IN THE GRAND COURT OF THE CAYMAN ISLANDS

CAUSE NO: FSD 584 OF 2012

BETWEEN	SETH PINEGAR	PLAINTIFF
A N D	ISOFTSTONE HOLDING LIMITED	DEFENDANT

IN CHAMBERS
BEFORE THE HON. CHIEF JUSTICE
THE 13th DAY OF SEPTEMBER 2013

APPEARANCES: Mr. Tony Heaver-Wren and Ms. Anna Gilbert of Appleby for the Plaintiff

Mr. Nigel Meeson QC and Mr. Michael Mulligan for the Defendant

JUDGMENT

1. The Plaintiff Mr. Pinegar is a citizen of the United States of America and at all material times, a resident of the People's Republic of China (the "PRC").

2. The defendant ("IHL") is a Cayman Islands company whose shares of a class called the American Depository Shares ("ADSs"), are listed on the New York Stock Exchange ("NYSE").

3. IHL is engaged in Information Technology business through its subsidiary companies in China and in other places around the world. iSoftstone Information Technology (Group) Co Ltd ("IITG") which is incorporated in the PRC, is one of those subsidiaries.

4. Mr. Tianwen Liu ("Mr. Liu") is and was at all material times the founder, Chairman and CEO of both IHL and IITG.

5. This action is brought by the Plaintiff against IHL, claiming damages for breach of his employment agreement entered into with IITG; an agreement which includes vested share option agreements provided through IHL. The breach is alleged to have resulted in the loss of opportunity to convert IHL shares (acquired by exercise of options) into ADSs and to acquire and trade those ADSs to which the Plaintiff claims to have become entitled. Alternatively, the Plaintiff claims specific performance of the share option agreements; including the right of conversion to ADSs.

6. IHL counterclaims for the sum of USD1,210,058 said to be due from the Plaintiff as withholding taxes arising from the exercise of certain of the vested share options. This is the amount IHL claims it is liable, as counter party to the share option agreements, to pay to the Revenue of the PRC and for which it is entitled to be indemnified by the Plaintiff.

7. On 13 September 2013, I heard competing applications: that by the Plaintiff to strike out IHL's counterclaim and a cross-summons by IHL for summary judgment on its counterclaim, in the event the Plaintiff's strike out application fails.

8. The basis of the Plaintiff's strike out application can be described briefly in terms of his summons: it is that the court has no jurisdiction to entertain IHL's counterclaim and/or that the counterclaim is not justiciable and is an abuse of process, being a claim for the enforcement indirectly in this jurisdiction of the revenue law of a foreign state.

9. IHL's cross- summons for summary judgment would proceed on the basis that barring the strike out application, the Plaintiff would have no prospect of a successful defence to its counterclaim.

10. It follows that I should deal first with the Plaintiff's strike out application, turning next to IHL's summary judgment application, only if the Plaintiff fails to strike out IHL's counterclaim.

Background to the Plaintiff's claim

11. According to his Amended Statement of Claim, in or around May and June 2008, the Plaintiff had discussions with Mr. Liu regarding possible employment: specifically this was about assisting IHL with mergers and acquisitions; with pre-initial public offering fund raising; attending meetings of the Board of Directors and other investor-related events, and to lead its initial public offering intended for listing on the NYSE.

12. The Plaintiff describes himself as an experienced investment banker who was at that time employed to UBS, a major international bank and based in New York. The discussions involved him having to leave UBS and relocate to Beijing.

13. His discussions with Mr. Liu resulted in his engagement from 1 July 2008 to 30 June 2011 with IITG as a Senior Vice President and Head of Corporate Development, based in Beijing. This involved him entering into an Employment Letter of Intent with IITG on the 1 July 2008 and at about the same time, a Labour Contract, in the Chinese language, also with IITG.

14. The terms of his engagement included the incentive of share options, to be exercised over shares in IHL and in keeping with the corporate incentive plans and the terms of specific share option agreements.

15. The first Share Option Agreement was entered into on 20 December 2008 ("the 2008 Agreement"). It granted the Plaintiff 2,176,462 options with respect to shares of IHL

governed by the 2008 Share Incentive Plan ("the 2008 Plan"). The exercise price of the option was USD0.30 per share.

16. Of particular significance to the present action, the 2008 Agreement provided under the heading "Withholding taxes" that:

> *"You will not be allowed to exercise this option unless you make acceptable arrangements to pay any withholding or other taxes that may be due as a result of the option exercise or sale of shares under this option. In the event that the Company determines that any federal, state, local or foreign tax or withholding payment is required relating to the exercise or sale of shares arising from this grant, the Company shall have the right to require such payments from you, or withhold such amounts from other payments due to you from the Company or any Affiliate."*

17. And further that:

> *"The Company has the authority to deduct or withhold or require [the grantee in question] to remit to the Company, any amount sufficient to satisfy applicable national, state, local and foreign taxes arising from this Option Award...."*

18. Two share option agreements were entered into in 2009. By the First 2009 Agreement, the plaintiff was granted 170,000 options with respect to shares governed by the IHL 2009 Share Incentive Plan (the "2009 Plan"). On 1 August 2010, pursuant to the Second 2009 Agreement (and when read with the First 2009 Agreement), the

plaintiff was granted an additional 435,292 options with respect to shares governed by the 2009 Plan.

