Section 238 roundup: recent developments in Cayman Islands appraisals

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Section 238 of the Cayman Islands Companies Act (2023 Revision) (the **Act**) provides a mechanism by which shareholders can dissent from mergers and consolidations and have the fair value of their shares determined by the Grand Court of the Cayman Islands (the **Court**).

In this latest update in our series of section 238 roundups, [1] we identify the key recent decisions and developments that have shaped the Cayman Islands appraisal landscape and look forward to what the future may hold for investors in this space.

Recent outcomes

FGL Holdings

In *FGL Holdings*[2] the Court found for the first (and only) time, that fair value should be assessed solely by reference to the transaction/merger price. However, the facts of this case were unusual and did not bear many of the hallmarks typically seen in other section 238 proceedings. In particular, the nature of FGL's operations as a financial services business meant that it was not amenable to a traditional discounted cash flow (**DCF**) analysis. Furthermore, FGL's privatisation did not arise from a conventional management/controlling shareholder buy-out, but rather from a buyer who was unaffiliated with FGL who had overwhelming support from the general body of unaffiliated shareholders.

Consequently, while this decision will no doubt have been a disappointing outcome for the dissenting shareholders involved, it did not materially alter the jurisprudential landscape for other section 238 cases featuring distinctively different fact patterns.

For more detailed analysis of the decision in *FGL Holdings* see FGL Holdings – Cayman Court determines fair value at transaction price.

Trina Solar

In *Trina Solar Limited*[3] the Cayman Islands Court of Appeal (**CICA**) overturned the first instance decision to award an uplift of only slightly over 1% and instead ordered an uplift of between 41-63% (with the final figure still to be determined).

In doing so, the CICA threw out the merger price altogether, and instead placed a 70% weighting on a positively adjusted DCF valuation and 30% on the adjusted trading price. The decision demonstrates that merging companies will struggle to rely on the merger price in circumstances where there are conflicts of interest and insufficient protections in place to ensure that the interests of unaffiliated shareholders are adequately protected. This is particularly acute in management buy-outs, where companies must now expect the deal process and the independence of the special committee to come under increased scrutiny

For more information on this successful appeal, see Trina Solar: dissenting shareholders successfully challenge fair value awarded by Cayman Grand Court.

iKang

The trend towards heavy weighting on discounted cashflow methodologies continued in *iKang Healthcare Group*,[4] where the Court placed a 90% weighting on a DCF valuation and 10% on a guideline public companies methodology. Moreover, due to the flawed nature of the merger process, the Court declined to allow the transaction price to even be considered as a cross-check to fair value.

This marks the highest weighting given to a DCF valuation in a section 238 appraisal since *Shanda Games*[5] in 2017 and is a welcome counter-balance to the deference given to the transaction price in *FGL Holdings*.

Settlements

Other high-profile section 238 proceedings have also recently settled on confidential terms, including *JA Solar*[6] and *Qihoo*.[7]

Developing areas

Amongst the many recent developments in the section 238 landscape have been important interlocutory decisions on short-form mergers, disclosure, privilege, valuation dates, interim payments, and costs.

Appraisal rights in "short-form" mergers

In *Changyou.com*,[8] the CICA upheld the Court's first instance decision that shareholders of

companies that effect "short-form" mergers[9] are entitled to dissent under section 238.

Changyou was later granted leave to appeal the CICA's substantive decision to the Privy Council,[10] which remains pending.

For more detail on these latest developments in short-form merger appraisals see Appraisal rights confirmed in Cayman Islands short-form mergers and Short-form mergers: the appraisal saga continues in Changyou.

Dissenter disclosure

In *58.com*,[11] the Court revisited the boundaries of dissenter disclosure, which have remained substantially the same since the CICA's decision in *Qunar*.[12] 58.com's attempts expand the scope of dissenter discovery were however rejected, with the Court reaffirming that dissenting shareholders are not themselves the subject of the valuation exercise and their particular motives and commercial positions are consequently irrelevant. For similar reasons, discovery cannot be sought from dissenters for the purpose of undermining their credibility.

The standard *Qunar* discovery categories were applied, along with the usual two-year temporal "look back" period from the valuation date.

For more detail on the scope of dissenter disclosure following *58.com* see Dissenter disclosure in Cayman appraisals revisited.

Company disclosure

Companies have repeatedly sought to minimise the burden of their own disclosure obligations and in *New Frontier Health Corporation*[13] the company attempted to reduce the standard lookback period for its discovery whilst also seeking more time to provide these documents to the dissenting shareholders.

