IN THE GRAND COURT OF THE CAYMAN ISLANDS

FINANCIAL SERVICES DIVISION

Cause No FSD No. 112 of 2017(RPJ)

IN THE MATTER OF THE COMPANIES LAW (2016 REVISION)

AND

IN THE MATTER OF KONGZHONG CORPORATION

BETWEEN

KONGZHONG CORPORATION

PETITIONER

AND:

(1) MASO CAPITAL INVESTMENTS LTD

(2) BLACKWELL PARTNERS LLC – SERIES A

(3) KEVIN X KU

(4) HAIFENG TANG

HEADNOTE

Section 238 Companies Law-case management-conduct of meetings of experts with company management-admissibility of transcript and regulation of meetings-costs principles - Judicature Act (2017 Revision) s.24(1) and (3)-Order 62 rr4(11)and 11(12) -costs to follow event-indemnity costs-costs on a summons for directions-costs in cause-discrete applications.

RULING

INTRODUCTION

1. Kongzhong (the **Petitioner** / **Company**) applies for costs arising out of a summons for further directions it filed on 24 May 2018.

2. The Petitioner's summons was an application in proceedings commenced under section 238 of the Companies Law.

3. When I heard the application on 27 June 2018, the issue that remained in dispute was the Petitioner's proposed amendment to paragraph 14 of the Directions Order regarding the admissibility of the transcript of the management meeting.

4. On 13 July 2018 I made the order sought by the Petitioner that the transcript of the management meeting held pursuant to paragraph 14 of the directions order dated 5 February 2018 (as varied) (**Directions Order**) and its contents shall not be admissible in evidence, unless otherwise agreed or directed by the court.

5. I gave a reasoned Judgment on 6 August 2018 (the Judgment). In it I commented that directions concerning meetings to be held between experts and the Company's management had been subject to limited trial experience, as only three section 238 Companies Law valuation cases had proceeded that far (paragraph 3). I confirmed that in my earlier Judgment of 2 February 2018 (the **Earlier Judgment**) I had found that the court had jurisdiction to order the Company's management team to meet with the experts and that such meetings are to be "open" so that the experts are entitled to refer to and rely upon information obtained during the course of such meetings in helping them to prepare their reports, unless good arguments were advanced as to why that should not be the case (paragraph 4). I commented that my reasoning in the Earlier Judgment followed from my view that these meetings are likely to be helpful to the experts and it would be more productive if they were able to rely on information obtained. If any party wished to suggest that that should not be the case, they could apply to the court with reasons as to why that should be so (paragraph 5). I noted that I was not following Segal J's approach in *Trina*, which as I understood it, was to render inadmissible in evidence anything said in such meetings, unless the parties agreed to waive what he considered to be a form of without prejudice privilege (paragraph 6).

6. The Petitioner had (having notified the Respondents that it intended to do so) applied for its costs to be paid on the indemnity basis. I gave liberty to apply as to costs in respect of the summons and gave a direction on 31 October 2018 for the exchange of written submissions so that the parties' costs of that summons could be dealt with on the papers.

7. The parties exchanged written submissions on 16 November 2018 and then further written submissions in reply on 30 November 2018. The Petitioner seeks an order that the Respondents pay its costs on the indemnity basis. The Respondents reject the Petitioner's application and seek an order that costs be in the cause and that they should be paid the costs of this application on the standard basis.

The Petitioner's case

8. The only matter for determination by the court at the hearing of the summons was the order sought at paragraph 4 and that order was made. The Petitioner was the successful party and is therefore entitled to recover its costs of the summons, unless there are exceptional circumstances to justify departure from the general rule, which is that costs follow the event. Such circumstances, it submits, are not present,

particularly given that the basis for the order sought and authorities supporting the order were articulated in *inter partes* correspondence before the summons was filed. The Petitioner points to the correspondence as evidencing that it took steps to resolve matters which were the subject of the directions sought in the summons with the Respondents during May and June 2018.

9. The Petitioner also submits that ultimately this court dispensed with the Respondents' argument that the Petitioner was not entitled to seek to vary the Directions Order and confirmed that the issue in dispute between the parties was a case management issue and stated (see paragraph 36 of the Judgment):

"...that the Petitioner was perfectly entitled to apply as it had done under the liberty to apply provisions of the directions order for a specific direction in relation to the status of the transcript."

