IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

Cause FSD 123 of 2015 (IMJ)

IN THE MATTER OF PART XVI OF THE COMPANIES LAW (2013 REVISION)

AND THE MATTER OF FOUNTAIN MEDICAL DEVELOPMENT LTD

BETWEEN

FOUNTAIN MEDICAL DEVELOPMENT LTD

Petitioner

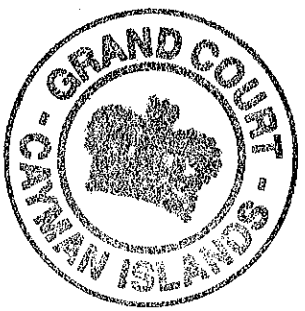
AND

QIAO JOANNE JIANG CHEN

Respondent

IN CHAMBERS

Appearances:	**Ms. J Colegate of Collas Crill on behalf of the Petitioner** **Mr. R Hacker QC instructed by Ms. A Peccarino and Mr. B Patel of Travers Thorp Alberga on behalf of the Respondent**
Before:	**The Hon. Justice Ingrid Mangatal**
Heard:	**6th and 7th November 2017**
Draft Judgment Circulated:	**16 January 2018**
Judgment Delivered:	**19 January 2018**



HEADNOTE

Section 238 of the Companies Law (2016 Revision) - Application for specific discovery - Order 24 Rule 7 of the Grand Court Rules (1995 Revision) - Expert evidence as to relevance.

JUDGMENT

Introduction

1. This is an application by the Respondent to the proceedings Qiao Joanne Jiang Chen ("**Dr. Chen**"), by summons dated 26 June 2017 (the "**Summons**"). It is made pursuant to Order 24, Rule 7 of the Grand Court Rules ("**1995 Revision**") (the **"G.C.R**"), and is for an order that the Petitioner Fountain Medical Development Limited (the **"Company**") , gives discovery of the documents specified in the Summons.

Abbreviated Background

2. The Company is an exempted limited liability company incorporated in the Cayman Islands on 8 June 2007.

3. On 11 May 2015, the Company's directors resolved to undertake a merger (the "**Merger**"). This was approved at an Extraordinary General Meeting of the Company's shareholders held on the same date (the **"EGM**").

4. Dr. Chen is a former holder of 2,208,000 Class 2 common shares of the Company (the **"Shares").** Her shareholding was extinguished (she says very much against her wishes), as a result of the Merger.

5. The Petition in this case is a proceeding filed by the Company under section 238 of the ***Companies Law*** (2016 Revision) (the **"Law**"), specifically sub-section 238(9) seeking the Court's determination of the fair value of Dr. Chen's shares.

Evidence

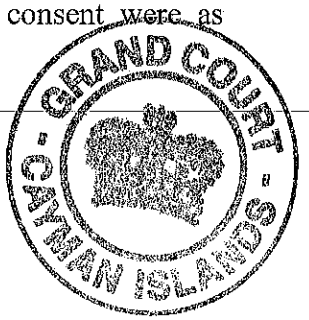
6. The Summons is supported by Dr. Chen's first affirmation which was filed on 22 August 2017. Dr. Chen states that she was one of the founding members of the Company, a major shareholder and a former director of the Company. She indicates that prior to the Merger, she was directly and heavily involved in the affairs of the Company. The Company's evidence in answer is the second affidavit of Dan Zhang, which was filed on

22 September 2017. Mr. Zhang is a director and shareholder and he was also a director, major shareholder and founding member of the Company prior to the Merger. Dr. Chen's reply evidence is her second affirmation, which was filed on 16 October 2017.

7. Latterly, expert evidence was filed by both parties. This evidence has obviated the need for the Court to trawl through the numerous allegations and counter-allegations as to relevancy and connectedness and other matters raised by the parties' factual witnesses themselves. The Affidavit of George Bullmore was filed on behalf of the Company on 5 October 2017 and the Affirmation of Rick Schwartz was filed on behalf of Dr. Chen on 27 October 2017.

