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Appealing Appraisal Actions: New Judgments from the Cayman Courts

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A well-known and now widely used part of local legislation, Section 238(8) of the Cayman Islands *Companies Law* (the "Companies Law"), entitles a shareholder who dissents from a merger or consolidation of a Cayman company under the statutory merger provisions contained in Part XVI of the Companies Law to be paid "the fair value of his shares". Disputes about how to determine "fair value", both in terms of procedure and calculation methodology, have been voluminous over the past eighteen months or so, and have resulted in a sharp increase in the number of fair value appraisal actions before the Grand Court of the Cayman Islands (the "Grand Court").

Flowing from that litigation, and adding to the growing jurisprudence on this front, the Cayman Islands Court of Appeal (the "CICA") has recently released a number of highly anticipated decisions concerning various interlocutory issues arising in the course of litigation of this nature. The most important of the judgments released so far and discussed in brief below, analyse the contentious issues of: (1) interim payments to and injunctions by dissenting shareholders (referred to generally below as "Dissenters") pending the outcome of the appraisal litigation; (2) discovery of documents by Dissenters; and (3) the application of a "minority discount" to the value of the Dissenters' share price.

Section 238 of the Companies Law

As is now widely accepted, in an appraisal action commenced by petition under Section 238 of the Companies Law, the sole purpose of the action is for the Court to determine the fair value of the shares of the shareholders who have dissented to the merger of two companies, together with a fair rate of interest to be paid by the company to the Dissenters. However, this type of action differs from litigation in the normal course in that there is no plaintiff and no defendant, and there is no burden of proof on one party or the other to prove the allegations they make. Instead each party bears the burden of proving the value for which it contends, and relies on the Court to finally determine the fair value. In theory, the process should be a straightforward and non-contentious valuation exercise with reference to the necessary financial and business information. However, as has been shown in the following judgments, various interlocutory issues inevitably arise as to the various rights and entitlements of the parties involved, and the proceedings can quickly veer into contentious territory.

Provisions for Payments to Dissenters

In *In the matter of Trina Solar Limited*[1], the Grand Court had at first instance refused an interlocutory application made by a group of Dissenters for worldwide freezing orders over the assets of the company in question pending the outcome of statutory fair value appraisal proceedings. The Dissenters had applied to the Grand Court because the company had agreed to transfer many of its assets in its subsidiaries to other companies in China, ostensibly to progress the company's post-merger restructuring. While the Dissenters had received an interim payment from the company following a separate application to the Grand Court, the Dissenters argued that the company's actions would have the effect of significantly reducing the assets of the company so that it would ultimately be impossible for the company to satisfy in full any judgment of the Grand Court following the substantive trial. The Grand Court declined to grant the injunction.

Unhappy with the Grand Court's decision, the Dissenters took their case on to the CICA which, while finding that the Dissenters had crossed the "jurisdictional threshold" so as to be entitled to ask for the grant of an injunction on the terms they had sought, determined that the company's evidence had proved the transactions in question were not undertaken for less than proper consideration or on terms that were prejudicial to the company. Further, the fact that the company had made a provision for payment to the Dissenters, based on a realistic assessment of the company's liability to the Dissenters, was enough to avoid the need for an injunction. The CICA held that the provision made by the company did not need to be for the full amount claimed by the Dissenters with reference to their expert advice, but a "reasonable and prudent provision" made after taking advice from legal and valuation advisers and with the company "forming a balanced and cautious view of the risks of the litigation". No injunction was granted by the CICA, but the decision remains a helpful guide to companies facing similar litigation.

Minority Discount

The separate question of whether a minority discount should be applied to the Dissenters' shares in the course of the valuation exercise was one of the issues considered in the decision of *In the matter of Shanda Games Limited*[2] ("Shanda"). The decision in *Shanda* is particularly interesting because the CICA has moved away from earlier local authority and seemingly altered the landscape against which fair value of the Dissenters shares is to be properly assessed in the future.

