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DATE: October 25, 2005

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RE: Petrokazakhstan Inc. v. Lukoil Overseas Kumkol B.V. - Action No. 0501 13439

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Court of Queen's Bench of Alberta

Citation: PetroKazakhstan Inc. v. Lukoil Overseas Kumkol B.V., 2005 ABQB 789

Date: 20051025
Docket: 0501 13439
Registry: Calgary

In the Matter of Section 193 of the *Business Corporations Act*, R.S.A. 2000, c. B-9 as Amended

And in the Matter of a Proposed Arrangement Involving PetroKazakhstan Inc., 818 Acquisition Inc. and the Shareholders and Optionholders of PetroKazakhstan Inc.

Between:

PetroKazakhstan Inc.

Petitioner

- and -

Lukoil Overseas Kumkol B.V.

Respondent

Reasons for Judgment
of the
Associate Chief Justice
Neil Wittmann

Introduction

[1] The Petitioner, PetroKazakhstan Inc., ("PetroKazakhstan"), seeks a Final Order approving an arrangement ("the Arrangement") pursuant to section 193 of the *Business Corporations Act*, R.S.A. 2000, c. B-9 ("the *ABCA*"). Lukoil Overseas Kumkol B.V. ("Lukoil") objects to the proposed Order, alleging that it will effectively confiscate or extinguish pre-emption rights it holds under a shareholders' agreement with PetroKazakhstan. Certain shareholders of PetroKazakhstan (representing 16.99% of the total shares), 818 Acquisition Inc. ("818 Acquisition") and CNPC International Ltd. ("CNPC") also appeared on the application in support of the Arrangement.

[2] The Executive Director of the Alberta Securities Commission has been served with notice of this application and has declined to make submissions.

Facts

[3] PetroKazakhstan, an Alberta corporation, is an international energy company engaged in the acquisition, exploration, development and production of oil and gas and the refining and sale of oil and refined products in Kazakhstan. It is publicly traded, widely held and, as of September 8, 2005, 74,035,524 common shares were issued and outstanding. As well, 1,975,287 options were outstanding as of August 18, 2005.

[4] On August 21, 2005 PetroKazakhstan entered into an agreement with CNPC, a Cayman Island corporation and a wholly owned subsidiary of China National Petroleum Corporation, to effect a business transaction pursuant to the arrangement provisions in section 193 of the *ABCA*. ("the Arrangement Agreement"). By the Arrangement Agreement, 818 Acquisition, a wholly owned subsidiary of CNPC, will acquire all of the outstanding PetroKazakhstan common shares for $55 USD per share and all outstanding options (that will be deemed to vest) for the difference between $55 USD and the exercise price for each outstanding option. The Arrangement Agreement is subject to the approvals of the holders of the requisite numbers of common shares in PetroKazakhstan and the holders of options to buy PetroKazakhstan common shares (collectively "the Securityholders"). It also requires the approval of this Court pursuant to section 193 of the *ABCA*. If the transaction is approved, PetroKazakhstan will be an indirect, wholly owned subsidiary of CNPC.

[5] Pursuant to the Arrangement Agreement, CNPC agreed to consider an alternative proposal allowing shareholders to elect to receive $54 USD per share and one share of a newly formed oil and gas company that would seek opportunities in Central Asia ("the Spin Off Proposal"). CNPC has since advised that it does not wish to proceed with that proposal.

[6] Goldman Sachs International was retained by the PetroKazakhstan Board of Directors to act as financial advisor in relation to the Arrangement. On August 21, 2005, it provided an opinion to a Special Committee of the Board that the proposal of $55 USD per share is fair from a financial point of view to the Securityholders. On the basis of that opinion and having concluded that the Arrangement is in the best interests of PetroKazakhstan and fair to the shareholders, the Board recommended that the shareholders approve the Arrangement by way of resolution ("the Arrangement Resolution").

[7] On September 14th, 2005 an Interim Order was made by Cairns J. of this Court directing PetroKazakhstan to seek approval of the Arrangement by the Securityholders at a special meeting on or about October 18, 2005. The Interim Order also provided for dissent rights, notice and conduct requirements and the procedure for allowing interested parties to make submissions at the application for the Final Order.