Agreed Directions Orders

8. It is to be noted that it is the parties that have agreed a number of directions orders to date, based upon discussions amongst themselves and signed off by the Court without any hearings or argument/discussion. These orders entered into by consent were as follows:



(a) Order on 9 February 2016 (the **"Directions Order"**) ;

(b) Order on 2 May 2016 (the **"First Variation Order"**);

(c) Order on 20 July 2016 (the **"Second Variation Order"**);

(d) Order on 8 May 2017; and

(e) Order on 26 October 2017.

9. In the Directions Order, in relation to discovery, the parties of their own volition agreed to standard Order 24 discovery by list, with inspection thereafter. That provision was not varied in any of the subsequent Consent Orders.

10. By the original terms of the Directions Order, the parties were to exchange experts' reports in relation to the fair value of the Shares on 9 May 2016.

11. In accordance with the Directions Order, on 7 March 2016 the parties exchanged their discovery lists and inspection took place on 14 March 2016.

12. Dr. Chen thereafter changed her Cayman Attorneys from Appleby to Travers Thorp Alberga ("**TTA**") and the parties agreed (by way of the First Variation Order) to extend the time for exchanging expert reports to 11 July 2016.

13. Dr. Chen engaged Zolfo Cooper (now Kalo) as valuation experts in mid-2016, and on 1 July 2016 TTA wrote to the Company's Attorneys, Collas Crill ("**CC**"). As Mr. Hacker QC sets out in his written submissions on behalf of Dr. Chen, the letter:

(a) advised that a number of documents not referred to in either of the Lists of Documents exchanged between the parties had come to TTA's attention; and

(b) enumerated a series of disclosure requests and requests for clarification made by Dr. Chen's then valuation experts, Zolfo Cooper, which they needed for the purposes of completing their expert report.

14. Dr. Chen served a supplemental list of documents on 5 July 2016.

15. The TTA letter of 1 July 2016 requested a response within 7 days and threatened an application to the Court if one was not forthcoming. On 6 July 2017, CC wrote to TTA confirming that they had asked their client to provide the documents "*as a matter of urgency*" and that :

> *"[the Company] will provide the requested information and documentation as soon as they are able".*

16. It is Dr. Chen's position that there was a clear and unequivocal promise in the CC letter of 6 July to supply the requested documents and information and which amounted to a binding agreement, which she relied upon to her detriment, and provided good consideration by not pursuing her threat to make application to the Court. Mr. Hacker QC indicates that, in the event, and in clear breach of the agreement, the majority of the documents and information were not provided, whether "*as a matter of urgency*" or at all.

17. Indeed, the Second Variation Order specifically provided by consent that the time for the exchange of the Expert Reports was again extended until "*14 days after the [Company]'s provision of information and documentation requested by [Dr. Chen] in her letter dated 1 July 2016, to the extent that such information and documentation is within the [Company's] possession, custody and power*".

18. The Order on 8 May 2017 provided for the Company to pay to Dr. Chen an interim payment of US$996,094 and this has been done.

19. As indicated earlier, the application has now been simplified by the fact that, albeit there was initially some disagreement between the parties as to the need for expert evidence, by Consent Order dated 26 October 2017, it was agreed that both parties would be permitted to adduce expert evidence by way of affidavits. Originally, TTA had taken the position that, since the Company had agreed to give standard Order 24 discovery, that the classic test laid down in the well-known ***Peruvian Guano*** case, (1882) 11 Q.B.D. 55 applied, and that the Court could judge relevance by applying that test having regard to the factual evidence presented by the parties. CC maintained that the Company nonetheless wished to adduce expert evidence in opposition to the Summons.

