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S238 in action: five things to note in "fair value" appraisal proceedings in the Cayman Islands

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The section 238 appraisal process under the Companies Act[1] in the Cayman Islands is a vital safeguard designed to protect minority shareholders' economic interests. When there is a merger or consolidation involving at least one Cayman company under Part XVI of the Companies Act, a dissenting shareholder may demand payment of the "fair value" in respect of all his shares. If the company and the dissenting shareholder cannot reach an agreement on the price within a specified period, the company shall (and any dissenting shareholder may) file a petition with the Grand Court of the Cayman Islands for an appraisal and/or determination of the fair value of the dissenting shareholder's shares.

Jurisprudence in relation to section 238 cases has developed rapidly since *In the Matter of Integra Group* [2016] (1) CILR 192, the first section 238 case which reached trial in late 2015. This briefing sets out five practical points highlighted in recent decisions of the Cayman Islands Courts.

The meaning of fair value

There is, unsurprisingly, no "one size fits all" approach to determine what the 'fair value' is. The question often turns on a question of valuation methodology and involves consideration of extensive expert evidence. The Court's methodology in weighing expert evidence is taken from Delaware jurisprudence, cited in *Shanda Games*:[2]

> *"In making the fair value determination, the court may look to the opinions advanced by the parties' experts, select one party's expert opinion as a framework, fashion its own framework, or adopt piecemeal some portion of an export's model methodology or mathematical calculations. But, the court may not adopt an 'either-or' approach and must use its judgment and an independent valuation exercise to reach its conclusion."*

Importantly, this means that while the Court is restrained in undertaking its own expert analysis, it is allowed to adjust the figures determined by the experts.

Further, there is no fixed methodology which an expert must consider. In *Trina Solar Limited*[3], the Grand Court explained that:

> *"[t]he reference to fair requires that the manner and method of that assessment and determination is fair to the dissenting shareholder by ensuring that all relevant facts and matters are considered and that the sum selected properly reflects the true monetary worth to the shareholder of what he has lost, undistorted by the limitations and flaws of particular valuation methodologies and fairly balancing, where appropriate, the competing, reasonably reliable alternative approaches to valuation relied on by the parties."*

In this particular case, the Court adopted a "blended" valuation approach in appraising the "fair value", by applying a different weightage to the merger price, the unaffected trading price and the more conventional discounted cashflow valuation.

1 2022 Revision.
2 *Shanda Games Ltd v Maso Capital Investments Ltd and ors* [2020] UKPC 2 ("*Shanda Games*") at pages 42-43, citing *Andaloro V PFPC Worldwide Inc* Court of Chancery, Delaware, New Castle 2005 Del. Ch. Lexis 125 as [34]
3 *In the Matter of Trina Solar Limited FSD 92 of 2017* (NSJ)

Minority discount

In determining the meaning of "fair value" in the context of section 238, it is important to consider the question of whether a minority discount should be applied to reflect that the dissenting shareholders do not have control of the company.

In *Shanda Games*, the dissenting shareholders argued as part of the appraisal process that they should be paid a pro-rata share of the full value of the company. The question went before the Privy Council, which determined that there is no 'bright line' – an application, or exclusion, of a minority discount as a rule. However, that decision, as observed in *Nord Anglia*[4], suggests that there will be a starting assumption of a minority discount; in the absence of some indication to the contrary, or special circumstances, the minority shareholders' shares should be valued as a minority shareholding and not on a pro-rata basis. This is because, in a merger, the offeror does not acquire control from any individual minority shareholder.

The valuation date

Interestingly, the Companies Act does not specify the date at which the determination of fair value is to be made. The first reasoned decision on the issue of valuation date was only handed down in early 2022 in *In the Matter of Sina Corporation*[5], where the Court was asked to determine whether the valuation date ought to be the date on which the Extraordinary General Meeting ("**EGM**") approving the merger was held or, alternatively, the date of the closing of the merger.

In many cases, the EGM date and the merger completion date coincide or are within a few days of each other. However, in the case of *Sina Corporation*, at the time of the EGM there was material uncertainty as to whether the transaction would complete due to the prospect of a key condition precedent not being satisfied and there was a three-month gap between the EGM and the date of completion.

In *Sina Corporation*, it was held that the "fair value" of the relevant shares should be determined immediately before any vote of shareholders is held to consider (and if thought fit to approve) any proposed merger i.e., as at the date of the EGM. However, the Court also expressed the view that each case will turn on its own specific facts and the date is not to be rigidly fixed for all cases. The overriding consideration is to ensure that the date for valuation is, like everything else in the process of determination, fair.