[8] The meeting of the Securityholders to seek approval of the Arrangement Resolution was held at 9:00 a.m. on October 18, 2005. The Arrangement Resolution was approved by over 99% of the votes cast by the Securityholders present in person or represented by proxy at the meeting and entitled to vote, voting as a single class. The Arrangement Resolution was also approved by over 99% of the votes cast by the PetroKazakhstan shareholders present in person or represented by proxy and entitled to vote, excluding votes cast by related parties.

[9] Lukoil and PetroKazakhstan each hold 50% of the shares in Turgai, a Kazakhstan company that holds petroleum licences in Kazakhstan. Turgai was originally established as a 50/50 joint venture between LUKoil Oil Company and state owned Yuzhneftegaz to develop the northern part of the Kumkol oil and gas field in southwestern Kazakhstan. The southern part of the same field continued to be developed by Yuzhneftegaz. Following its acquisition of Yuzhneftegaz in 1996, PetroKazakhstan (then Hurricane Hydrocarbons Ltd.) succeeded to Yuzhneftegaz' 50% share in Turgai.

[10] On December 27, 1999 Lukoil, AO PetroKazakhstan Kumkol Resources ("PKKR"), then known as Open Join-Stock Company Hurricane Kumkol Munai or HKM, and Turgai entered into a shareholders' agreement ("the Shareholders' Agreement"). PKKR was then and is now a wholly owned subsidiary of PetroKazakhstan.

[11] The relevant provisions of the Shareholders' Agreement provide:

> 9.2 Restrictions on Assignment. Without prejudice to Article 3, no assignment of any Interest hereunder shall be made by any Shareholder unless such assignment is made in accordance with the provisions of this Article 9:
>
> 9.2.1 Any Shareholder may, at any time and with prior notice to the other Shareholders and JV, assign all or part of its interest to any Affiliated Party of such Shareholder, which has demonstrated its financial and technical ability to perform the existing and future obligations and liabilities arising out of this Agreement and has undertaken that if an Affiliated Party ceases to be the assignor's Affiliated Party, then, prior to such event, the respective Interest of such Affiliated Party:
>
> > (i) shall revert to the assignor or to another assignor's Affiliated Party which has demonstrated its financial ability and assumed obligations as required by this sub-section 9.2.1; or
> > (ii) shall be transferred to the other Shareholder or to a Third Party in accordance with the provisions of Section 9.2.2.
>
> 9.2.2 Any Shareholder may at any time assign all or part of its Interest to any other Shareholder or any Third Party, which, in any case, has demonstrated its financial and technical ability to perform the existing and future obligations provided for by this Agreement provided, however, that if any Shareholder intends to make such

assignment, it shall give prior notice to the other Shareholders indicating the name and the address of the proposed assignee and the terms and the value of the proposed assignment, after which:

(i) any of other Shareholders may, within 30 days following the receipt of such notice, request by way of a notice delivered to other Shareholders, that such assignment be made to such Shareholder, in which case such assignment shall be made on the same or equivalent terms as specified in the notice of the proposed assignment, and if more than one Shareholder requests such assignment the terms shall be shared in proportion to their respective Interests in relation to each other. If such proposed assignment of the whole or a part of the Interest of any Shareholder is made for consideration other than money or is related to any other property, which constitutes a part of a more comprehensive (package) deal, the Shareholders shall perform a reasonable cash evaluation of the Interest (or a part thereof). If the Shareholders fail to reach an agreement as to the value of the Interest, the Shareholders shall designate an independent expert with international expertise to make a proper evaluation, and such expert's evaluation shall be final and binding upon the Shareholders. Such other Shareholders may qualify under the provisions of this Section 9.2.2(i) if they agree to pay in cash the such value in lieu of the amounts receivable in case the assignment is made in favour of Third Parties or other Shareholders; and

(ii) If no other Shareholder requests the assignment of such Interest, the relevant Shareholder may, subject to the above provisions, make the assignment to such proposed assignee on the proposed terms.

(iii) In case the cost of the Share offered to the Third Party is less than the cost indicated in the notification of prospective transfer sent by not transferring Shareholder in accordance with Section 9.2.2 then such not transferring Shareholders have preemptive right for purchase of the transferred Share in the same order as it is envisioned in this section 9.2.2.

