it in good standing, the amount of which will be wholly immaterial to OPII's profit and loss account, let alone its balance sheet. To the contrary, it seems to me that the presentation of this petition and any consequent amalgamation will generate extra cost and I simply do not understand how the merger with a dormant shell company can result in "value creation". Whatever value may in fact be created has not been disclosed to the Court.

12. In my judgment Mr Kanga's affidavit does not sufficiently describe purpose and effect of the proposed scheme of arrangement to meet the requirement of GCR O.102, r.20(3)(a). It is reasonable to infer that OPII's only two shareholders and its ultimate beneficial owners must in fact know the true commercial reason for presenting this Petition, but the Rules require that the *Explanatory Statement* must itself contain all the information reasonably necessary to enable shareholders and creditors to make an informed decision about the merits of the proposed scheme. The Rules require transparency. It is not sufficient that the ultimate beneficial owners probably do understand from other sources what is really intended to be achieved by this scheme of arrangement. In my judgment this *Explanatory Statement* fails to meet the requirement of GCR O.102, r.20(4)(e).

13. As regards the requirements of O.102, r.20(3)(b) and (c), Mr Kanga's affidavit states (at §21) that OPII has just two registered shareholders. He says that both shareholders are "companies registered in the British Virgin Islands". In spite of the fact that Mr Kanga is both a director of OPII and its company secretary, his affidavit tends to give the impression that he knows very little about its ultimate beneficial ownership, which cannot possibly be true. He says (at §11) that I,000 shares have been issued, but I am not told how many have been issued to each shareholder. The spilt between the two shareholders might be 50%/50%. It might be 99%/1%. I am not told whether these two BVI companies are mutual funds, family investment holding companies or mere custodians or nominees. If one or other of them are custodians, I might have to consider whether or not it would be appropriate to give directions under GCR O.102, r.20(6). Mr Kanga

goes on to propose that the scheme meeting should be held at his office in Geneva, because he "understands" that "the management" of one company is based in Switzerland and the other in Gibraltar. He does not indicate why he thinks that Geneva is more appropriate than Gibraltar. If Mr Kanga is in fact "intimately acquainted with the affairs" of OPII as alleged in his affidavit (§1), I would not only expect him to know who owns the company, but I would expect him to have a direct line of communication with the principals of these two BVI companies. I would expect him to have discussed this scheme of arrangement with them and I would expect him to know in advance whether or not they support his proposal. It may well be that the matters contemplated by the Rules are irrelevant in this particular case because the ultimate beneficial owners of these two BVI companies in fact know exactly what is going on and why this petition is being presented. But this would miss the point. The Court and the creditors are also entitled to know what is going on. The Rules require transparency. This is an *ex parte* application and the Petitioner has an obligation to make a full and frank disclosure of all material information. In my judgment, Mr Kanga's affidavit does not constitute a full and frank disclosure and does not comply with the requirements of O.102, r.20(3)(b) and (c).

14. It is also important to note that this scheme of arrangement is presented to the Court as a shareholders' scheme, as opposed to a creditors' scheme. The creditors of OPII are not parties to the scheme, with the result that the Court is not being asked to convene a creditors' meeting. Nevertheless, the creditors (including the deferred creditors, any contingent creditors and claimants) have a real interest because the effect of the proposed scheme (and any necessary orders under Section 87) is that they will become creditors of a different company. Two consequences follow. First, the creditors should have the right to be heard on the Petition. Second, the *Explanatory Statement* should disclose the information reasonably necessary to enable them to determine whether or not this amalgamation will have any prejudicial effect upon. They should have the information necessary to enable them to determine whether or not they need to exercise their right to be heard. For the reasons already explained, this *Explanatory Statement* fails to meet this criteria.

15. The *ex parte* summons quite properly seeks a direction (in §14) that the Petition be advertised. It proposes advertisement in the Gazette (presumably as a matter of record) and in the international edition of the *Wall Street Journal.* Mr Kanga's affidavit (§21) actually proposes that the Scheme Meeting be advertised in this way. Advertising the Scheme Meeting is not the same thing as advertising the Petition. Given that there are only two shareholders with whom Mr Kanga must have a direct line of communication, I assume that the statement made in his affidavit is a

mistake and that it is really proposed to advertise the hearing of the Petition for the benefit of creditors on the assumption that there will be direct communication with the two shareholders. It follows that the advertisement should be done in the manner most likely to bring the Petition to the attention of creditors. Whilst there can be no harm in advertising in the *Wall Street Journal* (apart from its very high cost), it seems to me that it would be more useful to advertise it in a business newspaper having a national circulation in Pakistan or a local circulation in Islamabad. However, the absence of credible evidence to support this Petition means that I do not have to make any direction about its advertisement. Suffice it to say that if I had allowed this Petition to proceed, I would not have been satisfied that advertisement in the *Wall Street Journal* alone was appropriate.

16. Counsel's response to the obvious inadequacies of the evidence was to ask for an adjournment. In my judgment this Petition is fatally flawed because it is not supported by credible evidence and the *Explanatory Statement* is positively misleading. It follows that the Petition must be dismissed.

Dated 18th December 2009

The Honourable Mr Justice Andrew J. Jones QC