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UPDATE

# Shanda Games: Grand Court's valuation upheld but Cayman ploughs its own furrow on minority discounts

On an appeal by Shanda Games Limited (Shanda), against Justice Segal's decision at first instance not to apply a minority discount to the valuation of the Dissenting Shareholders' shares in Shanda, the Cayman Islands Court of Appeal has held that a minority discount should be applied to cases under section 238 of the Companies Law (2018 Revision) (the Law). The decision represents a significant departure by the Cayman courts from the established position in Delaware and Canada where the courts do not apply minority discounts in appraisal cases. Shanda's appeal against Segal J's approach to the award of interest was, however, dismissed by the Court of Appeal, as was its attempt to re-open its case to adduce fresh expert evidence.

## Background

Under section 238 of the Law, a shareholder in a Cayman registered company who dissents from a merger or consolidation of the company is entitled to be paid 'the fair value of his shares'. In two first instance decisions, the Cayman courts either accepted or held that a shareholder is entitled to a proportionate share of the capital and value of the company treated as a going concern and, accordingly, no minority discount is to be applied in determining the fair value of the dissenting shareholder's shares.

In *Integra*, the first of the two cases, it was agreed between the parties that no minority discount should be applied; Jones J made it clear that he agreed with that proposition.[1] In the second case, *Shanda* itself,[2] Segal J was required to decide the minority discount point. It was accepted before the Judge that the settled position in Delaware and Canada, both of which have well-developed appraisal regimes upon which the Cayman regime is largely based, was that no minority discount applied. In Delaware, the point of principle underlying this approach is that 'what is being valued in a Delaware appraisal action is the dissenting minority's interest in the corporation as a whole rather than their block of shares'.[3] Shanda contended that in unfair prejudice cases in England under the Companies Act 2006, where the court makes a finding of 'unfair prejudice' and orders the petitioner's shares to be bought out, the starting point is that a minority discount is to be applied when valuing the petitioner's shares, save where the court is dealing with a 'quasi-partnership'.

In *Shanda*, Segal J held that minority discount should not be applied in section 238 cases for the following reasons:

1. the purpose of the fair value standard is to ensure the full protection of the minority and they should be compensated for the value of their full interest in the company, which is their proportionate share in the capital and value of the company; and

[1] *In re Integra Group* (unreported, 28 August 2015) at para 20.

[2] See our previous legal update, 'Demystifying the de-listing process: guidance on section 238 fair valuation'.

[3] *In re Shanda Games Limited* (unreported, 25 April 2017) at para 92(c).

2. the English unfair prejudice cases were '*clearly distinguishable*'. The English statutory language was different to section 238 and, unlike in unfair prejudice cases, section 238 does not assume a notional sale of the dissenting minority's shares.

## Application to re-open

The Court of Appeal first dealt with an issue relating to Segal J's decision to refuse the Company permission to re-open its case to adduce evidence from a new expert after trial. The basis for Shanda's application was that the evidence of its valuation expert had been so deficient as to warrant fresh evidence being adduced. The Court of Appeal refused Shanda leave to appeal on this matter (holding that leave was necessary), and in any event held that it would have dismissed the appeal had leave not been necessary. The decision to refuse Shanda permission to re-open its case was a discretionary one; Shanda's application was late, having been made 4 months after the conclusion of the hearing, and Segal J had been best placed to assess the extent to which the assistance derived from the new expert justified resumption of the hearing.

## The Court of Appeal's reasoning in *Shanda* on minority discounts

Overturning Segal J on this issue, the Court of Appeal held that minority discounts are to be applied when determining the fair value of a dissenting shareholder's shares under section 238 of the Law.

Delivering the judgment of the Court, Martin JA, with whom Goldring JA and Morrison JA agreed, undertook a detailed analysis of: (i) the Delaware and Canadian appraisal jurisprudence; (ii) the English authorities relating to 'squeeze-outs' and schemes of arrangement under the English Companies Act 2006 (to which Segal J had not been taken at first instance and each of which had direct parallels in Cayman statutes, representing 'two circumstances in which majority shareholders may acquire the shares of an unwilling minority'[4]); (iii) the English unfair prejudice authorities; and (iv) the position under appraisal regimes in Bermuda and the BVI.

Martin JA considered that the settled Delaware position was heavily influenced by, if not based on, public policy considerations. These policy considerations were at odds with the policy underlying the English squeeze-out cases to the effect that it is not unfair to offer a minority shareholder the value of what he possesses, namely, a minority shareholding. Further, the two other regimes contained in the Cayman Companies Law by which majority shareholders may acquire an unwilling minority's shares (i.e. squeeze-outs and schemes of arrangement) both allowed a minority discount to be applied. Therefore, it seemed 'unlikely in the extreme that the simplified merger and consolidation regime introduced as Part XVI of the Companies Law is intended to depart from that approach'.[5] Finally, the statutory language of section 238 supported this view given that its focus is on the value of a shareholder's shares and not on the value of the company as a whole.