9.3 Continuing Obligations and Release from Obligations. Shareholder which assigns the whole or a part of its Interest shall continue to be liable to all other Parties under all its obligations related to its Interest to be assigned under this Article 9 and assumed before the effective date of the assignment in accordance with Section 9.4. Further, these liabilities shall become the assignee's liabilities. In accordance with the provisions of this Article 9, the assignor shall be released

> from any and all it obligations in respect of the Interest assigned in accordance with the provisions of this Article 9 which arise on and after the effective date of the assignment.
>
> 9.8 Change of Control. The restrictions set forth in this Article 9, including the preemptive right of the other Shareholders to acquire the assigned Interest in accordance with Section 9.2.2, are also applicable to any direct or indirect assignment of interests, shares or participatory shares in the equity of a Shareholder as a result of which the Ultimate Parent Company ceases to be a direct or indirect holder of at least 50% of the equity of such Shareholder (such assignment shall be referred to as the "Change of Control"); provided, however, that any similar change of the Ultimate Parent Company of a Shareholder shall be considered to be a Change of Control and shall be deemed an assignment subject to the provisions of this Article 9.

[12] "Ultimate Parent Company" is defined in the Shareholders' Agreement in relation to each Shareholder, as "a party which directly or indirectly controls 50% (fifty per cent) or more of the interest or voting shares of such Shareholder, which in its turn is not under similar control of any other person".

[13] "Shareholder" is defined in the Shareholders' Agreement as HKM, which was the previous name of PKKR, and Lukoil as well as their "lawful successors and transferees".

[14] "Interest" is defined as "a percentage of the aggregate number of the JV Shares owned by a Shareholder at certain moment in comparison to the aggregate number of shares and proportionate indivisible percentage of rights and liabilities arising hereof."

[15] The Shareholders' Agreement also provides for binding arbitration in the event of a dispute between the Shareholders. The relevant provisions in that regard are as follows:

> 12.1 Applicable Law. This Agreement shall be governed and construed in accordance with the laws of the Republic of Kazakhstan without regard to the conflict of law rules.
>
> 12.2 Arbitration. The Parties shall use their best efforts to amicably settle any disputes, conflicts or claims between themselves which arise out of or in connection with this Agreement. If the Parties fail to resolve any such dispute within [30] days after such dispute arises, any such disputes, conflicts or claims, including, without limitation, any dispute over the interpretation, legality, coming into effect or termination hereof, shall be finally resolved through arbitration in accordance with provisions of this Section, and either Party may refer the dispute, controversy or claim to arbitration.

[16] As stated, at the time that the Shareholders' Agreement was made, December 27, 1999, the shares of Turgai were jointly owned by Lukoil and PKKR, which are subsidiaries of LUKoil Oil Company and PetroKazakhstan respectively.

[17] On April 20, 2001 PKKR assigned its 50% interest in Turgai to PetroKazakhstan (then still known as Hurricane Hydrocarbons Ltd.). At that time a supplementary agreement to the Shareholders' Agreement ("the Supplementary Agreement") was executed by Lukoil, PKKR, PetroKazakhstan and Turgai whereby PetroKazakhstan became liable for all of the obligations under the Shareholders' Agreement in respect of the interest assigned to it, with the exception of obligations arising under three specified provisions to the extent that they remained undischarged.

[18] On July 6, 2004, PetroKazakhstan commenced an arbitration against Lukoil in relation to a number of issues and submitted a Statement of Claim on April 22, 2005. On October 4, 2005 Lukoil filed its full Statement of Defence and Counterclaim in that arbitration, alleging, *inter alia*, that the Arrangement triggers the pre-emptive rights provisions under Article 9.8 of the Shareholders' Agreement. It seeks, among other things, to enforce its right to purchase PetroKazakhstan's shares in Turgai, as a pre-emptive right or right of first refusal granted under the Shareholders' Agreement.