In dismissing the New Frontier's arguments, the Court noted that a five-year lookback period for company discovery was customary and even though New Frontier had only been incorporated four years prior to the merger, it had since acquired business operations which existed before its incorporation. A five-year lookback period was ordered.

For more detail on lookback periods and the short shrift given to the company's request for more time to provide its discovery, see Discovery in Cayman Islands shareholder appraisals: no "new frontiers".

Privilege

In *58.com*[14] the Court clarified the circumstances in which a company involved in section 238 proceedings can assert privilege against dissenting shareholders.

The Court found that companies cannot withhold any documents relevant to fair value from dissenting shareholders based on legal advice privilege and can only assert litigation privilege in respect of documents specifically created for the purpose of prospective section 238 litigation.

This crucial decision has opened the door for dissenters to obtain, without challenge, discovery of legal advice that had historically been withheld in Cayman Islands appraisals.

For further discussion on the limitations of privilege in section 238 proceedings see Privilege in Cayman Islands appraisals – the door opens for dissenting shareholders.

Valuation dates

In *Sina Corporation*, [15] the CICA was invited to reconsider the date at which the dissenters' shares should be valued.

The Court at first instance had found that the valuation date in section 238 appraisals should, generally speaking, be the date of the EGM approving the merger. The CICA found no good reason to depart from this starting point on the facts of the case. However, it did indicate that a different valuation date could be used in future cases if it is fairer to do so, such as where buyers may have suppressed information for their own benefit or where a price sensitive event occurs after the EGM but before statutory notices of dissent are given.

Significantly, even though the valuation date remained the date of the EGM in *Sina*, the CICA found that subsequent price sensitive events could still be considered for valuation purposes if they were ascertainable as at the date of the EGM. Furthermore, the time period of a company's discovery should also be extended to cover any such price sensitive events occurring after the valuation date.

Interim payments

Interim payments remain an important part of the section 238 appraisal process, enabling dissenting shareholders to receive substantial sums pending the final determination of fair value.

In *Xingxuan Technology* [16] the Court confirmed the principles that apply to interim payments. Endorsing and applying the approach taken in *eHi Car*, [17] the Court found that it may order an interim payment of any amount as it thinks just in all the circumstances. In determining this sum, the Court will assess the "irreducible minimum" amount that it can safely be assumed a dissenting shareholder will recover. The company's previous position on fair value (for instance by reference to the merger price and its statutory fair value offer) will, at the very least, be a key factor for the Court, although it will also consider whether any positive evidence or cogent legal arguments point to a lower amount.

In awarding an interim payment of 85% of the merger price in this case, the Court found that there was no persuasive evidence or legal argument pointing to a valuation below the merger price save for the possible application of a minority discount. Adopting a broad-brush approach and erring on the side of caution, the Court consequently applied a 15% discount to the merger consideration for interim payment purposes.

For more discussion on interim payments see Interim payments in Cayman Islands shareholder appraisal actions - principles and pitfalls.

Costs

Costs awards in section 238 proceedings are determined by reference to what the Court deems equitable in the circumstances.[18] The discretion is a wide one, with a focus on doing what is just. Alongside this discretion sits the general principle that the "successful party" in Cayman Islands litigation should normally recover their reasonably incurred costs from the unsuccessful party.[19] "Success" in a fair value appraisal is however capable of multiple interpretations, and the Court has helpfully provided some recent guidance.

In *FGL Holdings*,[20] the Court confirmed that success in each section 238 case is fact specific and is not simply reflective of "who writes the cheque" at the end of the trial. Instead success depends upon factors such as the arguments advanced by the parties; their conduct in the lead up to and during trial; the opinions provided by the valuation experts; the fair value determination; and any prior offers made by the company. At trial, the Court had accepted the primary valuation method of FGL's valuation expert, while finding that the dissenters' expert's methodology provided neither a balanced view nor a central estimate. The dissenters had also accepted an interim payment from FGL before trial equivalent to the merger price, with an agreed condition that they would not have to repay any of it should fair value be determined at less than the merger price. The dissenters then continued the litigation to try to beat that price and failed to do so. Taking all these factors into account, the Court decided that FGL was the successful party and ordered the dissenters to pay FGL's costs (including the costs of its data hosting platform and contract reviewers outside the Cayman Islands) on the standard basis. Furthermore, the Court ordered that these costs be payable jointly and severally (rather than the more common pro-rata basis according to the number of shares held by each dissenter) to eliminate the risk of FGL having to pursue multiple entities for individual portions of the costs award.