20. At the time when Mr. Bullmore's Affidavit was filed on behalf of the Company, he had only Dr. Chen's evidence (as opposed to Mr. Schwartz' evidence) to consider in relation to relevance of documents. Mr. Bullmore is a Chartered Accountant, a former senior Partner of KPMG and is currently retained as a consultant to KPMG. He indicates that during his 46 years in the accountancy profession, he has audited companies in a wide variety of business sectors and has particular expertise in the fields of offshore audit and accounting, business valuations and damages calculations.

21. At paragraphs15-24 (inclusive), Mr. Bullmore states as follows:

> *"15. There are several accepted valuation techniques that could be applied in determining the fair value of a company's shares. I summarize the most prevalent techniques below:*
>
> *15.1. DCF Method*

This valuation technique determines fair value by calculating the present value of expected future cash flows including a terminal value at the end of a projection period. It is difficult to apply to companies which are projected to be loss making in the future.

15.2 Transaction Multiples Method

This valuation technique derives fair value by considering valuation multiples of comparable transactions. It is difficult to use in circumstances where there are few data points relating to private transactions. In other words, the evaluation of traded comparable requires knowledge of the company being evaluated.

15.3. Traded comparable method

This valuation technique determines fair value as a multiple of revenue or earnings of the underlying company. The multiple is derived from the market capitalization and revenue/ earnings metrics of a pool of comparable, traded companies. Commonly used multiples under this approach are Price/ Earnings, Enterprise Value/ Earnings Before Interest, Taxes, Depreciation and Amortization and Enterprise Value/ Sales ("EV/Sales").

16. *Taking into account the role and function of the Company within the FMD Group I would anticipate that the value of the Company would best be determined using the traded comparable method, and in particular the EV/Sales method. This is easy to apply because:*

16.1. One can use public company data;

16.2. There are fewer inputs required as compared to the DCF Method; and

16.3. *In the Pharma/clinical testing space this method tends to be preferred.*

17. *Notwithstanding my conclusion, I have considered the requests for documents and information set out in the Schedule (discussed below) from the perspective of all three valuation methodologies described in paragraphs 15.1 to 15.3 above, which may be less suitable but which may still be applied to ensure that the potential range of relevant documents can be identified.*

C. The Schedule of Requests

17. [Error in numbering] *The Schedule sets out 29 categories of requests for documents and information pertaining to the Company and the wider FMD Group. I have considered each of the categories of documents/information requested by the Schedule and in doing so I have considered the:*

17.1. *type of information/documents requested.*

17.2. *corporate entity/entities to which the information/documents relate/concern;*

17.3. *date range of each request and its proximity to the Merger date.*

18. *There is no definitive guidance on relevant date ranges in valuation literature, and the relevance of date ranges in request for documents are dependent on the specific circumstances of each valuation, the valuation methodologies adopted and the judgment of the valuer.*

19. *When I refer to date ranges, I mean date ranges in respect of specific one-off events, for example a valuation or share purchase.*

Obviously, if for example a contract was in force as at the valuation date it will be relevant regardless of when it was executed.

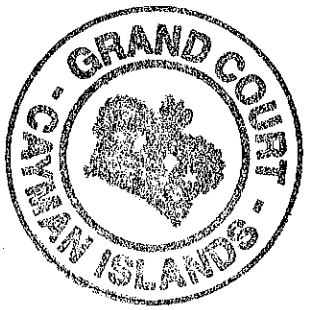
20. *Notwithstanding this, in my experience it is generally possible to carry out a meaningful valuation of a well-established company with three years of historical records and data available.*

21. *The purpose of reviewing historical data is to estimate the future profitability and possible results of the entity being valued. In the case of start-up companies where there is a rapid change in the scope and volume of operations past data quickly becomes less relevant in projecting future results. Accordingly, in the valuation of FMD Cayman I would not consider it necessary to review documents produced more than two years prior to the Valuation Date unless there was a specific reason for doing so.*

