Taking Cayman Islands companies private: options for stakeholders

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This is the second note issued by Carey Olsen regarding "take-private" transactions, for the first please click here. Such transactions involve taking listed Cayman Islands companies private, often as a precursor to re-listing them on a more favourable stock exchange.

Several recent take-private transactions have been accomplished by using the statutory merger regime in Part XVI of the Companies Law (as revised) (the "Law"). However, given the incidence of dissenting shareholder litigation following such mergers, some clients are considering other avenues to achieve the same end. Two such additional avenues exist: a scheme of arrangement under section 86 of the Law; and a tender-offer and "squeeze-out" under section 88 of the Law.

This note outlines the different legal options for taking a Cayman Islands company private and analyses the potential advantages and disadvantages of each (see Appendix for tabular summary).

The Cayman Islands merger regime

When the statutory merger regime is used to take a listed company private, the process is usually commenced by the establishment of a new Cayman Islands company to merge with the listed Cayman target company. The terms of the merger are embodied in a formal plan of merger, which the board (or a special committee of the board) considers in consultation with a financial expert to advise them on, inter alia, the fairness of the offer price for the shares. Following board approval, a special resolution of the shareholders of the company (two-thirds, or more if the articles so prescribe) must vote in favour of the merger.

Alternatively, if the bidding party and its affiliates together control 90% or more of the shares in the listed company, then a streamlined version of the merger regime will be available which does not require shareholder approval. However, even in this case, minority shareholders will enjoy dissenting shareholder rights (see below).

The "dissenting shareholder" / "fair value" provisions

"Dissenting" shareholders are shareholders that lodge an objection in writing before the vote on the proposed merger stating that they will demand payment for their shares if the merger is authorised by the vote. Following notice by the company to the dissenting shareholders that the merger has been approved, the dissenting shareholders may demand payment of the "fair value" of their shares. If the dissenting shareholder and the company do not agree upon the price to be paid within the following 30 days, the company must (and the shareholder may) file a petition under section 238 of the Law to have the "fair value" of the shares determined by the Court.

Tender offer utilising "squeeze out" provisions

This process involves a bidder making an offer to the shareholders to purchase the entire issued share capital of the listed company. When used for take-private purposes, the bidder would typically be a newly incorporated company. The bidder is free to set whatever minimum acceptance threshold it sees fit, and the shares can be acquired as soon as the minimum threshold and other conditions are satisfied.

If shareholders holding at least 90% of the "shares to which the offer relates" accept the offer within four months of it being made, then the bidder may in the next two months acquire the remaining shares upon the same terms as the original offer by giving notice to the dissenting shareholders.

The phrase "shares to which the offer relates" excludes both shares already acquired by the bidder and shares the subject of a binding contract to be acquired by the bidder (or its affiliates and concert parties) before the date of the offer. However, shares subject to irrevocable undertakings to accept the offer will still generally count towards the 90% threshold. The tender offer would also be subject to the rules and regulations of the exchange on which the shares are listed, which is outside the scope of this note.

Dissenting shareholders' rights

The dissenting shareholders have one month from receipt of the bidder's notice to apply to the Court for relief from the compulsory acquisition process. The Court has wide discretion to make any order it considers appropriate. However, in contrast to the section 238 dissenting shareholder process, the Court in a "squeeze-out" related application will generally not interfere unless the dissenting shareholders can establish that they have been treated unfairly or prejudicially to other shareholders of the same class.

Scheme of arrangement

A scheme of arrangement is a compromise or arrangement entered into between a company and its creditors or shareholders (or any class of them) which is approved by the Court in accordance with section 86 of the Law. It can be more flexible than a merger. For example, the consideration could involve an exchange of shares, cash, or a combination of both.

Implementing a scheme of arrangement involves at least two Court hearings and the holding of one or more shareholders' meetings to approve the scheme. It is therefore potentially a lengthier and more costly process through which to implement a take-private. However, if approved, it will afford the bidder certainty in relation to the economic outcome as there will be no subsequent dissenting shareholder "fair value" determination process.

The process

The steps required to implement a scheme of arrangement for a take-private are as follows:

- **First / "convening" hearing**: A petition is filed at Court along with an interlocutory summons seeking directions for the convening of the shareholders' meeting(s) to approve the scheme. The summons must be supported by: an affidavit setting out the proposed scheme, an "explanatory statement", and all ancillary documents. Notice of the first hearing is usually given to the shareholders to allow them to raise any objections regarding the composition of the share/voting classes.
- **Scheme meetings**: Following the first hearing, the meeting(s) are convened in accordance with the directions of the Court. For the scheme to be approved, a simple majority in number representing 75% in value of each class of shareholder that is present and voting must vote in favour of it.
- **Second / "sanction" hearing**: A second affidavit is filed setting out the result of the scheme meeting(s) in advance of the second hearing. At this hearing the Court will determine whether or not the scheme should be sanctioned. Any shareholder who voted at the meeting(s) and any other person with a substantial economic interest in the scheme may appear at the second hearing.

The scheme becomes effective when the Order sanctioning the scheme is filed with the Registrar of Companies. Once effective, the scheme binds all the shareholders regardless of whether or not they voted in favour of the scheme.

Class composition

An issue that arises in most cases is whether or not there is more than one "class" of shareholders and if so, the consequent need to hold multiple, separate shareholders' meetings for each class. "Class" in this context does not simply refer to the different classes of shares issued (although the rights afforded to different categories of shares will be a relevant consideration in determining whether the shareholders should vote in the same class). The composition of classes is often hotly contested because, for example, one or more minority shareholders may effectively enjoy a veto right over the scheme if they are found to constitute a separate shareholder class.