19. According to the Plaintiff's pleadings, the terms of the First 2009 Agreement, Second 2009 Agreement and 2009 Plan were substantially in form similar to the 2008 Agreement and 2008 Plan, save that:

(1) The exercise price was US$0.50 per option and US$0.65 per option respectively;

(2) The options were "deemed exercised" upon completing the exercise procedures, payment of the exercise price and any applicable withholding tax;

(3) The grantee was given the right to elect to pay relevant taxes by the withholding of shares, the surrender of other shares or cash payment.

20. The Plaintiff avers that in or about early November 2010, Mr. Liu agreed verbally with the Plaintiff on behalf of IHL to accelerate vesting of the Plaintiff's 2008 options. This he says, was agreed in order to compensate him in respect of a short-fall in compensation earlier agreed.

21. Further from those discussions, that it was the understanding of both himself and IHL that following the Initial Public Offering ("IPO"), the shares issued to him pursuant to his options would become tradable on a stock exchange. That this represents normal practice in an IPO and was necessary to give value to the options granted to him as remuneration and incentive for his employment.

The IPO and exercise of the 2008 options

22. On or about 14 December 2010, IHL completed its IPO of ADSs which thus became listed on the NYSE: "NYSE:ISS".

23. The IHL ADSs traded on the NYSE are governed by a Deposit Agreement dated on or about 14 December 2010 between IHL and JP Morgan Chase N.A. ("JPM") as Depository and Holders of ADSs from time to time (the "Deposit Agreement"). The Deposit Agreement is governed by New York law.

24. Pursuant to clause 3 of the Deposit Agreement, upon a deposit of IHL shares, JPM would then issue ADSs in the form attached to the Deposit Agreement (at a rate of one ADS for each ten (10) ordinary IHL shares).

25. However, shares issued or to be issued to management of IHL and its affiliates were subject to a 180 day Lock Up period following the IPO, during which such shares could not be traded. This Lock Up period ended on 10 June 2011.

26. The Plaintiff avers to having received on 4 May 2011 an email sent to option-holder employees by Linda Tang - then head of IHL's Legal Department - introducing them to Computershare, a web-based application IHL had produced to allow employees to be able to exercise options and automatically sell shares, following the conversion of shares to ADSs and following expiration of the IPO Lock Up. The e-mail included an individualized log-in and password.

27. The Plaintiff avers that on 10 June 2011, he received a group email from Ms. Tang informing him that he would be able to sell his shares commencing 13 June 2011 (in the form of ADSs) and he would be required to conform to the Insider Trading Policy attached to the email.

28. Notwithstanding his preference for ADSs upon exercise of the 2008 options when he had elected to do so on 12 January 2011, the Plaintiff had then been advised by

another of IHL's lawyers (a Ms. Lv), that although he would be allowed to exercise the options, no ADSs would be issued during the Lock Up period.

29. Accordingly, on or about 24 January 2011, the Plaintiff wired the sum of USD489,718.92, of which all but USD20 (viz: USD489,698.92) was received by IHL on or about 9 February 2011. His notice of exercise was hand-delivered to Ms. Lv, and, as required for due diligence purposes, IHL had a copy of his passport on file. A reference letter was also provided in respect of him by IHL's United States lawyers, thus completing all formalities as far as he was concerned.

30. In confirmation of his exercise of the 2008 options, on 15 February 2011 the plaintiff was sent a share register for IHL showing that he had been issued 1,632,346.00 ordinary shares in IHL (the "2008 Shares").

31. According to the Plaintiff, in issuing shares to him, IHL did not raise any concern about withholding taxes (as it might have done as referred to under the heading in the 2008 Agreement: "Withholding taxes", above at paragraphs 16 and 17).

Exercise of the 2009 options

32. Between 16th – 18th May 2011, the Plaintiff attempted to exercise 85,000 vested options from the First 2009 Agreement by tendering his Notice of Exercise and payment in the amount of USD42,500. He was informed that USD42,480 was received – apparently the result again of USD20 having been taken as the wire transfer fee. He was also told of a shortfall – albeit only of USD5 – in respect of the payment for the 2008 options and required to make good the USD25 combined shortfall. This he avers he sought to do by offering a deduction from his June 2011

salary and so, by latest 29 June 2011, he had paid and/or tendered the full amount payable on exercise, not only of the 2008, but also of the 2009 Options as well.