The company's discovery obligation

As noted by the Grand Court in *In the Matter of eHi Car Services Limited.*[6], the directions orders made in each Section 238 case are to some extent bespoke, but a uniformity of approach in relation to certain issues is discernible from the decisions and orders made. In particular, there has been a reasonably uniform approach concerning extensive initial documentary disclosure required by a company by way of uploading relevant documents to a data room.

In general, it is the company that holds the majority of the information relevant to its value. When faced with complaints that the standard form directions are duplicative, unfair and disproportionately costly to the company, the Court held that such directions are useful and the best "starting point", as long as they are not shown to work injustice in the particular case.[7]

In *Sina Corporation*[8], the company was faced with a different type of difficulty in complying with its disclosure obligations. The company argued that in light of the enactment of Data Security Law, Personal Information Protection Law and Cybersecurity Law in the People's Republic of China ("**PRC**"), it should be given an opportunity to seek regulatory approval from the relevant PRC authorities in relation to the provision of documents and information. The first directions hearing came before the Court in January 2022. At this early stage of the proceedings the Court was not minded to express a view as to whether the undoubted centrality of company discovery in section 238 proceedings and the Court's ability to determine fair value outweighed the concerns expressed by the company as to compliance with PRC law. It was said that the need for an exercise in examining the documents, the applicable provisions of PRC law and the risk of prosecution and the nature and extent of that risk, had not yet arisen.

The Court however would not simply kick the can down the road. It refused to allow advance 'carve outs' for the company's discovery obligations (e.g. by withholding documents from production unless and until regulatory approval was given), nor did it consider it appropriate to delay the discovery timetable to sometime after such regulatory approval was given. Instead, the Court adopted a practical case management decision by making the usual order for discovery, leaving the onus upon the company to comply or apply to the Court for further directions as soon as it perceived that it would not be able to do so. As such, the issue may come before the Court again as and when such application is made.

The dissenting shareholder's discovery obligation

When it comes to disclosure by the dissenting shareholder, such obligation tends to be more limited in scope. In *Qunar*[9], the Court of Appeal limited the dissenting shareholders' disclosure to certain categories of documents which related to the value of the company under consideration. Such categories of documents have since been incorporated as part of the standard directions. Attempts to expand the dissenter shareholders' discovery obligation beyond the *Qunar* categories in subsequent cases have been largely unsuccessful.[10] Documents pertaining to the motivations or involvement of the shareholders (for example, if they are

4 *Re Nord Anglia* FSD No 235 of 2017 (IKJ), Judgment dated 17 March 2020 (Kawaley J) (unreported)
5 *In the Matter of Sina Corporation* FSD 0128 of 2021 (25 January 2022) ("*Sina Corporation*")
6 *In the matter of eHi Car Services Limited* (unreported judgment dated 22 June 2021, Parker J) ("*eHi Car*") at paras. 9-11
7 *Ibid.* at para. 17
8 *In the Matter of Sina Corporation* FSD 0128 of 2021 (25 January 2022)
9 *In the matter of Qunar Islands Limited* [2018 (1) CILR 199]
10 See for example *JA Solar Holdings Co., Ltd.* (Unrep. 18 July 2019), *eHi Car Services Limited* (unreported judgment dated 22 June 2021, Parker J) and *In the Matter of 58.com*, Inc FSD 275 of 2020

Continued

"speculative investors engaged in arbitrage or long-term shareholders who are being 'taken out' against their will") are generally considered to be irrelevant, as the fair value of the dissenting shareholders' shareholding needs to be determined in any event for all dissenting shareholders and regardless of whether or not they might be said to be more or less 'deserving'.[11]

Conclusion

Section 238 proceedings are hard fought, often for high stakes and involves highly experienced experts. Many of the existing practices are persuasive but not set in stone. As the matter involves a determination of what is "fair", there are always fact-specific circumstances which may prompt one to re-assess the applicability of the standard rules or approaches. Mindful that a dissenting shareholder is required to give notice of the intention to exercise his/her rights under section 238 early on in the process *i.e.* before the resolution approving the merger takes place, legal advice should be obtained sooner rather than later. Carey Olsen is experienced in advising on section 238 proceedings and are prepared to navigate its clients through the different stages of the process.

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11 *In the matter of Qunar Islands Limited* [2018 (1) CILR 199], see para. 63

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