In summary, a given shareholder class should comprise those members whose rights are "not so dissimilar as to make it impossible for them to consult together with a view to their common interest". Essentially, this involves an analysis of the shareholders' legal rights (as opposed to commercial interests) and how those rights might be affected by the proposed scheme. Shareholders do not need to have identical rights to constitute a single class.

Fairness test

The composition of classes should be determined at the first / convening hearing. The Court will be reluctant to reconsider this issue after the shareholders' meeting(s) have taken place. In order to sanction the scheme, the Court must be satisfied that the statutory requirements were met at the meeting(s) and that the scheme is substantively fair. In practice, where the statutory majorities have been achieved without procedural irregularities, successful challenges based on fairness are rare.

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The Court may refuse to sanction the scheme if, for example:

- the meeting was not well attended (whether in person or by proxy), such that those shareholders who voted did not represent a fair cross-section of members;
- the scheme document did not include all information reasonably required for shareholders to decide how to vote; or
- prior to the meeting, new material information emerged or a change in circumstances occurred that shareholders were not able to assess prior to the vote.

Comparison of the options

Question: when should a bidder consider alternatives to a section 238 merger for a take-private?

Answer: In the initial stages - when assessing economic viability, corporate structure, and time-frame for the transaction. Risk of dissenting shareholder activism could jeopardise the commercial objectives of the transaction, particularly in circumstances where:

- the proposed consideration for the merger is shares in the new private company, and not cash (or only partly cash); and/or
- the value of the company is high, but its available cash (or ability to raise finance) to buy out dissenting shareholders is relatively low.

The ability of up to one-third of the listed company's shareholders to dissent and launch Court proceedings aimed at obtaining a potentially significantly higher price may undermine the economic viability of the proposed take-private transaction.

Question: when might a scheme of arrangement be a preferable option?

Answer: Notwithstanding that a scheme will always involve at least two Court hearings, it does not follow that it will always be more expensive and time-consuming. A crucial advantage of a scheme compared to a merger is that once approved at the meeting(s) (75% in value and a simple majority in number of each class) and by the Court, there is little risk of any further litigation or additional payments in favour of those shareholders who voted against the scheme.

This greater certainty, combined with lower shareholder approval thresholds than those required for a tender offer and "squeeze-out", make schemes of arrangement a potentially attractive option is some cases. Additionally, schemes of arrangement will facilitate complex restructuring options (including dealing with creditors) that are not achievable via mergers or tender offers.

Question: when will a tender offer and "squeeze-out" be the preferable option?

Answer: When a bidder is confident that at least 90% of the shareholders of the listed company (excluding those affiliated or acting in concert with the bidder) will accept the take-private offer. The tender offer can be subject to any given threshold for shareholder approval (subject to the listing rules). Once 90% acceptance is achieved, any dissenting shareholders can be "squeezed out" under section 88 of the Law without risk of subsequent "fair value" Court proceedings and potentially payment of an increased purchase price. However, if the 90% threshold is not reached there is a risk that the company cannot be taken private without implementing further legal procedures, for example; a merger or scheme of arrangement.

Question: can the different options for a take-private be combined?

Answer: It may be advantageous to implement a tender offer process and once 90% of the shares are held by the bidder and its affiliates, implement a "streamlined" merger under section 233(7) instead of a "squeeze-out" under section 88. The benefits of this approach include that the bidder and its affiliates' shares count toward the 90% shareholder threshold (for a squeeze out they do not count) and the four to six month statutory period to implement a "squeeze out" will not apply.

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Appendix

	Advantages	Disadvantages
Merger **(ss 232 to 239)**	• Approved by a special resolution (two- thirds). • No Court approval necessary. • In the absence of any "fair value" litigation, often the quickest and least expensive option.	• Dissenting shareholders may invoke right to be bought out at "fair value". • Risk of expensive litigation to determine "fair value". • Depending upon number of dissenters and quantum of uplift in share purchase price, economics of the entire transaction could be jeopardised.
Tender offer followed by: **"Squeeze-out" of dissenting shareholders** **(s 88)**	• No "fair value" rights: dissenting shareholders are bought out at offer price. • The Court will not intervene unless there is a clear case of unfair or prejudicial treatment of shareholders.	• 90% threshold for shareholder approval. • Shares owned, or to be acquired by bidder and affiliates, are usually excluded from 90% (ie 90% approval of independent shareholders required). • Cannot be implemented until four to six months from offer date.
Tender offer followed by: **"Streamlined" merger regime** **(s 233(7))**	• An alternative to a "squeeze out". • Applies when bidder acquires 90% or more of the target company (including shares held by bidder and affiliates). • Do not need to wait four to six months.	• Dissenting shareholders may invoke their right to be bought out at "fair value", therefore there is a risk of litigation to determine "fair value". • Economic risk is mitigated because maximum number of dissenters is known (no more than 10%).
Scheme of arrangement **(s 86)**	• Dissenting shareholders do not need to be bought out, but can be "dragged along" if the scheme becomes effective. • A flexible procedure that can accommodate a restructuring of the company in addition to the take-private.	• Requires approval by a majority in number representing 75% in value of each class of shareholder present and voting. • Court-sanctioned process requiring at least two Court hearings. • Will take at least two to three months to implement.

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