IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

Cause No.: FSD 129 of 2016 (IMJ)

IN THE MATTER OF THE COMPANIES LAW (2016 REVISION)

AND IN THE MATTER OF QIHOO 360 TECHNOLOGY CO. LTD

IN CHAMBERS

Appearances:	**Mr. Robert Levy QC instructed by Mr. Rupert Bell and Mr. Patrick McConvey of Walkers for the Dissenting Shareholders/Applicants Mr. Thomas Lowe QC instructed by Ms. Jessica Williams, Mr. Paul Madden and Mr. James Elliott of Harney Westwood and Riegels for the Company/Respondent**
Before:	**The Hon. Justice Ingrid Mangatal**
Heard:	**27 September 2018 and 4 October 2018**
Draft Ruling Circulated:	**12 December 2018**
Ruling Delivered:	**19 December 2018**

HEADNOTE

Section 238 Proceedings - Application for previously Court-ordered Forensic audit to be terminated - Company's leave to instruct expert witness be revoked - and Company be debarred from relying on factual evidence at trial

RULING

Introduction

1. This is an application by (a) Maso Capital Investments Limited ("**Maso**"); (b) Blackwell Partners LLC – Series A ("**Blackwell**"); and (c) Crown Managed Accounts SPC acting for and on behalf of Crown/Maso Segregated Portfolio (together with Maso and Blackwell, the "**Dissenting Shareholders**") for an order against Qihoo 360 Technology Co Ltd (the "**Company**"), in the following terms:-

"1. *The Forensic Audit (as defined at paragraph 6 of the Order dated 27 July 2017, (the "**July Order**") be terminated forthwith and the obligations of the parties and the Forensic Expert (as defined at paragraph 6 of the July Order) pursuant to paragraphs 8 to 12 of the July Order cease forthwith.*

2. *The Company be solely liable for all costs arising out of and in connection with the Forensic Audit, and shall reimburse the Dissenting Shareholders with all costs paid to Alvarez & Marsal Dispute & Investigation Limited in relation to the Forensic Audit within 7 days of the date of this Order.*

3. *The Company's leave to instruct an expert witness and serve expert evidence at the trial of these proceedings be revoked and that the following paragraphs of the Order for Directions dated 25 October 2016 (the "**Directions Order**"), be amended to remove the following references and to make consequential amendments where necessary:*

   (a) the words "....(a) Petitioner; and" in paragraph 7;

   (b) the obligation for the meetings held pursuant to paragraph 9 to be held jointly;

   (c) paragraph 11c;

   (d) the requirement for any joint expert meeting(s) pursuant to paragraph 12 and a joint memorandum to be prepared pursuant to paragraph 13; and

   (e) the words "The Petitioner and" in paragraph 15.

4. *Paragraph 13 of the July Order be amended so that the time for the Dissenting Shareholders' expert to serve his report be extended to six weeks after the date of this Order.*

5. *The Company cannot rely on any factual evidence at the trial of these proceedings.*

6. *The Company pay the costs of the Summons and all costs related to or arising from the Forensic Audit on the indemnity basis, to be taxed forthwith if not agreed."* (The "**Summons**")

Background

2. By a Consent Order dated 25 October 2016 (the "**Consent Order**"), the Company agreed to give discovery of documents in the manner therein provided. That discovery process was supposed to have been completed by 18 November 2016. The time for discovery was extended to 10 January 2017 at a directions hearing on 21 December 2016. Harney Westwood and Riegels ("**Harneys**"), the Company's present attorneys, had at that time just been instructed by the Company, and sought extensions of time to comply with the Consent Order. The Court granted extensions of time, but for shorter periods than requested by the Company. By the varied directions, discovery was to be completed by 10 January 2017 and the trial of this case was to be fixed not before 29 May 2017.

3. Not satisfied with the Company's approach to its discovery obligations, the Dissenting Shareholders filed a summons dated 3 March 2017 (the "**March 2017 Summons**") by which, amongst others, they sought orders, that the Company preserve its electronic data, that a forensic expert be appointed to conduct an audit and search of documents based on key word searches.

