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UPDATE

The Grand Court of the Cayman Islands confirms the midpoint approach for the fair rate of interest under section 238(11)

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The Grand Court has decided in *Qunar Cayman Islands Limited*[1] that the fair rate of interest in section 238 proceedings is the midpoint between the company borrowing rate and the prudent investor rate. No costs were ordered to be paid by the company despite the share price exceeding the merger price.

Introduction

The fair value of the shares in the company was determined at trial in 2019[2] as US$31.20 per ADS. Although the Court preferred the methodology of the company's valuation expert, the fair value was slightly higher by US$0.81 per ADS than the company's merger offer (US$30.39 per ADS). It was also higher than the company's position at trial (US$28.09 per ADS). The dissenters therefore succeeded in beating both the merger offer and the company's position at trial but they failed to persuade the Court to adopt their own valuation methodology, which would have produced a substantially higher figure at 4.15 times the merger offer.

The Court has now determined the fair rate of interest under section 238(11) of the Companies Act and the issue of costs.

Interest

Approach

The company argued that the Court should move away from the traditional test endorsed by the Court of Appeal in *Shanda*[3] and drawn from former Delaware cases, which identifies the midpoint between the company borrowing rate[4] and the prudent investor rate.[5] The company instead suggested the Court should adopt either the market approach and apply the rate at which the company could have borrowed from a third party lender (2.55%), or the damages approach which relies upon the company cash deposit rate and a blended rate of two prudent investor rates (an average of 2%).

The Court was not persuaded by the company's arguments and held that there was no good reason to depart from the settled practice at first instance. Whilst the Court did not find that the Court of Appeal

[1] Unreported, 29 March 2021.
[2] *In re Qunar* [2019] (1) CILR 611.
[3] *In re Shanda Games* [2018] (1) CILR 352.
[4] The company borrowing rate *represents the advantage to the company by temporarily retaining the additional funds so that it might avoid the need to borrow, resulting in reduced interest expense on a loan* (para 43).
[5] The prudent investor rate *represents the disadvantage to the dissenters in loss of earnings on the funds which should have been paid* (para 65).

decision in *Shanda* is binding, the proposition is '*strongly arguable*' and the midpoint approach was adopted.

Rates

The company argued that it was unlikely to borrow in the short term as it had sufficient cash balances and therefore it was illogical to use the company borrowing rate to represent the benefit derived by the company as a result of retaining the sums ultimately payable to dissenters. The company instead argued for a cash deposit rate[6] of 1.45%. The Court rejected this and decided that the company borrowing rate was the fair rate to use to measure the advantage to the company and accorded with Delaware jurisprudence. The Court decided this rate should be 4.3%.

As for the dissenter loss side of the equation, the Court rejected the investor borrowing rate as a metric and looked to the prudent investor rate. The company argued that because dissenters knew the Court would not award negative interest rates, they were not bearing the risk of losing money and so the prudent investor rate should be based on a risk free rate at 1.6% to 1.7%. If this was to be rejected, then the company argued that, in accordance with *Shanda*, the rate should be based on a very low risk portfolio of bonds only.

The Court rejected the company's arguments. The risk free rate was inappropriate as a matter of law and the low risk portfolio approach did not accord with the returns a professional investor would have achieved if the sums in issue had been added to its funds. The Court accepted the dissenters' position on the prudent investor rate and the asset allocation adopted by their expert, with the various rates over time adjusted to a simple rate equivalent. These prudent investor rates were substantially higher than the company borrowing rate of 4.3% and, accordingly, the midpoint between the company borrowing rate and the prudent investor rate exceeds this figure.

The Court decided that there was no power to award compound interest. Simple interest therefore applied.

Period

The Court found that the start date for interest was the fair value offer date (23 March 2017) as opposed to the date when the merger was completed (28 February 2017). The end date for interest on the balance due was the earlier of this judgment (with judgment interest under the Judgment Debts (Rate of Interest) Rules running thereafter) or payment.

Costs

The Court set out a number of propositions on costs, namely (i) section 238(14) gives the Court a wide discretion on costs to do justice in all the circumstances (ii) a successful party should recover the reasonable costs incurred by it (iii) in section 238 proceedings it is not helpful to lay down any generally applicable principles in what constitutes success or failure (iv) there may be circumstances where it is appropriate to exercise the court's discretion by reference to identifiable issues (v) where a successful party makes allegations improperly or unreasonably the Court may deprive it of its costs and order it to pay the other party's costs in whole or in part and (vi) a dissenter's risk is limited to the additional costs incurred by the company as a result of its participation if unsuccessful.

The company argued that the parties should bear their own costs of the proceedings up to 7 February 2019, when the company wrote to the dissenters proposing to pay US$36.468 per ADS, and from this date the dissenters should bear the company's costs. This amount exceeded the fair value later determined at trial (US$31.20 per ADS) but the proposal was also put on the basis that it included interest and that each party should bear their own costs.

The dissenters argued that because they beat the company's merger offer of US$30.39 by US$0.81 per ADS and beat the fair value figure advanced by the company at trial of US$28.09 by US$3.11 per ADS, the dissenters were clearly the successful party and that the party who writes the cheque must pay the costs. As for the alleged without prejudice offer of 7 February 2019, the dissenters argued it did not represent an offer capable of reversing the usual rule as to costs because (i) the amount offered had not been paid into

[6] The company cash deposit rate *represents the advantage to the company through withholding the sums payable to yield returns or interest from investing the funds* (para 44).

Court (ii) it was an offer made subject to contract and hence was not an offer capable of immediate acceptance and (iii) gave an unreasonable timeframe for acceptance. The dissenters also argued that because it did not include payment of the dissenters' costs, in accordance with the rules for payment into court, it was unclear whether the alleged offer was more valuable to each dissenter than the result obtained at trial. Accordingly, it was not a metric that should be taken into account.

The Court formed the view that, even though the practical result of the trial was that the company had to write a cheque to the dissenters, the *common sense outcome in the real world is that the company succeeded at trial*. The approach of the company's valuation expert had been accepted (save in two minor respects) and the uplift on the merger offer was only 2%, whereas the dissenters' valuation would have resulted in an uplift of 415%. Whilst the Court acknowledged that this was counter balanced by the fact that the dissenters beat both the merger offer and the company's position at trial, it commented that the case at trial was in reality about the vast delta between the two competing valuations.

As for the company's offer letter, the Court accepted the dissenters' submissions in relation to the uncertainty caused by its wording and also concluded that the dissenters did not conduct themselves unreasonably in not accepting it. The Court therefore held that there should be no order as to costs.

Comment

The advent of another first instance decision adopting the midpoint approach and the indication that *Shanda* is arguably binding on this issue hopefully settles the point for future litigants in section 238 proceedings.

As for costs, the Court's approach appears to be that the issue of costs will be more nuanced in section 238 proceedings than in ordinary commercial litigation for damages. Whether there is really a justification for treating section 238 proceedings as a different class of proceedings for the purpose of costs will no doubt be a hotly contested issue. However, the decision risks an increase in complex satellite costs litigation and ever more esoteric arguments as to what success is. It also suggests that where the delta between two valuations is very significant, costs may not necessarily be awarded to a dissenter that narrowly beats the merger offer.

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