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UPDATE

Trina Solar Limited: Cayman Islands Court of Appeal finds transaction price unreliable and increases DCF valuation weight to 70 per cent

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The Cayman Islands Court of Appeal has handed down its judgment (unreported, 4 May 2023) in the section 238 fair value appraisal of Trina Solar Limited reversing a number of the findings made at first instance. The most important being that the correct approach in this case is to attribute a zero weighting to the transaction price on account of (i) the significant deficiencies surrounding the robustness of the market check process and (ii) the Company's failure to provide adequate documentary and witness evidence. Although the final calculations have been remitted for further determination by the Grand Court, the overall result will be a substantial increase in the fair value of the shares.

Background

In our previous update,[1] we discussed the Grand Court decision of Justice Segal (the **Judge**) dated 23 September 2020 where it was held that the fair value of Trina Solar Limited (the **Company**), a manufacturer and seller of solar panels which was taken private on 13 March 2017, should be calculated with reference to 30 per cent to the market price, 45 per cent to the transaction price and 25 per cent to the discounted cash flow (**DCF**) valuation. The outcome was that fair value was only slightly higher than the transaction price. The Dissenters appealed the Judge's decision to the Cayman Islands Court of Appeal (the **CICA**) on the grounds set out below.

Ground 1 – Market Price

The Dissenters argued that the Judge had erred in three respects in relation to the market price, namely that (i) the market in the Company's American Depositary Shares (**ADS**) was semi-strong efficient; (ii) it was reasonable for Ms Glass, the Company's valuation expert, to place weight on the reports of analysts; and (iii) there was no material non-public information (**MNPI**) as at the valuation date.

The CICA agreed with the Judge that if reliance is to be placed on the trading price of a share, there must be sufficient evidence demonstrating the requirements for a semi-strong version of the efficient market hypothesis (**EMH**) are satisfied. A market is 'semi-strong form efficient' if it fully reflects all public information and no significant changes in stock price would be expected on days where there is no new value-relevant information. The Dissenters submitted that the Judge was wrong to conclude that Ms Glass' evidence satisfied these evidential requirements in light of a statement made in her cross-examination where she admitted she did not do an event study because she was not trying to prove anything about the EMH. In dismissing this point, the CICA held that the Judge was perfectly entitled to decide after considering all of the evidence before him that Ms Glass was not resiling from her conclusions made in her expert report that the market for the Company's ADS was 'semi-strong form efficient'.

It was accepted by the CICA that there was no satisfactory evidence before the Judge which would entitle him to find that the analyst reports relied upon by Ms Glass were considering intrinsic value of the Company's ADS as these reports were concerned only with expectations of short-term market prices.

[1] https://www.mourant.com/file-library/media---2020/trina-solar-limited-and-the-meaning-of--fair-value--in-s.238-fair-value-appraisal-cases.pdf

However, this was not enough to lead the CICA to the conclusion that no reliance could be placed on the market price or that the weighting should be adjusted.

The CICA upheld the Judge's decision that there was no MNPI and that the Company's projected sales for 2017 were reasonable in light of the objective market factors known at the time. However, the CICA accepted the Dissenters' submission that the Judge had erred in his approach to the Company's failure to provide (i) the short-term and medium-term sales contracts in existence as at the valuation date and (ii) a witness who could speak to the management projections and explain why the initial forecasts produced internally were greatly reduced prior to being released to the market. The CICA held that the Judge was wrong to draw adverse inferences against the Dissenters for not requesting such evidence and instead should have penalised the Company for these failures. This was particularly so in the circumstances of a management buy-out where the buyer group was in a position to know all of the detailed financial and commercial information about the Company. This was not enough, however, to overturn the Judge's finding that there was no MNPI.

Ground 2 – Transaction Price

There were various points regarding the transaction price, however the Dissenters' primary submission was that, in light of the Judge's factual findings of the flaws in the conduct of the special committee and the market check process, it was not open to him to place weight on the transaction price.

The CICA agreed and held that no reliance could safely be placed on the transaction price given: (i) the significant deficiencies in the market check process; (ii) that this was a management buy-out with all the potential difficulties and conflicts of interest which this brings; (iii) the material risk that the Company's founder and chairman, Mr Gao's position had a chilling effect on prospective bidders; (iv) the deficiencies in the fairness opinion; (v) the concerns about the independence of the members of the special committee and whether they were willing to act adversely to Mr Gao's interests; and (vi) the Company's complete failure to produce relevant evidence.

