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UPDATE

Section 238 fair value determinations: more guidance from the Court

Update prepared by Paul Christopher (Managing Partner, Hong Kong), Alex Last (Partner, Cayman Islands), Christopher Harlowe (Partner, Cayman Islands) and Simon Dickson (Partner, Cayman Islands)

Two recent unreported decisions of the Grand Court have given valuable guidance on how the Court will approach a number of pre-trial issues (including discovery and interim payments) which may arise between parties to a 'fair value' determination pursuant to section 238 of the Companies Law.

Background

In previous legal updates[1] we discussed the statutory merger regime in the Companies Law. We also discussed the Grand Court's ruling in *Integra*[2] which set down important guidance on how the 'fair value' of a dissenting shareholder's shares will be determined pursuant to the statutory merger regime.

By way of quick recap, shareholders of Cayman companies which have voted to merge are entitled, pursuant to section 238 of the Companies Law, to dissent from the merger. The dissent of a shareholder does not prevent the merger of the company. However, unless the company and dissenting shareholder can agree on the price to be paid for the dissenting shareholder's shares, the company must file a petition in the Grand Court for a determination of the fair value of the shares.

Whilst the statutory merger process has been a feature of Cayman legislation since 2009, fair value petitions were sporadic until recently. To date, most have involved Cayman companies listed on London or New York stock exchanges and with subsidiaries in the People's Republic of China. The merger process is often initiated by the company's management team wishing to take the company private.

There are a number of fair value proceedings currently making their way through the Grand Court, which have given rise to some interesting issues.

Qihoo 360 Technology Co. Ltd – interim payments

In *Qihoo 360 Technology Co. Ltd*[3] (Quin J), the dissenting shareholders sought an order for an interim payment out of moneys previously paid into Court by the company. The amount was paid into Court 'as security for payment by the Company to the Dissenting Shareholders of the fair value of the shares of the Dissenting Shareholders to be determined in this Petition'. It is notable that, whilst the company had offered the dissenting shareholders approximately US$17 million for their shares prior to the commencement of the proceedings, it agreed to pay approximately US$92 million into Court.

[1] See our legal updates 'Cayman Court makes first ruling on the meaning of "Fair Value" under the statutory merger regime' and 'Going private: how to obtain fair value under the Cayman statutory merger regime'.

[2] *In the matter of Integra Group (Unreported, 10 September 2015).*

[3] *Blackwell Partners LLC – Series A et al v Qihoo 360 Technology Co. Ltd* (Unreported, 26 January 2017).

The dissenting shareholders sought an order that the entire US$92 million be paid to them as an interim payment pursuant to Order 29 of the Grand Court Rules. The company objected. The main issue was whether Order 29 applies to fair value proceedings. The company's primary argument was that the dissenting shareholders were not owed a debt or entitled to damages (as required by Order 29) but were rather only entitled to be paid fair value for their shares and that value had not been established by the Court. Rejecting the company's arguments, the Court held that:

- section 238 petitions were proceedings falling within Order 29;
- a fair value determination by the Court pursuant to section 238 comes within the interpretation of 'interim payment' pursuant to Order 29; and
- given that the company had offered to pay the dissenting shareholders US$17 million for their shares and paid US$92 million in Court, the dissenting shareholders would obtain judgment against [the company] for a substantial sum of money, as required by Order 29.

In reaching its conclusions, the Court rejected the company's argument that section 238 was a self-contained statutory code for the determination of fair value that did not permit any discretionary overlap for interim payments pursuant to Order 29. The Court also appeared to reject the company's argument that an interim payment should not be made because the whole point of the payment into Court (which was made by consent of the parties) was to avoid the need for an interim payment.

The Court noted that there was considerable force in the dissenting shareholders' reliance on Jones J's obiter comments (made in the context of determining fair value and interest payable to dissenting shareholders) in *Integra*:

'It could be said that the [dissenting shareholders] have been kept out of the money since July 2nd 2014, a date on which Integra made its written offer to pay Fair Value of US$10 per share pursuant to section 238(8). For whatever reason, it did not offer to pay this amount (or any lesser amount) on account pending the outcome of the proceedings. It follows that Integra has had the use of the [dissenting shareholders'] money for more than a year.'

The Court ordered an interim payment to the dissenting shareholders of US$17 million (ie the company's own stated fair value of the shares). The Court refused to order payment of the entire US$92 million held in Court because it found that would be pre-empting the trial judge's determination of fair value, made with the benefit of hearing expert evidence from the company and the dissenting shareholders.

Qihoo suggests that the Court will not accept that voluntary payment of moneys into Court as sufficient and will require the company to make an interim payment to dissenting shareholders pending the outcome of the fair value determination.

In *Qihoo*, the Court ordered an interim payment in the amount the company had previously offered the dissenting shareholders. However, it should be noted that the Court had regard to the fact that the company had agreed to pay into Court (on a no admissions basis) an amount more than five times higher than it had previously offered to pay for the shares. The Court appeared to be satisfied that the dissenting shareholders would receive at least US$17 million for their shares. It is unclear whether the Court, in the absence of a payment into Court which so significantly exceeded the company's offer, would take the same approach.

Homeinns Hotel Group – discovery issues

Homeinns Hotel Group[4] (Mangatal J) was concerned with the types of documents the parties to a section 238 petition should be required to disclose and the circumstances in which they should be disclosed. In particular:

- the Court directed that the company provide certain classes of documents identified by the dissenting shareholdings as relevant to the valuation and in the possession of the company. The Court rejected the company's argument that discovery should take place in the usual way (ie by the mutual exchange of relevant documents in the parties' respective possession, custody or power). The Court noted that, in section 238 litigation, the company would inevitably hold the relevant material and it did not make sense to require the dissenting shareholders to give discovery of documents. The Court also noted the comments of Jones J in *Integra* that the parties' respective valuation experts should have all relevant material made available to them;
- for much the same reason, the Court also ordered that additional documents requested by either side's expert should be made available. The Court rejected the company's contention that documents should only be made available if both party's respective experts requested the document; and
- the Court declined to direct the company to provide English translations of Chinese language documents, noting the absence of any such obligation in civil proceedings generally.

The decision in *Homeinns*, following the comments of Jones J in *Integra*, makes it clear that the Court will be concerned to ensure that the parties' respective valuation experts are provided with all the material they require to prepare their valuations reports and will resist attempts by the company, which will usually hold all the relevant material, to limit the disclosure of documents.

Conclusion

The recent decisions in *Qihoo* and *Homeinns* are illustrative of the types of issues which have arisen during the pre-trial stages of s.238 fair value determinations. Whilst the Court has stressed that the directions made in any section 238 proceeding should not be seen as a template for all such proceedings, the increasing number of fair value determinations in Cayman has led to a growing body of guidance on the practice and procedure the Court will adopt in these matters.

Further section 238 rulings are expected shortly.

[4] *Homeinns Hotel Group v Maso Capital Investments Limited et al* (Unreported, 7 February 2017).

Contacts

Paul Christopher
Managing Partner, Mourant Ozannes
Hong Kong
+852 3995 5700
paul.christopher@mourant.com

Alex Last
Partner, Mourant Ozannes
Cayman Islands
+1 345 814 9243
alex.last@mourant.com

Christopher Harlowe
Partner, Mourant Ozannes
Cayman Islands
+1 345 814 9232
christopher.harlowe@mourant.com

Simon Dickson
Partner, Mourant Ozannes
Cayman Islands
+1 345 814 9110
simon.dickson@mourant.com

2021934/73156827/1