

2017 will see at least one, and probably more, rulings handed down by the Court in share valuation claims. We expect a continued increase in shareholder valuation claims being pursued by professional dissenting shareholders

2016 in review: The rise of Cayman Islands share valuation disputes and professional dissenting shareholders

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During 2016, shareholders in Cayman Islands companies often availed themselves of the Court procedure for determining the fair value of their shares. That trend is likely to continue into 2017. A substantial driver of this has been the perceived opportunity by value arbitrage investors looking to take advantage of the trend for US-listed, Cayman Islands incorporated, China companies going private – known as the “march back East”. A take private transaction involves a valuation by a Cayman Islands company of the fair value of its shares. Shareholder-investors objecting to the company-determined value are keeping the Cayman Islands Court increasing busy.

Section 238 of the Companies Law provides a mechanism by which a shareholder may refuse to accept the consideration offered to the shareholder for his shares in a merger or consolidation of the company, and instead have the Cayman Islands Court determine the fair value of those shares.

There were nine shareholder valuation proceedings commenced in the Cayman Islands in 2016 - a significant increase from 2014 and 2015, which saw one proceeding commenced in each year.

Of these nine proceedings, five have the same dissenting shareholder group and eight have a dissenting shareholder group that are reported to be event-driven hedge funds (i.e. the fund invests in securities affected by corporate events such as mergers) – these are ‘professional’ dissenting shareholders.

Of the nine companies whose shares are subject to a fair value determination, eight conduct their operations through subsidiaries in the People’s Republic of China (the other conducts a large onshore drilling operation in Russia). The majority of these mergers or consolidations have been US\$1-2 billion value transactions, and in one case US\$9.3 billion. Each was reportedly initiated by a management consortium in conjunction with sponsors or affiliates, many of whom were existing shareholders, looking to take the company private.

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Harneys has acted in the vast majority of the cases filed to date, amassing world class expertise and, consistent with its dominating Asia-Pacific footprint, acting for the China corporates.

Previous decision - *In the matter of Integra Group*

The Court's decision in *In the matter of Integra Group*¹, handed down on 28 August 2015, is the first and (currently) only Cayman Islands decision in a section 238 share valuation claim and is highly encouraging to potential dissenting shareholders. Section 238 does not prescribe a valuation methodology for the Court to apply. In *Integra*, the Court combined an income approach (using a discounted cash flow methodology) with a market approach, with a 75 per cent and 25 per cent weighting respectively. The Court also confirmed that there should be no minority discount. The market approach can provide an indication of value by considering the trading prices of the company's own shares or the trading prices of comparable companies (or some combination of the two). While the Court was clear that the appropriate valuation method will depend on the circumstances of the particular case, the approach in *Integra* was positive for the dissenting shareholders because the fair value determined by the Court was not disproportionately burdened by the price slump being experienced in the Russian oil services industry at the time.

Looking to 2017

2017 will see at least one, and probably more, rulings handed down by the Court in share valuation claims. We predict a continued increase in shareholder valuation claims being pursued by professional dissenting shareholders. We also expect to see more and more 'passive' dissenting shareholders, who seek to piggyback off the work and resources of a professional dissenting shareholder, while taking no active part in the proceeding and so avoiding any concomitant cost liability, in the event that the professional dissenter has made a bad bet.

However, we predict 2017 will be the high point for share valuation litigation in the Cayman Islands. Participation in share valuation litigation is a very unattractive prospect for a company. These proceedings are highly resource intensive on the company side. The company typically fields numerous information requests from its own and the dissenting shareholders' independent expert; maintains an electronic data room; and the company's management is usually required to participate in at least one conference with the experts. The dissenting shareholder does not bear the same burdens. Some dissenting shareholders abuse the process. Then there are the other inevitable demands on time and resources that accompany litigation, the costs consequences that may follow if the Court determines that the fair value to be even a modest amount higher than the transaction value, and the obligation to pay interest on the fair value at a generous rate.

Following a (typically billion US dollar) take-private merger or consolidation, where the company is busily pursuing a new direction free from the regulatory and compliance burdens of public trading, this litigation can be a particularly unwelcome distraction.

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¹ Unreported, FSD 92 of 2014, Jones J