FEBRUARY 2021

mourant

UPDATE

Changyou.com Limited: Fair value in a short-form merger

Update prepared by Simon Dickson (Cayman Islands) and David Ramsaran (Cayman Islands)

The Grand Court of the Cayman Islands has confirmed a member is entitled to exercise appraisal rights to determine the fair value of its shares in a short-form merger.

Background

On 24 January 2020, Changyou.com Limited, a Cayman Islands exempted company (the **Company**) operating in the People's Republic of China as a leading developer and operator of online and mobile games, announced that it had entered into a merger agreement to effect a take-private transaction to delist the company.

The merger was not subject to a vote of the shareholders of the Company. Rather, in accordance with section 233(7) of the Companies Act (2021 Revision) (the **Act**), it was structured in the form of a 'short-form' merger; that is, one where at least 90 per cent of the shares are held by the 'parent' company, in this case Changyou Merger Co.

The minority shareholders (the **Dissenting Shareholders**), who held 4.8 per cent of the voting shares, were paid what the Company's financial advisors assessed to be the value of their shares. The Dissenting Shareholders followed the statutory process to dissent from the merger and petitioned for the appraisal of the fair value of their shares by the Grand Court of the Cayman Islands (the **Court**).

The application

The Company objected to the issuing of the petition, arguing that a short form merger under section 233(7) did not provide for a fair value appraisal of the dissenters' shares under section 238 of the Act. The Company submitted that section 238 requires notices of dissent to be filed after the passing of a special resolution and hence is not a procedure that can be used where no special resolution is required and where no dissent process is set out in the relevant section.

The Dissenting Shareholders submitted that the right to an appraisal under section 238 applies to all forms of merger and consolidation under Part XVI of the Act. The Dissenting Shareholders argued, *inter alia*, that any other construction of the statute would result in the absurd position that a 90 per cent shareholder could compulsorily acquire the minority shares at whatever price they saw fit to pay (or indeed no price at all). Therefore, the Act should be construed so as to avoid the absurdity of the deprivation of the minority of the right to have the fair value of their shares assessed by the Court.

The decision

The Chief Justice, whilst acknowledging the mismatch between the terms of section 238 and subsection 233(7), agreed that it would be absurd to exclude dissentient shareholders of a company subject to a short-form merger from the protection of section 238 simply because, unlike in the case of a long-form merger, the member is not allowed to vote. The need for protection is clear and so Parliament should not be taken as having intended to exclude such protections in a short-form merger. The exclusion of short-form mergers from section 238 appraisal rights would be anomalous, having regard to the protections afforded to minorities under schemes of arrangements, squeeze-outs and elsewhere within the Act itself.

Accordingly, the procedural provisions of section 238 should be construed so as to avoid any implication of minority shareholders being susceptible to having their shares compulsorily acquired other than at a fair value determined by the Court.

Comment

The Court's decision is a good example of the pragmatic approach the Court will take to statutory construction where a literal reading will lead to absurd results. It also provides welcome clarity to this evolving area of law and reminds those seeking to take a company private that appraisal rights will be available for those dissatisfied with the price at which their shares are to be compulsorily acquired.

Contacts

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

David Ramsaran
Articled Clerk, Mourant Ozannes
Cayman Islands
+1 345 814 9133
david.ramsaran@mourant.com

[2021934/80080922/1]