The CICA cited the judgment of Bouchard C in *Re Solera Holdings*[2] as a helpful summary of the key features to be looked at when considering whether weight should be placed on the transaction price. This included '*a robust market check with outreach to all logical buyers and a go-shop characterised by low barriers to entry such that there is a realistic possibility of a topping up bid*' as well as '*easy access to deeper, non-public information and a special committee composed of independent, experienced directors armed with the power to say no*'.

The CICA found that if there are fairly minor breaches in the deal process, this may well enable weight to still be given to the transaction price. However, if the breaches are substantial, little or no weight should be given. It was further noted that, while the existence of any conflict of interest does not preclude absolutely any reliance on the transaction price, it certainly militates against such reliance. The CICA agreed that the Judge was wrong to penalise them for the lack of evidence as to whether other bidders would have come forward if they had been approached. It was for the Company to provide sufficient evidence to show that the conditions for the reliance of the transaction price were satisfied. The most effective way in which this can be ensured is if the company knows that inferences are likely to be drawn against it if it fails to be entirely open and transparent.

Ground 3 – Management Projections

The CICA held that the Judge adopted too high a test for departing from management projections. It was incorrect to say that the Court may only intervene if the projections have been shown to be '*obviously wrong, careless or tainted by an improper purpose (such as bias)*'. If, after weighing all the evidence, the best forecast was not the management projections, the Judge must reach his own decision on the most realistic forecast.

As part of the management projections, the Company predicted the average selling price (ASP) for the solar module industry between 2017 and 2023. The Judge considered that the figures in the management projections were inadequately explained or supported by independent data sources. Both industry experts' evidence contained flaws and the Judge felt unable to rely on those figures either. Ms Glass carried out her

[2] [2018] WL 3625644 (30 July 2018), p17.

own ASP analysis using some of the sources used by the industry experts. The Judge upheld the management projections on the basis that the various alternative methodologies carried out by Ms Glass *'do not demonstrate that the management projections were clearly or likely to be in error'*. The CICA held that the Judge was wrong to come to this conclusion. The task of the Judge was to determine what the best price prediction was for the ASP, not simply whether the Dissenters had shown that the management projection figures were clearly wrong. Given Ms Glass' figures were materially different from those in the management projections, the Judge had to determine whether to proceed with Ms Glass' figures, the management projections or somewhere in between. The CICA held that the only reasonable conclusion for the Judge to reach in these circumstances was that the ASP should be calculated in accordance with Ms Glass' evidence.

A similar point was raised regarding the Judge's decision of the energy generating capacity factor percentage set out in the management projections. The CICA held that it was wrong for the Judge to expressly find that the estimate of 13.7 per cent was probably below a reasonable forecast yet proceed with accepting that figure anyway. The Judge instead should have done his best on the evidence to reach his own figure. The CICA projected a capacity factor of 14.35 per cent for 2017 increasing by 0.05 per cent every year up to 2023.

Ground 4 – DCF discount

It was common ground between the valuation experts at trial that a country risk premium (CRP) should be included in the calculation of the Company's cost of equity to reflect the fact that China is a higher-risk market. Ms Glass claimed that the full CRP should be adopted due to the Company's links with China and expansion plans into emerging markets, while Mr Edwards, the Dissenters' valuation expert, argued that only 50 per cent should apply due to the large portion of sales made to low risk countries. The CICA upheld the Judge's decision to accept Ms Glass' evidence notwithstanding the Dissenters' argument that the Judge's reasoning was contradictory.

The CICA rejected the argument by the Dissenters that the Judge had erred in his decision of accepting Ms Glass' size premium of 2.04 per cent by failing to take into account all the answers they had provided in their responsive evidence and rejected the Dissenters' submission that the Judge was wrong to accept Ms Glass' pre-tax cost of debt figure of 5.5 per cent, as opposed to Mr Russo's 4.9 per cent figure. While noting that the Judge's reasoning was inconsistent, the CICA held he was perfectly entitled to prefer the evidence of Ms Glass and other statements in his judgment made this clear.

Ground 5 – Weighting

The CICA found there were no grounds for interfering with the Judge's weighting of 30 per cent for the market price. Having decided that no weight can properly be placed on the transaction price, the CICA held that a 70 per cent weighting should be given to the DCF valuation.

Comment

The key aspect of this decision is that, where the sale process has not been robustly carried out and discovery is insufficient, weight will not be placed on the transaction price. The decision also clears away a growing sense of the Court's tolerance of deficiencies in company disclosure. It is now clear that the Company is required to give full and transparent disclosure and where it fails to do so, adverse inferences should be drawn. Finally, the decision is a reminder that where the evidence of the experts is not satisfactory, the Court should always try to exercise its own judgement to find the correct result; a difficult task for those sitting on cases such as this.

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