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Fair Value in Cayman Company Mergers

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The Cayman Court's First Ruling

1. Introduction

In the Matter of Integra Group, unreported, 28 August 2015 (Jones J), is the first time that the Grand Court of the Cayman Islands has considered the meaning of the 'fair value' of shares held by a dissenting shareholder in the context of a merger carried out under Part XVI of the Cayman Islands Companies Law (2013 Revision) (the **"Law"**).

The decision will be of interest not just to those involved in any pending 'fair value' disputes under of the Law but also to those planning future mergers and consolidations under Cayman's regime.

In providing welcome guidance, the Court has now made clear that:

1. 'fair value' for the purposes of s.238(1) of the Law means the dissenting shareholder's proportionate share of the business as a going concern without any minority discount or premium for the forcible taking of their shares;
2. the date for ascertaining 'fair value' is the date on which the merger decision is made (i.e. the date of the EGM convened to vote on the merger); and
3. there is no prescribed valuation methodology – 'fair value' may be proved using any techniques or methods which are generally considered acceptable in the financial community and are otherwise admissible in Court.In the Integra case, the parties followed a valuation process in which the company was valued by two valuation experts who provided their evidence to the Court.

2. Brief Background to the Cayman Islands merger & consolidation regime and the shareholder dissention

process

The merger and consolidation regime was introduced in the Cayman Islands in May 2009. Subject to certain exceptions, these provisions of the Law allow two or more companies in the Cayman Islands to vest their undertaking, property and liabilities of such companies into a consolidated company (where a consolidation is being effected), or into the surviving company, in the case of a merger.[1]

The process for triggering shareholder dissention rights is prescribed in the Law and is subject to strict time limits:

(i) Shareholders desiring to be paid 'fair value' for their shares under s.238(1) of the Law are required to give the company written objection to the transaction before the vote on the merger or consolidation takes place.

(iii) Within 20 days of that notice, each shareholder must notify the company of his election to dissent in respect of all or some of his shares and demand payment of the 'fair value'.

At the point of dissenting, the shareholder's rights as a shareholder of the company cease and are replaced with the right to be paid a 'fair value' of his shares, to be involved in proceedings to determine the 'fair value,' and to challenge the validity of the merger.

Irrespective of whether a shareholder exercises his dissention rights to be paid 'fair value' for his shares under s.238(1), a merger or consolidation will be effective upon registration of the plan of merger by the Registrar of Companies (or upon the date specified in the plan).

Following the receipt of a shareholder's election to dissent, the company must then make a written offer to each dissenting shareholder to purchase his shares at a price the company determines to be the 'fair value' of the shares. The Law requires that the parties first attempt to agree upon the price, and if an agreement cannot be reached, the company must (or the shareholder can) file a petition with the Court for a determination of the 'fair value'.[2]

3. The Court's decision in Integra

The transaction was effectively a management buyout structured as a merger under Part XVI of the Law. A shareholder minority in the Integra Group (**"Integra"**) exercised their right to dissent from the merger and demand payment of the 'fair value' of their shares.

At the time of the proposed buyout, Integra was listed on the London Stock Exchange. Immediately before the approval of the management buyout its shares were listed for US$7.50 per share. An offer was made at US$10 per share and was supported by a committee of independent directors and by a valuation by a major international bank. The dissenting shareholders refused Integra's offer. With no agreement reached within the statutory period, Integra filed its petition in the Cayman Islands Grand Court.

The Court considered the opinions of independent valuation experts instructed by the parties. The Court, preferring the expert evidence that was favourable to the dissenting shareholders, concluded that the 'fair value' of the shares was their proportionate share of the company's business as a going concern as at the point immediately before the date on which the merger was approved without any minority discount or premium for forcible taking, and without reference to any premium or dilution attributable to the merger. That conclusion led to a 'fair value' figure of US$11.70 per share (an increase of US$1.70 per share over the merger offer price).

The Court determined that the fair rate of interest to be paid by Integra was the mid-rate between Integra's assumed return on cash and its assumed borrowing rate from the date on which it made its offer to buy the dissenting shareholders' shares (4.95%).

4. Additional points of interest from Integra

The Courts are likely to take the view that valuation experts are the best judge of what information is or is not relevant for their purposes. In the Integra case, it was not considered appropriate for Integra's management to have taken it upon themselves to control what information would be made available to the experts and to have refused to upload to an electronic data room some of the material requested by the experts. Dissenting shareholders in this type of process, therefore, are entitled to much more information than would otherwise be available to shareholders in the ordinary course.

The Judge expressed the view that it was not particularly helpful for the Court to be provided with a *range* of values by experts in the context of this type of dispute. Experts and those instructing them will be well advised to take note of this in presenting their expert evidence in future cases.

Given the Court's approach to assessing the fair rate of interest in this case, it would seem commercially sensible for companies responding to dissenting shareholder petitions on 'fair value' to offer to the dissenting shareholder an upfront payment of the amount that the company considers to be the 'fair value' for the shares. Having done so, the Court is more likely to limit any award of interest to an amount based on the difference between the amount paid and the amount that the Court ultimately determines to be the 'fair value'.

5. Conclusion

Assessing 'fair value' will invariably be a fact-based exercise which requires an important element of judgment by the Court. This first decision of the Grand Court in the context of Cayman's statutory merger and consolidation regime provides assistance to all those involved in transactions of this type, and demonstrates that the Court will take a commercial and transparent approach to the often complex issue of determining ‘fair value’.

[1] The relevant provisions may be found in ss.232-239A of Part XVI of the Law.

[2] See our detailed briefing on the Cayman Islands merger and consolidation regime.

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