[19] Lukoil filed a Notice of Intention to Appear in these proceedings to oppose the approval of the Arrangement on the basis of the alleged breach of the Shareholders' Agreement by PetroKazakhstan in failing to allow Lukoil to acquire PetroKazakhstan's shares in Turgai. Specifically, it seeks a dismissal or stay of the approval of the Arrangement until the arbitration is complete or until PetroKazakhstan complies with Article 9.8. In the alternative, it seeks to have PetroKazakhstan's interest in Turgai held and managed by an inspector. In the further alternative, Lukoil requests that if the Final Order is approved, that it be expressly without prejudice to Lukoil's rights under the Shareholders' Agreement and in particular under Article 9.8 thereof.

[20] The Arrangement Agreement provides that CNPC may withdraw from the transaction if the Court does not approve the Final Order by November 30, 2005, subject to any extensions provided for in the Arrangement Agreement.

Criteria For Approval

[21] The test on an application to approve a plan of arrangement under section 193 of the *ABCA* is well established:

> 1. Have the statutory requirements to approve the plan of arrangement been fulfilled?
>
> > (a) Does the proposed plan meet the definition of an "arrangement"?

> (b) Is it impracticable for the applicant to effect a fundamental change in the nature of the arrangement under any other provision of the *ABCA*?

2. Is the arrangement put forward in good faith?

3. Is the arrangement fair and reasonable?

See: *Trizec Corp. (Re)* (1994), 21 Alta. L.R. (3d) 435 (Q.B.); *Renaissance Energy Ltd. (Re)*, [2000] A.J. No. 1030 (Q.B.); *St. Lawrence & Hudson Railway Co. (Re)* (1998), 76 O.T.C. 115 (Gen. Div.). This test is agreed appropriate by all counsel.

[22] Accordingly, I shall address each of those considerations. If I find that the test is satisfied I will go on to consider whether the allegation raised by Lukoil, that the Shareholders' Agreement has been breached, bears on that finding.

Analysis

1. Statutory Requirements

(a) *Arrangement Definition*

[23] Section 193(1)(f) of the *ABCA* provides:

> 193(1) In this section, "arrangement" includes, but is not restricted to,
>
> > (f) an exchange of securities by a corporation held by security holders for property, money or other securities of the corporation or property, money or securities of another body corporate that is not a take-over bid as defined in section 194,

[24] Section 194(g) of the *ABCA* provides:

> "Take-over bid" means an offer made by an offeror to shareholders to acquire all the shares of any class of shares of an offeree corporation not already owned by the offeror, and includes every take-over bid by a corporation to repurchase all the shares of any class of its shares that leaves outstanding voting shares of the corporation.

[25] A take-over mandates offers to shareholders directly, they do not vote as a group. Take-over bids provide shareholders with withdrawal rights, rather than dissent rights which were provided here. Approval in an arrangement is required by 66 2/3 of voting securities and by the court.

[26] These considerations together with the fact that this transaction involves an exchange of securities of PetroKazakhstan for money, satisfy me that the definition of an "arrangement" under section 193(1)(f) of the *ABCA* is met.

(b) *Impracticability*

[27] The threshold for establishing impracticability is low and requires only that the applicant establish that other provisions of the *ABCA* would be difficult to put into practice to achieve the same result: *Imperial Trust Co. v. Canbra Foods Ltd.* (1987), 50 Alta. L.R. (2d) 375 (Q.B.), or that reasonable business objectives could not otherwise be achieved without onerous temporal and financial constraints: *Pacifica Papers Inc. (Re)* (2001), 92 B.C.L.R. (3d) 158, 2001 BCSC 1069, aff'd (2001), 93 B.C.L.R. (3d) 62, 2001 BCCA 486.

[28] PetroKazakhstan submits that it is impractical to effect the Arrangement and achieve its desired objectives of allowing the simultaneous acquisition of the shares and treatment of all outstanding options at the same time, under any provision other than section 193 of the *ABCA*. These objectives were necessary to maximize the value to the Securityholders and to obtain the 69% premium over the closing market price of the shares on June 24, 2005 (the last trading day prior to the media report that PetroKazakhstan was assessing the feasibility of a sale transaction). The premium amounts to approximately $1.7 billion USD. PetroKazakhstan also submits that the Spin Off Proposal was a significant factor in choosing to proceed by way of arrangement and that the cost and delay of restructuring the transaction since that proposal was withdrawn by CNPC would be highly prejudicial to the Securityholders and PetroKazakhstan.

