"Fair Value" in Merger Transactions: *In Re Integra Group*

On 28 August 2015, Jones, J., gave the first Judgment in the Grand Court of the Cayman Islands on the meaning of "fair value" in merger transactions pursuant to s. 238(1) of the Companies Law (2013 Revision) (the **"Law"**).

Statutory Mergers under Cayman law

Section 233 (1) of the Law provides that two or more companies limited by shares and incorporated under the Law may (subject to any express provisions to the contrary in any of their memoranda or articles of association) merge or consolidate in accordance with the statutory procedures set out in the Law. As is typical, in *Integra* the transaction which gave rise to the proceedings is perhaps better described commercially as a management buy-out (**"MBO"**) but was structured as a statutory merger under Part XVI of the Law between two companies incorporated in the Cayman Islands namely; Integra Group (the **"Company"**) and a newly incorporated special purpose vehicle owned and controlled by the MBO participants. A plan of merger complying with the statutory requirements was approved by a special resolution of the Company's shareholders passed at an extraordinary general meeting (**"EGM"**). The merger was duly completed and the Company's shares delisted from the London Stock Exchange.

Dissenting shareholders are not required to accept a merger or consolidation agreement which has been approved by the requisite majority. Instead, they are entitled to dissent and to demand payment for the fair value of their shares. Section 238(1) of the Law provides that:

"A member of a constituent company incorporated under this Law shall be entitled to payment of the fair value of his shares upon dissenting from a merger or consolidation."

Section 238(2) provides that a shareholder of a constituent company who intends to dissent from a merger or consolidation must give written notice of objection to the company before the vote is taken, stating his intention to demand payment for his or her shares if the merger is authorised. Where the merger or consolidation is authorised in the EGM the dissenting shareholder's company must notify the shareholder of this fact within the next 20 days. By section 238(5), a dissenting shareholder is then required, within 20 days of receiving that notice, to give the company a written notice of his or her decision to dissent and a demand for payment of the fair value of his shares. Section 238(8) then provides that either the shareholder's company or the merged or consolidated company must make a written offer to the shareholder to purchase his or her shares for a specified price which it has determined to be the fair value (which could be more or less than the merger consideration). The legislation contemplates that the parties will then negotiate and attempt to agree upon the price to be paid. If no agreement is reached within a 30 day period, section 238(9) requires that the company must (and the dissenting shareholder may) present a petition to the Court for a judicial determination of the fair value of the shares. Section 238(11) provides that:

"At the hearing of a petition, the Court shall determine the fair value of the shares of such dissenting members as it finds are involved, together with a fair rate of interest, if any, to be paid by the company upon the amount determined to be fair value"

Principles to follow in Statutory merger cases

Until *Integra* all such arguments arising under section 238(1) about fair value have been compromised, with the parties' respective counsel arguing about the legal principles involved and in particular, whether such a valuation should be based on English law principles or the laws of the State of Delaware in the US and Canada from which the legislation appears to have gained its inspiration. In *Integra* Jones, J., held that the correct approach was one which followed the practice in Canada and Delaware. Citing the dicta of Lambert J.A., in *Cyprus Anvil Mining Corp v Dickson* (1986) 8 B.C.L.R. 145, Jones J. noted that "every appraisal case turns on its own facts and that there is a need to consider all the evidence that might be helpful to the Court." The Judge accepted the propositions set out in *The M & A Lawyer* (2014) entitled "*Dissenting Shareholders' Appraisal Rights in Cayman Islands Mergers and Consolidations."* This argued that the drafting of what is now Part XVI of the Law was heavily influence by Delaware and Canadian law and suggested that, having regard to the principles established in those jurisdictions, the Grand Court should have little difficulty in accepting the following propositions:

"*1. Fair Value is the value to the shareholder of his proportionate share of the business as a going concern, save where it is worth less on a net assets (i.e. liquidated) basis as at the merger date: ex hypothesis the shareholder has bought into the company as a going concern, not in anticipation of participating in a liquidation, and it follows that, when he elects to dissent from a merger or a consolidation brought about at the behest of the majority, he is thereafter deprived of his proportionate share of an active enterprise and is entitled to be compensated for it. In determining the measure of such compensation, the Court should be guided by the following considerations:*

1.1 Fair value does not include any premium for forcible taking (i.e. expropriation of the shares).

1.2 It is neither appropriate nor permissible to apply a minority discount when making the determination."

These propositions were accepted by the Judge. In addition Jones J. cited the dicta of Anderson J., in *Brant Investment Ltd et al v KeepRite Inc et al* (1987) 60 OR (2d) 737 at p. 772 (Ontario High Court of Justice) that shareholders "*should have no enhancement in the value of their investment attributable to the transaction which gave rise to their dissent.*" Jones, J., stated that he agreed "*with this proposition and its converse, namely that the dissenting shareholders should not bear any dilution or diminution in the value of their investment resulting from the merger*."

Date at which the determination of fair value is to be made

The Law does not specify the date at which the determination of fair value is to be made. However, having regard to both Canadian and Delaware statute, Jones, J., found that the appropriate date was the point immediately before the merger was approved at the EGM.

There was also some argument as to the appropriate interest to be awarded to dissenting shareholders, who had not yet received any payment in respect of their (now former) shareholding in the Company. Again, the Grand Court held that it should have regard to authority relating to a similar Delaware provision and made reference to *Cede & Co., Inc v Medpoint Healthcare, Inc* 2004 Del. Ch, Lexis 124 at page 21. Jones J., found that the Delaware Courts have interpreted their legislation "*in a way which involves balancing the rate which the surviving corporation would have had to pay to borrow funds and the rate which a prudent investor could have earned on cash or cash equivalents during the relevant period*. In *Integra*, the Grand Court held that the mid-rate between the Company's assumed return on cash and the Company's assumed US$ borrowing rate was the "fair rate of interest."

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