

FAIR VALUE FOR DISSENTING SHAREHOLDERS IN CAYMAN MERGER REGIME



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When minority shareholders of Cayman Islands entities are being treated unfairly, they are able to take advantage of some strong tools under the Companies Act (As Revised) (the Act). One of those tools are the appraisal rights and fair value assessments available to a shareholder who has dissented from a merger or consolidation pursuant to section 238 of the Act. This type of litigation is experiencing a sharp increase in the Cayman Islands as a result of a number of factors including the delisting of Chinese companies in the United States due to legislative and policy changes there and in China.

A company intending to carry out a merger must obtain the approval of its directors and members by way of special resolution, or other requirement stated under its articles. A shareholder who intends to dissent from the merger must give the company written notice of its objection before the vote on the merger. Immediately, the shareholder

ceases its rights under the shares except to be paid the fair value of those shares.

The Act sets out other procedural steps to be taken by the company and the dissenter, including deadlines for the company to issue a written notice to those shareholders who object to the merger that the merger is approved, a written notice to the company of the shareholder's decision to dissent and demand payment of the fair value of its shares, and a written offer from the company to each dissenter to purchase its shares. The shareholder risks permanently losing its right to an appraisal if these steps are not followed.

If within the statutory timeframe the price of the shares is not agreed, the company shall (and the dissenter may) petition the court for a determination of the fair value and fair rate of interest of the shares of all dissenters. The reference to 'fair' requires that the court considers all relevant facts and

matters and the true monetary worth of the shares, without considering any particular valuation methodologies and fairly balancing, where appropriate, the competing approaches to valuation relied on by the parties¹. The court is tasked with determining the price at which the shares would be exchanged between a willing buyer and seller in an arm's length transaction based on publicly available information. The rights of a dissenter are limited to seeking relief on the grounds that the merger is void or unlawful².

Section 238 proceedings give rise to specific and somewhat unique procedural requirements. In 2019 the court published standard pre-trial practice direction to provide a framework for the management of these proceedings (Practice Direction)³. The Practice Direction focuses on the key areas that have been contentious between parties over the years. These include the creation and population of an electronic data room for maintaining

¹ Re Trina Solar Limited (Unreported, 23 September 2020) (FSD 92 OF 2017 (NSJ)).

² Ibid.

³ Practice Direction No. 1 of 2019, Directions for Proceedings Brought Under Section 238 of the Companies [Act] (As Revised).

documents relevant to the fair value of the company as at the relevant valuation date, including documents created both before and after that date; discovery and inspection of documents relevant to the fair value; the provision of factual and expert evidence; the convening and conducting of meetings between the experts and the company's management; and requests by the experts for further information from the company.

The importance of the Practice Direction was reinforced in *eHi Car Services Limited*⁴, a decision in which the court refused an application by the company to materially vary the directions orders made in similar cases, which have to some extent become fairly "standard". The court refused the application because it was not satisfied that the "standard" directions had been working any material injustice or are otherwise unfair such that it should grant a significant departure from the norm. Nevertheless, there remains latitude for disagreement between parties because the Practice Direction is not detailed or comprehensive. There are often competing arguments regarding the appropriate valuation methodology that should be used to ascertain "fair value", whether a minority discount should be applied, and the "fair rate of interest" (if any).

Valuation methodology

The court is tasked with determining the appropriate methodology on the facts and circumstances of each case. Whether fair value, as estimated using a DCF method analysis or any other generally accepted business valuation method, should be above or below the deal price, is also dictated by the facts and circumstances of each case.

Minority discount

A minority discount is the level of discount that could be applied in an appropriate case, depending on the valuation exercise under consideration, to determine the value of the dissenter's minority interest. The court will rely on expert evidence on the principle to be applied in deciding whether a minority discount is appropriate.

Interest

The court has a discretion to award a dissenter the "fair rate of interest" for his shares, which is the midway point between a rate of interest representing the return on the unpaid appraisal moneys that a prudent investor could have made and the rate of interest that the company would have had to pay to borrow the equivalent sum.

Conclusion

The statutory mechanism serves to protect minority shareholders; however, there is a risk that the court can determine a value less than that of the merger price. Section 238 proceedings are to a large extent an expert driven process therefore, the reliability of expert evidence at trial is critical to the court's performance of the assessment of "fair value".

The jurisprudence relating to Cayman's merger regime is relatively young. However, the Cayman courts have found guidance from Delaware and Canada, which have similar merger regimes to Cayman, to be helpful in terms of the approach to the similar issues the courts of those jurisdictions have adopted, notwithstanding the differences in the language of the relevant legislation, the policy behind it, insofar as one can identify that, and procedure.

4 (Unreported, 24 February 2020) (FSD 115 of 2019).

