

# S238 in action: CICA clarifies approach to 'fair value' appraisal proceedings in Trina Solar Limited

**Briefing Summary:** The Cayman Islands Court of Appeal ("CICA") has delivered a valuable judgment on the application of section 238 of the Companies Act (as revised) in *Re Trina Solar Limited*.<sup>[1]</sup> This case update can be read in conjunction with our previous briefing setting out certain practical points to note in 'fair value' appraisal proceedings.

**Service Area:** Dispute Resolution and Litigation

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## The Background

Trina Solar Limited (the "Company") was incorporated in the Cayman Islands as a listing vehicle to take Changzhou Trina Solar Energy Co Limited public on the New York Stock Exchange.

In December 2015, a group of investors, including the founder of the Company, its chairman and its CEO, offered to acquire the Company at US\$11.60 per American Depository Share or ADS ("Merger Price"). An independent Special Committee was appointed to evaluate the fairness of the offer, and it approved and recommended it to shareholders.

At an EGM held in December 2016, 97.8% of shareholders voted in favour of the merger, and it was completed in March 2017. However, 2.2% of shareholders did not approve of the Merger Price and exercised their statutory right (under s 238 of the Companies Act) to have the fair value of their shares determined by the Grand Court of the Cayman Islands ("Dissenters").

When the dispute came before Segal J (the "Judge") at the Grand Court, 'fair value' was determined to be marginally higher than the Merger Price, or US\$11.75 per ADS. This was based on a weighting of 30% adjusted trading price, 45% Merger Price, and 25% discounted cash flow ("DCF").

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The Dissenters appealed to the CICA on the basis that the fair value of their shares was in fact much higher. The CICA allowed the Dissenters' appeal, rejecting the Grand Court's finding on fair value and its reliance on the Merger Price. The CICA placed a 30% weighting on adjusted trading price, a 70% weighting on a positively adjusted DCF valuation, and no weighting at all on Merger Price.

The CICA's decision provides important guidance on the circumstances in which Cayman courts will disregard the merger price in determining fair value; the weight that should be given to adjusted trading price and DCF valuations; and the importance of full and frank disclosure in section 238 proceedings.

## 1. Merger Price

The CICA confirmed that the following factors are relevant when considering whether the merger price provides a reliable indicator of fair value:

- the availability of robust public information;
- easy access to non-public information;
- a robust market check;
- a special committee comprised of independent directors; and
- any conflicts related to the transaction.

The Dissenters' principal submission was that the Judge had erred in according a weighting of 45% to the Merger Price because the merger was determined in a manner that made it an unreliable indicator of fair value. The CICA agreed with the Dissenters, finding that the flaws in the deal process were so significant that the Merger Price should not be given any weight at all. More specifically, there were deficiencies in the market check process, potential conflicts of interest in respect of the management buyout, concerns about the independence of the Special Committee, flaws in the fairness opinion obtained by the Special Committee, and incomplete factual evidence provided by the Company.

In such circumstances, the Court reasoned that the only reasonable decision was to give the Merger Price zero weighting. To do otherwise would be to create a substantial risk that companies in future will 'not be open and transparent about all relevant evidence'.

## 2. Weight given to Adjusted Trading Price/Market Price<sup>[2]</sup>

The CICA confirmed that the Court may rely on the adjusted trading price or market price of a company only if it is satisfied that the market is semi-strong efficient<sup>[3]</sup> and there is no material non-public information ("MNPI"). Whether it will be right to do so in a particular case depends on the circumstances.

Although the CICA did not overturn the Judge's finding that the market for the Company's ADS's was semi-strong efficient or that there had been no MNPI in respect of the Company's likely sales, it observed that the Company had failed to provide proper disclosure or produce a witness who could assist with questions concerning its management projections. The CICA remarked that the Company had escaped lightly in avoiding adverse inferences resulting from these failures.

### 3. DCF Valuation<sup>[4]</sup>

The CICA clarified that if there is evidence before the Court that raises an issue as to the appropriateness of certain assumptions or forecasts in management projections, the Court must consider the evidence of all parties and reach its own decision on the most realistic forecast.

