MAPLES GROUP

UPDATE

Fair Value is Merger Price for First Time in Cayman Islands s.238 Companies Act Appraisal Case

In *FGL Holdings,* the latest ruling on Cayman Islands merger appraisals (Parker J, 20 September 2022[1]), the Grand Court determined that the merger price represented fair value, meaning that shareholders who dissented from the merger did not receive any uplift via the appraisal proceeding.

Maples and Calder, the Maples Group's law firm, acted for FGL in the proceeding and successfully opposed the dissenters' claim for more than double the merger price. Fair value was determined to be US$11.06 per share, not the US$23.00 that the dissenters sought.

The ruling is notable because it is the first time the Grand Court placed full weight on the transaction price to determine fair value. In doing so, the Court concluded that while the market for FGL's stock was efficient, no reliance should be placed on the adjusted market price due to the temporary dislocation in value caused by COVID-19. The Court also rejected the dissenters' attempt to rely upon an income approach to value their shares via a discounted earnings analysis.

Background

FGL is a US-based life insurance company which was listed on the NYSE. In late 2019, it received an unsolicited bid from FNF, a publicly-listed minority shareholder, to buy all of FGL's outstanding stock for US$11 per share. Following lengthy negotiations, in February 2020, a special committee of FGL's board entered into a merger agreement with FNF. The merger consideration consisted partly of cash and partly of FNF stock, estimated at the time to have a cash value of approximately US$12.50 per FGL share.

Between February and May 2020, the effects of COVID-19 on the business of FNF caused its stock price to drop, reducing the cash value of the merger consideration from US$12.50 to US$11.06 per share. The merger required the support of unaffiliated shareholders to complete, and those who attended the EGM on 29 May 2020 voted overwhelmingly in favour of the transaction.

Appraisal Proceeding

At the trial, FGL argued that the market for its stock on the NYSE prior to the merger announcement was semi-strong efficient, there was no material non-public information ("MNPI"), and that the unaffected share price could be reliably "rolled forward" to the date of the EGM. Because of a decrease in the value of FGL's business during this time, the estimated adjusted market value of the shares, which FGL said

[1] https://maples.com/-/media/files/pdfs/client-updates/fgl-holdings-v-kingstown-partners-master.pdf

reflected fair value, was less than the merger price. Furthermore, as the transaction process was robust, conducted at arms' length by experienced directors and advisors, and without any topping bids, the merger price represented an upper bound on fair value. The difference between estimated fair value and the merger price could be explained by FNF's expectation of synergies from the transaction. Although there was a decrease in the market price of FNF stock caused in part by the impact of COVID-19, the cash component reduced the impact of this on the merger consideration, and the terms of the merger agreement negotiated by FGL's special committee prevented FNF from being able to withdraw from the merger.

The dissenters argued that the efficient market theory was subject to sufficient academic debate to render it unreliable, and that in this case questions about: (i) the relative efficiency of the market for FGL's shares; (ii) the existence of alleged MNPI; (iii) and whether the temporary dislocation in the efficiency of the market caused by COVID-19 meant that no reliance should be placed on a rolled-forward market price.

Parker J determined that the market for FGL's stock prior to the announcement was semi-strong efficient and that there was no MNPI. However, he was not persuaded that the market price could reliably be rolled forward to the valuation date because COVID-19 had such a disruptive effect during the period in question. The comparative adjusted market price analysis based on data available for other companies produced some results which were at variance with actual prices. Accordingly, although the use of the market price approach was possible, it was less reliable to rely on it in this case, where there were other methods of valuation which correlated to produce a consistent band of results.

The dissenters argued that the fair value should be exclusively determined on an income approach. As FGL's business involved the sale of insurance products and annuities, a discounted cash flow ("DCF") model was not possible. Instead, the dissenters argued in favour of what they called a discounted earnings analysis – essentially a discounted dividend model. However, FGL's historic dividends were *de minimis*, and regulatory restrictions with respect to solvency and capital ratios limited its ability to declare and pay additional dividends while the company continued to write new business. The dissenters' approach relied upon the adoption of adjusted operating income and aggressive assumptions about the company's future dividend policy, including a long term forecast which resulted in almost all excess income being distributed in cash to shareholders.

Parker J concluded that this was not a reliable valuation method. It was based on projections which were out of date by the time of the valuation, and unlike a traditional DCF, did not value cash flows to equity. In addition, it did not take into account the operative reality of FGL's dividend policy and regulatory restrictions. Much of the value in the model depended upon subjective inputs such as a high terminal growth rate and low discount rate, which could not be supported by either the evidence or persuasive reasoning. As a result, the Court determined that no reliance could be placed upon the discounted dividend model.

However, Parker J concluded that the transaction process was well designed, robust, with no topping bids, and conducted as an arms' length commercial negotiation. The judge took a favourable view of FGL's factual witnesses (its CEO, former head of Financial Planning & Analysis, and a special committee member). The transaction price had been endorsed by the unaffiliated shareholders voting on the valuation date and was consistent with other valuation indicators, including a fairness opinion provided by Houlihan Lokey, the views of analysts, and an actuarial report. The merger price of US$11.06, i.e. the cash value of the combination of cash and

FNF stock on the date of the EGM, was therefore a sound and unbiased indicator of fair value which could not to be said to be unfair to the dissenters.

The trial advocacy was conducted by Richard Boulton KC of One Essex Court and Mac Imrie KC and Malachi Sweetman in our Dispute Resolution & Insolvency team.

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September 2022
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