22. *In terms of documents which post-date the Valuation Date, I have been instructed that these are only to be considered relevant to the valuation to the extent that they provide additional information about the circumstances of the company as at the valuation date. The longer the date of production of a document is from the valuation date, the less likely it is to contain relevant information.*

23. *In my opinion, under any of the valuation methodologies described in paragraphs 15.1 to 15.3 above, I would not consider it necessary to review documents produced more than one year after the valuation date, unless I had a specific reason for doing so.*

24. *Given that the valuation date is in May 2015 and that the document request is stated in terms of calendar years, erring on the side of more generous disclosure I consider that (in the absence of a special reason to consider a document to be relevant)*



the acceptable range of disclosable calendar years is 2013 to 2016. I should point out that this period corresponds very closely to the period discussed in paragraph 55 of Jiang 1, which refers to financial information three years before and one year after the Merger as being directly relevant to the fair value calculation for the shares."

(My emphasis)

22. Mr. Schwartz is a Managing Director in the Valuation Advisory Services Group of Duff & Phelps, with a PhD in Engineering-Economic Systems. In his Affirmation filed on behalf of Dr. Chen, he indicates that he has over 30 years of experience in providing valuation, market research, forecasting, and strategy analysis services to clients in the pharmaceutical/biotech, medical device, diagnostic, health care services, and information technology industries, among others. It is his view that his experience is directly relevant to the type of business in which the Company is or was engaged. In his Affirmation, where he has had the benefit of seeing Mr. Bullmore's Affidavit, Mr. Schwartz indicates that he has formed his views as to relevance independently of the views expressed by Dr. Chen, though he has been informed by Dr. Chen's understanding of what documents may be available and should be disclosed.

23. Broadly, Mr. Schwartz has indicated that in his view the documents in the schedule to the Summons are relevant. He has done so by way of Exhibit "RS-1A", to his Affirmation. This consists of a Table, examining the documents referred to in the Schedule to the Summons, in terms of relevance, and includes both Mr. Bullmore and Mr. Schwartz's comments. At paragraphs 14-20 (inclusive) of his Affirmation, he states as follows:

> *"14. When valuing a business, standard practice is to consider multiple approaches. Best practice is to consider the results of valuations based upon the application of more than one approach, triangulate on the best estimate of value, and inform and support that conclusion. I will define the three valuation approaches that I believe to be relevant to FMD's valuation:*

a. *Cost Approach*

The Cost Approach provides an indication of value based on the "replacement cost" of the business, using the balance sheet. This method can be informative as related to a young or newly created entity, in an early growth or formation stage during which current performance and/or financial projections for the subject entity are not readily available as a basis for applying the Market or Income Approaches.

b. *Market Approach*

The Market Approach indicates the value of a business based on comparing the business to publicly-traded companies and transactions involving company securities or similar businesses in the relevant industry. This approach can provide valuations that are estimated through the Guideline Companies Method or the Comparable Transactions Method.

The Guideline Companies Method indicates the value of the business by comparing the business to publicly-traded companies in similar lines of business. The conditions and prospects of companies in similar lines of business depend on common factors such as overall profitability and demand for their products and services (e.g. During the past five years and projected for the next five years relative to the valuation date). An analysis of the market multiples of companies engaged in similar businesses can yield insight into investor perceptions and, therefore, the value of the subject company.

The Comparable Transactions Method involves estimating the value of a business based on exchange prices in actual marketplace transactions.

c. *Income Approach*

The Income Approach indicates the value of a business based on the present value of the cash flows that the business could be expected to generate in the future. The Income Approach is widely accepted in the field of valuation as one of the primary methodologies used in estimating a company's value. The Income Approach is typically applied through a Discounted Cash Flow Method (DCF Method) or a Capitalized Economic Income Method and is based on

financial projections and informed by historical financials, typically five years of each relative to the valuation date.

