

Approach to interest and costs in section 238 proceedings confirmed in the Cayman Islands

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In the recent judgment of *In the Matter of Qunar Cayman Islands Limited*,^[1] the Grand Court of the Cayman Islands (**Court**) confirmed and clarified how interest on awards in section 238 proceedings is to be calculated, and how the costs of such proceedings are to be determined.

The judgment helpfully clarifies that the midpoint approach previously taken in *Integra* and *Shanda* is the correct methodology for determining the fair rate of interest payable in section 238 proceedings. This will be welcomed by dissenting shareholders, particularly where the Company has a relatively high cost of borrowing and/or where the prudent investment rate of return has been high during the period that they have been kept out of their money. However, the precise midpoint will always be fact specific and is likely to be the subject of expert evidence in most cases.

The Court's refusal to award the Dissenters' their costs of the proceedings confirms, for the first time, that the default position of 'loser pays' will often be more nuanced in the section 238 context. It may not simply be a question of whether dissenting shareholders have beaten the merger price. Where the crux of the dispute lies instead in the difference between the opinions of the parties' respective experts, the Court will consider the question of success in the proceedings more broadly. Similarly, the Court will not necessarily order that dissenting shareholders pay the Company's costs merely because they have not accepted a settlement offer that exceeds the Court's determination of fair value. The Court may instead consider it appropriate to analyse whether the particular offer was capable of acceptance and whether the dissenting shareholders conducted themselves unreasonably in not accepting it.

Background

Qunar Cayman Islands Limited (**Company**) effected a merger pursuant to section 233 of the Companies Act (as revised) (**Act**)^[2]. Certain minority shareholders (**Dissenters**) dissented

from this merger in accordance with section 238 of the Act, and the Company petitioned the Court to determine the fair value of the Dissenters' shares. The Court ultimately determined that the fair value of the Dissenters' shares was 2% higher than the merger price[3].

The Court was then required to determine the fair rate of interest payable to the Dissenters and whether either party was entitled to costs, in circumstances where the fair value of the shares was found to be only marginally above the merger price.

Decision

Fair rate of interest – the "midpoint approach" confirmed

Section 238(11) of the Act states that the Court must determine the "fair rate of interest, if any, to be paid by the company upon the amount determined to be the fair value". There is no further definition in the Act of what constitutes "a fair rate of interest".

Justice Parker held that "the fair rate of interest should be approached in a way which is consistent with the nature and purpose of the statutory jurisdiction and language, which is to protect the dissenting shareholders from the effect of a forced merger and in particular to compensate them for being out of their money and to fix a fair rate of interest in that regard".

Following the decisions in *Integra*[4] and *Shanda*[5], the Court confirmed that it was right, as a matter of principle, to take account of both the disadvantage to the Dissenters in being kept from the funds they had previously invested in the Company, and the advantage to the Company in having the benefit of access to those funds in the interim.

The Court consequently determined that the fair rate of interest was the midpoint between the rate which prudent investors in the position of the Dissenters could have obtained if they had the money to invest (**Prudent Investor Rate**) [6] and the rate at which the Company could have borrowed the amount representing the fair value of the Dissenters' shares (**Company's Borrowing Rate**) [7].

Interest period

The Court also determined that interest in section 238 proceedings is payable from the date that the Company makes its written fair value offer (ie 30-50 days prior to commencing proceedings), and runs until the earlier of when any judgment is given as to any interest payable or when the Dissenters are actually paid for their former shareholdings in the Company (taking into account any interim payment).

After any judgment is made on interest, further interest then runs at the statutory judgment interest rate, which is presently set at $2\frac{3}{8}\%$.

Basis of interest – simple or compound

The Court held that there was no legal basis for awarding compound interest in section 238 proceedings and found that simple interest should apply.

Liability for costs of the proceedings

The Dissenters had initially contended that an uplift of 415% to the merger price should be awarded, but the Court ultimately determined that the uplift was only 2% higher than the merger price. In these circumstances, the Court considered that this was a case where "a more nuanced approach should apply [to costs] than merely to look at 'who writes the cheque'".

The Court had rejected the Dissenters' expert's central thesis of a systematic undervaluation of Chinese companies on US exchanges and disagreed with his discounted cash flow calculations almost in their entirety. Given that the real issue for the Court was the vast delta between the parties' respective expert valuations, and since the Court's determination was significantly closer to what the Company's expert had opined was fair value, the Court held that the common sense view was that the Company had succeeded at trial, and that it would not be fair to order the Company to pay the Dissenters' costs.

The Company did not seek all of its costs, but instead argued that the Dissenters should be ordered to pay its costs from the time that they refused a "without prejudice save as to costs" offer to settle the proceedings for a 20% uplift on the merger price, made two weeks before the trial commenced. The Court held it would not be fair to make such an award due to uncertainty in the wording of the settlement offer, which was made on a "subject to contract" basis and, even if the offer was capable of acceptance, the Dissenters did not conduct themselves unreasonably in their response to it in the circumstances.

Accordingly, the Court made no order as to costs in favour of either party, and the parties each bore their own costs of the proceedings.

[1] In the Matter of Qunar Cayman Islands Limited Unreported Judgment, 29 March 2021 (Parker J)

[2] Formerly known as the Companies Law (as revised). The Cayman Islands Citation of Acts of Parliament Law, 2020, which came into force on 3 December 2020, provides that any enactment that has been a "Law" is amended by omitting the word "Law" and substituting it with the word "Act".

[3] In the Matter of Qunar Cayman Islands Limited 2019 (1) CILR 611 (13 May 2019)

[4] In the matter of Integra Group 2016 (1) CILR 192

[5] In the matter of Shanda Games Limited Unreported Judgment, 25 April 2017 (Segal J)

(Grand Court); In the matter of Shanda Games Limited 2018 (1) CILR 352 (Cayman islands Court of Appeal)

[6] The Court adopted both the asset allocation (equities 40%, bonds 45% and cash 15%) and prudent investor rates based thereon, proposed by the Dissenters' expert.

[7] The Court adopted the Company Borrowing Rate proposed by the Dissenters' expert of 4.3%.

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