4. The March 2017 Summons was heard over two days on 11 and 12 May 2017 and the Dissenting Shareholders succeeded. This Court gave judgment on 27 July 2017 (the "**July 2017 Judgment**") reported at [2017 (2) CILR 43].

5. There have been other subsequent applications by the Company, including seeking leave from the Court of Appeal, to appeal the July 2017 Judgment, in which leave was refused

– see the Court of Appeal judgment, reported at [2017 (2) CILR 585]. It is not necessary to go into these other applications at this stage.

The Dissenting Shareholders' Position

6. This application seeks very serious relief. However, the Dissenting Shareholders, represented by Queen's Counsel Mr. Levy, say that the case is "*stark*". The Dissenting Shareholders allege that, contrary to the express terms of the July Order which provided that the Company should preserve all data and other matters for the purposes of a Forensic Audit, the Company has expressly directed a number of employees to delete and destroy data (**"the Destruction Instruction"**).

7. The Dissenting Shareholders allege that that instruction is a flagrant breach of the July Order. They also say that the evidence filed by the Company, breaches Practice Direction 4 of 2015. To the extent that the Company's evidence on these points is admissible, the Dissenting Shareholders aver that the Company's answers to the core allegations on the data destruction issue are not only incredible, they are demonstrably incorrect. It is argued further that none of the assertions in the Company's evidence (to the effect that nobody acted on the Destruction Instruction), can be properly tested. The Forensic Expert (as defined at paragraph 6 of the July Order) cannot say with certainty whether data has been deleted, or that deleted data could be restored. Thus, the Dissenting Shareholders submit, a fair trial cannot be assured.

8. In addition to this, the Dissenting Shareholders take a further point. They say that the Company, which is a leading internet security and search engine provider in the People's Republic of China, (the "**PRC**") which was valued at merger price at around US$9.8 billion and has subsequently re-listed in the PRC at many multiples of that amount (initially its market capitalization was approximately US$60 billion upon re-listing only a portion of its assets), has taken an incredible stance. The Company claims that because

of alleged "*eye issues*", its multi-billionaire chairman, Mr Zhou, did not have a computer or any electronic device issued to, used by or available to him, and that he has never used a computer since setting up the Company in 2006. Such items would be an "*Electronic Device*" within the ambit of the Forensic Audit.

9. The Dissenting Shareholders say that this is unacceptable. Not only is it incredible, but they submit that there is a wealth of material showing Mr. Zhou's evidence and the Company's case on this to be untrue. Reference was made to Mr. Zhou's autobiography in 2017, "*A Disrupter; Zhou Hongyi Biography*" where Mr. Zhou said "*I've been using computers for 30 years*" and that his "*..requirements for living conditions are pretty low. As long as I can sleep and a space for my computer I'm ok*".

10. In addition to the autobiography referencing Mr. Zhou's love of his computer, the Dissenting Shareholders have also provided the Court with a recent video of Mr. Zhou in his office showing a large computer screen and keyboard on his desk. There is also evidence of Mr. Zhou engaging in archery. The Company has also put in evidence some photographs of Mr. Zhou's office which show no computer. That evidence Mr. Levy Q.C. submits, is self-serving and unreliable.

11. The upshot of this, Learned Counsel submits, is that there is no purpose in continuing the Forensic Audit. Further, that it should cease immediately and the Company should pay forthwith all of the costs of that exercise (both legal fees and the fees of the forensic auditor) incurred by the Dissenting Shareholders, on an indemnity basis. Additionally, because a fair trial is not possible, the Company should be barred from adducing expert evidence at trial. It was posited that the Company has, by its conduct, put itself in this situation.

12. The argument continues, that whilst the Court's power in such circumstances would usually result in an order for striking out the claim or defence, such relief is not

appropriate in an appraisal case under section 238 of the ***Companies Law (2018 Revision)*** (the "***Companies Law***"). This is because the statutory regime requires that there be a determination of fair value. As a result, it was submitted that the orders sought in the Summons are an appropriate sanction for the egregious conduct of the Company. It was submitted that there is precedent in the Cayman Islands in a section 238 case for such sanction being ordered following a breach of discovery obligations. Reference was made to the decision of McMillan J ***In the matter of Bona Film Group Ltd*** (Unreported, Grand Court, McMillan J. 13 March 2017). In that case the debarring order was preceded by an 'unless' order.