[29] I, therefore, find that it is impracticable for PetroKazakhstan to effect a fundamental change in the nature of the Arrangement under any other provision of the *ABCA*.

2. Good Faith

The only allegation of bad faith raised by Lukoil concerns the claim that its pre-emptive rights will be effectively defeated by the Arrangement. I will deal with this objection later in these Reasons. Otherwise, good faith is not in issue.

3. Fair and Reasonable

[30] The test to determine whether an arrangement in fair and reasonable is one of business judgment: can the court conclude that an intelligent and honest business person, as a member of the class concerned and acting in his or her own interest, might reasonably approve of the plan?: *Trizec Corp. (Re)*; and *Renaissance Energy Ltd. (Re)*.

[31] In this case there is cogent evidence demonstrating that the Arrangement meets this criterion:

(i) Goldman Sachs International provided an opinion that the consideration to be received by the shareholders is fair from a financial point of view to the shareholders;

(ii) the Board of Directors and a Special Committee have concluded that the Arrangement is in the best interests of PetroKazakhstan and is fair to the shareholders;

(iii) the Arrangement yields a 69% share premium over the market price that existed immediately before the auction process was announced;

(iv) the shareholders received full disclosure in the Circular; and

(v) the shareholders were permitted to dissent.

[32] An additional consideration or "litmus test" in the determination of whether an arrangement is fair is the vote of the securityholders themselves: *St. Lawrence & Hudson Railway Co. (Re)* at para. 27; and *Renaissance Energy Ltd. (Re)* at para. 23.

[33] In the present case, the Arrangement Resolution was approved by over 99% of the votes cast by the Securityholders present in person or represented by proxy at the meeting and entitled to vote, voting as a single class. The Arrangement Resolution was also approved by over 99% of the votes cast by shareholders present in person or represented by proxy and entitled to vote, excluding votes cast by related parties. There can be no doubt that there has been an overwhelming majority vote.

[34] Having considered all of the evidence, and subject to Lukoil's objections concerning the Shareholders' Agreement couched in terms of fairness, I find that the Arrangement is fair and reasonable.

4. Lukoil's Pre-emptive Rights

Lukoil's Position

[35] Lukoil argues that the Arrangement can not be considered fair and reasonable nor put forward in good faith becasue it is contrary to law. Lukoil further submits that the business judgment test can not be satisfied where the plan of arrangement undercuts the business purpose and intent of the corporation's commercial agreements, in this case the Shareholders' Agreement. It bases both of these submissions on the allegation that a Final Order approving the Arrangement would be tantamount to the confiscation of its pre-emptive right to acquire PetroKazakhstan's interest in Turgai pursuant to the Shareholders' Agreement, for the benefit of the PetroKazakhstan Securityholders.

[36] Lukoil observes that at the time the Shareholders' Agreement was executed, LUKoil Oil Company and PetroKazakhstan held their interests in Turgai through their respective subsidiaries and were, therefore, Ultimate Parent Companies for the purposes of Article 9.8 of the Shareholders' Agreement. As such, it submits there is no doubt that a Change of Control, such as that contemplated by the Arrangement would have been triggered by the Plan of Arrangement in 1999 when the Shareholders' Agreement was executed.

[37] PetroKazakhstan is a widely held corporation without a shareholder that holds 50% of its interest or voting shares, as required by the definition of Ultimate Parent Company. PKKR's interest in Turgai was assigned to PetroKazakhstan on April 20, 2001. Lukoil submits it is not commercially reasonable, however, to interpret the pre-emptive rights provisions in a manner that assumes that, by consenting to the assignment of PKKR's interest in Turgai to PetroKazakhstan in 2001, Lukoil was thereby agreeing that PetroKazakhstan would no longer be bound by the Change of Control provisions while Lukoil itself remained bound.

[38] Lukoil argues further that although PKKR no longer holds any shares in Turgai, it remains a Shareholder in accordance with the definition of that term in the Shareholders' Agreement which specifically names HKM (which is now PKKR). In this regard it asserts that PKKR is still bound by some Shareholder obligations as a result of the Supplementary Agreement.

