Shanda Games Limited – Court of Appeal Judgment

Service area / Dispute Resolution and Litigation, Restructuring and Insolvency

Location / Cayman Islands, Hong Kong and Singapore

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On 6 March 2018, the Cayman Islands Court of Appeal handed down judgment in an appeal brought by Shanda, holding that a "minority discount" should be applied in assessing the fair value of a dissenter's shareholding. The judgment provides welcome certainty in take-private litigation in Cayman with the Court largely affirming the established valuation methodology of the Grand Court in conducting fair value assessments of companies under s.238 of the Companies Law.

Minority discount

In both the first instance judgment of Shanda and a previous judgment in Integra, the Grand Court, having regard to fair value valuation principles in Delaware and Canada, held that a minority discount (the discounted value of the dissenters' shares reflecting the limited influence or control afforded by the minority shareholding) should not be applied in Cayman fair value proceedings under s.238. In Shanda this resulted in a fair value determination of US$8.34 per share (US$16.68 per ADS) as against the merger price of US$3.55 per share (US$7.10 per ADS). The dissenting shareholders' shares were valued at US$73,575,995.

Shanda, in appealing the first instance judgment, contended that the trial judge should not have had regard to Delaware and Canadian jurisprudence, but should instead have looked to the English authorities governing schemes of arrangement and squeeze-out valuations (as well as valuations in the unfair prejudice context). In contrast, the dissenters argued that a "going-concern" value should be adopted as is the case in Delaware and Canada. The English authorities were distinguishable in that English legislation governing schemes of arrangement and squeeze-outs does not expressly require the Court to apply a standard of "fair value", in contrast to Delaware, Canadian and Cayman legislation.

In Shanda, the Court of Appeal held that the dissenters' shares should be subject to a minority discount, following the English authorities. The Court drew parallels to British Virgin Islands and Bermudian authorities which support the application of a minority discount. The Court distinguished the various Cayman and English authorities in the just and equitable winding-up and unfair prejudice contexts (which disallow a minority discount), on the basis that such cases apply in quasi-partnership cases.

The Court of Appeal noted that there are three means of taking a company private: (i) merger, (ii) scheme of arrangement, and (iii) squeeze-out. According to the Court, a minority discount applies to valuations in schemes and squeeze-out cases. Nothing in the Companies Law suggests that a different approach should be taken for mergers. The Court favoured applying a consistent approach to valuation across the three categories.

Valuation methodology

The Court of Appeal rejected the three valuation methodology appeal points made by the dissenters. As has always been the case in Cayman, the Court is entitled to adopt, some, all or none of the expert evidence to assist the court in arriving at a reasoned, fair valuation.

Interest

The Court of Appeal held that the "mid-point" approach adopted by the trial judge (and in earlier Cayman cases) is appropriate. In this case, the rate of interest payable was that falling at the mid-point between a prudent investor's assumed rate of return on investment (the prudent investor rate) and the rate at which the company could borrow capital representing the sum of the fair value of the dissenters' shares (the borrowing rate). Shanda was capable of borrowing at the prime rate of 3.5%. A prudent investor would not be limited to investing in three month fixed deposits in Cayman banks as suggested by Shanda. Instead the Court considered investment grade corporate bonds at 5.09% to be relevant and suitable to use for the prudent investor rate in this particular case. Accordingly, the mid-point was 4.295%.

The important take-aways

The key take-away points are: (i) the existing legal principles governing valuation of dissenters' shares remain exactly the same, (ii) the only exception is that a discount should be applied to the fair value assessment in recognition that dissenters hold a minority interest; and (iii) the calculation of interest in s.238 cases remains unchanged.

Interestingly, during the Court of Appeal hearing Shanda elected not to pursue various additional appeal points concerning valuation methodology that it had formerly raised. Its appeal on valuation was confined to the minority discount issue. The three valuation methodology points raised by the dissenters were rejected. It remains to be seen whether Shanda or the dissenters will appeal to the Privy Council, and if so, whether the appeal will cover valuation methodology generally or will be limited to the minority discount issue. We will keep you up to date with developments as they arise.

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