HARNEYS

Mergers and fair value: What does it mean to a dissenting shareholder?

Shareholders in a company that is the subject of a takeover and merger have certain intrinsic rights available to them in the event that they dissent to the merger, most notably a right to have their shares purchased at a 'fair value'. The meaning of fair value, as it is applied by the courts, is different in each jurisdiction and this article discusses the merger regime and explores the manner in which courts interpret 'fair value' in the British Virgin Islands, Cayman Islands and Bermuda.

Introduction

Carly Fiorina, a former CEO of Hewlett-Packard and a current (as at the time of writing) United States presidential candidate once commented that 'a merger is hard to pull off under any circumstances. It's harder when everybody is against you'. This is particularly true when those against you are dissenting shareholders to whom a merging company will need to account for the 'fair value' of their shares.

This article explores the merger, consolidation and amalgamation regimes in the British Virgin Islands, Cayman Islands and Bermuda, and in particular focuses on the right afforded to dissenting shareholders in each of those jurisdictions to have their interests bought out at a 'fair value', and the meaning of that concept in each jurisdiction.

Although typically used synonymously, 'mergers', 'amalgamations' and 'consolidations' are afforded unique meanings as a matter of company law in the respective jurisdictions this article addresses. Broadly speaking, a merger is the process by which two or more existing companies merge into one of the constituent companies. A consolidation is the process by which two or more existing companies are consolidated into a new company, while an amalgamation (which is applicable to Bermuda) is the process by which two or more companies continue their operations as a single company (akin more to a 'merger' as described above). For simplicity, we have referred in this article to the concepts of mergers, consolidations and, in the case of Bermuda, amalgamations, generally as 'mergers', although each has its own nuanced meaning in the BVI, Cayman Islands and Bermuda.

Mergers are becoming increasingly common in the current competitive economic climate, where businesses are being forced to explore synergies with former competitors and often this can lead to a leaner, more efficient business as a result.

It is noted that legal advice should always be sought and the foregoing is intended only to be consumed for general information purposes.

The statutory framework

The principal legislation dealing with company law in each of the BVI, Cayman Islands and Bermuda are the BVI Business Companies Act 2004 (the ***BVI Act***), the Companies Law (2013 Revision)(the ***Cayman Law***) and the Companies Act 1981 (the ***Bermuda Act***) respectively. All of the company laws in the BVI, Cayman Islands and Bermuda have a statutory framework by which mergers are governed and all provide flexible structuring mechanisms. Indeed, mergers in each of these jurisdictions are well used and continue to be a favoured method of takeover or consensual restructuring. Recent examples include Apex Partners' US$1.6 billion buyout of Tommy Hilfiger Corporation and Essilor International SA's US$565 million takeover of NASDAQ listed FGX International Holdings Limited in the British Virgin Islands, Silver Wheaton's billion-dollar acquisition of Anani Investments Ltd from Glencore PLC for mixed cash and commission consideration in the Cayman Islands and Exor SpA's US$6.9 billion dollar takeover of PartnerRe Ltd in Bermuda.

Mergers in the BVI, Cayman Islands and Bermuda can take place between companies incorporated in those respective jurisdictions or between a company incorporated in one of

those jurisdictions and one or more overseas companies, provided that the laws of the overseas company permit the merger. BVI, Cayman Islands and Bermuda law also allow a merger to take place between a parent company and its subsidiary, which means that often times the provisions are used in facilitation of a group restructuring. The effect of the merger will be that the merged entity (in the case of a merger) or the new entity (in the case of a consolidation) will hold all the assets and liabilities of the constituent companies and all of the rights, privileges, immunities, powers, objects and purposes of each of the constituent companies will be transferred to it.

There is a great deal of flexibility available in the manner in which mergers are conducted and structured and typically mergers will allow shares to be cancelled, reclassified, converted into money or other assets, including shares, debt obligations or other securities in the merged or new entity. Indeed, even shares of the same class can be treated differently in a merger or consolidation plan such that some shareholders in the constituent companies are made shareholders of the merged or new entity while others may be bought out.

While minority shareholders that do not want the merger to go ahead, cannot, in either of the BVI, Cayman Islands or Bermuda, stop the merger, they can dissent and, pursuant to statute, insist upon a right built into each of the BVI Act, Cayman Law and Bermuda Act, to dissent and be bought out at a 'fair value'. Each jurisdiction has a system prescribed in the legislation to have the merging company agree on a 'fair value amount', which typically means that parties will have to spend approximately 60 days trying to agree to the 'fair value', failing which they may ask that the court appraise the 'fair value' of the dissenting shareholders' shares.

The manner in which the courts decide what constitutes 'fair value' will depend on the facts of individual cases and each of the BVI, Cayman Islands and Bermuda has taken a different approach to the issue as is outlined below.