[39] Alternatively, it argues that PetroKazakhstan remained the Ultimate Parent Company after April 20, 2001. Specifically, it states that the Shareholder and the Ultimate Parent Company can be one party, so long as it "directly or indirectly controls 50% or more of the interest or voting shares of such Shareholder, which in its turn is not under similar control of any other person". It argues that "interest" means Interest as that term is defined in the Shareholders' Agreement, notwithstanding that it is not capitalized in the text.

[40] Accordingly, it submits that the Arrangement will result in a Change of Control in PetroKazakhstan as an Ultimate Parent Company either in respect of PKKR or in respect of itself and, therefore, the pre-emptive rights provisions are engaged.

[41] Lukoil points to section 5.1(b) and section 7.2 of the Arrangement Agreement as evidence that PetroKazakhstan anticipated that Lukoil's pre-emptive rights would require consideration under the Arrangement. In particular, Article 5.1(b) provides that PetroKazakhstan will:

> assist [CNPC] and [818 Acquisition] in any discussions which [they] may wish to have with any other parties to the Joint Venture Entities upon the reasonable request of [CNPC], provide all reasonable assistance and furnish all reasonably available information to [CNPC] and [818 Acquisition] to defend, rebut or otherwise challenge any claims (A) that this Agreement or the Arrangement trigger any rights for any third party to purchase [PetroKazakhstan's] interest in any Joint Venture Entities, or violate any agreement relating to any Joint Venture Entities;

[42] Lukoil submits that this provision effectively induces a breach of contract because, it submits, the parties are thereby contractually obliged to deny Lukoil its rights under the Shareholders' Agreement.

[43] Lukoil argues further that the pre-emptive rights under Article 9.8 of the Shareholders' Agreement apply to indirect assignments prior to the completion of the change of control transaction. Specifically, Article 9.8 applies the provisions of Article 9.2 which is engaged when a party "intends" to make an assignment.

PetroKazakhstan's Position

[44] PetroKazakhstan takes the position that, as a result of the assignment of PKKR's interest in Turgai to PetroKazakhstan, a corporation in which no shareholder currently owns more than 9%, there is no longer an Ultimate Parent Company. It concludes that, as there is currently no Ultimate Parent Company which can "[cease] to be a direct or indirect holder of at least 50%" of the corporation's shares in accordance with Article 9.8, the pre-emptive rights provisions are not triggered.

[45] In answer to Lukoil's assertion that PKKR remains a shareholder in Turgai, PetroKazakhstan points out that the Supplementary Agreement explicitly discharges PKKR from its obligations under the Shareholders' Agreement. It also notes that even if PKKR remains a Shareholder, PetroKazakhstan will continue to own at least 50% of PKKR following the Arrangement.

[46] As to the argument that PetroKazakhstan is the Shareholder and Ultimate Parent Company, it observes that, because PetroKazakhstan will continue to own the interest in Turgai following the Arrangement and will continue to hold rights and obligations under the Shareholders' Agreement, the pre-emptive rights provisions are not activated.

[47] In any event, PetroKazakhstan argues that the pre-emptive rights could arise only after the Arrangement has actually occurred. It points to the words in Article 9.8: "...assignment of interests...as a result of which the Ultimate Parent Company ceases to be a direct or indirect holder of at least 50% of the equity of such Shareholder". If it were otherwise, and an intention alone could give rise to a pre-emptive right, PetroKazakhstan argues that a Shareholder could be held to sell its interest in Turgai even though the change of control did not actually occur.

Analysis

[48] If the remedies sought by Lukoil are granted, the termination of the Arrangement is probable as it is unlikely that the arbitration would be complete before November 30, 2005, after which CNPC is entitled to withdraw from the Arrangement. PetroKazakhstan suggests that the appointment of an inspector may also have the effect of terminating the Arrangement as such an appointment is not a term of the Arrangement Agreement. Were the Arrangement terminated, there is no evidence that another deal could be put together which would yield the $1.7 billion

USD premium that is being paid under the proposed Arrangement. Obviously, if this opportunity were lost it would prejudice the PetroKazakhstan shareholders, perhaps irreparably.