15. *Depending on the valuation approach used and relevant facts and circumstances, the time frame of information and documentation to support that valuation may vary. I note that at paragraph 18 of the Bullmore Affidavit, Mr. Bullmore appears to agree with me on this point. I also note that at paragraph 17 of the Bullmore Affidavit, Mr. Bullmore also appears to agree that it is appropriate to consider all three valuation methodologies. However, Mr. Bullmore draws an overly narrow conclusion by applying only one methodology with a correspondingly narrow date range.*

16. *I will discuss below the time frame of information and documentation relevant for each approach.*

a. *Cost Approach*

In the absence of management estimates of the "replacement cost" that would be required to re-create the subject entity's current stage of development, historical costs incurred are the best starting point to estimate the replacement cost. Therefore, the relevant timeframe is from the subject entity's inception/start of expenditures, through the Valuation Date.

b. *Market Approach*

While the technical application of this method usually involves trailing twelve month financials and projected twelve month financials, the implementation details require a broader time frame of consideration, typically five years prior and projections/plans for five years post Valuation Date.

For example, the selection of comparable companies to use in determining multiples requires an understanding of the subject company's historical performance over the last five years relative to potential comparable companies in order to select those most comparable to the subject company. To illustrate, if the subject company were in a rapid growth mode and/or sustained high revenue or profit volatility

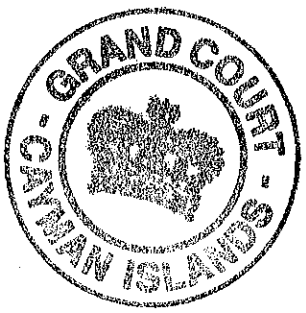
during the prior five years, other companies that are more mature and/or have more stable revenues and profitability might be accorded less weight or be excluded from the set of comparable companies, depending on other metrics driving that selection.

Similarly, the selection of comparable companies and/or where to place the subject company within the range of multiples of the selected comparable companies should consider the subject company's projections (five years post valuation date) in comparison to those of the potential or selected comparable companies. To illustrate, if the subject company has plans for future acquisitions and/or for growing its current business and/or expanding into other products/services or geographies, and/or initial public offering (IPO), investors will tend to place higher value on such a company relative to other companies with comparable current/recent revenue and profitability but with prospects that are not as aggressive/optimistic and/or well-defined or articulated.

c. *Income Approach*

A robust valuation based on an income approach should consider at least five years of history and five years of financial projections relative to the Valuation Date. Some key reasons for this include:

- *Projections are informed/validated by prior performance. Prior growth rates, profitability, and impacts of expansion initiatives, regulatory or government actions, and acquisitions and restructurings are examples of information that must be considered against the projections that have been developed for future performance. Past performance is not an absolute predictor of future performance, but whether future performance is projected to follow past trends or not, analysis of past performance is critical to supporting the assumptions used in the projections.*
- *Projections for at least five years post Valuation Date are required for a robust valuation given FMD's plans and/or prospects for geographic expansion, business growth, investment raising, a potential IPO or liquidity event, as well as to consider the impact of potential changes in government policies and regulatory actions, competition, and industry dynamics. Given these issues driving the value of the Company, a minimum of five*



years would be required as a basis for normalized-year projections for purposes of valuing the Company as a going concern using the income approach. Alternatively, specific plans and expectations for a liquidity event (e.g. Merger, purchase or sale of a company, or IPO) based on management's assessments as of the Valuation Date would be required.