Meaning of 'fair value'

For most people 'fair value' will have a natural meaning correlated to the 'intrinsic' value of the company in respect of which fair value is sought and a pro-rata share of that intrinsic value based on the shareholding that a person may have in the company. While there is no statutory guidance on what considerations are to be taken into account when determining 'fair value', the question has been considered by common law at length and 'fair value' in the legal context has a very distinct meaning. The question has been the subject of a recent body of case law in the BVI, the Cayman Islands and Bermuda, and while there are a number of overlapping principles of interpretation in each of those jurisdictions, there are key distinctions which need to be borne in mind.

The leading case in the BVI is *HRH Prince Faisal v PIA Investments* (BVIHC (Com) 2011/03), which came before the Honourable Justice Bannister in the BVI Commercial Court. The case concerned the valuation of a BVI-incorporated joint venture, whose business included owning and operating a number of high profile hotels in the United States and Europe, between HRH Prince Faisal bin Salman, a member of the Saudi Arabian royal family and Pakistan International Airlines Corporation (***PIAC***).

The relationship between HRH Prince Faisal and PIAC was governed by a shareholders' agreement, pursuant to which, amongst other things, if either of the shareholders wished to sell its shares, the other shareholder would have a right of first refusal. The articles of the company were subordinated to the shareholders' agreement. Although starting the joint venture as equal partners, HRH Prince Faisal divested himself of the majority of his interest at an earlier stage (in November 2005), such that by 2007, when the events which were the subject of the proceedings took place, he was a clear minority shareholder, while PIAC was a clear majority shareholder.

In 2007, HRH Prince Faisal served on PIAC a notice of an intended sale to a third party of 7,200 shares in the company (approximately one per cent of the issued share capital of the company) which triggered an ability for PIAC to exercise a right of first refusal at the price of US$1,194 per share. PIAC however sought to amend the articles of the company such that it was no longer subordinated to the shareholders' agreement and so that it could avail itself of the merger provisions of the BVI Act in order to 'squeeze out' a minority shareholder.

PIAC accordingly served HRH Prince Faisal with a notice of redemption in relation to his minority holding pursuant to section 176 of the BVI Act, at a redemption price of US$60 per share. Section 176 provides for a compulsory redemption of a minority shareholder, provided that such redemption is sought by a majority of at least 90 per cent of the votes of the outstanding shares. HRH Prince Faisal rejected the redemption price and thereby sought to avail himself of the statutory appraisal procedure in section 179 of the BVI Act, pursuant to which the parties must attempt to agree a 'fair value', failing which they must each engage an expert valuer (which valuers then engage a third valuer) to value the shares.

In that case, however, rather than engage separate valuers in accordance with the BVI Act, HRH Prince Faisal and PIAC entered into a protocol for the appraisal of the value of the shares. However, a valuation under the protocol also failed. In ensuing proceedings brought by HRH Prince Faisal, the BVI court held that parties may contract out of the appraisal regime set out in section 179 of the BVI Act and significantly gave *obiter* guidance on the meaning of 'fair value'.

The Honourable Justice Bannister reasoned that 'fairness' depends on the individual case and what is 'fair' in one circumstance may not be 'fair' in another. He conceded that the usual position in the case of 'fair value' in the context of being compulsorily redeemed is that no minority discount should likely be applied (and for these purposes the principles can likely be safely extended to where minority shareholders are 'squeezed out' by the statutory merger and

consolidation procedures in the BVI), although he stopped short of making it a hard rule, as it will depend on individual cases. The principal consideration as to whether a valuation was 'fair' was to ensure that it does not 'favour one party at the expense of the other', and in applying that test (although he only made the comment in obiter), he stated that he was not convinced, 'in those circumstances (ie where HRH Prince Faisal deliberately turned himself into a minority shareholder), it is necessarily fair that he should be paid out on a non-discounted basis'.

The BVI approach of tackling the question of 'fair value' on a case-by-case basis, and without necessarily disallowing a minority discount even in cases of forced or compulsory acquisitions, may be regarded as commonsensical and pragmatic, as it allows a great deal of judicial flexibility in the context of cases which can be extremely fact specific. Notwithstanding that, it is fairly different to the approach taken very recently by the Cayman Court in *In the Matter of The Integra Group*, unreported (Jones J, 28 August 2015)(***Re Integra***). This is the first (and so far only) case in which a Cayman court has had to consider the meaning of 'fair value' in the context of a compulsory buy out of a minority shareholder.

