



## Section 238 appraisals: Q&A with Shaun Maloney

Insights - 09/12/2021

With an upward trend in Chinese operating companies delisting from US stock exchanges, shareholder appraisal litigation continues to grow in the Cayman Islands. In this interview, Ogier partner and appraisal rights specialist Shaun Maloney shares his insights on fair value proceedings under section 238 of the Cayman Islands Companies Act.

### **What is section 238 and what do appraisal proceedings concern?**

Section 238 of the Companies Act gives shareholders a statutory right to dissent from the merger of a Cayman Islands incorporated company, and to be paid a judicially determined fair value for their shares instead of the merger consideration that is offered to them by the company.

The situations which typically give rise to section 238 proceedings are those where Cayman Islands incorporated companies operating in the People's Republic of China are taken private from US stock exchanges by the company's own management and/or a consortium of private investors at a price which some, or all, of the minority shareholders consider to be an undervalue.

Section 238 provides a protection mechanism for shareholders who have effectively been "squeezed out" in such deals. We have also seen it used by institutional investors looking to obtain a return on investment by purchasing shares in a company before it is taken private and then relying on their appraisal rights to challenge the value that the company has ascribed to the transaction.

### **So what should a shareholder do if it is unsatisfied with the amount that a company is offering for their shares?**

There are a number of statutory requirements that must be complied with if a shareholder wishes to exercise its appraisal rights under section 238. These include strictly prescribed timeframes and formalities for issuing written notices of objection and dissent.

Once a valid notice of dissent is given, the company is then obliged to offer to purchase the dissenter's shares at the price that it determines to be fair value. In the absence of reaching an

agreement with the dissenting shareholder, the company must then file a petition to have fair value determined by the Grand Court of the Cayman Islands (the **Court**).

### **Are there any potential pitfalls in this process that shareholders looking to participate in section 238 proceedings should be aware of?**

Whilst the dissent process is largely prescribed by statutory wording, there are a number of technical requirements that must be met in order for a shareholder to validly exercise its dissent rights. For example, even though the shareholder is not required to vote at the EGM, it is critical that they give the company written notice of their objection to the merger in advance of this meeting. In order to do so, they must also have converted any American depository shares to ordinary shares and ensured that any shares that might be held by brokerage firms are transferred into their own name.

These preliminary steps can take some time to execute and, if not done properly, may be fatal to a prospective dissenter's ability to seek a court determination of fair value for their shares.

### **What happens once the petition is filed with the Court?**

The first step in the process is typically a directions hearing, at which the Court will resolve procedural issues and set a timetable for the next steps in the proceeding through to trial. The Court's orders at this stage are primarily focussed on the disclosure of documents/information and the preparation of reports by each side's independent valuation expert. Once factual evidence and expert reports have been exchanged, the matter will be set down for trial.

The trial itself is largely focussed on expert valuation reports. The experts who produce the reports are extensively cross-examined, along with any factual witnesses. After hearing submissions from legal counsel, the judge must then make his or her own determination as to the fair value of the particular shareholdings. While this decision will necessarily be informed by the evidence and legal submissions that have been presented by the parties, the judge's role is not to choose which party's proffered valuation is "correct", but rather to reach his or her own independent determination of fair value, having regard to all of the material that is put before the Court.

### **How long might this appraisal process take, and are there any avenues for dissenting shareholders to recoup their investment in the meantime?**

The length of time until a section 238 proceeding is finally determined by the Court depends on the complexity of valuing the particular shareholdings in question and any interlocutory disputes and/or appeals that may arise. However, the Court has an overriding objective to deal with every matter in a just, expeditious and economical way and it is usually realistic to expect the appraisal proceedings to be concluded within two to three years from the date that the petition is issued.

In order to prevent their financial investment being tied up in the meantime, dissenting shareholders can seek an interim payment from the company. The quantum of such a payment is set by reference to the sum that it can safely be assumed the dissenter will recover at trial, and is normally agreed between the parties without the need for a court application. This interim payment can then be redeployed however the dissenting shareholder sees fit (subject to being under an ongoing obligation to repay any amount received that might later be found to be above the fair value of the dissenter's shareholding).

### **What about any interest, how is this calculated?**

Dissenters are entitled to receive a fair rate of interest upon the amount determined to be the fair value of their shareholding. This interest will run on any unpaid amount from the time of the company's fair value offer (made prior to issuing the petition) until the earlier of when any judgment is given as to any interest payable or when the dissenting shareholder is actually paid for their former shareholdings in the company (taking into account any interim payment).

In calculating the rate of interest, the Court will in principle take the midpoint between the rate of return that prudent investors in the position of the dissenting shareholder could have obtained and the company's own borrowing rate. This midpoint rate will vary based on the particular circumstances of the dissenting shareholder and the company in question, but is likely to exceed 5% per annum in many cases.

### **So how have dissenting shareholders fared in the cases to date?**

Section 238 proceedings are most commonly resolved by way of a negotiated settlement between the company and dissenting shareholders, rather than at trial. The terms of such settlements are confidential; however, our working assumption is that the outcomes reached are beneficial for dissenting shareholders.

Only five proceedings (out of almost 30 filed to date) have so far resulted in a final judgment. Each of these decisions has determined the fair value of the dissenters' shareholdings to be higher than the deal price that was offered by the company, with the amount of this uplift ranging from less than a 1% all the way up to 81% (plus interest).

### **What about the future, do you foresee there being any increase in shareholder appraisal opportunities in the Cayman Islands?**

Ogier currently acts for dissenting shareholders in a large number of ongoing appraisal proceedings and we anticipate that activity in this area is only going to increase further. In particular, there is currently a great deal of press coverage about the potential for US-listed companies with operations in Asia to delist and either be taken private or seek an alternative listing. With nearly 250 such companies presently listed in New York, most of which are incorporated in Cayman, it is expected that this will give rise to further section 238 appraisal opportunities, as shareholders seek

to challenge the amounts they are offered for the cancellation of their shares upon delisting.

## How is your team placed to meet this expected increased demand?

Ogier has a strong cross-border team of appraisal rights specialists located in our offices in the Cayman Islands, Hong Kong, London and Jersey who are acutely familiar with every aspect of the appraisal process. Our team collaborates to provide a "round the clock" service to our clients in their own time zone and native language.

For those with a potential interest in section 238 appraisal proceedings, we are always happy to have an exploratory call to talk through the process for obtaining fair value for their shareholdings in more detail.

## About Ogier

Ogier is a professional services firm with the knowledge and expertise to handle the most demanding and complex transactions and provide expert, efficient and cost-effective services to all our clients. We regularly win awards for the quality of our client service, our work and our people.

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