13. As pointed out by the Dissenting Shareholders, in the July 2017 Judgment, when taking the exceptional step of appointing a forensic expert to conduct a forensic analysis of the Company's information technology systems, the Court found as follows:

(a) *"....the Company's approach to the discovery process has been in instances somewhat careless and cavalier resulting in incomplete and ineffective discovery."*

(b) there had been variations in responses to questions posed of the Company "*some of which are hard to reconcile without full or complete discovery*";

(c) that a substantial suite of documents that the Company said no longer existed had been plainly shown to be in the Company's possession;

(d) that it was "*strange that, at least initially, the Company has sought to distance itself from the documents available to the Special Committee*";

(e) that "*in the light of the Company's inconsistent positions, coupled with its cavalier approach to previous aspects of the discovery process, in my judgment there has been an insufficiency of discovery*";

(f) that "*I cannot say that I find the Company's statements that it has given complete and full disclosure reliable*";

(g) that "*the discovery process has not been handled with the care required in order for the Court to ensure that its Orders are carried out and that the discovery process is carried out fairly*";

(h) that "*....in all probability the Company has or has had other relevant documents other than the ones disclosed*";

(i) that "*This case is also in my judgment an exceptional one, not only because of the central importance of discovery in section 238 proceedings and the Company's role in that process, but also because of the Company's inconsistent and cavalier approach to discovery resulting in insufficient discovery under previous orders*"; and

(j) that the appointment of a forensic expert was "*.....necessary to avoid a denial of justice to the Dissenters, as well as to allow the Court to properly carry out the function* ....[of] *appraising the fair value of the Dissenting Shares*".

14. Thus, the Forensic Audit of the Company's information technology systems was considered necessary by the Court in order to avoid a denial of justice to the Dissenting Shareholders. The Dissenting Shareholders take the stance that the position has deteriorated since then, making the serious allegation that the Company has sought to impede the Forensic Audit in order to render it worthless.

15. Paragraph 1 of the July Order provided that the Company should "*forthwith take all steps necessary to preserve all computers.... and all or any data in the Company's possession,*

custody or power which may be relevant to these proceedings which is held or stored on or by Electronic Devices or similar means in any jurisdiction whatsoever until the conclusion of the cause or further Order of the Court".

16. The Dissenting Shareholders say that the evidence shows that, far from acting in accordance with the July Order, the Company directed certain staff to "*Delete/Completely Uninstall all instant messaging applications including Lanxin, Fetion, WeChat, QQ etc*" and also to delete "*Personal private information .... Such as pornographic photos, bank passwords etc.*" - the Destruction Instruction.

The Dissenting Shareholders' Evidence – Mr. Jain's Fourth Affidavit ("Jain 4")

17. In Jain 4 Mr. Jain gives evidence that:

(a) Mr. Davin Teo of Alvarez & Marsal Dispute & Investigation Limited ("**A&M**") was appointed as the Forensic Expert in January 2018 (many months after the July Order), and that he then began sending weekly reports pursuant to the July Order;

(b) On 26 March 2018, Mr. Teo began interviewing the employees of the Company (as part of the Forensic Audit);

(c) On 3 May 2018, Mr. Teo was sent, by a member of the Company's staff via WeChat, a spreadsheet which had been circulated to Company staff that included the Destruction Instruction (the "**Excel Spreadsheet**"). This had been included on a spreadsheet dated 2 May 2018, that was arranging the delivery of the recipients' electronic devices for imaging in purported compliance with the July Order. In other words, in complete defiance of the July Order, the recipients were being instructed to delete data before delivering their machines up for imaging; and

(d) In the course of a telephone call on 4 May 2018, Mr. Teo informed the parties that an employee of the Company had forwarded to him, by WeChat, the Destruction Instruction. It should be noted that the Destruction Instruction was written in Chinese.

18. Following this indication on 4 May 2018, the Dissenting Shareholders' attorneys, Walkers, wrote to Harneys, expressing concerns about the Destruction Instruction and asking who at the Company had given it, to how many people, how many people had acted on it and how many devices were affected. The letter also reminded the Company of its obligations under the July Order and Harneys' obligations as attorneys to the Company.

