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ARTICLE

In the Matter of Qunar Cayman Islands Ltd: Cayman Islands Appraisal Actions – Moving Towards Standard Directions?

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Introduction

In ordinary commercial litigation there is a plaintiff making a claim and a defendant resisting the claim made by the plaintiff. There is a well-established set of standard directions which will be made leading to a trial of the action. This will involve mutual discovery, exchange of witness statements and, in some cases, directions for expert evidence. There is little scope for disagreement about the directions which are made, other than questions of timing.

In an appraisal action, commenced by petition under section 238 of the Cayman Islands Companies Law, the sole purpose of the action is for the Court to determine the fair value of the shares of the shareholders who have dissented to the merger of two companies, together with a fair rate of interest to be paid by the company to the dissenting shareholders. The proceedings are quite unique in that respect because there is no plaintiff and no defendant and there is no burden of proof on one party or the other to prove particular allegations. Instead each party bears the burden of proving the value for which it contends, but ultimately the Court will decide upon the fair value.

Such a process ought to be straightforward and non-contentious as it simply involves a valuation exercise which necessarily requires the assistance of valuation experts who require access to the necessary financial and business information upon which to base their opinions.

Given that appraisal actions are unique, in that a statutory burden is placed upon the Court by the Companies Law to appraise the fair value, it would be possible to conceive of some unique directions which could be applied to such cases. For example the Judge could sit with assessors or there could be one or more court appointed experts and discovery could be directed by the experts. This would follow a more inquisitorial approach to the discharge of the statutory requirement placed upon the Court. However, the Cayman Islands follows a traditional English adversarial approach and has therefore adapted the traditional commercial litigation directions to appraisal actions, with some minor modifications. As a result there is now a fairly standard set of directions which are typically made in such cases. The basic modifications to the usual directions orders are as follows:

– Because of the voluminous nature of the company's documents and their availability in electronic form the practice is for the company to open a data room in order to provide access to the lawyers and the experts.

– The Experts are permitted to request documents, to ask questions of the company, and also request a meeting to be held between themselves and the management of the company.

Unfortunately in every single reported case to date, starting with the Russian company in *In the matter of Integra Group*[1] through to the latest Chinese company case, *In the matter of Qihoo 360 Technology Co. Ltd,*[2] difficulties have arisen as to discovery by the company, even against the background of consent orders and a formal acceptance of the need to provide all relevant documents.

However, in *In the matter of Qunar Cayman Islands Ltd.,*[3] unlike in almost every other case, the Company was not even prepared to agree to provide discovery, save on a very limited basis by reference to a restricted category of documents which it had drawn up. On the other hand, although unwilling itself to give discovery of all relevant documents, the Company sought discovery from the dissenting shareholders. The Court was therefore required to determine the scope of discovery to be required of a company in a section 238 action and whether the dissenting shareholder ought to give discovery.

Notes

1 [2016] 1 CILR 192.
2 Unreported 27 July 2017.
3 Unreported 20 July 2017.

A further point arose in that unlike previous cases, this case involved multiple dissenters so that the Court had to decide whether it had the power to restrict the number of experts, and if so whether that power should be exercised.

The decision produced no surprises, but reinforces the approach that the Cayman court has taken to the case management of appraisal actions, having regard to their unique nature.

Background

Qunar Cayman Islands Ltd (the 'Company') is a Cayman Islands exempted limited company that had been listed on the Nasdaq Stock Market in 2013. In June 2016, it was the subject of a 'take private' transaction pursuant to which it was to enter into a merger agreement with Ocean Management Holdings Ltd and Ocean Management Merger Sub Ltd (the 'Merger'). The Merger was approved in February 2017. Eight shareholders forming four groups, (collectively, 'the Dissenters') dissented to the Merger and commenced the appraisal process provided for in Section 238 to formally assess the 'fair value' of their shares (the 'Proceedings'). The Proceedings came before the Court for directions on 23 June 2017. Although the broad structure of the directions had been agreed, there remained a number of areas of disagreement, including as to the proper approach to discovery by the Company, the appointment of a joint expert, and the question of whether the Dissenters should also be compelled to give discovery.

Discovery by the Company

Surprisingly and rather unrealistically the Company sought to limit its disclosure to a specified list of categories of documents. Unsurprisingly, the dissenters took exception to this proposal and contended for discovery to be given by the Company of all relevant documents in the usual way. The dissenters proposed that discovery should be given first of documents which would be readily to hand as a result of the merger process, including consideration of fairness by the special committee and its financial adviser. Subsequently the company should disclose all other documents relevant to valuation of the company and in addition any documents specifically requested by any of the experts. The Company sought to impose some limitations on the ability of the experts to request documents by requiring them to justify such requests.