33. On that basis, IHL having failed to issue his 85,000 shares, he claims that it is also in breach of the First 2009 Agreement. Alternatively, IHL ought to have issued the number of shares for which the price was tendered and so, in breach of the First 2009 Agreement, IHL has failed by latest 29 June 2011 to issue 84,960 shares (being 85,000 shares less 40 shares at $0.50 per share, totaling USD20 – the alleged related shortfall).

Further Consulting Agreement

34. The Plaintiff avers that having tendered his resignation from IITG on 7 May 2011, he and Mr. Liu entered into further discussions which resulted in his re-engagement to provide consulting services to IITG on certain projects. He would not be compensated for those services (apart from reimbursement of expenses) but that IHL would deliver over the share certificates for the exercised 2009 options; vesting of the options in respect of 108,823 shares under the Second 2009 Agreement would be accelerated and the 2008 Shares (already issued) and 2009 Shares (once issued) would be converted to ADSs for trading on the NYSE.

35. The Consulting Agreement was entered into around 6 July 2011 and provided for the Plaintiff to provide services to IITG for the period 1 August 2011 – 31 August 2011.

36. On 24 June 2011, the Plaintiff had sent the share certificates for 1,632,346 IHL shares to his brokers at UBS and requested that those be converted to ADSs.

37. However, in breach of the Consulting Agreement, IHL failed to deliver the share certificates for the exercised 2009 options and failed to procure or to allow the 2008

(or 2009) shares to become tradable on the NYSE. Furthermore, for the reason of IHL's breaches, the Plaintiff did not seek to exercise the accelerated options under the Second 2009 Agreement as should have been allowed by the Consulting Agreement.

Taxation

38. The Plaintiff alleges that between 18 July and 23 December 2011 he had numerous conversations with IHL's lawyers and Mr. Liu directly, in which he requested that his shares be made tradable and that his exercise of his 2009 options be given effect. During these conversations:

    (1) He was told that there were issues in relation to taxation, but despite repeated requests he was not told how much tax had actually been assessed as due, when it was payable, to whom, or how it should be paid;

    (2) Despite this lack of information, he was told that his 2009 Shares would not be issued and all shares not made tradable until he agreed that the proceeds would be used to pay whatever tax might be due; and

    (3) He asked for the 2009 Payment to be returned to him but it was never refunded.

39. It is germane to the Plaintiff's claim and he alleges that the issues of taxation relied upon by IHL cannot be justified by reliance on the terms of the 2008 Agreement (under the head of "Withholding taxes", above) and its failure to issue and convert shares under the 2008 and 2009 Agreements are unjustified and not given in good faith. His Statement of Claim elaborates upon this at paragraph 49.

40. In the result and as the consequences of IHL's breaches, he claims damages calculated on the basis of the price per ADS at which he would have been able to trade them had the breaches not occurred (viz: at the high of USD16.00 per ADS).

41. As the 2008 shares held by him have still not been made tradable (by reason of IHL's breach) he claims still to be unable to sell them at the ADS price current at the time of his pleadings – USD4.72 per ADS – and therefore gives no credit for their value.

42. In the premises, the Plaintiff claims to have suffered loss of USD2,921,870.40 (calculated as 1,632,346 + 85000 + 108823 shares at USD16.00 per ADS or per 10 IHL shares) together with interest thereon.

43. It is against this claim for USD2,921,870.40 that the Amended Defence and Counterclaim of IHL avers that IHL is entitled (in the words of the 2008 Agreement) "*to deduct or withhold, or require [the Plaintiff] the grantee in question to remit to IHL an amount sufficient to satisfy applicable national, state, local and foreign taxes arising from this Option Award...*"

44. According to paragraph 49 of IHL's Defence and Counterclaim, that amount is USD1,210,058. It is however, prepared to give the Plaintiff credit for the USD42,480 paid by him in purported exercise of the vested share options under the First 2009 Agreement, for a net counterclaim amount of USD1,167,578.

45. At paragraph 29 (d) IHL avers that this amount is determined by it having taken PRC tax advice and from queries with "the relevant tax authorities". The advice received is that under PRC laws, such withholding taxes became payable upon the Plaintiff's exercise of the share option and upon the issuance of the ordinary shares to the Plaintiff under the 2008 Agreement.

46. Thus, the 2008 Shares are the real focus of the Counterclaim.

47. In so far as they are the subject of the amount of tax requested –USD1,167,578 - the 2008 Shares are also the focus of IHL's summary judgment application by which it claims a contractual entitlement to that "Requested Amount."

48. IHL's present applications are supported by an affidavit by Mr. Zhang Xiaosong, its Chief Financial Officer. He exhibits to his affidavit a legal opinion issued by Han Kun Law Offices based in Beijing; and upon which he relies as showing that IHL has a reasonable, legitimate basis to have made the determination of the withholding taxes payable as the Requested Amount.