The CICA expressly rejected the proposition that the Court can only vary a forecast in management projections if the forecast is shown to be "...obviously wrong, careless or tainted by an improper purpose". This sets the bar too high. The court is perfectly entitled to conclude that the best forecast is that put forward by the expert witness or lies somewhere between the management projections and that of the expert witness. On the facts, the CICA found that the Judge's decision to proceed on the basis of the selling prices in the management projections was outside the band of decisions reasonably open to him.

The Dissenters further challenged the discount rate that should be applied to the future cashflows. They argued that the Judge had erred in applying a premium to compensate for the risks of investing in a "higher risk" country like China; in applying a premium to reflect risks relating to the size of the Company; and in estimating the future pre-tax cost of debt of the Company.

While acknowledging that the Judge's findings could have been better expressed, the CICA rejected these challenges to the Judge's discounts. The CICA ruled that it was not for an appellate court to substitute their own discretion for that of the judge by undertaking a narrow textual analysis of a judgment.

### 4. The Importance of Disclosure

The CICA went on to make several remarks about the importance of full and frank disclosure in section 238 proceedings. It emphasized that it is the Company and its financial advisers, rather than the dissenting shareholders, who have the burden of ensuring that the Court is privy to all relevant information. Companies can be expected both to comply with wide ranging discovery orders, and to produce a witness with first-hand knowledge of the merger transaction.

The CICA also stated that dissenting shareholders should not normally need to apply for specific or further discovery. As a matter of course, companies can be expected to disclose all of the information that a court might require to reach its own decision on fair value.

## Conclusion

The CICA's decision is a timely reminder that companies must carefully consider the fair value of any merger or acquisition transaction, particularly in a management buyout scenario. Companies should also be prepared to meet wide-ranging disclosure obligations and to justify their various processes to the court.

Carey Olsen has extensive experience assisting clients navigate mergers and appraisal actions in offshore jurisdictions.

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*[1] CICA (Civil) Appeal No. 009 of 2021. Judgment delivered on 4 May 2023.*

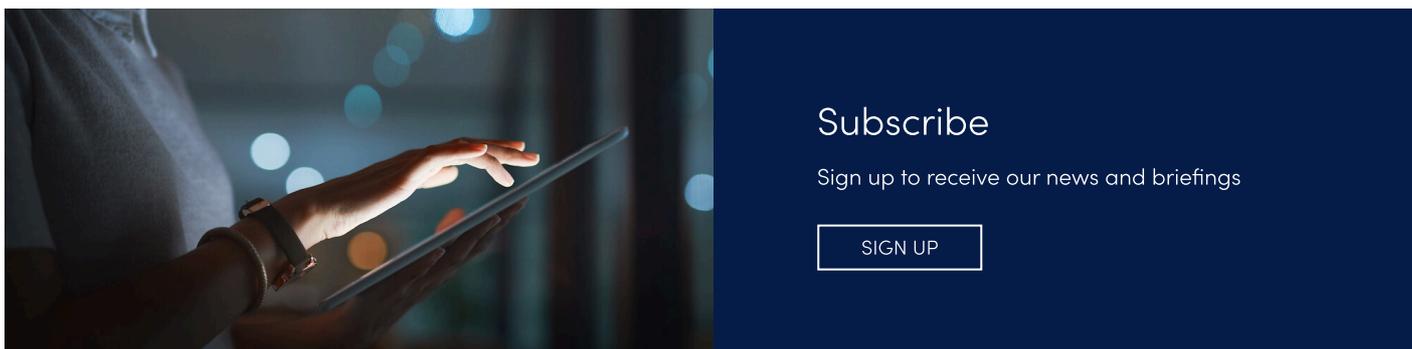
*[2] The price at which shares were trading on the relevant stock market adjusted to remove the effect of the offer to acquire at the Company at a known price.*

*[3] A "semi-strong efficient" market is a market where all publicly available information concerning a company is quickly impounded into the company's stock price.*

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*[4] A prediction of future cash flows with the application of a discount rate to translate the same into a present capital value.*

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