

UPDATE

# Shanda Games: Privy Council appraises the minority discount

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In the first s.238 fair value decision to be appealed to the Privy Council, the highest appellant court for the Cayman Islands, the Judicial Committee of the Privy Council has held that if a dissenter holds a minority shareholding, the fair value of those shares should reflect any applicable minority discount.

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## History of the appeal

In November 2015 Shanda Games Ltd (**Shanda**) merged with Capitalcorp Ltd, as part of a take-private transaction. The fair value of the shares was determined pursuant to s.238 of the Cayman Islands Companies Law (the **Law**). At trial, fair value was found to be \$8.34 per share, in comparison to the merger consideration of \$3.55 per share. As part of the expert evidence, it was agreed that should the court find that a minority discount should be applied, that discount should be 23%.

The court at first instance found that no minority discount should be applied in determining fair value. This decision was reversed by the Cayman Islands Court of Appeal (the **CICA**).<sup>1</sup> The dissenting shareholders (the **Dissenters**) subsequently appealed to the Privy Council (the **PC**). The primary issue to be determined by the PC was whether the CICA was correct to hold that a minority discount should be applied in the determination of the fair value of the Dissenters' shares (the **Minority Discount Point**). A secondary issue arose as to whether the requirement to award a fair rate of interest requires the court to do so in accordance with the principles governing interest awards in relation to debt claims or damages claims (the **Interest Point**).

## Minority Discount Point

The PC held that a minority discount should be applied in most circumstances when determining the fair value of the Dissenters' shares pursuant to s.238 of the Law. In determining the Minority Discount Point, the PC were careful to avoid any wider analysis of what is meant by fair value or to prescribe any particular methodology to ascertain fair value.

The PC reached its conclusion for three primary reasons:

### (1) Statutory provisions comparable to s.238 of the Law do not provide for pro rata valuation

The PC looked to other comparable Cayman Islands statutory provisions dealing with schemes of arrangements and "squeeze outs", which enable a minority shareholder to have the court review or fix the value of the minority shareholder's shares. The PC observed that the English courts, when applying the equivalent UK provisions, would approve a value which reflects that the shares are a minority holding. The PC considered that it would be surprising if the Cayman Islands legislature intended to introduce a fundamentally different approach to share valuation under s.238 of the Law as against the approach

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<sup>1</sup> See our earlier updates covering the Shanda Games litigation: *Demystifying the de-listing process: guidance on section 238 fair valuation* (June 2017) and *Shanda Games: Grand Court's valuation upheld but Cayman ploughs its own furrow on minority discounts* (March 2018).

adopted in England and Wales regarding these analogous provisions. The PC found that there was nothing to indicate any such divergence was intended by the Cayman legislature when drafting the Law.

## **(2) The general principle is: what has to be valued is what the shareholder has to sell, being a minority holding**

The PC placed some reliance on the principles in *Short v Treasury Comrs* [1948] 1 KB 116, affirmed [1948] AC 534, and held that a shareholder is only entitled to be paid for the share with which the shareholder is parting, namely a minority shareholding, and not for a proportionate part of the controlling stake which the acquirer thereby builds up, still less a *pro rata* part of the value of the company's net assets or business undertaking. The PC further held that it is a general principle of share valuation that (unless there is some indication to the contrary) the court should value the actual shareholding which the shareholder has to sell and not some hypothetical share. Accordingly, in the absence of some indication to the contrary or other special circumstances, a minority shareholder's shares should be valued as a minority shareholding.

## **(3) The similarities between the Delaware appraisal remedy and s.238 of the Law do not justify departure from this general principle**

The PC noted that "fair value" is a broad term that is not defined in the Law. Notwithstanding this, the PC found that it cannot have been intended by the Cayman Islands legislature that fair value should be wedded to what the Delaware courts consider it to mean. The PC found that while the jurisprudence of Delaware and other jurisdictions is of great value and can be used as a source of guidance, it is not binding on the Cayman courts. There may be different rules in different contexts, and economic and social policy considerations can play a role in certain jurisdictions adopting particular (and different) views of the law.

### **The Interest Point**

In determining a fair rate of interest, the court in *Shanda* took the midway point between the rates of interest representing the return on the unpaid appraisal monies that a prudent investor could have made, and the rate that the company would have had to pay to borrow the equivalent sum. *Shanda* argued that this was contrary to principles established under English law; however, the interest appeal challenged the court's judgment by reference to a new argument, which was not relied on before the first instance judge. The argument was accordingly rejected by the PC.

### **Key points to note**

Following this decision, it now appears that the Cayman courts will in most circumstances apply a minority discount when adopting a discounted cash-flow analysis to assess the fair value of Dissenters' shares. However, the PC were clear that this is not a bright-line rule and it will be a matter for the court to decide whether to adopt a minority discount, having taken into account all of the circumstances. Where a minority discount is to be applied, the facts of the case may necessitate this being very low, or even nil, as was found to be the case in the matter of *Qunar Cayman Islands Limited*.

The decision is also of some interest in that it confirms that the jurisprudence of Delaware should not be followed blindly; the court must take into account the various differences between the two legal systems. This is hardly a surprising conclusion and accords with the practice of the courts to date.

The decision does not provide guidance on how a fair value determination is to be made by the Cayman courts. The PC was not asked to opine on that issue and accordingly made clear that no guidance would be given.

Mourant has a wealth of experience in s.238 appraisal proceedings, most recently and notably having acted for the largest group of dissenting shareholders in the matter of *Nord Anglia Education, Inc.*, being the largest s.238 fair value proceeding in the Cayman Islands to date.

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