49. At paragraph 3.3, the Han Kun opinion states that with respect to the withholding obligations in particular, IHL as the "Implementing Entity" is responsible for (i) filing, on behalf of its grantee/employee the Plaintiff, the Individual Income Tax ("IIT") return, (ii) withholding taxes due on the exercise of the options, and (iii) payment of such taxes to the tax authorities. That those taxes shall be paid in accordance with IIT deadlines, ie: within 7 days from the end of the month during which the income was received, pursuant to the IIT Law then in effect at the time of the 2008 exercise (ie: 7 days from the end of January 2011).

50. The opinion is further expressed that IIT was payable on all of the Plaintiff's taxable income, being not only his salary and the value of the IHL ordinary shares received, but also their value as calculated based upon the closing price of ADSs on the exercise date on 18 January 2011; viz: USD20.65 per ADS.

51. As IIT is said to have been then payable at 45%, the IIT payable on the Exercise Income is opined to be USD1,295,214.14 – some USD85,000 more than the Requested Amount claimed in the Counterclaim.

52. In his defence and reply to the IHL counterclaim, the Plaintiff will rely upon a contradicting opinion from the Zhong Lun Law Firm based in Shenzhen. Rendered in Mandarin, it appears from an English translation that the Zhong Lun opinion in summary is as follows:

> *"In a nutshell, our lawyers are of the opinion that the Han Kun Memorandum has made error not only on the determination of the time arising taxation liabilities (exercise day), but also on the calculation of the taxable amount. It is suspected that it probably has distorted on the interpretation of the law and has cast burden on Seth's (the Plaintiff's) taxation liabilities".*

The **basis for the strike out application**

53. The present task does not require me to resolve the factual merits of the case on the disputed facts presented by the Plaintiff and IHL, either as the disputed facts arise out of the circumstances of the case or out of the differences of opinion on PRC tax law[1].

54. There is however, a narrow question of fact that arises now for consideration on the Plaintiff's application to strike out the Counterclaim: it is whether the Counterclaim is in fact and substance designed to give extra-territorial effect to PRC tax laws. On the facts of this case, the question is whether IHL is acting as or for the withholding agent, or nominee, of the PRC tax authorities by asserting a claim which in form

[1] It is settled principle that questions of foreign law are to be treated as matters of fact for determination by the court. See, for instance, TMSF v Wisteria Bay Ltd 2007 CILR 310 at 315

arises as a matter of contract with the Plaintiff but in substance is a claim for payment of PRC taxes being pursued on behalf of the PRC tax authorities.

55. The evidence about this, which the Plaintiff says can be construed only as leading to the conclusion that IHL is in fact acting as agent or nominee of the PRC, comes from IHL itself in the form of paragraph 10 of Mr. Xiaosong's affidavit where he states:

> *"The relevant individual income tax has not been paid. (IHL) is in the course of liaising with the tax authority in the PRC separately with a view to resolving this issue in an amicable manner. These are the Company's own affairs. It is noteworthy that the Plaintiff's failure to pay the Requested (Amount) to IHL leads to its own exposure of late payment interest and fines (ranging from one-half to three times of the unpaid tax amount as stated in the (Han Kun) opinion".*

56. In this regard that the Han Kun opinion (as set out above at paragraph 49-51) is clearly to the effect that the tax reporting and withholding obligations under PRC tax laws are imposed upon IHL as the "Implementing Entity" of the Option Plans. The opinion goes on to explain further that when filing the IIT return, IHL is required to report to the competent tax bureau the details of stock subscription or transfer (including type of stock, quantities, granting price, exercise price, market price, transfer price, etc).

57. And further, that in case the Implementing Entity fails to withhold and pay taxes, or to report the implementation of the plan or the exercise of the option, penalties may be levied in accordance with PRC tax law. Notably, delayed payment of taxes may trigger late payment interest at the rate of 0.05% of the unpaid tax amount for each

day of delay, and late submission of information may be subject to fines up to RMB 10,000. In case of non-payment by the Implementing Entity, the taxpayer himself (in this case the Plaintiff) may be ordered to pay the tax and the late payment interest and the Implementing Entity may be subject to a fine ranging from 50% to three times the unpaid tax amount.

58. The Han Kun opinion concludes on this aspect that IHL (by its PRC affiliates) should be responsible to withhold the IIT in relation to the 2008 Option exercise and pay the IIT to the relevant PRC tax authority.

59. The Zhong Lun opinion does not seek to contradict the Han Kun opinion as to whether or not IHL (or its affiliates) should be regarded as the Implementing Entity and so, as to their liability to ensure payment of the withholding taxes.

60. Instead, the Zhong Lun opinion focuses on the question whether the liability to tax had in fact arisen and the possible extent of that liability in the circumstances where the IHL shares had not yet been allowed to be converted to ADSs, concluding as follows (at page 3 of 4):

> *"In this case, the "exercised shares" nominally held by (the Plaintiff) had never been registered with a securities and custody organization abroad, ie: the NYSE, therefore, according to the requirements of the PRC laws, taxation liabilities for (his) incomes from share option shall not be arisen (sic)....*
>
> *Our lawyers are of the opinion that since the incompletion of the exercise of (the Plaintiff's) right to (IHL's) share option(s), the taxation liabilities for individual income taxes from individual share options as required by the PRC*

laws have not been actually arisen. So, the calculation of the payable tax amount is senseless. In other words, though, according to the opinion of Han Kun's lawyers, (the Plaintiff's) liabilities to taxation have already arisen, the calculation of (his) payable tax amount is also wrong."