19. On 9 May 2018, Mr. Teo circulated his weekly report dated 8 May 2018, in which he provided a translation of the Destruction Instruction. In that report Mr. Teo explains that he spoke to Mr. Mingyi (Calvin) Jin who said he was "*unaware of the situation*" (that is, presumably unaware of the Destruction Instruction, although it appears that he may well have received the WeChat message, as he set up and was a member of the WeChat group created for the purpose of communicating with Mr Teo and his team). However, Mr. Teo had also spoken to Ms. Fu Yang (who had sent the Excel Spreadsheet containing the Destruction Instruction to Mr. Teo) who had said that the said Destruction Instruction was written by a (as then unnamed) "*leader in the finance team*". Apparently Ms. Fu explained that the Destruction Instruction was given to the staff by the finance team leader as directions for giving their computers up for data collection (pursuant to the July Order) and she "*should have removed these steps prior to sending*" Mr. Teo the Excel Spreadsheet by WeChat.

20. The Dissenting Shareholders opine that it is alarming that somebody charged with collecting machines for the purpose of the Forensic Audit considered that she should have deleted the Destruction Instruction before sending it to the Forensic Expert. They pose the questions - why "*should*" Ms. Fu have deleted it? Who told her she should have

done so? Why would she think it right to conspire not to be frank and transparent with Mr Teo? One would have thought, it was submitted, that a company that was serious about its obligations would have kept a perfect record of a chain of custody of how data was collected, rather than deleting very important instructions. In point of fact, it is clear, Mr. Levy QC submits, that Ms. Fu had been 'caught out' and had wished she had deleted the highly incriminating and worrying Destruction Instruction.

21. In the course of a telephone call with Mr. Teo on 10 May 2018, the parties were told that Mr. Jin had emailed Mr. Teo some answers to questions Mr. Teo had asked concerning the Destruction Instruction. Mr. Teo also explained that he was unable to say with certainty whether anything had been deleted from any machines.

22. On 10 May 2018, the parties received an email from Mr. Teo attaching two documents, being (i) the email from Mr. Jin to Mr. Teo giving the Company's answers to some of the questions posed, and (ii) an email that Mr. Jin had apparently sent to the Company's employees on 8 May 2018 entitled *"Important – Perservation [sic] Order"* (the "**Email Directive**"). In Mr. Jin's email sent to Mr. Teo on 10 May 2018 at 11.37 am, Mr. Jin identified Ms. Sun Min Zhu as the one who had written the Destruction Instruction on the Excel Spreadsheet.

23. Dealing with the Company's response to Mr. Teo's questions, it asserted that the Company received Mr. Teo's request to collect the computers of Ms. Sun and her team on 17 April 2018 and passed that request to Ms. Sun. In turn, Ms. Sun communicated with her team to establish a schedule for the collection of the machines, and for the purposes of doing so, prepared the Excel Spreadsheet that contained the Destruction Instruction. Apparently, despite the Company being a leading technology company, Ms. Sun circulated a print out of the Excel Spreadsheet by hand to her team. Whether or not that is true, the Dissenting Shareholders say, it does not detract from the fact that the recipients of that Excel Spreadsheet would have seen, and read, the Destruction

Instruction. It is known that, Ms. Sun apparently confirmed to Mr Jin that she had circulated the Excel Spreadsheet to the following individuals: "*LUO, Ting, Li, Siyao, JIA, Hejun, ZHAO, Hongwen, GUO, Min, LIANG, Wenjing, LI, Jun, ZHU, Ting ZHAO, Xin, WEN, Xiaomei, WANG, Fei, WANG, Jiezhen, LIN, Li and HAN, Jiali*" (Chinese names omitted). It was submitted that as faithful employees, and the Destruction Instruction being written in their native language, they would have acted upon such clear instructions, and that it is fanciful to suggest that they would not (or did not).

24. Mr. Jin also explained that the Company did "*not know if her team members have chatted to other colleagues or otherwise shared the existing form*". Two things follow, Learned Counsel submits. First, that the members of Ms. Sun's team received the form; if not they would not have been able to share it. That means that even if the forms were not emailed to them, they had physical hard copies. The second point is that it is fanciful to suggest that people in an office would not chat about instructions to remove programs/data.