## An exception to the minority discount?

At paragraph 44, by analogy with the approach taken in the English unfair prejudice cases, the Court of Appeal left open the possibility that a minority discount may not be applicable in 'quasi-partnership' cases where a relationship of trust and confidence subsisted. Martin JA noted that Shanda was not such a company. In future, the Court may look for the usual incidents of a 'quasi-partnership' relationship in section 238 cases. The features of a quasi-partnership are set out in a well-known passage of Lord Wilberforce's judgment in the seminal case of *Ebrahimi v Westbourne Galleries Ltd*. [1972] 2 W.L.R. 1289.[6]

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[4] *Shanda* at para 35

[5] *Shanda* at para 49

[6] As regards quasi-partnerships, Lord Wilberforce said: '*Certainly the fact that a company is a small one, or a private company, is not enough... The superimposition of equitable considerations requires something more, which typically may include one, or probably more, of the following elements: (i) an association formed or continued on the basis of a personal relationship, involving mutual confidence - this element will often be found where a pre-existing partnership has been converted into a limited company; (ii) an agreement, or understanding, that all, or some (for there may be 'sleeping' members), of the shareholders shall participate in the conduct of the business; (iii) restriction upon the transfer of the members' interest in the company - so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.*'

On particular facts, dissenters might rely on the presence of quasi-partnership features as an exception to the applicability of a minority discount.[7]

## What discount will the court apply?

The amount of any minority discount in future cases is likely to be fact dependent and in all likelihood will be the subject of evidence from the parties' valuation experts.

In *Shanda*, it was agreed by the valuation experts that in the event any such discount was to be applicable the minority discount to the dissenting shareholders' 1.64% shareholding in Shanda should be 23%. In material terms, this reduced the value of the shares by about US$16.9 million, which nevertheless represented only a portion of the uplift the Grand Court awarded above merger consideration.

## The persuasiveness of Delaware jurisprudence

The Cayman courts have relied quite heavily on Delaware case law in relation to section 238 cases to date. Martin JA, however, considered that Segal J had gone too far in Shanda when he said that, 'it is entirely appropriate to have regard to and pay close attention to the decisions of the courts in Delaware (and Canada)', noting that Segal J had failed to ensure that the application of the Delaware rules was consistent with other parts of Cayman law.[8]

Having departed from Delaware appraisal jurisprudence on the important issue of minority discounts, it remains to be seen in future the extent to which the Cayman courts follow developments in the Delaware appraisal authorities or have closer regard to the approach of the English courts in respect of the valuation of a petitioner's shares under the unfair prejudice provisions of the English Companies Act 2006.

## Interest

Section 238(11) empowers the Cayman court to award 'a fair rate of interest' to a dissenting shareholder. Shanda appealed the rate of interest of 4.295% awarded by Segal J. This represented the mid-point between (i) the rate at which he decided Shanda could have borrowed the amount representing fair value of the Dissenting Shareholders' shares in order to pay it to them and (ii) the rate which he decided prudent investors in the position of the dissenting shareholders could have obtained, had they had the money to invest.

In adopting the 'mid-point approach' Segal J followed the course taken by Jones J in *Integra*, which also represented the former Delaware practice in relation to interest. The parties had agreed that this was the correct approach to adopt at first instance. However, on appeal Shanda contended that this approach was inconsistent with the purpose of an award of interest under English and Cayman law, and argued that the rate awarded should have represented only the cost to the dissenting shareholders of being deprived of their money, i.e. the rate they would have had to pay to borrow money to replace the unpaid fair value of their shares.

The Court of Appeal accepted that the statement of Steyn J in *Banque Keyser Ullman SA v Skandia (UK) Insurance Co Ltd* represented the correct legal position in England with regard to interest on damages, but noted that section 238 cases, unlike damages cases, do not proceed on the basis that any right of the dissenting shareholder has been infringed so as to require the court to restore him to some anterior position; rather, the court's concern is to 'ensure that he receives fair value for what he is obliged by statute to give up'. The corollary of that, Martin JA continued, was to remove the focus from the dissenter and place it on the entirety of the circumstances.

In light of this, it was right to say that both the disadvantage to the dissenter and the advantage to the company should be taken into account, with the mid-point approach representing a logical way of balancing advantage and disadvantage. Segal J had not, accordingly, erred in principle. The Court of

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[7] For example see *In re Fountain Medical Development Ltd* (unreported, 19 January 2018, Mangatal J) for a case that in Mangatal J's words '*does not represent the typical section 238 Proceedings that have made their way through the Courts of the Cayman Islands*', a case where '*the dissenting shareholder is a sole individual, who claims to be a founding member and a former director who had been integrally involved in the affairs of the Company*' (para 25).

[8] *Shanda* at paras 46 to 47.

Appeal's judgment has provided some welcome clarity as to the approach the Cayman court is likely to adopt when awarding a fair rate of interest in section 238 proceedings.

## Contacts


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





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