Justice Parker referred to the findings of the Court in a number of earlier judgments concerning Section 238, including *Integra* and *In the matter of Homeinns Hotel Group*.[4] He reiterated that the Court is not itself an expert valuation tribunal and must be guided in these matters by the expert evidence from experienced valuers, who will need access to relevant historical data, documents and information concerning the company that will assist with the assessment of fair value required by the Law. The judge noted that such documents should be readily available and that it was 'the usual order' in appraisal cases.

Justice Parker ordered that the Company should give discovery by first uploading to a data room the specific classes of documents which came into being in the course of the Merger process, before uploading all documents that are relevant to fair value as part of the Company's ongoing discovery obligation, rather than limiting discovery to a set list of documents (as proposed by the Company). The Court also found that it would be inappropriate to limit in advance the experts' requests for documents and that instead it should be open to them to be able to ask for any further specific information they deem necessary for the purposes of their valuation, so long as the requests for documents are not oppressive, disproportionate or calculated to embarrass or harass the Company.

Finally, and contrary to the approach taken in *Homeinns*, the Court ordered that the documents discovered should be disclosed by way of a formal List of Documents in the form prescribed by the Grand Court Rules (the 'GCR'). Although the data room index could be incorporated by reference into Schedule 1 Part 1 of the standard form, Schedule 1 Part 2 required identification by the Company of the documents which the Company objects to producing (usually on the grounds of privilege), and Schedule 2 requires the Company to identify relevant documents which it has had, but no longer has and to state when they last had them and what has become of them.

These are important provisions which should not lightly be discarded. In other cases which have come before the Court, difficulties have arisen over the disclosure given by the Company.

In *In the matter of Bona Film Group Limited*[5] MacMillan J noted that 'It is of some concern to the Court that over a period of time the Company has failed to comply with the Court's directions'. In that case the Company failed to comply with a consent order for directions resulting in an unless order which was not complied with as a result of which the Company was debarred from adducing any expert evidence at trial.

Notes

4 Unreported 12 August 2016.
5 Unreported 13 March 2017.

In both *In the matter of Shanda Games Limited*[6] and *Qihoo* concerns about the reliability of the Company's discovery led in each case to the appointment of forensic experts, in *Shanda Games* by consent and in *Qihoo* by order of the Court.

There appears to be a developing trend for Chinese companies in appraisal actions to resist providing comprehensive discovery (as in *Qunar*) or worse to fail to comply with their obligations under Court orders (as in *Bona Film)* or at least act in such a manner as to cast serious doubt upon whether they have complied (as in *Shanda Games* and *Qihoo*). This behaviour threatens to undermine the section 238 process and seriously hinder the Court's ability to carry out its statutory duty to appraise the fair value of the shares of dissenting shareholders. It is therefore not surprising that the Cayman Islands courts are willing to appoint forensic experts in appropriate cases, and ultimately to impose sanctions upon delinquent companies which may result in their being unable to adduce expert evidence at trial. In *Bona Film* the company's protracted delinquency ultimately led to the appointment of provisional liquidators.

Experts

This was the first case to come before the Court where there were multiple dissenters. The question therefore arose as to whether the dissenters should be permitted to each call an expert, or whether there should be a limitation so that there would be one expert appointed by the Company and one appointed jointly by the Dissenters. With 4 separate groups of dissenters there was the spectre of the Court potentially having a total of 5 experts producing valuations and appearing at trial. Unsurprisingly the Court did not relish that prospect, but had to contend with an argument that it would be inconsistent with the Financial Services Division Guide and the right to a fair trial if one dissenter were forced to share an expert with another. It was suggested that the usual order would be for each party to be permitted to call an expert and so where there were multiple parties there would be multiple experts.

The Court did not consider that requiring a party to share an expert with another party with whom its interests were aligned could be considered an infringement of the right to a fair trial and ultimately decided that one expert should be instructed by all the dissenters jointly.

The Court observed that it has a discretion to give leave for a party to be allowed to call expert evidence. Furthermore, Justice Parker also referred to GCR Order 38, rule 4, which provides for the Court to limit expert evidence. He held that the discretion was to be exercised not merely as a matter of case management and efficiency (in accordance with the overriding objective) but also to ensure a fair trial so that each party has a proper opportunity to put forward its case and test the other party's case.

In relation to the proper role of the experts in Section 238 proceedings, Justice Parker noted: Given that their evidence should be and should be seen to be independent work product uninfluenced by the pressures of litigation or any party, so that they can provide independent assistance to the Court by way of an objective and unbiased opinion, there is no room for them to in any way take on the features of an advocate for their client.

