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FGL Holdings – Cayman Court determines fair value at transaction price

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The Grand Court of the Cayman Islands has recently handed down judgment in *FGL Holdings*, [1] finding that fair value under section 238 of the Companies Act (as revised) was the same as the transaction price that had been offered to the dissenting shareholders (**Dissenters**).

While this is the first time that the Court has determined fair value solely by reference to the transaction price, the facts of this appraisal were somewhat unusual and did not bear many of the hallmarks typically seen in other take private transactions that have previously resulted in section 238 proceedings.

Background

FGL Holdings (FGL) was a financial services business listed on the New York Stock Exchange and sold annuities and life insurance policies to clients based in the US. In February 2020, FGL announced a proposed privatisation merger, and an *extraordinary general meeting* (EGM) was held shortly thereafter. At the EGM, over 99% of unaffiliated shareholders voted in favour of the merger, with only 1,621 of FGL's 213,320,205 total shares being voted against it. The merger consideration received by those shareholders who voted in favour of the merger was US$11.06 per share.

Following the EGM, FGL effected the merger and petitioned the Court to determine the fair value of the shares formerly held by the Dissenters, who had rejected the merger consideration.

FGL's valuation expert, Professor Lehn, opined that the fair value of the Dissenters' former shareholdings was only US$8.60 based on an adjusted market price calculation. In contrast, the Dissenters' expert, Mr Davidson, considered that fair value was US$20.78 based on an 85% weighting attributed to a dividend discount model (akin to a discounted cash flow analysis), and 15% to the transaction price of $11.06 per share..

Decision of the Grand Court

Income-based valuation methodologies

The Court acknowledged that income-based methodologies can be an accurate measure of value, however their reliability is contingent upon the reasonableness of the financial projections being applied and the validity of subjective assumptions underlying various inputs.

Significantly, the Court agreed with FGL's contention that financial services businesses, such as FGL, cannot be valued using an income-based model without encountering real difficulties. Furthermore, the Court found that Mr Davidson's dividend discount model did not reliably estimate dividend payments after the explicit forecast period and contained too many speculative and biased inputs based on assumptions that were not considered to be reasonable or 'real world'. This was exacerbated by almost 90% of Mr Davidson's dividend discount model value calculation arising from his own projections of FGL's future earnings beyond the explicit forecast period, which required an improbable outperformance of FGL's competitors.

The Court accordingly rejected Mr Davidson's dividend discount model valuation as an appropriate or reliable methodology for calculating fair value.

Market-based valuation methodologies

In considering the applicability of FGL's market trading price to the fair value of the Dissenters' shares, the Court noted that if there is sufficient evidence demonstrating semi-strong efficiency for particular shares at a certain time in a given market, then in the absence of any material non-public information or evidence that the shares were undervalued by the market, the market price will generally provide the best indication of fair value.

While there is no presumption in Cayman law that markets are generally efficient, the Court accepted that the market for shares listed on the New York Stock Exchange is semi-strong efficient and the event study performed by Professor Lehn demonstrated that FGL's shares had traded in an efficient market. Furthermore, the non-public information that that Mr Davidson had sought to rely on to displace the reliability of the market price was not sufficiently material, as it would not have affected a reasonable investor's decision as to whether or not to buy or sell FGL's shares.

Notwithstanding this, the novel issues posed by the COVID-19 pandemic were found to have caused unprecedented short-term market dislocation in the period preceding the merger, causing market prices to depart from underlying drivers of value. In such circumstances, the Court found that Professor Lehn's attempt to estimate a hypothetical adjusted market trading price as at the valuation date by rolling forward the unaffected trading price of FGL's shares was speculative, inappropriate and an unreliable measure of fair value.

Instead, the Court determined that the merger consideration received by those shareholders who voted in favour of the merger provided the soundest indicator of value and achieved the fairest outcome in all the circumstances. While the Dissenters had drawn the Court's attention to alleged flaws in the deal process, they fell short of proving that the deficiencies in this process rendered the US$11.06 transaction price unreliable. The sales process had been well designed, reasonably robust, at arm's length and represented a transaction between a willing seller and buyer, who were both listed in the US. No serious competing bids had been prevented from being made, or unreasonably rejected by FGL.

Taking all these matters into account, the Court concluded that the fair value of the Dissenters' former shareholdings in FGL was the transaction price of US$11.06 per share.

Analysis of decision

As noted above, this is the first Cayman Islands appraisal decision that has determined fair value to equate to the transaction price. However, the decision is rather fact specific and the operations of FGL and the circumstances in which it was taken private are distinguishable from most other section 238 appraisal proceedings.

Unlike preceding cases, which have almost exclusively concerned Chinese operating companies, FGL's operations were based in the US and its cashflows were not exposed to the market and associated risk factors of mainland China. It was also heavily regulated and subject to strict capital reserve and US reporting requirements that do not normally feature in Cayman appraisal proceedings. The nature of FGL's operations as a financial services business also meant that it was not amenable to a traditional discounted cash flow analysis, which is often used in section 238 valuations. In addition, FGL's privatisation did not arise from a conventional management/controlling shareholder buy-out, where management may be incentivised to get the best deal as a buyer rather than as a seller. In this case, the buyer was unaffiliated with FGL and there was overwhelming support for the take-private transaction from the general body of unaffiliated shareholders.

Consequently, while this decision will no doubt have been a disappointing outcome for the particular Dissenters involved, the judgment does not appear to have materially altered the jurisprudential landscape for other ongoing, and future, section 238 cases featuring distinctively different fact patterns.

Dissenting shareholders may also take some comfort from the Court's astute appreciation of the dislocation of the market price from underlying drivers of value in the wake of the COVID-19 pandemic. Given the market volatility that is presently being caused by other ongoing world events, it is possible that the Court may be similarly persuaded not to place significant weight on a company's market trading price in other section 238 proceedings if an analogous disconnect in value can be established.

[1] Unreported Judgment, 20 September 2022 (Parker J)

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