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Dissenting Shareholders, Freezing Injunctions, and Provision for Payment: A new judgment of the Cayman Islands Court of Appeal

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In *In the matter of Trina Solar Limited*[1] ("Trina Solar") the Grand Court of the Cayman Islands refused an interlocutory application, made by a group of dissenting shareholders (the "Dissenters") of a Cayman Islands company, for worldwide freezing orders over the assets of the company pending the outcome of statutory fair value appraisal proceedings. Having been declined this relief by the Grand Court, the Dissenters took their case on to the Court of Appeal of the Cayman Islands. In its judgment released in February 2018[2], the Court of Appeal dismissed the Dissenters' appeal and provided substantial and helpful guidance not only about the stringent tests to be met in order to obtain interlocutory injunctive relief in this context, but also about the need for companies to take full financial and legal advice when determining the amount to be retained by way of provision against dissenting shareholder claims pending determination of a fair value petition.

Background

Trina Solar Limited (the "Company") had completed a statutory merger pursuant to Part XVI of the *Companies Law* (*2016 Revision*) (the "Law") and, having received notice of the Dissenters' election to dissent from the Merger, subsequently presented a petition under Section 238 of the Law seeking a determination by the Grand Court of the fair value of the Dissenters' shares.

Following the presentation of the petition, but prior to any substantive hearing of it, the Company entered into a series of transactions pursuant to which it transferred assets in its subsidiaries to other companies in China, ostensibly to progress the Company's "go private" post-merger restructuring. The Dissenters were very concerned about the Company's course of action: their view was that the restructuring would have the effect of significantly reducing the assets of the Company so that it would ultimately be impossible for the Company to satisfy the Judgment of the Grand Court following the trial of the petition. Questions were also raised by the Dissenters about the propriety of certain of the asset transfers.

In an effort to protect their position, the Dissenters filed an application for an injunction to freeze the Company's assets pending the hearing of the petition. In support of their application, the Dissenters provided an expert valuation opinion that showed the fair value of their shares to be significantly higher than the merger price paid by the Company. The financial limit of the freezing injunction sought was therefore an amount equal to the difference between: (1) the figure the Dissenters said was the upper limit of the range suggested by their expert as being the fair value of their shares; and (2) the interim payments already made by the Company to the Dissenters (the latter having been received by the Dissenters following related and protracted proceedings between the parties). This totalled approximately US$185 million.

[1] *In the matter of Trina Solar Limited*, Grand Court of the Cayman Islands (Financial Services Division) Cause No. FSD 92 of 2017 (NSJ) (unreported, 6 November 2017)
[2] *In the matter of Trina Solar Limited*, Cayman Islands Court of Appeal Cause No. CICA 26 of 2017 (unreported, 9 February 2018).

The Company vigorously opposed the Dissenters' injunction application. In doing so, the Company provided its own valuation opinion, which supported the merger price, and argued that the valuation evidence provided by the Dissenters was largely speculative, "unsupportable" and "untethered to reality", so as not to satisfy the burden of proof on the good arguable case test applicable to an injunction application. The Company also argued that the Dissenters had not met the "real risk of dissipation" requirement because the post-merger transactions were all necessary steps required to achieve an advantageous PRC listing, which the Company has a legitimate business interest in pursuing. Finally, the Company argued that damages would be an adequate remedy for the Dissenters and that the balance of convenience fell in its favour: there was no basis for suggesting that the Company would structure its affairs with a view to avoiding any future liability to the Dissenters, and the granting of the injunction would likely cause serious damage to the Company by delaying or creating uncertainties concerning the PRC listing. In any event, the Company claimed (albeit late in the proceedings) to have made provision to meet any potential judgment awarded for the benefit of the Dissenters.

Decision at First Instance

After discussing the test for the granting of freezing orders, as recently considered by the Honourable Chief Justice of the Cayman Islands in *Classroom Investments Inc -v- China Hospitals, Inc*[3]*,* Segal J identified the three key issues which fell to be determined in this case. These were:

- Whether the Dissenters had demonstrated that they had a good arguable case: (1) that the fair value of their shares was at least above the merger price (so that the they would obtain a judgment above the level of the interim payments at the trial of the Section 238 petition); and (2) that the fair value of the Dissenters' shares was at the upper limit of the valuation range provided by their expert;
- Whether there was a real risk of dissipation; and
- Whether it was just and convenient to grant a freezing injunction, and if so whether it should be granted on the balance of convenience.