Ultimately, Justice Parker found that if the Court is to achieve its overriding objective of dealing with every cause or matter in a just, expeditious and economical way, it was appropriate that one expert was instructed jointly and severally for all four groups of Dissenters. The Court considered that one expert instructed by all dissenters was likely to be of most assistance to the Court, especially in relation to interactions with the Company's expert. The Court also noted that in any event, the interests of all dissenters should be aligned in that they share a common interest in the determination of a fair value of their shares.

Discovery by the Dissenters

Surprisingly, the Company made an application for the Dissenters to give discovery, notwithstanding that the Court had already ruled on this question *In the matter of Homeinns Hotel Group* where the same application had been dismissed. The Company relied upon a Delaware decision: *In Re Appraisal of Dole Foods Company, Inc.*[7] ('*Dole*') in which dissenters were ordered to give discovery.

Justice Parker noted that while the Court would take into account and pay close attention to the decisions of the Courts in Delaware, given the similarity of the jurisprudence and statutory merger provisions, the *Dole* decision was of 'little assistance in relation to procedural matters such as discovery where the Delaware jurisdiction is so different'.

He also observed that the Court would require very clear grounds upon which to make an order for dissenting shareholders to give discovery, and that those grounds would be solely directed towards assisting the Court in determining fair value. No such order would be made if it were not necessary either to dispose of the matter fairly or so as to save costs. Although the hypothetical possibility of discovery being ordered from dissenters could not be ruled out, where there were

Notes

6 Unreported 25 April 2017.
7 C.A. No 9079 – VCL (Del. Ch. Dec. 9 2014).

specific documents that were in the dissenters' possession, but not the Company's, such an order would only be made in a very rare and exceptional case, and this was not such a case.

No order would be made for the purpose of obtaining material to seek to undermine the credibility of the dissenters or its witnesses, and material which might give an indication of the value which the dissenters themselves may have thought the company or their shares to have had, prior to or for the purposes of merger, was irrelevant and of no assistance to the Court in determining fair value in the Cayman Islands.

Although it had been suggested that that valuations of third parties based on public information were relevant to a determination of fair value, the Judge did not consider this to be correct. Once an expert has the company's full records, nothing helpful could be gained by reviewing third-party valuations. The motivations and views of the Dissenters were unlikely to assist the Court in its rather narrow exercise of adjudication, informed as it would be by the expert evidence. The Judge noted that Section 238 cases should not be treated like ordinary civil litigation as it pertains to discovery where parties seek to undermine each other's cases through discovery and related interlocutory procedures. , which may be designed to assist in the cross-examination of witnesses. In section 238 cases the witnesses facing cross-examination on previous inconsistencies or matters relating to their investment strategies, would be on the dissenters' side if the Court ordered them to give discovery and those matters were irrelevant to the Court's task and may indeed be inadmissible.

He concluded that Mangatal J was clearly right in her Ladyship's decision *In the matter of Homeinns Hotel Group* that it was not appropriate for the Dissenters to be ordered to provide discovery in the usual way pursuant to a standard direction under Order 24 of the GCR.

The judgment

The decision of the Court in *Qunar*, is to be welcomed. The statutory appraisal process depends upon the valuation experts assisting the Court to be able to access all documents which may be relevant to the valuation of the Company. It is the Company which is being valued, based upon its current financial position and expected future earnings. It is therefore self-evident that it will be the Company which uniquely holds the relevant documents which will be required by the valuation experts to prepare a valuation of the Company. Absent full financial and business transparency by the Company it is difficult to see how the Court is able to reach a reliable determination of fair value.

It is unfortunate that the companies who have appeared before the Court to date have shown an unwillingness to cooperate in what ought to be a straightforward and non-contentious court appraisal process. Nevertheless, the Cayman Islands court has demonstrated that it will make appropriate orders to ensure that it is not prevented from being able properly to appraise a fair value as required by the Companies Law.

The decision of Parker J further entrenches what has now become the standard structure of directions in appraisal actions, removing any doubt as to the scope of the company's discovery obligation and confirming that *Homeinns* was correctly decided in not including any standard direction for disclosure by dissenters. In addition it has resolved the outstanding question as to the number of experts which will be permitted where there are multiple separately represented dissenting shareholders.

It is therefore to be hoped that in future cases directions will be agreed so that, subject to compliance by the company, such actions should proceed in the straightforward manner envisaged by the statutory appraisal regime in the Companies Law.[8]

Notes

8 At the time this article was prepared the Company was seeking permission to appeal.

International Corporate Rescue

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