61. Given the specific bases of disagreement, it appears that there is no real debate between the experts on PRC law over whether or not IHL would be liable as Implementing Entity for withholding taxes in the event there is a real liability to tax arising from the incidence of either the actual transfers of IHL shares to the Plaintiff or from the purported exercise of the 2008 Options or First 2009 options, by the Plaintiff.

62. On the basis of the unrefuted evidence put before me by IHL, I am therefore, at this stage obliged to proceed on the basis, at the very least, that there is a good arguable case that that might be so.

63. At this stage, I am obliged to take this view of the case, notwithstanding the attractive, commonsensical tone of the Zhung Lun opinion that – the IHL shares not having yet been converted to ADSs – "*the calculation of the payable tax amount is senseless*". The question of the incidence of taxation is a factual issue that can be resolved properly only at trial and is the important factual issue that would go to determine the extent, if any, of the liability for withholding taxes.

64. On a strike out application where disputes of fact may not properly be resolved, I must proceed on the basis that IHL could arguably be liable as the Implementing Entity.

65. This preliminary conclusion also sets the context for the consideration of the further question whether IHL genuinely counterclaims in contract – relying on its right to indemnity - or whether, in substance if not in form, it really acts as nominee or agent of the PRC tax authorities.

66. I recognize in this context, the Plaintiff's criticisms and concerns over the opacity of IHL's dealings with the PRC tax authorities. Mr. Xiaosong's terse and cryptic statement that IHL "*is in the course of liaising with the tax authority in the PRC*" without any explanation as to the details of those discussions, will certainly require of full disclosure if the matter must go to trial. Apart from anything else that might be relevant, the Plaintiff will certainly be entitled to know to what extent if at all, IHL will have admitted to a liability to withholding taxes on its own behalf as a consequence of its dealings with the Plaintiff. Only to the extent such a liability properly exists or is admitted, could IHL be entitled to a contractual indemnity from the Plaintiff.

67. But as things stand, in the absence of evidence to the contrary, the test established by GCR Order 18 rule 19[2] for striking out IHL's counterclaim has not been met. Specifically, it has not been shown to the necessary clear standard, that there is not or could not be under the contract, a valid indemnity which IHL can enforce against the

[2] Which provides that the court may at any stage of the proceedings order to be struck out or amended any pleading or the endorsement of any writ in the action, or anything in any pleading or in the endorsement on the ground that: a) It discloses no reasonable cause of action as the case may be; or b) It is scandalous, frivolous or vexatious; or c) It may prejudice, embarrass or delay the fair trial of the action; or d) It is otherwise an abuse of process of the Court;
and the Court may order the action to be stayed or dismissed or judgment to be entered accordingly, as the case may be.
Here the Plaintiff relies on rule 19(a), asserting that the counterclaim discloses no reasonable cause of action and is therefore clearly non-justiciable, citing *Barnett Ltd. V Kerr-Jarrett (1980-1983) CILR n. 1.* Alternatively, that it is an abuse of process and so should be struck out under rule 19 (d) or in exercise of the Court's inherent jurisdiction, citing: *RBC et al v Thai Asia Fund Ltd. 1996 CILR 9*

Plaintiff and that IHL is instead, in reality and substance, acting at the instigation of the PRC tax authority for the purposes of the direct or indirect enforcement its revenue laws in this jurisdiction.

Applicable law

68. The following discussion of the applicable law, largely in agreement with the submissions on behalf of IHL, will serve to explain my foregoing conclusions.

69. Dicey, Morris & Collins, "*The Conflict of Laws*" 14th Edition states that direct enforcement of a foreign revenue (or other penal) law occurs when a foreign state or its nominee seeks to obtain money or property, or other relief, in reliance on the foreign revenue (or penal) rule in question.[3] By contrast, indirect enforcement occurs (i) where the foreign state (or its nominee) in form seeks a remedy which is not based on the foreign rule but which in substance is designed to give it extraterritorial effect, or (ii) where a private party raises a defence based on the foreign law in order to vindicate or assert the right of the foreign state[4].