On the first issue, Segal J noted that in Section 238 cases, where liability is assumed, there is no need for a dissenting shareholder in an application for a freezing injunction to establish the elements of the cause of action on which it relies; dissenting shareholders are simply required to satisfy the Court that they will succeed on the issue of quantum.

In this case, the valuation opinion evidence as to quantum produced by both the Company and the Dissenters was not based on the comprehensive disclosure of non-public financial information, which is the data usually made available to the experts specifically appointed for the purposes of providing evidence for the substantive trial of the fair value petition (different experts had been appointed in the *Trina Solar* proceedings to give full valuation evidence on behalf of the parties in the trial). The resulting valuations were therefore very different, and both experts disputed and disagreed fundamentally with the analysis the other had undertaken.

In considering both parties' valuation evidence, Segal J repeated the comments of Quin J in *Re Qihoo 360 Technology*[4], that "*great caution needs to be applied in relying on valuation reports prepared at an early stage of s.238 proceedings"*. Nevertheless, following a relatively detailed analysis of the three main areas of disagreement between the experts, Segal J concluded that the valuation produced by the Dissenters' expert had crossed the jurisdictional threshold by showing to the requisite standard that there was a good arguable case that the value of the Dissenters' shares were at least above the merger price.

However, Segal J did not consider it necessary to go on to determine whether there was a good arguable case that the fair value was within the Dissenters' expert's valuation range. This was because the Company was found to have produced compelling evidence to justify the post-merger restructuring as being undertaken as part of the normal post-merger activities of the Company for legitimate and commercial purposes. Furthermore, Segal J found that the evidence showed that the Company had adopted a proper approach to the provision and retention of sufficient funds to meet the Company's potential liability, based on a careful assessment through legal and valuation advice. The Dissenters were found to have failed to show

[3] [2015] (1) CILR 451
[4] (unreported, 26 January 2017*)*

a real risk of dissipation or any unjustified conduct on the part of the Company and the Court concluded that it would not be just and convenient to grant the freezing injunction.

Appeal

On appeal, the Dissenters argued that Segal J had misapplied the principles outlined above and that not only did the evidence show that the Company was in fact actively dissipating its assets, but the Company had failed to prove that it had made adequate provision that would prevent an unjustifiable dissipation of assets to the detriment of the Dissenters.

The Court of Appeal agreed with the findings of Segal J that the Dissenters had crossed the "jurisdictional threshold" so as to be entitled to ask for the grant of an injunction on the terms they had sought, and that whether the injunction should be granted and if so in what amount was at the discretion of the Judge. In respect of the exercise of the Judge's discretion, the Court of Appeal agreed with the view of Segal J that the Company's evidence proved the transactions in question were not undertaken for less than proper consideration or on terms that were prejudicial to the Company. Further, the fact that the Company had made a provision for payment to the Dissenters based on a realistic assessment of the Company's liability to the Dissenters was enough. The latter point was particularly contentious on appeal: Segal J had determined that the provision made by the Company did not need to be the full amount claimed by the Dissenters with reference to their expert advice but a "reasonable and prudent provision" made after taking advice from legal and valuation advisers and with the Company "forming a balanced and cautious view of the risks of the litigation". This was particularly so in this case, where the Court found "plain and obvious problems" with the limited nature of the evidence of the Dissenters' expert (given as it was at an early stage of the proceedings) and concluded that it was likely to have been overstated in that it had produced a result for the overall value of the Company vastly greater than that produced both by the merger price and by the unaffected market capitalisation.

The Court of Appeal agreed with the findings of Segal J concerning provisions for payments to the Dissenters in this case, but emphasised that any provision made in statutory appraisal cases must always be a proper one. In practice, this requires the company to take into account the risk that the fair value ultimately awarded to the dissenting shareholders will substantially exceed the Company's identified merger price, and to act in a "balanced and cautious" manner by formulating the provision amount after taking full financial and legal advice. The Court of Appeal also noted that the company will be expected to put aside any resentment of and hostility to the dissenting shareholders and act reasonably, responsibly, and in good faith when deciding what retention should be properly made.

Conclusion

The decision in *Trina Solar* shows that the Cayman Court is content to consider applications for freezing injunctions by dissenting shareholders in the course of statutory fair value appraisal proceedings, even where those applications are based on valuation reports prepared by recently engaged experts at a very early stage of the proceedings. However, where the post-merger restructuring can be shown to be for a legitimate and commercial purpose, and the company involved has made sufficient provisions to meet its potential post Section 238 proceedings liability taking into account the factors described above, it will be very difficult for dissenting shareholders to show that there is a real risk of dissipation and/ or that, on the balance of convenience, it would be just and convenient to grant such an injunction.

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