At first instance in *Shanda*, it was the view of the company that a minority discount should be applied to the Dissenters' shares, on the basis that the shares to be valued constituted a very small minority of the total shares in the company and such a discount would be applied in any market-based sale of the company's shares. However, the Grand Court had determined that a minority discount should not apply in assessing the fair value of the shares of Dissenters, on the basis that it was the Dissenters' proportionate interest in the company considered as a whole that was being valued. This was a decision consistent with the position taken by the Courts in Delaware and Canada (where the equivalent merger appraisal regimes operate) and indeed with prior local authority such as the decision of Jones J in *In the Matter of Integra Group*.[3]

However, reversing the decision of the trial judge in *Shanda*, the CICA agreed with the company and held that certain English authorities (which permit a minority discount to be applied in other contexts[4]) should be applied in the context of a Section 238 appraisal action. In essence, the CICA held that the legislative intent in enacting Section 238 was that it should be construed alongside and according to the same principles as the provisions already contained in Sections 86, 87 and 88 of the Companies Law (dealing with takeovers and squeeze-outs), because they are simply three ways of achieving the same commercial objective. And, as there are English authorities which hold that a minority discount could be applied in a takeover scheme of arrangement and in a statutory squeeze-out, it follows that when enacting Section 238 the legislature cannot have intended that the situation should be different from that which already existed. The Judgment therefore confirms that a minority discount should now be applied to Dissenters' shares in appraisal actions before the courts of the Cayman Islands.

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[1] CICA 26 of 2017 (unreported, 9 February 2018)
[2] CICA 13 of 2017 (unreported, 9 March 2018)
[3] [2016] 1 CILR 192
[4] See for example *Re Grierson, Oldham & Adams Ltd* [1968] Ch 17, *Irvine -v- Irvine (No 2)* [2007] 1 BCLC 445, *Golar LNG Ltd -v- World Nordic SE* [2011] Bda L R 9, and *Olive Group Capital Limited -v- Mayhew* [2016] ECSCJ No 167, as cited by the Honourable Judges.

Dissenter Discovery

Finally, in *In the matter of Qunar Cayman Islands Ltd*[5] the Court was required to determine, among other things, the scope of discovery in a Section 238 action and in particular whether the Dissenters ought to give discovery. In that case, the company had also been the subject of a 'take private' transaction resulting in a merger but four groups of Dissenters had dissented and commenced the statutory appraisal process. In the course of the proceedings, the company made an application for discovery by the Dissenters, notwithstanding that the Grand Court had already ruled on this question in *In the matter of Homeinns Hotel Group* where the same application had been dismissed.[6] In advancing its case, the company relied upon a Delaware decision known as *In Re Appraisal of Dole Foods Company,Inc*. ("Dole")[7] in which the Dissenters had been ordered to give discovery. At first instance, the Grand Court noted that while it would take into account and pay close attention to the decision of the courts in Delaware, given the similarity of the jurisprudence and statutory merger provisions, the *Dole* decision was of '*little assistance in relation to procedural matters such as discovery where the Delaware jurisdiction is so different'*. The Grand Court ultimately decided in favour of the Dissenters, who had resisted discovery on the basis that the Dissenters' internal analyses of share price were not relevant and it was therefore not appropriate for Dissenters to provide discovery of their documents.

However, the CICA disagreed. Noting that the question of fair value is closely related to the question of what a willing buyer and a willing seller would exchange for the shares of the company, the CICA found that valuations conducted within the market generally are relevant. It followed that the analyses and valuations conducted by the Dissenters were also considered by the CICA to be of importance to the valuation exercise: the Dissenters were held to be not merely potential investors, but actual investors and therefore "*active members of the market who are willing to put their money where their analysis is*". The CICA expressed the view that discovery is a mutual obligation, requiring equality and fairness, and Section 238 litigation is not a "*unique field in which one-sided disclosure*" ought to be practised. Discovery by the Dissenters was therefore ordered, and will be expected in future proceedings of this nature.

Further Judgments

Further judgments are anticipated, both from the Grand Court and the CICA, in the coming months. These will likely bring even greater clarity and further specific guidance not only as to the roles and responsibilities of the different parties to statutory appraisal litigation in the Cayman Islands, but also as to the expectations of the local Courts regarding the proper conduct of the parties as they work their way through the valuation process. Results may differ, but the local statutory appraisal procedure is becoming increasingly well-defined and mature.

[5] CICA 24 of 2017 (unreported, 10 April 2018)
[6] [2017] 1 CILR 206
[7] CA No 9079 (December 9, 2014)

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