Appraising section 238 "fair value" proceedings in the Cayman Islands: An overview

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Section 238 of the Companies Law (2020 Revision) (**section 238**) provides an avenue through which shareholders of a merged or consolidated Cayman Islands company can apply to have the "fair value" of their shares determined by the Grand Court of the Cayman Islands (the **Court**).

Development

Section 238 has its origins in section 262 of the General Corporation Law of the US State of Delaware[1], and was first introduced into the Cayman Islands Companies Law in May 2009 as part of a wider reform concerning mergers and consolidation.

After a relatively uneventful first few years in operation, section 238 is now at the forefront of Cayman Islands jurisprudence. In particular, there has been a trend of Cayman Islands incorporated companies operating in the People's Republic of China being taken private, delisting from the US stock exchange, and then relisting on alternative stock exchanges, sometimes at a much higher value shortly thereafter. This has provided significant opportunities for institutional investors to obtain returns by investing in such companies in the lead up to their imminent merger or consolidation and relying on their appraisal rights under section 238 to challenge the value that the company has ascribed to their shares.

Process

The procedure for section 238 proceedings is largely prescribed by the statutory wording of section 238 itself, which sets out the formalities to be complied with by both the company and the dissenting shareholders. These steps include prescribed timeframes for issuing written notices of objection, authorisation, and dissent, a written offer by the company to purchase dissenters' shares at a specified price (that the company determines to be their fair value), and,

in the absence of agreement, ultimately filing a petition to have the fair value of the dissenting shareholdings determined by the Court.

Shortly after the petition is filed, typically a directions hearing takes place at which the Court will resolve procedural issues to regulate the next steps in the proceeding. The Court's orders are primarily focussed on the preparation of reports by valuation experts that will later be relied on as evidence as to the fair value of the shareholdings in dispute. They usually include orders relating to the appointment of experts, disclosure of documents relevant to valuation, confidentiality protections, expert information requests, meetings between the experts and the company's management, exchange of expert reports, factual evidence and provision for a further case management conference as the proceeding nears trial.

The orders made in each case are to some extent bespoke but a convergence in approach in relation to certain issues is discernible from the reasoned decisions and orders being made. The Court has recently confirmed in *eHi Car*[2] that, so long as these "standard" directions are not shown to do injustice in the particular case, the Court will treat these as the best starting point and that parties can expect consistency, absent good reason to depart from them. In that particular case, the Court refused every single departure from previous standard-form directions orders for which the company had contended.

The length of time until a section 238 proceeding is determined by the Court necessarily depends on the complexity of valuing the particular shareholdings involved. However, the Court has an overriding objective to deal with every matter in a just, expeditious and economical way, which has led to section 238 proceedings generally being set down for trial around two years from the date that dissenting shareholders notify the company of their decision to dissent from the merger or consolidation.

The trial itself is largely focussed on the expert valuation reports and cross-examination of the experts that have produced these reports. After hearing submissions from legal counsel, the presiding judge must then make his or her own determination as to the fair value of the particular shareholdings held by the dissenters. While this decision will necessarily be informed by the evidence and legal submissions that have been presented by the parties, the judge's role is not to choose which party's proffered valuation is the "correct" one. Rather, the judge must reach his or her own independent determination of fair value, having regard to all of the material that is put before the Court.

Outcomes

It is more usual for section 238 proceedings to be resolved by way of a negotiated settlement between the company and the dissenting shareholders than to proceed to full trial. Such settlements are confidential, save for the order discontinuing the proceedings being placed on the Register of Final Judgments and Orders; such orders do not contain any detail as to the terms of settlement itself.

Only three proceedings have thus far resulted in final judgments being issued by the Court – *Integra*[3] *Shanda Games*[4] and *Qunar*[5]. In *Integra*, the dissenting shareholders received a 17% uplift on the consideration that they had been offered by the company as fair value for their shareholdings, plus 4.95% interest from the date that the company made its statutory written offer to purchase the shares until the date of payment. In *Shanda Games* the uplift was 134.9%, plus 4.3% interest. This uplift was subsequently reduced to 81% (plus interest) by the Cayman Islands Court of Appeal (**CICA**) [6] to take account of a "minority discount", or discount for lack of control, in valuing the dissenters' shareholdings, which was recently upheld by the Judicial Committee of the Privy Council[7]. The precise uplift in *Qunar* is not specified in the judgment, with the Judge instead directing the experts in that case to perform a new calculation based on the Court's findings. Given that the Company's expert evidence was largely accepted in *Qunar* [8], one may reasonably expect that the uplift will be lower than in *Shanda Games*.

Developing areas

Due to the relative infancy of the section 238 jurisdiction in the Cayman Islands, the law in this area is rapidly evolving. Some of the key recent developments in section 238 jurisprudence have been in the areas of minority discount, interim payment, management meetings and disclosure.

Minority discount

As alluded to above, the application of minority discount in the context of section 238 proceedings has been hotly contested, both as a matter of principle and also as to the appropriate rate to be applied.