70. An example of the former type of indirect enforcement is the *Peter Buchanan Ltd* case (fn 4), in which a Scottish company in liquidation sought to recover from one of its directors in Eire assets under its control which the liquidator (appointed by the Scottish court at the instance of the Scottish revenue authorities) would use only for the purposes of satisfying that State's claim for taxes due from the company. This

[3] Op cit, pg 102 para 5-023; citing *Brokaw v Seatrain UK Ltd [1971] 2 Q.B. 476, 483 (CA)*; *Att- Gen. of New Zealand v Ortiz [1984] A.C. 1 (CA)*, per Ackner L.J., affirmed on different grounds: *Williams & Humbert Ltd v W&H Trademarks (Jersey) Ltd [1986] A.C. 368, 467*

[4] Op cit, pg 103, para 5-025; citing *Peter Buchanan Ltd v McVey [1954] I.R. 89, [1955] A.C. 516n* (as explained in *Williams & Humbert Ltd v W&H Trademarks (Jersey) Ltd* (above)

was found by the Irish court to be an impermissible attempt at direct enforcement of a foreign revenue law.

71. On the other hand, *Williams & Humbert* (fn 3)) is an example of the court's willingness to overlook the involvement of the foreign State where indirect enforcement was alleged. There the Spanish Government expropriated by decree shares in various Spanish companies, and appointed new directors to those companies and to their English subsidiaries. The new directors commenced action in England in the name of their respective companies to recover assets which were held by former shareholders and alleged to belong to their companies. The House of Lords held that the action was not an indirect enforcement of the Spanish decree which had already taken effect as a matter of law in Spain entitling that State to take control of the companies. The action was therefore regarded as designed to vindicate the rights of the plaintiff companies, not directly or indirectly to satisfy claims by the Spanish State.

72. The contrasted outcomes from the circumstances of those two well settled cases, is illustrative for present purposes: they mark the different treatments given to a claim which in substance (even if not in form) sought indirectly to enforce the foreign revenue law and one which sought in substance to vindicate private rights even if the instigator and an ultimate beneficiary was a foreign state.

73. This difference of approach is deemed not to be inconsistent with the centuries old principle as recognized and restated in *Government of India v Taylor*[5] - that the courts do not enforce foreign revenue laws because tax gathering is distinct from matters of private contract and is a matter of authority and administration between a state and

[5] [1955] AC 491, 514

those within its jurisdiction. Accordingly, the courts will not enforce foreign revenue laws nor judgments based on foreign revenue claims[6].

74. As declared by Tomlin J, in *Re Visser*[7]:

> *"...[T]here is a well recognized rule, which has been enforced for at least 200 years or thereabouts, under which these courts will not collect the taxes of foreign states for the benefit of the sovereign of those foreign states."*

75. Longstanding as it is, the limitations upon the rule which will recognize the difference between a private and state interest behind a tax related claim, have been developed in the case law and are now just as recognized as the rule itself. As Lord Mackay of Clashfern declared in *Williams & Humbert v. W & H Trademarks (Jersey) Ltd*[8] :

> *"No countenance was given in Government of India v Taylor*[9]*, in Rossano's case [1963] 2 Q.B. 352 nor in Brokaw v Sea Train U.K. Ltd (above) to the suggestion that an action in this country could be properly described as the indirect enforcement of a penal or revenue law in another country when no claim under that law remained unsatisfied. The existence of such unsatisfied claim to the satisfaction of which the proceeds of the action will be applied appears to me to be an essential feature of the principle enunciated in the Buchanan case [1955] A.C. 516 for refusing to allow the action to succeed."*

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[6] *Dicey*, op. cit, para 5-029.
7. *[1928] Ch 877, 884*
[8] Ibid, at page 441
[9] *[1955] A.C. 491*

76. In the relatively recent case of *Wahr-Hansen et al v Compass Trust et al*[10] Henderson J, after a comprehensive review of the case authorities, accepted as a matter of Cayman law, that for the "tax gathering" defence to prevail against a claim on the basis that it seeks directly or indirectly to collect taxes on behalf of a foreign state, the following three elements must be present (as summarized from the head note):

1. There has to be an unsatisfied tax claim;
2. The entire proceeds of the litigation must be payable or recoverable to the foreign revenue authority. A claim initiated to benefit ordinary creditors could not be seen as an extension of a sovereign power;
3. The claim must be, in substance, an attempt to collect foreign tax. The court had to consider the substance, not the form, of the proceedings and would not entertain a claim that involved, even indirectly, the enforcement of a foreign revenue law, albeit that the claim might be wholly private in nature.

77. Additional qualifications upon the tax gathering defence were proposed but not wholly accepted by Henderson J. Among those was the proposition that the foreign state had to be shown to be "in control" of the impugned litigation.

78. This notion is however, relevant to the present case where the Plaintiff asserts that from the admitted "liaison" between IHL and the PRC tax authority, it is to be inferred that IHL has admitted to a tax liability which remains unpaid and therefore acts under the control of the PRC in this action as a nominee or agent, seeking to recover the amount of the admitted, but as yet unpaid, taxes.

[10] Full citation: *Wahr-Hansen, Andres Jahre Rederi As and Bridge trust Company Limited v Compass Trust Company and Fourteen Others [2007] CILR 55*

79. In this regard Henderson J. observed[11] that the question of control can be an important one, but it is subsumed in the third element – is the claim in substance an attempt to collect foreign tax? Accordingly, evidence that a claimant was acting as a "puppet" of the foreign taxing authority would support a finding that the claim was an attempt to collect tax.