In the successful *Trina Solar* appeal[21] the CICA also overturned the Court's earlier determination that there be no order as to costs[22] and ordered the company to instead pay (i) 50% of the dissenting shareholders' costs of the first instance trial; and (i) 75% of their costs of the appeal, on the standard basis. In doing so, the CICA adopted an issues-based approach to costs, reducing the dissenters' costs award due to the time devoted to issues they did not successfully appeal, notwithstanding their wider success in the proceedings.

The CICA also considered costs following the valuation date appeal in *Sina Corporation*.[23] Even though the company had not succeeded in all of its arguments in that appeal this had not caused a sufficiently serious increase in the length or cost of the proceedings. Consequently, the dissenters were ordered to pay the company's appeal costs on the standard basis. However, in taking a different approach to the Court in *FGL Holdings*,[24] the dissenting shareholders were only made liable to pay these costs pro-rata to their respective shareholdings rather than on a joint and several basis.

For more information on how cost principles have been applied in section 238 cases see Update on costs awards in Cayman Islands shareholder appraisals.

Future developments

It is anticipated that section 238 jurisprudence will continue to evolve at a rapid pace in 2024. The long-running and hotly contested *58.com*[25] appraisal is expected to go to trial mid-year and interlocutory skirmishes are heating up in other cases on novel issues such as the impact of Chinese data protection laws on the ability of companies to fulfil their discovery obligations.

The pipeline of new section 238 appraisal opportunities also remains strong, with multiple Cayman companies having been taken private at the end of 2023 and the outlook for dissenting shareholders being positively reinforced by the recent outcomes and decisions discussed above.

Ogier presently acts for dissenting shareholders in multiple ongoing section 238 matters and our cross-border team of appraisal rights specialists are well placed to provide legal advice and representation in fair value proceedings in the Cayman Islands.

[1] Our 2020 and 2022 roundups can be accessed here and here

[2] *In the matter of FGL Holdings* (unreported judgment dated 20 September 2022, Parker J)

[3] *In the matter of Trina Solar Limited* (unreported judgment dated 4 May 2023, Birt JA, Field JA, Beatson JA)

[4] *In the matter of iKang Healthcare Group* (unreported judgment dated 21 June 2023, Segal J)

[5] *In the matter of Shanda Games Limited* (unreported judgment dated 25 April 2017, Segal J)

[6] *In the matter of JA Solar Holdings Co., Ltd.* (FSD 153 of 2018)

[7] *In the matter of Qihoo 360 Technology Co. Ltd.* (FSD 129 of 2016)

[8] *In the matter of Changyou.com Limited* (unreported judgment dated 16 September 2022, Martin JA, Goldring JA, Morrison JA)

[9] Where a parent merges with a subsidiary in which the parent already holds 90% of the voting power and a special resolution of its members is not required to approve the merger

[10] *In the matter of Changyou.com Limited* (unreported judgment dated 20 December 2022, Martin JA, Goldring JA, Morrison JA)

[11] *In the matter of 58.com, Inc.* (unreported judgment dated 8 March 2022, Ramsey-Hale J)

[12] *In the matter of Qunar Cayman Islands Limited* [2018 (1) CILR 199]

[13] *In the matter of New Frontier Health Corporation* (unreported judgment dated 17 August 2022, Doyle J)

[14] *In the matter of 58.com, Inc.* (unreported judgment dated 22 March 2023, Kawaley J)

[15] *In the matter of Sina Corporation* (unreported judgment dated 26 September 2023, Birt JA, Moses JA, Field JA)

[16] *In the matter of Xingxuan Technology Ltd* (unreported judgment dated 26 May 2023, Doyle J)

[17] *In the matter of eHi Car Services Limited* (unreported judgment dated 28 November 2019, Kawaley J)

[18] Section 238(14) of the Act

[19] O.62, r.4 of the Grand Court Rules

[20] *In the matter of FGL Holdings* (unreported judgment dated 19 April 2023, Parker J)

[21] *In the matter of Trina Solar Limited* (unreported judgment dated 4 August 2023, Birt JA, Field JA, Beatson JA)

[22] *In the matter of Trina Solar Limited* (unreported judgment dated 8 December 2021, Segal J)

[23] *In the matter of Sina Corporation* (unreported judgment dated 27 November 2023, Birt JA, Moses JA, Field JA)

[24] *In the matter of FGL Holdings* (unreported judgment dated 19 April 2023, Parker J)

[25] *In the matter of 58.com, Inc.* (FSD 275 of 2020)

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