10. The Petitioner argues that it is entitled to its costs on an indemnity basis because the position adopted by the Respondents in opposition to the direction sought in paragraph 4 of the summons was unreasonable in that it was wrong as a matter of law, inconsistent with the inherent jurisdiction of the court's case management powers, and inconsistent with recent authority on the issue and to which reference had been made in correspondence before the hearing.

The Respondents' case

11. The Respondents reject the Petitioner's case and seek an order that costs be in the cause. The Respondents suggested this outcome to the Petitioner in an attempt to avoid the need for this application in July and October 2018 and the Petitioner rejected it on both occasions. They therefore submit that if I was to agree with the Respondents that costs should be in the cause, the Respondents costs of this application should be paid by the Petitioner on the standard basis.

12. The Respondents point out that at an initial directions hearing on 4 December 2017 they sought an order for management meetings to be conducted to assist the experts in the preparation of their reports and that those meetings should *not* be conducted on a without prejudice basis, but rather that the meetings should be open, such that the experts would be able to rely upon the information obtained in those meetings. The Petitioner submitted that the court had no jurisdiction to compel the conduct of management meetings and did not address the question of whether, if ordered, those meetings should be open or without prejudice.

13. This court decided (in the Earlier Judgment) that the Respondents were right and that the Petitioner should make appropriate members of its management team available to meet with the experts for the purpose of providing information and answering queries which were relevant to the preparation of their respective opinions. The parties should proceed on the basis that such a meeting is *open* so that the experts were entitled to refer to and rely upon any information obtained during the course of

such meetings in helping them to prepare their reports, unless there were good arguments as to why that should not be the case.

14. There was no appeal of that decision and instead in an exchange of correspondence in May 2018 the Petitioner initially reiterated that it objected to management meetings being ordered *at all* and stated that management meetings if ordered were to be held on a without prejudice basis.

15. The Petitioner proposed first, that there should be an order (agreed by consent) which provided that the transcript of the management meeting and its contents should not be admissible in evidence unless otherwise agreed or directed by the court. Additionally, the Petitioner proposed that experts may use the information obtained at the management meeting for the purposes of preparing their reports, save that if the Respondents' expert proposes to place any reliance on specific oral statements made by the Petitioner in support of any express finding or conclusion, the Respondents' expert shall afford the Petitioner a reasonable opportunity to clarify or comment on the relevant statement in writing before the expert completes his report.

16. The Respondents submit that the Petitioner's position by its letter dated 10 May 2018 and from Mr Lai's affidavit dated 24 May 2018 was that the management meetings should be held on a without prejudice basis, they were closed, that is to say the experts could only rely on anything said if they clarified the Petitioner's comment or statement in writing before the experts completed their reports, and that the transcripts were inadmissible in evidence, unless otherwise agreed or ordered by the court.

17. The Respondents did not agree to the Petitioner's draft consent order because the question of whether the management meetings were to be held on an open or without prejudice basis had already been decided against the Petitioner after full argument at the hearing on 4 December 2017 and the Petitioner had not appealed. The Respondents were not prepared to entertain an impermissible 'backdoor' appeal.

18. The Petitioner finally accepted, albeit belatedly, that management meetings cannot be held on a without prejudice or closed basis. In the Petitioner's 21 June 2018 written submissions, Mr Lowe QC stated at paragraph 31:

"The company does not dispute that a management meeting will occur in accordance with the order made at paragraph 14 of the directions order. However the company is seeking clarification and further direct from this Honourable Court in respect of the nature of the transcript produced from such a management meeting. In particular the company seeks an order that the transcript of the management meeting held and its contents is not admissible unless otherwise agreed directed by the court."

19. The Respondents submit that they had no choice but to respond to the without prejudice point because of the way the Petitioner had put its case and that they were again successful on it. They submit that Mr Lowe QC belatedly resiled from the

Petitioner's position that the management meeting should be without prejudice/closed and concentrated instead upon the admissibility of the transcript as a way of regulating the fairness of the process of recording oral statements made.