[49] Lukoil submits, however, that it will be prejudiced if the Arrangement is approved before the completion of the arbitration. Specifically, it states that it will fundamentally change the nature of Turgai if a wholly owned subsidiary of CNPC acquires 50% control. It argues that "the insertion of a foreign state owned corporation as a shotgun joint venture partner even for a brief period of time could have far reaching and unknown consequences to the joint venture given the sensitive geo-political environment". It is also concerned that CNPC might put pressure on Turgai to export to China instead of to Turgai's major commercial interests in the west.

[50] Even if prejudice to Lukoil is a legitimate concern on this application, these assertions are too vague and speculative to militate against the approval of an arrangement that is otherwise fair to the shareholders. "Unknown consequences" resulting from political considerations that may come to pass in other jurisdictions would involve this Court in an exercise of theoretical conjecture. Additionally, the suggested prejudice that would arise from pressure to sell PetroKazakhstan products to China rather than to other purchasers is not at all clear.

[51] Further, irrespective of Arrangement approval, Lukoil will be entitled to pursue its breach of contract claim through arbitration. If it is ultimately successful, there is nothing that would preclude it from exercising its rights to acquire PetroKazakhstan's interest in Turgai after the Arrangement has closed. Lukoil has made no argument to the contrary. Rather, it argues that arbitration would result in delay in exercising its rights and suggests that CNPC will not be motivated to expedite the arbitration hearing.

[52] Any such delay concerns can be addressed by proper management of the arbitration proceedings and compensation.

[53] In any event, the ultimate success of Lukoil's claims at arbitration does not bear on the fairness of the Arrangement to the PetroKazakhstan shareholders because it is an "all cash" deal. The Securityholders are not taking back shares of CNPC and, therefore, can not be affected by any liability that may result if Lukoil ultimately proves its claim.

[54] Lukoil argues further, that the Arrangement cannot be considered fair and reasonable, nor presented in good faith because it is contrary to law and because it undercuts the business purpose and intent of PetroKazakhstan's commercial agreements. It also submits that by approving the Arrangement this Court would be authorizing a breach of contract.

[55] Lukoil's submissions in this regard presume that the Arrangement will effectively breach the Shareholders' Agreement and more specifically Article 9.8 thereof. As noted, the parties to the Shareholders' Agreement have expressly agreed to submit their disputes to arbitration for resolution. The issue of the effect of the Arrangement on Lukoil's pre-emptive rights was referred to arbitration on October 4, 2005.

[56] Judicial decisions and provincial legislation clearly support holding parties to arbitration as a dispute resolution method where they have agreed to it absent waiver or a recognized exception. Further, courts in this jurisdiction are required not to intervene in matters governed by arbitration: *UNCITRAL Model Law on International Commercial Arbitration,* Article 8(1), being Schedule 2 of the *International Commercial Arbitration Act,* R.S.A. 2000, c. I-5; *International Commercial Arbitration Act,* R.S.A. 2000, c. I-5, section 4(1); *Kaverit Steel & Crane Ltd. v. Cone Corp.* (1992), 85 Alta. L.R. (2d) 287 (C.A.), leave to appeal to S.C.C. refused, [1992] 2 S.C.R. vii. Accordingly, it would be inappropriate for this Court to make any determination of Lukoil's claims of breach of contract.

[57] Even if this Court were inclined to consider the issue, which I expressly decline to do, I would note that the determination of the allegations raised by Lukoil are well beyond the scope of this application. The positions of the parties demonstrate that the language of the Shareholders' Agreement may admit of two contrary interpretations of the pre-emptive rights provisions. They also illustrate that there are several complex and interrelated arguments that need to be analysed, possibly with the assistance of parol or other evidence.

[58] I would also observe that the Shareholders' Agreement is governed by the law of the Republic of Kazakhstan. As that law has not been proven in these proceedings, the *lex fori* would generally prevail as it is the only law available: *Triathlon Leasing Inc. v. Juniberry Corp. and Hong* (1995), 157 N.B.R. (2d) 217 at 228 (C.A.); J.-G. Castel, *Canadian Conflicts of Laws*, 6th ed. (Toronto: Butterworths, 2005) at §7.4. However, the Shareholders' Agreement choice of law clause 12.1 states that no regard shall be had to the conflict of laws rules. Thus, it may be that the foreign law must be proved in any event.

