Appraisal rights confirmed in Cayman Islands short-form mergers

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The Cayman Islands Court of Appeal has upheld the Grand Court's decision in *Changyou.com*, [1] confirming that shareholders of companies that effect "short-form" mergers [2] are entitled to be paid the fair value of their former shares upon dissenting from the merger under section 238 of the Companies Act (2021 Revision) (**Act**).

Background to Changyou

Changyou.com Limited (**Changyou**) is a Cayman Islands incorporated company, which develops and operates online and mobile games in China. Changyou recently merged with its parent company and de-listed from the NASDAQ, effectively forcing out the independent minority shareholders under a short-form merger.

Certain minority shareholders attempted to dissent from the merger. However, Changyou contended that appraisal rights were only available in long-form mergers (where there is a shareholder vote required to approve the merger) and that the prospective dissenters were not entitled to seek payment of the fair value of their former shares under section 238 of the Act due to the merger being in short-form (where no shareholder vote was required).

Grand Court decision that appraisal rights are available in short-form mergers

In January 2021, the Grand Court determined that, when properly construed, the provisions of section 238 allowed the appraisal process to operate in respect of short-form mergers.

A more detailed overview of the decision at first instance and the Grand Court's reasoning can be found in Ogier's earlier article Short-form mergers – appraisal rights confirmed in the Cayman Islands in Changyou judgment.

Changyou's appeal

Changyou then argued on appeal that:

- When the provisions of section 238 were read together, the ability to dissent was clearly conditional upon the taking of a shareholder vote, thereby excluding the right to dissent from short-form mergers (where no vote is required)
- The absence of appraisal rights in short-form mergers was not absurd or anomalous, nor was it incompatible with the Cayman Islands Constitution [3]
- There was no justification for re-writing section 238 to give effect to appraisal rights for short-form mergers, whether by a process of statutory construction or pursuant to the Constitution

Court of Appeal's decision that section 238 must be read down to comply with the Constitution

The Court of Appeal preferred the Company's construction of the terms of section 238 but agreed with the Grand Court that this produced an absurd result that could not have been intended by the legislature. In the Court of Appeal's view, there had been an obvious legislative error in not taking account of the absence of a shareholder vote in short-form mergers when the operative provisions of section 238 were drafted. However, in departing from the approach taken by the Grand Court, it held that the ordinary rules of construction did not permit this error to be rectified by any process of ordinary construction falling within the proper ambit of judicial interpretation of statute.

This brought into play whether the principles of construction mandated by the Constitution produced a different result. The Court of Appeal found that the Constitution was engaged, as shares in a company are a form of "property", for which the Constitution assures a right of peaceful enjoyment and ordinarily precludes dispossession without prompt payment of adequate compensation. As drafted, section 238 was held to deprive minority shareholders in short-form mergers of the right to peaceful enjoyment of their shares and access to the Court for the determination of their fair value and prompt payment upon having them compulsorily acquired. Furthermore, the Court of Appeal determined that there were no other alternative remedies available to minority shareholders that would otherwise protect the rights guaranteed by the Constitution, and undoubtedly conferred by appraisal rights in long-form mergers.

The Court of Appeal concluded that section 238 was unclear or ambiguous as to its compatibility with the Constitution, given the mismatch between the operative provisions and the perceived legislative intent. This gave the Court of Appeal a greater degree of interpretative

latitude than is otherwise available under the ordinary rules of construction. In particular, the Constitution required the Court of Appeal to resolve this uncertainty in favour of compliance with the protections afforded by the Constitution, as far as it was possible to do so.

In directing how the wording of section 238 should be adapted to enable the mechanics of the dissent process to operate in respect of short-form mergers, the Court of Appeal adopted the following approach:

- A member wishing to object to a short-form merger, must provide a notice of objection to the company under section 238(2) "immediately after the date on which the plan of merger is given to [them] pursuant to section 233(7)"
- The company must then give written notice of authorisation to any objecting members under section 238(4) "within 20 days immediately following the date on which the plan of merger or consolidation is filed with the Registrar"
- A member who elects to dissent from the short-form merger must then give written notice of their dissent under section 238(5) within the next 20 days

Read in this way, section 238 conforms with the intention of the legislature to provide appraisal rights in both long and short-form mergers and the requirements of the Constitution to protect against compulsory acquisition of property without prompt payment of adequate compensation.

Discussion of the Court of Appeal's decision

This decision will be welcomed by minority shareholders in Cayman Islands companies, who can now be assured [4] that they will be able to avail themselves of appraisal rights in the event of a merger, regardless of whether it is in a long or short form.

The precise timeframe for potential dissenting shareholders to give their notice of objection under section 238(2) however remains open to interpretation and urgent legal advice should be sought by any prospective dissenters in a short-form merger to ensure that they comply with the requirement to provide this notice "immediately" after receiving the plan of merger.

More broadly, the Court of Appeal's decision also demonstrates the pragmatic approach that the Cayman court will take in rectifying legislation in circumstances where the Constitution is engaged, and the statute cannot otherwise be read down under the ordinary rules of construction. This will no doubt be influential in future cases where the Constitution is similarly involved, outside of the shareholder appraisal context.

Ogier is one of the leading shareholder appraisal firms in the Cayman Islands. For more information contact your usual Ogier contact or one of the authors of this article.

[1] *See In the matter of Changyou.com Limited* CICA (Civil) Appeal 6 of 2021

[2] Where a parent merges with a subsidiary in which the parent already holds 90% of the voting power, and a special resolution of its members is not required to approve the merger

[3] Bill of Rights, Freedoms and Responsibilities, Cayman Islands Constitution 2009

[4] Subject to any appeal to the Judicial Committee of the Privy Council

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