20. The Respondents submit that they did not know the case they were required to meet because of the way in which the Petitioner had put its case. On its own evidence, the Petitioner was unequivocally advocating for management meetings to be closed and to be held on a without prejudice basis. It only became clear at the eleventh hour upon receipt of the Petitioner's submissions that this was no longer what was being proposed. The Respondents should not be penalised in costs in having to deal with points which were ultimately rendered moot and which resulted in costs being thrown away. It would be unfair as a matter of principle for the Respondents to be ordered to meet the costs of responding to a point which the Petitioner ultimately abandoned because it had already been decided against it. In the circumstances the Respondents consider that they should be entitled to their costs, however it is submitted that the ordinary order on a directions application should be made, that is, costs in the cause. In view of the Petitioner's conduct in relation to its summons for further directions its request for a cost order on an indemnity basis is plainly unreasonable.

The law

21. This court's jurisdiction to make orders for costs is derived from the Judicature Law (2017 Revision). The court has a discretionary power to determine the extent to which costs are to be paid in civil proceedings - see sections 24(1) and (3). The discretion has to be exercised in accordance with Order 62 of the Grand Court Rules 1995 (revised edition) (**GCR**).

Costs to follow the event

22. A successful party should be entitled to recover its reasonably incurred costs from the opposing party unless, in the circumstances of the case, justice requires some alternative order - see *AB Jnr v MB(Grand Court) per Smellie CJ 16 June 2013 at para 28 and Order 62 rr 4(2) and (5) GCR.*

23. The principles that the court should follow when considering whether it is appropriate to depart from the usual rule (that costs should 'follow the event') were summarised by the Court of Appeal in *Re Elgindata Ltd (no 2) [1992] 1 WLR 1207 per Nourse LJ:*

" The principles are these, (i) costs are in the discretion of the court, (ii) they should follow the event, except when it appears to the court that in the circumstances of the case some other order should be made, (iii) the general rule does not cease to apply simply because the successful party raises issues or makes allegations on which he fails, but where that has caused a significant increase to the length or cost of the proceedings, he may be deprived of the whole or a part of his costs, (iv) where the successful party raises issues or makes allegations improperly or unreasonably the court may not only deprive him of his costs it may order him to pay the whole or a part

the unsuccessful party's costs .....Moreover, the fourth (principle) implies that a successful party who neither improperly nor unreasonably raises issues or makes allegations on which he fails ought not to be ordered to pay any part of the unsuccessful party's costs."

Indemnity costs

24. The court's power to make an *inter partes* order for costs to be paid on the indemnity basis is dealt with in Order 62 rr 4 (11) and 11(12). The power can only be exercised where the court is satisfied that a party has conducted proceedings, or that part of proceedings to which the order relates, improperly, unreasonably, or negligently (rule 4(11)). Where it appears to the court that anything has been done, or that any omission has been made, improperly, unreasonably, or negligently by or on behalf of any party, the court may order that the costs of that party in respect of the act or omission shall not be allowed, and that any costs occasioned by it to any other party shall be paid by him to that party.

25. The interplay between these two rules was explained in *Al Sadik* [2012] (2) CILR 33 by Jones J:

"9.The interplay between these two rules is not immediately obvious. The application of those rules depends upon establishing that a party has behaved improperly, unreasonably or negligently in some way, but I think that they are aimed at dealing with misconduct in two different contexts. Rule 4(11) is aimed at substantive misconduct on the part of a party personally which results in a court expressing its disapproval by making an order for indemnity costs against him. Rule 11 (as a whole) is aimed at procedural misconduct by a party and/or his attorney which causes their opponent to waste money on legal fees and expenses which would not otherwise have been incurred. In both cases the result is an order for indemnity costs because rule 4(11) deals with substantive misconduct committed by the party for which his lawyer is not responsible, the order for indemnity costs can be made against only the party personally. In contrast rule 11 is aimed at procedural misconduct of a kind likely to be committed by attorneys for which their clients should not necessarily be held responsible. It follows that rule 11 is wider than rule 4(11) in that it enables the court to make wasted costs orders against a party under paragraph (2) or against his attorney under paragraph (3). Orders can be made against attorneys for the purpose of compensating the opposing party and/or compensating their own clients.

10. It follows from this analysis that rule 11 (2) and (3) our compensatory in nature. The court can only make a wasted costs order if it is satisfied that the misconduct of the defaulting party and/or his attorney has caused their innocent opponent to waste money on legal fees and disbursements which would not have been incurred but for their default."