The salient facts of *Re Integra* were that Integra was a London Stock Exchange-listed, Cayman incorporated provider of oilfield services in Russia. In 2013, the management of Integra sought to buy-out the outstanding shares of the company at US$10 per share, representing an approximately 45 per cent premium over the preceding 30 day trading average, and a committee of independent directors resolved that the offer was 'fair'. The deal was structured as a merger pursuant to section 233 of the Cayman Law, and a number of minority shareholders, representing approximately 17 per cent in aggregate of the issued shares of Integra, dissented to the merger pursuant to section 238 of the Cayman Law, thereby triggering a statutory provision by which the surviving company and the dissenting shareholders were to agree on a price, failing which an application may be made to the Cayman court for 'determination of the fair value'.

In *Re Integra*, the court ruled in favour of the dissenting shareholders and awarded them US$11.70 per share. In terms of guiding principles when considering the question of 'fair value', the Cayman court held that no discount or premium should be ascribed to the forced taking of shares in a merger context and that the business needs to be valued as a 'going concern' and without any adjustment to value (whether higher or lower) which is attributable to the effect of the merger transaction (that is, a dissenting shareholder cannot avail themself of a premium that may be ascribed to the value following the merger, but equally should not be burdened with a fall in value that may be ascribed to the merger). In particular, the Cayman court considered that valuation in circumstances where a minority shareholder is a forced seller should be 'just and equitable'.

No direction as to the preferred valuation methodology was given by the Cayman court, and as in the BVI, the appropriate valuation methodology will be fact and industry dependent. The mere fact that Integra was a listed company did not necessarily mean that one could accurately look at the average trading price as a gauge. In particular, the fact that Integra was not heavily traded and was not as liquid as other traded shares would not make it appropriate to simply look at the traded price to ascertain value. The Cayman court, in that regard, considered that the assessment of fair value may be proved by established valuation techniques that are generally acceptable in the financial industry and which would otherwise be admissible as valuation evidence in court. A key distinction between the BVI and Cayman Islands, however, appears to be that, while in both jurisdictions the matter will ultimately turn on individual facts, the starting point in the Cayman Islands is that no minority discount (or merger premium) will apply in ascertaining 'fair value', while in the BVI, the court approaches the question on a case by case basis and a disapplication of minority discount is not necessarily assumed. In reaching that conclusion, the Cayman court applied principles set out in an article entitled 'Dissenting Shareholders' Appraisal Rights in Cayman Islands Mergers and Consolidations', which suggested that the Cayman court should have no trouble in applying principles established in Delaware and Canada (given that the drafting of the Cayman Law was heavily influenced by those jurisdictions). That article proposed that:

… he [a dissenting minority shareholder] is thereafter deprived of his proportionate share of an active enterprise and is entitled to be compensated for it … 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

While the question of 'fair value' has not been dealt with in Bermuda in the same level of detail as it has been in the BVI and the Cayman Islands, there have been cases that have advanced through the Bermudian courts that have considered (albeit to a lesser degree) the question of what constitutes 'fair value'. Principally, the issue was touched upon in *Artha Master Fund, LLC v Dufry South America* [2011] Bda LR 17, pursuant to which a dissenting minority shareholder, Artha Master Fund, LLC, to a merger and amalgamation, sought from the Bermudian court to, among other things, appraise the 'fair value' of its shares in the company pursuant to section 106 of the Bermuda Act. While the Bermuda court did not in fact appraise 'fair value' in that case (it simply ordered that expert evidence be obtained), and the matter does not appear to have gone further through the court in a reported judgment, the court did indicate that it regarded its role as being to 'determine whether its appraisal of the fair value is greater than the Defendant's assessment or not'.

In another case (in which the Bermuda court considered the question of 'fair value' in the context of a mandatory buy-out by a super majority (>95 per cent) shareholder of a super minority shareholder, *Golar LNG Limited v World Nordic SE* [2011] Bda LR 9, the court found that it should have regard to the 'market value' when considering 'fair value' and that

while there can be no prescriptive rule regarding 'fair value' (it was described as 'as much of an art as a science'), the court will have to have as much relevant information as possible before it in advance of being able to make a decision. In that case the court was happy that a 'fair value' in a forced buy out context could be a range of figures which are 'fair' on the basis of valuation reports and that a minority discount should usually apply to reflect a 'fair value'.

Conclusion

As is hopefully apparent from the aforementioned, the BVI, Cayman Islands and Bermuda treat the question of 'fair value' and how it is best reached very differently. All of the jurisdictions examined in this article approach the issue on the individual facts, although each take a different starting position: a 'clean slate' in the BVI in which the court will be open minded as to the applicability of a minority discount; a valuation approach on the basis of no discount or premium attributable to the merger itself in the Cayman Islands; and a range of valuations applicable in which typically a minority discount will apply in Bermuda. Each jurisdiction has clearly sought to mitigate against the potential for mergers being abused. While there is no one correct way in which the 'fair value' can be assessed, the issue remains very live and is an extremely dynamic area of law, which will continue to challenge the courts and be built upon.

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