

Shanda: Minority discounts in section 238 fair value proceedings

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The Board of the Privy Council (**Board**) recently handed down its decision in *Shanda Games*^[1], a case involving the determination of 'fair value' of shares pursuant to section 238 of the Cayman Islands Companies Law (**Law**). The Board upheld the Cayman Islands Court of Appeal (**CICA**)'s finding that a minority discount should be applied when determining the fair value of the dissenters' shares in Shanda, to take into account that those shares were a minority shareholding. However, the Board made it clear that its decision applied only to the fair value determination in *Shanda*, and held that the CICA was wrong to find that a minority discount will apply in all circumstances.

The Board upheld the CICA's ruling that, when determining the 'fair rate of interest' to be paid to dissenting shareholders, the Court should not use the principles applied when determining interest on an award of damages, but rather the 'mid-point approach' which takes into account the rate at which the company could have borrowed money, and the investment returns the dissenters could have achieved.

Background

Shanda Games Limited (**Shanda**), a leading online game developer based in China, was listed on the NASDAQ in September 2009. In November 2015, it was taken private by a consortium of Shanda's principal shareholders and management, by way of a merger pursuant to Part XVI of the Law. Shanda offered its shareholders US\$3.55 per share (**Merger Price**) in a deal which valued the company at US\$1.9 billion. Some shareholders (**Dissenters**) rejected that offer, requiring Shanda to commence proceedings under section 238 of the Law for the Grand Court to determine the 'fair value' of the Dissenters' shares.

In April 2017, Justice Segal of the Grand Court determined that fair value was US\$8.34 per share, around 235% higher than the Merger Price. He decided that there was no need to discount fair value to reflect the fact that the Dissenters had minority holdings. In a separate ruling in May 2017, Justice Segal determined that the fair rate of interest to be paid to the Dissenters was 4.295%, the midpoint between Shanda's cost of borrowing (3.5%) and the rate of return a prudent investor would have earned from the moneys (5.09%).

In March 2018, the CICA reversed^[2] the Grand Court's decision on the minority discount point. The CICA's main reasons were:

- English authorities dealing with cases involving the acquisition of minority shares ('squeeze-outs', schemes of arrangement and unfair prejudice proceedings) permitted the application of a minority discount, as did appraisal regimes in other Commonwealth jurisdictions;
- the two other mechanisms in the Cayman Islands law by which a majority could acquire the shares of an unwilling minority (i.e. squeeze-outs and schemes of arrangement) permitted the application of a minority discount;
- the CICA distinguished Cayman Islands and English authorities which refused to order a minority discount, on the basis that those cases involved a special relationship of trust and confidence between the majority and the minority (known as 'quasi-

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partnership' cases), which was not present in *Shanda*; and

- the Delaware authorities, which do not apply a minority discount, should not be followed despite the fact that the Cayman Islands law was, in significant part, modelled on the Delaware legislation. The Cayman Islands law was worded differently, and required the Court to value the shares actually held by the dissenters. In contrast, the Delaware legislation entitled dissenters to their proportionate share of the company's value (i.e. the total value of the company as a going concern, divided by the number of shares held by the dissenter).

The CICA rejected Shanda's appeal in respect of the fair rate of interest. It held that, in contrast to damages cases, in fair value proceedings, the purpose of interest was to ensure the dissenter received fair value for the shares that were compulsorily acquired by the company, and required the court to look at all the circumstances. In light of this, the CICA held that Justice Segal was right to take into account both the disadvantage to the Dissenters of being deprived of their money and the corresponding advantage to Shanda having use of those moneys.

The Privy Council's decision

The Board held that the CICA was correct to find that a minority discount should apply when determining the fair value of the Dissenters' shares in Shanda on broadly the same grounds as those of the CICA. Importantly, the Board also held that the CICA was wrong to decide that a minority discount should, as a matter of law, be applied in all cases. In rejecting a general rule, the Board noted that there may be circumstances in which it will not be appropriate to apply a minority discount.

The Board upheld the CICA's finding in relation to the fair rate of interest and saw no reason why Justice Segal's exercise of discretion should be open to challenge.

Take away points

The Board's decision reinforces the breadth of the court's discretion when determining fair value under section 238 and emphasises that the court will have regard to all the circumstances when deciding whether a minority discount should apply. It remains open for dissenters to argue that, in the circumstances of a particular case, a minority discount should not apply.

The Board's decision did not deal with the valuation methodology to be used in the Cayman Islands, or how the court will quantify a minority discount. However, some guidance can be taken from the Grand Court's decision in *Qunar*^[1], which was handed down after the CICA's ruling in *Shanda* and therefore determined fair value in the manner contemplated by both the CICA and the Board (i.e. by valuing the shares held the dissenters, rather than their proportionate share of the company).

In *Qunar*, the Grand Court quantified the minority discount at zero, based on the circumstances of the company. Justice Parker accepted that 'fair value' under section 238 is not a proxy for market value or merger price, although those prices may provide a *good cross-check* for a DCF valuation. Justice Parker confirmed that, as a matter of mechanics, any applicable minority discount should be deducted from the share price derived from a DCF valuation.

Led by Partner Rocco Cecere, Collas Crill's highly experienced section 238 practice is a sought-after, market-leading presence in merger appraisal cases in the Cayman Islands. Please contact [Rocco](#) for more information.

^[1] [2020] UKPC 2

^[2] *In the matter of Shanda Games Limited* [2018 (1) CILR 352]

[3] *In the matter of Qunar Cayman Islands Limited* FSD 76 of 2017 (13 May 2019, unreported)

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