26. The court also has an inherent jurisdiction to grant costs on the indemnity basis - see *Ahmad Hamad Algosaibi v Saad [2013] (2) CILR 344 at para 9 per Smellie CJ*:

"In considering awards for indemnity costs, the court's focus should primarily be on the conduct of the losing party, not on the substantive merits of the case. Such an award should be made only in exceptional circumstances, such as where the losing party behaved improperly, negligently or unreasonably. Advancing a claim which was unlikely to succeed, or which did in fact fail, was not by itself sufficient for the award of indemnity costs; to justify such an award there should normally be an element in the losing party's conduct which deserved a mark of disapproval. That conduct would need to be unreasonable to a high degree though may fall short of deserving moral condemnation".

Decision

The nature of the application

27. In determining a fair costs outcome I have first assessed the nature of the application. As I said in my Judgment this was a further case management hearing on the question of management meetings with experts. As I pointed out in my Judgment in section 238 cases the court is heavily reliant on experts and in order that the court is provided as efficiently as possible with all relevant information upon which ultimately to make a decision on fair value, the maximum benefit that can be derived from management meetings was desirable (see paragraph 37).

I said that (at paragraph 38):

"..I have decided that the admissibility of the transcript of such a meeting should be a matter for agreement between the parties and ultimately a matter for the trial judge. It seems to me that arguments over precisely what was said, the context in which it was said, the room for interpretation of what was said and the emphasis which may be placed on a verbatim written transcript is not helpful to the overriding objective or to assisting the court. If these transcripts were admissible in evidence without more it seems to me that inordinate amounts of time and effort could be spent arguing over the subtleties and nuances of exactly what was said, the accuracy of precise translation, and the argued for implication or consequence. There is a real risk of more heat than light being generated."

28. The narrow issue of whether the transcript of the management meeting should be admissible in evidence was not a discrete issue divorced from the wider considerations advanced before the hearing and which arose from the previous case management hearing. It is intimately connected with the following questions: once management meetings are ordered by the court and should therefore take place, how they are to be conducted; their purpose; and what use may be made of information and statements made in them. A transcript of the meeting is one way of using the output of the meeting and its admissibility as evidence at trial is an obvious question which arises. It is clear from the Judgment (see paragraphs 40 - 44) that guidance was being sought and was obtained in relation to matters of fairness, the nature of the

evidence provided by Company's management, and the way that meetings should be conducted. In that regard I accepted Mr Lowe QC submissions that there should be a protection to avoid transcripts becoming litigation tools or traps (-see paragraph 42). I also made it clear that the experts may use the information and other material obtained at the meeting in order to prepare their reports because if they were unable to do so then information which they considered relevant to fair value could not be explained in their reasoning and by reference in their reports, which would be unfair and would put them in a very difficult position (-see paragraph 44).

29. As Kawaley J recognised in *Nord Anglia (unreported, 24 October 2018)* the costs to follow the event rule is the governing principle of the costs regime and costs orders in relation to distinct issues may be ordered where applications have been pursued on a freestanding basis.

30. However, he also made the point that the character of the summons for directions is, conceptually at least, an essentially neutral and necessary case management mechanism aimed at advancing the proceeding to trial for the mutual benefit of all parties (see paragraph 32). He found that whilst the predominant practice is therefore that costs are generally to be in the cause at directions hearings, this is consistent with the costs to follow the event principle, because the successful party recovers at the end. I respectfully agree and indeed that was the order I made following a contested hearing on the first summons for directions when in my earlier Judgment I decided a majority of points in favour of the Respondents.

31. The order sought by the Petitioner in paragraph 4 of the summons for further directions was not in my view a freestanding discrete issue but a consequential matter arising from my Earlier Judgment. The admissibility of the transcript of the management meeting was a matter arising from my decision that the management meetings would *not* be without prejudice but open and was not the only guidance obtained at the hearing.

32. In my view the application clarified for both parties the way management meetings and their output should be treated beyond the narrow issue of the admissibility of the transcript.

The way the case was advanced and argued

33. The Petitioner says it has succeeded on its narrow application and had made its position clear to the Respondents, at least from receipt of the summons as of 24 May 2018, so should be awarded its costs. However, that is not the way the case was advanced before the hearing, or indeed heard and decided.

34. I ultimately decided that the status of the transcripts was a case management issue and that the Petitioner was perfectly entitled to apply for an Order to clarify how they were to be dealt with (see paragraph 36 of my Judgment), but that was not the only issue in play between the parties as they prepared for the hearing.