The Company's Position

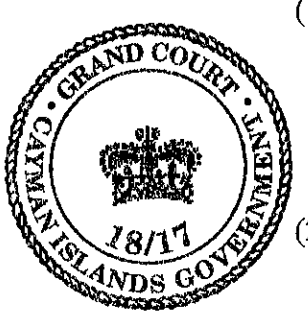
25. The Company points out that the Summons has been issued by the Dissenting Shareholders part-way through the Forensic Audit ordered by this Court by paragraph 6 of the July Order.

26. Since the issue of the Summons, the work carried out by the independent Forensic Expert, Mr. Teo, appointed in accordance with the July 2017 Order, has been halted at the Dissenting Shareholders' insistence. Mr. Teo has filed numerous weekly reports in accordance with paragraph 9 of the July Order.

27. By the Summons, the Company says that the Dissenting Shareholders seek punitive and draconian orders.

28. Mr. Lowe QC who appears for the Company, neatly characterizes the Summons as following three primary heads of complaint raised by the Dissenting Shareholders, by which they assert that:

(1) The Company has instructed its employees to delete documents and files and in particular, instant messaging applications such as WeChat, which may contain documents relevant to fair value - the Destruction Instruction;



(2) The Chairman has sought to extricate himself from the Forensic Audit by claiming he has "*bad eyesight*" as a reason for why he does not use a computer or any form of electronic device (the "**Chairman Issue**"); and

(3) There are problems with the Company's email archive system such that it may be difficult to properly extract and review the relevant archived emails (the "**Email Issue**").

29. Mr. Lowe QC notes that the primary complaint is based on non-compliance of the July 2017 Order, and indicates that the Company denies that there has in fact been non-compliance.

30. It was submitted by Mr. Lowe QC that in order to obtain the draconian relief sought, the Dissenting Shareholders need to establish a deliberate and contumelious breach by the Company of the July 2017 Order. He argued as follows:-

(1) There is no basis for an order disallowing relevant evidence submitted in good time. The remedy for the Dissenting Shareholders is to make an application for contempt or to invite the Court to draw adverse inferences. What the Dissenting Shareholders seek is tantamount to debarring the Company from defending the Proceedings which may be possible under

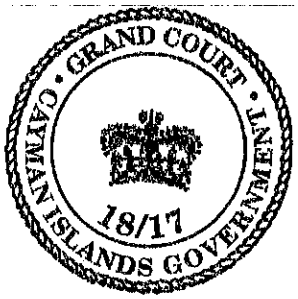
the Civil Procedure Rules ("**CPR**") in England but is not possible under the Cayman Islands' ***Grand Court Rules*** ("***GCR***").

(2) In ***Bona Films*** it was submitted by the dissenting shareholders that the Grand Court was entitled to apply the CPR to the extent that there was a "*lacuna*" in the Cayman Islands. That principle had never been extended to the CPR but only to the English Rules of the Supreme Court. ***GCR*** Order 1, Rule 5 makes it clear that English Rules are irrelevant to the application of the ***GCR***.

(3) It is, of course, true that the ***GCR*** adopted the Overriding Objective, which is to deal with matters justly (see Preamble to ***GCR***). It is submitted that it is inconsistent with this and the Company's right to a fair trial to make orders which put a party in the same position as a person who has been debarred from defending when a fair trial remains possible (see ***Arrows v Blackledge*** [2001] BCC 591, ***AHAB v SAAD*** [2011] 2CILR 434 and ***Renova Resources v Gilberston*** [2011] 2 CLIR 148):

(4) ***GCR*** Order 24, Rule 20 does not justify the order sought. There has been no unless order, still less a breach of one. It is not a consequence of non-compliance with ***GCR*** Order 24 that the Court has such power (***see Husband's of Marchwood v Drummond Walker Developments*** [1975] 1 WRL 603 and ***Star News Shop Ltd v Stafford*** [19998] 1 WLR 536).