80. That question, as it arises in this case, on the basis of the conclusion at which I have arrived, must be left for examination on the evidence at trial.

81. Henderson J. went on to conclude that notwithstanding that the plaintiff Wahr-Hansen had been appointed by the Norwegian court as administrator at the instance of the Norwegian state to trace the assets of the estate to meet tax liabilities, as there were other beneficiaries of the estate, the action was not to be dismissed simply as an attempt by the Norwegian state to collect tax. The claims were proprietary in nature against third parties owing fiduciary obligations to the estate and it was not necessary to consider any aspect of Norwegian tax law in order to resolve them. Further, that notwithstanding the circumstances of his appointment, the plaintiff Wahr-Hansen was not in the effective control of the Norwegian tax authority but of the Norwegian court as its appointee and therefore was not acting as the nominee of the Norwegian tax authority. In those circumstances, it was concluded that it would be a "significant extension" of the tax-gathering defence to conclude that the claim was an attempt to collect foreign tax.

82. In *Marada Global Corporation v Marada Corporation and Others*[12], Harre CJ held that the question whether a claim to be enforced in the Cayman Islands involved the

[11] Op cit at paras 91-93
[12] [1994-95] CILR 546

assertion of foreign sovereignty was to be decided under Cayman law (not that of the putative foreign State) and such determination would depend on the context of the case as a whole. It was reaffirmed that the Cayman courts would decline to exercise jurisdiction if asked to enforce a foreign penal or revenue law, directly or indirectly. Based on the facts before him, Harre CJ concluded that as the plaintiff's claim was initiated by a corporation (and not a foreign State) in respect of rights available to any private litigant and did not seek to enforce a penal power of a foreign State, the application to strike out the claim would be refused.

83. *Re Reid*[13] concerned a case in which a trustee who had offices in England and British Columbia, was liable in England to pay certain estate duties incidental to a trust estate. The estate was being administered in both jurisdictions. The assets in England were insufficient to satisfy the estate duties there and so the trustee was obliged to make up the difference and sought to be reimbursed from the assets in British Columbia. A remainderman under the will objected on the ground that acquiescence would involve the enforcement, directly or indirectly, of a foreign revenue law. The British Columbia Court of Appeal rejected that argument, recognizing that the English Treasury would not be affected whether or not the trustee was indemnified: the trustee had been required to pay the duty in any event and had already done so. Its action for an indemnity was therefore neither in substance nor in form an effort to enforce a foreign tax and the foreign State had no interest in the outcome of the proceedings.

84. IHL claims to be in a similar position here: an obligation in any event to pay the withholding tax to the PRC will put it in the position of seeking an indemnity from

[13] [1971] 2 W.L.R. 121

the Plaintiff on its counterclaim at trial. I accept for present purposes, that whether or not it is in that position, will be a matter of fact to be decided at trial.

85. Finally, *Tullow Uganda Ltd v. Heritage Oil and Gas Ltd and Anor*[14] is a very recent illustration of the principle that where a party contracts to indemnify another party where the other becomes liable for the indemnifer's foreign tax debts, the court will only concern itself with construing the indemnity clause and will not concern itself with whether there was an incidental enforcement of a foreign tax.

86. The defendant had agreed to sell its 50% interest in a licence for petroleum exploration in Uganda to the claimant:

a) Under the Share Purchase Agreement, Article 7.2 provided that the payment of "non-transfer taxes" would be the responsibility of the defendant, which included capital gains tax. It also provided that if any "non-transfer taxes" were charged to the claimant, then the defendant would be liable to indemnify an amount equal to the taxes to the claimant.

b) The Uganda Tax Authority ("UTA") assessed USD 313 million as the taxes payable on the transfer of the licence but the defendant, as the transferor, disputed the liability. On pain of forfeiture of the licence, the claimant eventually paid the taxes and, when reimbursement was refused, sued the defendant relying on the indemnity in clause 7.2.

c) The action was brought in England pursuant to the contract and the court concerned itself only with ascertaining whether or not the tax liability was due under Ugandan law and with construing the indemnity clause to determine whether the claimant could rely on it; concluding that as the claimant believed

[14] [2013] EWCH 1656

that the notices were valid and paid the taxes on the basis of that belief, it was entitled to be indemnified by the defendant.

87. The foregoing examination of the case authorities supports IHL's proposition in this case that if the withholding taxes must be paid to the PRC, an indemnity in favour of IHL could well arise to cover any anticipated loss as the result of IHL having to make those payments.

88. It is therefore arguable that IHL would be entitled to be indemnified in respect of sums which it has personally been compelled to pay abroad in the PRC in satisfaction of that foreign government's claim, even though the claim itself may be unenforceable in the Cayman Islands: see in *Re Reid* (above)[15].