In January 2020, the Privy Council in *Shanda Games* confirmed that, as a matter of principle, minority discount may be applied when determining the fair value of shares held by dissenting shareholders. However, in that case, the experts had previously agreed that if a minority discount were to apply then it should be at a rate of 23% (without this being argued at trial). By contrast, in the more recent trial of *Qunar*, the Court found, on the basis of the contested expert evidence before it, that there was no factual basis for applying any minority discount to the calculation of fair value (even if it could be applied in principle).

There is consequently still a wide scope for argument as to the size of any minority discount that may apply on the facts of the particular case.

Interim payments

It has become common practice for dissenting shareholders to seek an interim payment in order to mitigate the hardship or prejudice that they may suffer in being kept out of their money pending the Court's determination of fair value. The Court's jurisdiction to make interim payment orders was confirmed by the Cayman Islands Court of Appeal in *Qunar*[9].

Subsequently, in *Zhaopin*[10], the company submitted that interim payment relief was inappropriate in circumstances where the dissenting shareholders were sophisticated investment funds with a strategy focused on merger arbitrage. However, the Court strongly rejected this approach, finding that there is no legislative basis upon which to make any distinction between shareholders who purchased shares for one commercial purpose as distinct from another.

In late 2019, the Court in *eHi Car*[11] determined that the quantum of interim payment was by reference to the sum that it can safely be assumed the dissenting shareholders will recover at trial. In quantifying this, the Court warned that conducting a "mini-trial" should be avoided and, so far as is appropriate and possible, the Court will rely on valuation data that the company does not (or cannot credibly) dispute.

Management meetings

Despite the Court expressly recognising the utility of meetings between the company's management and the valuation experts in previous cases[12], the company in *eHi Car*[13] recently challenged the Court's jurisdiction to order management meetings.

In rejecting the company's jurisdictional challenge, the Court confirmed that the source of its power to order management meetings was its inherent jurisdiction as a court of justice to make procedural orders to achieve justice. It agreed that management meetings were a crucial part of the information gathering process and was satisfied that ordering management meetings was in accordance with the Court's overriding objective, proportionate, efficient and that it will achieve a fair outcome for both parties.

Disclosure

Following the CICA's decision in *Qunar* to extend the disclosure regime to dissenting shareholders, disputes as to the scope of discovery are now a point of contention for both the company and dissenters alike.

In *JA Solar*, [14] the Chief Justice of the Cayman Islands summarily rejected the company's attempts to limit the ambit of its own disclosure whilst simultaneously seeking discovery from the dissenting shareholders beyond the scope of the limited categories of dissenter disclosure that had been ordered in *Qunar*, observing that *"companies have a marked tendency to seek to provide far more limited discovery than what dissenting shareholders seeks and would ordinarily be discovered in contested commercial litigation. Indeed, companies in section 238 cases also have a tendency to offer directions that are far less obliging than those the dissenting shareholders seek (and have traditionally been ordered)."* Having found that that case was *"just another example of such"* conduct, the Chief Justice went on to say that the Court should approach the company's attempts to row back on established directions with scepticism.

More recently, in *eHi Car*[15] the Court similarly rejected the company's invitation to extend the scope of dissenter disclosure beyond the established categories in *Qunar*. In doing so, the Court found that the characteristics and motivations of dissenting shareholders are generally irrelevant to the fair value of the dissenters' shares. Further, it noted that *"it is not relevant to ascertain whether they are speculative investors engaged in arbitrage or long-term shareholders who are being 'taken out' by the majority against their will, as fair value needs to be determined in one way for all dissenting shareholders irrespective of whether or not they might be said to be more or less 'deserving'".*

Ogier's involvement

Ogier has experience in numerous section 238 proceedings, having acted at each stage, from the inception of an objection through to full trial. With its team of section 238 specialists operating cross-jurisdictionally, Ogier is able to provide its clients with seamless round the clock advice on section 238 matters.

[1] Although the extent to which Cayman jurisprudence in this area will develop by reference to Delaware law continues to be an area of interest.

[2] In the matter of eHi Car Services Limited (FSD 115 of 2019, 28 November 2019 and 24 February 2020)

[3] In the matter of Integra Group [2016] 1 CILR 192

[4] In the matter of Shanda Games Limited (FSD 14 of 2016, 25 April 2017)

[5] In the matter of Qunar Cayman Islands Limited (FSD 76 of 2017, 13 May 2019)

[6] In the matter of Shanda Games Limited (CICA 12 of 2017, 9 March 2018)

[7] Shanda Games Ltd v Maso Capital Investments Ltd & Ors [2020] UKPC 2

[8] Save in respect of the approach to share based compensation, terminal growth rate and minority discount

[9] Qunar Cayman Islands Limited v Blackwell Partners LLC – Series A & Anor (CICA 24 of 2017, 20 June 2018)

[10] In the matter of Zhaopin Limited (FSD 260 of 2017, 22 June 2018)

[11] eHi Car (28 November 2019)

[12] In the matter of JA Solar Holdings Co., Ltd. (FSD 153 of 2018, 18 July 2019); In the matter of

Trina Solar Limited (FSD 92 of 2017, 1 November 2017)

[13] eHi Car (24 February 2020)

[14] JA Solar (18 July 2019)

[15] eHi Car (24 February 2020)

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