[59] Lukoil submits that *GATX Corp. v. Hawker Siddeley Canada Inc.* (1996), 27 B.L.R. (2d) 251 (Ont. Gen. Div.) is on all fours with the present case. In that case GATX and Hawker Siddley jointly owned CGTX. The parties executed a shareholders' agreement which included a right of first refusal. Hawker Siddley proposed to transfer its interest to a newly created subsidiary corporation. It then proposed to sell the subsidiary, whose only asset was the interest in CGTX, to a competitor of GATX. It argued that it was entitled to structure a transaction in this manner because, among other things, the right of first refusal allowed the transfer of the parties' respective interests in CGTX to affiliates, without the consent of the other shareholder.

[60] Blair J. (as he then was) concluded that the primary force behind structuring the transaction in this manner was to avoid the application of the right of first refusal. He found, among other things, that the proposed transaction triggered and breached the right of first refusal and that it constituted a breach of the contractual duty of good faith.

[61] In that case, GATX sought a declaration that the transaction was not permitted, that it activated a right of first refusal in favour of GATX, that it was oppressive or unfairly prejudicial to GATX, and that it was contrary to section 241 of the *Canadian Business Corporations Act*, R.S.C., 1985, c. C-44.

[62] In addition, GATX asked the court for an order restraining performance of the transaction and for an order of specific performance of GATX's right of first refusal. GATX succeeded. No party disputed the existence of GATX's right of first refusal or the ability of the court to rule on the issues before it.

[63] Here there is no evidence that Lukoil owns any shares in PetroKazakhstan, nor do Lukoil's rights under the Shareholders' Agreement entitle it to become a shareholder of PetroKazakhstan. Lukoil's position is not analogous to GATX's position.

[64] Moreover, in this case the issue of whether Lukoil's pre-emptive rights have been triggered is to be resolved by arbitration, probably according to foreign law. For these reasons, *GATX* is distinguishable and has no application to this case.

[65] Finally, Lukoil argues that I need not necessarily determine these issues, but instead defer the Final Order until the completion of the arbitration. I have already dealt with the prejudice that would result in that event and, accordingly, I decline to do so. For the same reason, and assuming I have any jurisdiction to do so, I also decline to appoint an inspector to manage PetroKazakhstan's interest in Turgai until the arbitration is complete.

Conclusion

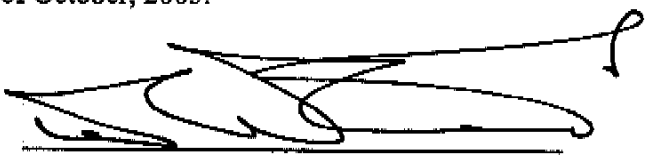
[66] The Arrangement satisfies the statutory requirements of section 193 of the *ABCA*. It is fair and reasonable and put forward in good faith.

[67] The effect of the Arrangement in terms of constituting a breach of the Shareholders' Agreement will not be decided by this Court, nor will this Court defer a Final Order pending determination of this issue by arbitration, or appoint an inspector to supervise PetroKazakhstan's interest in Turgai.

[68] Any potential victory for Lukoil in the arbitration can not transform an otherwise fair and reasonable, good faith Arrangement into an unfair and unreasonable or bad faith Arrangement.

[69] I grant the Final Order in the form submitted by PetroKazakhstan, with the reference to Parbold Overseas Ltd. being heard on the application deleted.

Heard on the 18th day of October, 2005.
Dated at the City of Calgary, Alberta this 25th day of October, 2005.



Neil Wittmann
A.C.J.C.Q.B.A.

Appearances:

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for the Petitioner

Vincent A. Mercier
for the Petitioner

Sean F. Dunphy/Anne C. McConville/Glenn N. Cameron
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Tristram J. Mallett
for CNPC International Ltd. and 818 Acquisition Inc.

Steven H. Leitl
for various shareholders

E.D.D. Tavender, Q.C./Sean Glass
for various shareholders