(5) If the evidence justifies a finding of contumelious failure to comply with a court order and a fair trial is impossible, then the Court might be justified in debarring a party from participation. When a fair trial is still possible, contumelious conduct is punishable, but not by debarring a party from putting its case (see ***Logicrose v Southend Utd FC*** [1988] cited in ***Renova Resources v Gilbertson***, at para 148):



"The object of Order 24, r.16 is not to punish the offender for his conduct, but to secure the fair trial of the action in accordance with the due process of the Court (see ***Husband's of Marchwood Ltd v Drummond Walker Developments Ltd*** *[1975] 2 All ER 30, [1975] 1 WLR 603). The deliberate and successful suppression of a material document is a serious abuse of process of the Court and may well merit the exclusion of the offender from all other participation in the trial. The reason is that it makes the fair trial of the action impossible to achieve and any judgment in favour of the offender unsafe.... But I do not think that it would be right to drive a litigant from the judgment seat without a determination of the issues as a punishment for his conduct, however deplorable, unless there was a real risk that that conduct would render the further conduct of proceedings unsatisfactory. The Court must always guard itself against the temptation of allowing its indignation to lead to a miscarriage of justice."*

(6) The Dissenting Shareholders also appear to be arguing that there has been destruction/withholding of material relevant to the issues in the Proceedings. Insofar as they do, such case is disputed.

31. It was further submitted that the Court should not determine this application summarily against the Company if by doing so it is deciding to disbelieve the evidence of certain witnesses.

DISCUSSION AND ANALYSIS

32. In my judgment, this application should be dealt with as concisely as possible. It is not, in my view just, to deal with a number of issues raised in the Summons, without having had the benefit of cross-examination. This is because it is disputed that there has been destruction/withholding of material relevant to these proceedings carried out by the Company. As regards the Chairman Issue and his alleged eye challenges, I must say that some of the positions taken by him in his evidence are quite incredible. However, I do not think it would be appropriate to make a finding against Mr. Zhou in the light of the

totality of the evidence, and without his evidence and explanations, (odd though they may be), having been tested by cross-examination.

33. Whilst I take the Dissenting Shareholders' point about the fact that of the 86 unsworn affirmations which were made in Chinese, that 85 of them do not comply with Practice Direction No. 4 of 2015, I am not prepared to dismiss this evidence, or to give it no weight. In those affirmations the affiants confirm that no Company documents have been deleted.

34. The Court notes that Mr. Teo has filed 19 Reports in each of which it is acknowledged that the Company has continued to provide assistance and cooperation.

35. Whilst the Destruction Instruction was unfortunate, (even peculiar), there is no evidence to indicate or suggest that the documents, if deleted, and consisting essentially of personal data, would have been responsive to the Forensic Audit.

36. As regards the Email Issue, Mr. Teo's weekly report dated 19 June 2018 shows that there is no problem with the email archive system to the extent and magnitude suggested by the Dissenting Shareholders. To the contrary, as submitted by the Company, the three identified remaining issues appear as if they were still being examined and can potentially be resolved.

37. In my judgment, there is no proper basis upon which the Court could find that there has been contumelious conduct or at the very least, continuing disregard for discovery obligations.

38. At the stage of this application, the Dissenting Shareholders have not analyzed the evidence or demonstrated that there has been deletion of important material. They have also therefore not been able, in any event, to demonstrate that a fair trial is impossible.

39. As a result of the views I have formed, it is not necessary to resolve some of the complex issues raised as to the breadth of the Court's powers to disallow or debar evidence. (See for example the arguments raised in paragraph [30] above.)

40. The evidence and circumstances of this application do not, in my judgment, reach the level that would be required in order to justify the draconian relief sought.

41. In my judgment, this application falls to be dismissed, with costs to be costs in the cause, with liberty to apply. If the Company had not made the unfortunate and odd Destruction Instruction, the Dissenting Shareholders might not have had a catalyst for making this application, and thus in my view, "*costs in the cause*" is a just order.

42. The Forensic Audit being performed by Mr. Teo is to resume as soon as reasonably practical in the new year, and reports are to be provided to the Court weekly, as before, giving updates on the progress made, or problems encountered. Thereafter, a case management conference will have to be fixed with a view to making directions for progressing this case to trial.

THE HON. JUSTICE INGRID MANGATAL
JUDGE OF THE GRAND COURT