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Re Kingboard Copper Foil Limited, Civil Appeal No. 24 of 2015 (Judgment dated 24 March 2017)

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The Court of Appeal recently handed down a decision in respect of an unfair prejudice petition pursuant to Section 111 of the *Bermuda Companies Act, 1981* (the "Act") in which the Court of Appeal analysed the issue of whether a failure to negotiate with the minority shareholders amounts to unfairness or oppression under the unfair prejudice regime in Bermuda.

As the Court of Appeal pointed out, this is the first matter in Bermuda in which an unfair prejudice petition succeeded at trial. This forms an unusual context in which to consider the application of the unfair prejudice provision under the Act. This Court of Appeal decision is of particular significance for Hong Kong legal practitioners and senior management of listed companies given approximately 30% of the listed companies in Hong Kong are Bermuda incorporated.

The Petitioner, Annuity & Life Reassurance Ltd., a Bermuda company, together with its non-party parent, Pope Investments LLC, a Delaware company, owns an approximately 10% minority stake in Kingboard Copper Foil Limited (the "Company"). The complaints of the Petitioner are two-fold:

(a) The first limb of the complaint is that the Company has been selling its products to other companies within the Kingboard Group (i.e. the Appellants' group of companies) at preferential rates, and thereby committing what was termed as "transfer pricing" or "preferential transfer pricing" ("Purported Transfer Pricing"). The Kingboard Group had always been the single largest customer of the Company.

(b) The sale of products by the Company to the Kingboard Group constituted "Interested Parties Transactions" which required independent shareholders' annual approval in the Company's annual general meetings under SGX listing rules. The Company had obtained such annual approval until the minority shareholders (particularly the Petitioner camp) vetoed it at the 2011 Annual General Meeting. Accordingly, the Company could no longer sell its products to the Kingboard Group, being its single largest customer. In response to this commercial crisis, a few months after the 2011 Annual General Meeting, the board of directors resolved to enter into a licencing agreement with a third party company, Harvest Resource Management Limited (the "Licence Agreement") under which the Company licensed out its production line to the licensee in return for a fixed licence fee. The second limb of the complaint is that the Licence Agreement was essentially the means by which the Appellants circumvented the Petitioner's (and other minority shareholders') veto rights in respect of "Interested Parties Transaction" under the SGX listing rules.

(c) The First Instance Judge found that the Petitioner failed to establish the Purported Transfer Pricing complaint. There is no appeal from that finding. The focus of the appeal is on the Licence Agreement complaint.

In first instance, the Trial Judge apparently accepted the expert evidence adduced by the Appellants, namely that the Licence Agreement was a response which had some mitigating effect to the Company's financial crisis arising out of the veto by the minority shareholders in respect of the Interested Parties Transaction mandate. However, notwithstanding that finding, the Judge went on to conclude that the carrying out of the Licence Agreement constituted an oppressive act against the minority, because (primarily) it was not implemented “on a transparent basis as a truly interim measure” and that the majority had not “promptly initiated *bona fide* open negotiations” (at [132] of the first instance judgment). This conclusion is significant because it seems to impose a duty to negotiate on majority shareholders to put forward “open negotiations with commercially reasonable proposal” so as to achieve a consensus with the complaining minority.

The Court of Appeal recognized that the veto right under the SGX listing rules given to the minority shareholders had a certain nuclear weapon quality: if the “nuclear button” is pressed, the Company could not sell to the Kingboard Group, being its single largest customer. Substitute customers would be hard to find given, as the Trial Judge found, major market players of copper foil/laminates are often vertically integrated and heavily depend on their “internal” customer/supplier.

The Court of Appeal identified a number of objections to the First Instance Judge’s conclusion that there was unfairness or oppression on the ground of a failure to open or conduct negotiations:

(a) It was both unpleaded and unargued at trial. The Petitioner’s case was that the Licence Agreement was a sham, which was rejected by the First Instance Judge.

(b) There is no authority supporting the proposition that the majority shareholders had a duty to open up negotiations. A determination that there has been unfair prejudice or oppression needs to rest on a principled foundation – see *Latimer Holdings Ltd -v- SEA Holdings NZ Ltd* [2005] 2 NZLR328 at [64]: “against which the commercial world and its advisers can measure conduct”. If there was such a duty, it is necessary to know the nature and extent of that duty. The Court of Appeal found it illogical to impose an obligation to offer something better or marginally better when the Trial Judge at the same time found that the Company was not unfair in carrying out its business (namely, the Purported Transfer Pricing allegation was not proven). That would be likely to prejudice the majority, as it runs the risk of shareholders voting irrationally in order to exert commercial pressure on the majority.

(c) The Licence Agreement is an interim measure in its own terms since it was terminable on a month’s notice.

(d) The Court of Appeal found it difficult to think that there was oppression or unfairness if the negotiations would not have succeeded: the Petitioner apparently had a strong belief that the Company’s affairs had been conducted in an oppressive or prejudicial manner to an extent which triggered an entitlement of relief under the unfair prejudice provisions under the Act. As the First Instance Judge put it, the Petitioner adopted “aggressive tactics designed to achieve a favourable buyout” which were “perhaps counter-productive” (Paragraph 175 of the First Instance Judgment). The Court of Appeal considered that any negotiation would not have resulted in any progress short of a determination by the Court that the Purported Transfer Pricing allegation was unsubstantiated. Given that the First Instance Judge ruled in the Appellant’s favour on the Purported Transfer Pricing point, there is no good ground to hold that the Appellant ought to have been willing to proceed or negotiate on the basis that the Purported Transfer Pricing allegation was accepted.

(e) It is apparent that there has been without prejudice discussion. The First Instance Judge suggested that immediate open negotiations would have removed unfairness. The Court of Appeal rejected such view – it could not see that fairness requires that any negotiations must not be without prejudice, especially when negotiations would usually be on that basis.

This Court of Appeal decision should be welcomed. With respect, the scholarly judgment of the Trial Judge opened up uncertainties to public companies and those advising them as to the extent of the duty to negotiate when minority shareholders adopt a high-risk, aggressive voting tactic in respect of independent shareholders’ mandate or similar situation under the applicable listing rules with an objective to achieving a favourable exit buy-out. Such uncertainties have through this decision been cleared by the Court of Appeal.

Conyers represented the successful Appellants. The Conyers team consisted of Partners Jeffrey Elkinson and Ben Adamson, both based in Bermuda, and Counsel Norman Hau based in Hong Kong.

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