17. *Furthermore, valuations of FMD exist for various dates both prior to, and following the Valuation Date. These valuations are sufficiently close to the Valuation Date that they are important to consider in establishing the fair value of the Company and the Shares at the Valuation Date. These other valuations will help me identify how the value of the Company changed and evolved in response to the Company's prior and current performance, prospects, and plans; governmental policies and regulatory actions; competitors; industry trends; and other drivers of value. These same considerations should be taken into account at the Valuation Date. Past valuations and the reliability and completeness of the Material on which they are based, will help me review the reliability of those valuations, and help me develop assumptions driving my valuation, and validate the valuation conclusion, at the Valuation Date.*

18. *Based on the aforementioned paragraphs and my review of the documents received to date, I disagree with Mr. Bullmore's statement that the "value of the Company would best be determined by using the traded comparable method, and in particular the EV/sales method. As I stated in paragraph 14 above, best practice is to consider the results of valuations based upon the application of more than one approach, triangulate on the best estimate of value, and inform and support that conclusion.*

19. *Mr. Bullmore also states that "It is generally possible to carry out a meaningful valuation of a well-established company with three years of historical records and data available." However, FMD was not a*

well-established company, given the rapidity with which its business and geographic footprint were evolving at the time of the Valuation Date, and Mr. Bullmore's comment, therefore, does not apply to the valuation to be undertaken for the purpose of these proceedings.

20. *Furthermore, Mr. Bullmore has an overly narrow view of the use of the historical data in stating that "[t] he purpose of reviewing historical data is to estimate the future profitability and possible results of the entity being valued." I believe this statement overlooks other ways to use historical data in company valuations. FMD was a dynamic and fast-changing business, such that historical data, in combination with prior valuations, may be crucial to developing valuations at later points in time. Additionally, a valuation for a given date should be validated, at least qualitatively, against available valuations for other dates, both before and after, and the associated contemporaneous facts and circumstances, particularly when the valuations, as acknowledged by Dr. Zhang, have changed dramatically over time, as was the case here."*

(My emphasis)

24. The Company has not denied the existence of the documents of which production is sought. The Company appears to take the view that the discovery sought is disproportionate and that there is a risk of breach of confidentiality on the part of Dr. Chen. It has also alleged that Dr. Chen is seeking this discovery for an improper purpose, simply seeking to impugn the Merger itself or to criticize the motivations of the Company's Board.

25. It is perhaps worth noting that this case does not represent the typical section 238 Proceedings that have made their way through the Courts of the Cayman Islands to date. In this case, the dissenting shareholder is a sole individual, who claims to be a founding member and a former director who had been integrally involved in the affairs of the Company. She does not on the evidence appear to be an arbitrage investor, (as dissenting

shareholders in some other cases have been labelled), and who have made frequent trips to the Court in various section 238 Proceedings.

26. The case is also unique in other ways. The parties appear to have adopted a consensual position of giving standard disclosure. As I understand it that has not been the type of order made by the Courts consistently or in the main to date in section 238 Proceedings. However, there is no need to delve further into that issue in this case, given the fact that provision of standard disclosure was a consensual position, and, more importantly, it is unnecessary to look into this issue at all, since there is now expert evidence before the Court as to what is relevant.

27. At the hearing in November, I asked Ms. Colegate, who appeared for the Company, what could reasonably be the difficulty in the Company providing the disclosure of documents which Mr. Bullmore obviously agreed could be relevant. Indeed, at the end of the two day hearing, I thought that it was agreed between Counsel for the parties that such documents would be provided by the Company, by the 28 November 2017. However, shortly after the hearing, the Court was advised that that agreement had unravelled. I must say that I view that as an unfortunate and impractical breakdown.

28. In my judgment in ***Qihoo 360 Technology Co Ltd FSD 129 of 2016 (IMJ)***, delivered 27 July 2017, at paragraph 88 I highlighted the fact, (as have Judges in other section 238 Proceedings), that experts may differ in the approach that they take and also as to the degree of detail or information required in order to carry out the valuation exercise required by section 238 Proceedings. At paragraphs 14 and 15 of the Court of Appeal's judgment in ***Qihoo*** CICA No. 20 of 2017, delivered 9 October 2017, per Martin JA, the Court of Appeal confirmed the acceptability of this approach.