IHL's summary judgment application

89. It follows that I may not, at this stage, accede to IHL's summary judgment application in its counterclaim.

90. On the basis of GCR Order 14 r.5(1), before I might grant summary judgment on a counterclaim, I must be satisfied that the Plaintiff (as defendant to the counterclaim) has "*no defence to a claim made in the counterclaim, or to a particular part of such a claim*".

91. The purpose of an application under O.14 4.1 or 4.5 is to enable a plaintiff (or defendant in the case of a counterclaim) to obtain a quick judgment where there is clearly no defence to his claim: *Home Ins. v Mentor Ins. [1989] 2 All. E.R. 74.* As a result, the burden that must be satisfied by an applicant is very strict and has deep jurisprudential roots: in *Jones v Stones [1894] AC 122*, the House of Lords held that

[15] Cited in *Dicey, Morris & Collin's* op. cit, p103 at para 5-024 on this point as in *Re Lord Cable [1977] 1 W.L.R. 7.15.*

summary judgment is *"intended only to apply to cases where there can be no reasonable doubt that a plaintiff is entitled to judgment and where therefore, it is inexpedient to allow a defendant to defend for mere purposes of delay".*

92. These principles have found expression in Cayman law by the adoption by this Court[16] of a two part test:

(i) Is what the defendant says credible?; and

(ii) Has he shown that there is a fair and reasonable probability that he has a real bona fide defence?

93. And further, of direct relevance to circumstances like the present, by the Court of Appeal in *Merren v Cayman National Bank*[17]; where at page 434 Vos J.A. stated that:

> *"The proper approach to an O.14 application, where there is conflicting or competing affidavit evidence, was settled in England in National Westminster Bank plc v Daniel [1993] 1 W.L.R. 1453 in which Glidewell, LJ reviewed the history and concluded by applying the dictum of Ackner, LJ in Banque de Paris et des Pays-Bci (Suisse) S.A. v Costa de Naray [1984] 1 Lloyd's Rep. 21 where he said at page 23:*
>
> > *"It is of course trite law that O.14 proceedings are not decided by weighing the two affidavits. It is also trite that the mere assertion in an affidavit of a given situation which is to be the basis of a defence does not ipso facto, provide leave to defend; the court must look*

[16] In *Zuiderent v Christiansen 2004-05 CILR Note 23; Rankin v Scott & Others 2008 CILR Note 9.*
[17] *2008 CILR 428.*

at the whole situation and ask itself whether the defendant has satisfied the Court that there is a fair or reasonable probability of the defendants having a real or bona fide defence."

94. Here the dispute joined between the Plaintiff and IHL involves questions of PRC tax law that will need to be resolved, with the assistance from expert witnesses. On the basis of the foregoing dicta, such matters are not appropriate for determination by summary judgment. Indeed, specifically and as noted above at fn 1, the local case law states that if there is a triable issue involving foreign law, expert evidence of the foreign law constitutes a matter of fact for determination of the court which should not be resolved on the basis of affidavit evidence alone but only after full enquiry upon the evidence[18].

95. IHL's application for summary judgment on its counterclaim does not satisfy the test for summary judgment under O. 14 as there are substantive questions to be resolved concerning the construction of the Option Agreements, the right of IHL to seek to presently enforce provisions of those agreements (even if they are to be construed as they contend) and important questions about tax law in the PRC.

96. The Plaintiff also raises further objections to the counter-claim as a claim in equity for specific performance of the Option Agreements. He argues in this context that IHL does not come to equity with clean hands because it must rely on its own failure to act in accordance with the employee Options Plans, failing to allow him to convert his shares to ADSs even while causing the shortfall which it alleges on its own case,

[18] And see further, *TMSF v Merril Lynch Bank & Trust Co. (Cayman) Ltd. 2009 CILR N. 15.*

between the alleged taxes and the actual present value of the shares[19]. Accordingly, even if IHL ultimately proves it is entitled to payment in the amount of the counterclaim, the Plaintiff says he should be entitled to set-off his claim against the counterclaim, and so no award should be made on the counterclaim until his claim to damages has been determined. These too, are matters to be resolved at trial.

97. The strike out and summary judgment applications are both refused.

98. Having gone into the issues of this case in some detail in this judgment, I feel obliged to express the view that the case is one clearly suitable for settlement by compromise. The parties should make best efforts to that end.

99. Costs of the applications are reserved

Hon. Anthony Smellie
Chief Justice

March 7, 2014

GRAND COURT CAYMAN ISLANDS

[19] Citing *Chappell v Times Newspaper Ltd. [1975] 1 W.L.R. 482* where Lord Denning MR declared on behalf of the Court of Appeal (at 502): *"It has long been settled both at common law and in equity that in a contract where each has had to do his part concurrently with the other, then if one party seeks relief, he must be ready and willing to do his part in it." See also Lamare v Dixon (1873) LR 6 HL 414.*