35. The Petitioner's attorney's letter of 10 May 2018 gave reasons for the order sought and the authorities in support. However, it also stated that '*... the company has objected to management meetings being held and made submissions at the directions hearing against such meetings for a variety of reasons. It remains our view that management meetings, if they are ordered should be held on a without prejudice basis'*.

36. Also a second order was identified suggesting a mechanism for the use of information given by way of oral statement at a management meeting (which would allow the person whose statement was being relied upon an opportunity to clarify or comment in writing before the expert completed his report). The second order was not proceeded with.

37. The Respondents initially rejected this proposal on the basis the Petitioner did not have the right to seek to vary the directions already made and that its recourse was to appeal the directions order. The admissibility point had not been raised at the original directions hearing on 4 December 2017 and the Respondents made clear their concern that the without prejudice point (which had not been appealed) should not be re-litigated. As can be seen from the response of 15 May 2018, the Respondents believed (1) that the Petitioner was objecting to management meetings being held at all and (2) the Petitioner was saying if they were to be ordered that they should be held on a without prejudice basis. In the circumstances that belief was reasonable and the Petitioner did not correct it until its written submission on 21 June 2018.

38. A further uncertainty arose because in his affidavit of 24 May 2018 filed on behalf of the Petitioner, Mr Lai concentrated on the without prejudice point, and was silent on the admissibility of the transcript. The Respondents took that to mean that the Petitioner was arguing that management meetings should be held without prejudice (notwithstanding my earlier Judgment) *as a consequence of which* the transcript was inadmissible. This understanding is consistent with Mr Thornton's first affidavit dated 11 June 2018 filed on behalf of the Respondents which dealt extensively with the reasons why in his view it made no sense to for the meetings to be held without prejudice. The response from Mr Maclean on behalf of the Petitioner dated 15 June 2018, whilst acknowledging that the restriction sought was not intended to prevent the experts from relying on explanations and clarifications made at the management meeting or in response to a pre-prepared list of questions, did not make clear how the experts might rely on the information derived from the management meeting if it were to be held without prejudice.

39. It only became clear that the Petitioner was not seeking to do so when skeleton arguments were exchanged on 21 June 2018 and it could be seen that the Petitioner's argument did not focus on the question of the legal status of the meeting. Indeed Mr Lowe QC indicated at the hearing that the legal status of the meeting did not arise at this stage of the proceedings but could be used as a 'safety valve' further down the line. He put his case on the basis of case management as to how the evidence could

be used and expressed a concern, as a matter of fairness, as to the way in which the process would be regulated. The way that point was dealt with was to decide that the transcript would be inadmissible unless agreed or ordered by the court.

40. Up until exchange of submissions on 21 June 2018 the Respondents say that they were concerned that in view of the Petitioner's position the management meeting might not have any utility at all and the experts needed to be able to rely on the information that was obtained. They did not appreciate that the Petitioner might be accepting that the experts would be entitled to rely on the information and clarifications given by the Petitioner in the management meeting (subject to certain safeguards). From the correspondence and evidence exchanged that was a reasonable view for the Respondents to have formed. As can be seen from paragraphs 31, 34 and 37 of my Judgment I confirmed that management meetings should be open and gave reasons.

41. In all the circumstances of the case, balancing the interests of justice, and taking into account the conduct of both parties, costs should be in the cause. Whilst the Order I will make is in accordance with the Respondents' submissions, a fair outcome is that costs be in the cause in respect of this application as well.

42. The issues concerning management meetings have been fully contested. They were aimed at and did in my view succeed at advancing the proceedings to trial for the mutual benefit of all parties. As the Petitioner's attorney's letter of 10 May 2018 pointed out, there were a number of recent decisions of the Grand Court to consider in relation to statements made at and the admissibility of transcripts obtained from management meetings (see *Trina, E-Commerce, Xiadou, E House* and *Nord Anglia*) and there was good reason for the matter to be addressed to ensure a consistent and fair approach. I should say that even had I formed the view that this was a discrete application and that in all the circumstances costs should follow the event, I would not have awarded the Petitioner indemnity costs. There was no conduct in this case which would justify such an order.

THE HON. RAJ PARKER
JUDGE OF THE GRAND COURT
18 DECEMBER 2018

GRAND COURT CAYMAN ISLANDS