29. At paragraph 3 of its judgment, the Court of Appeal also indicated general agreement with the statement of Jones J in ***In the Matter of Integra Group*** [2016](1) CILR 192 at [11] that "*the experts are the best judge of what information is or is not relevant for their purposes*".

Resolution

30. It is noteworthy that, in a number of instances, Mr. Bullmore agrees with positions taken by Mr. Schwartz (and Dr. Chen) as to relevance. Some of the main differences between the two experts concern the appropriate date range, and also the issue of the relevance of existing valuations carried out on dates other than the Valuation Date.

31. In any event, it is plain that at paragraph 18 of his Affidavit, Mr. Bullmore concedes that date range is ultimately a subjective question and depends upon the judgment of the valuer. At paragraph 24 of his Affidavit and in his own Schedule exhibited to his Affidavit ("TB1"), Mr. Bullmore confirms that "*....the acceptable range of disclosable calendar years is 2013 to 2016*", and thus expressly accepts that documents created after the Merger and the Valuation Date can be relevant.

32. In my judgment, the application satisfies the requirements of Order 24 Rule 7. In my view, disclosure of the documents sought should be ordered as they are relevant, and the discovery is necessary for disposing fairly of this matter; it is also proportionate. Mr. Schwartz has set out in some detail in his Affidavit, his reasons for seeking the level of disclosure that is sought in the Summons. Indeed, he has foreshadowed that since being retained in the matter, he has come to the view that there are other documents not referred to in the instant application that he may yet need to see. Further, that when other documents are disclosed, these may lead him to make further requests for additional documents.

33. I am satisfied that the liberty accorded to the experts to define relevancy in the instant case does not come close to be being oppressive or abusive and that Mr. Schwartz's views as to relevancy ought to be accorded weight and actioned by this Court by way of the disclosure process.

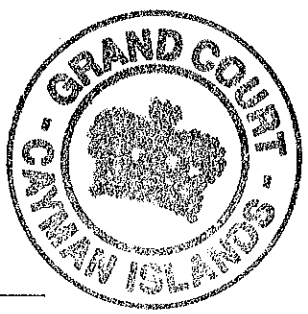
34. As regards the issue of confidentiality and potential breach, it does seem to me, as pointed out by Mr. Hacker QC, that TTA have repeatedly both (i) confirmed that Dr. Chen understands the implied undertaking of confidentiality; and (ii) offered to provide express undertakings to allay the Company's concerns. In these circumstances, and in the

absence of any evidence that Dr. Chen has misused any documents already disclosed in the Proceedings, I am not satisfied that this issue should present any obstacle to the discovery sought on behalf of Dr. Chen. In my judgment, however, as a check and balance, it is appropriate for express undertakings to be provided on behalf of Dr. Chen to deal with these concerns.

35. I am also of the view that there is no basis upon which the Court, in considering this application for discovery, can give any weight at this stage to the Company's allegations of improper purpose on the part of Dr. Chen. This is particularly so having regard to the expert evidence filed on behalf of Dr. Chen, and indeed, on behalf of the Company itself.

36. In the written submissions, Dr. Chen asks this Court to make more rigid orders in order to ensure that *"the Company can no longer ignore or flout* [the discovery] *obligations."* I am of the view that the Company has been very tardy in complying with disclosure obligations, particularly given the obligations it entered into voluntarily, and the assurances given in writing as to the documentation it would provide. It has also in my view delayed unnecessarily in providing the documents that its own expert has conceded are relevant. However, notwithstanding the foregoing, I do not think it necessary for the Court to make, for example, the Order sought that the Company swear an affidavit explaining in detail the search process carried out.

37. At this time, I am content to make the Order as sought in paragraph 1 of the Summons, and to order that the documents be provided by 9 February 2018. Dr. Chen is entitled to the costs of this application, on a standard basis to be taxed if not agreed.



THE HON. JUSTICE MANGATAL
JUDGE OF THE GRAND COURT