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transfer schemes and shareholders' voting in unchartered waters



Georgina Tsagas

University of Bristol Law School
Wills Memorial Building
Queen's Road
Bristol
BS8 1RJ

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Use and Abuse of power in changes of corporate control: transfer schemes and shareholders' voting practices in unchartered waters

Georgina Tsagas*

Summary

The first English case to deal with a share-splitting exercise, Re Dee Valley Group plc [2017] EWHC 184 (Ch), showcases the broader implications that stem from the law providing various participants with extensive power relating to the approval and the sanctioning of transfer schemes.

Introduction

In February 2017, a water utility FTSE 100 company, Severn Trent, successfully completed the takeover of its supplier Dee Valley Water, for £84m. Prior to the shareholders' meeting at which decision was to be made on the transaction, Mr. Cashmore, an employee of the Dee Valley Group, gifted 443 shares to the target company's employees, its customers and other individuals. At an ex parte hearing before a judge, two days before the shareholders' meeting was to take place, the Company obtained a direction permitting the Chairman of the meeting to reject the votes of the members who had derived their votes from Mr. Cashmore. In *Re Dee Valley Group plc*¹ the Court was called to decide on whether the exclusion of the votes of the so called 'independent members' from the process was legitimate. Had the votes *not* been excluded, the acquisition would have *not* materialised at that time. The case is the first English case to deal with a share-splitting exercise undertaken by a shareholder with the presumed aim of defeating the scheme by use of the 'majority in number' statute requirement. Its examination merits value, as it showcases how the potential use and abuse of power by various actors within the context of a transfer scheme can lead to adverse outcomes.

The power dynamics between actors within the context of offers for have occupied much thought over the past decade.² Cases involving attempted and successful acquisitions have prompted policy makers and bodies to review the efficacy of rules relating to the regulation of public offers³ and to update the Takeover Code following modern market phenomena.⁴ In the background, the controversial issues surrounding the other form of change of corporate control, the transfer scheme,

*Visiting Fellow London School of Economics, Department of Law 2017-2018; Lecturer in Corporate Law, University of Bristol Law School; Solicitor, qualified in England and Wales – practising.

¹ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch).

² Public Consultation Paper 2010/2, The Takeover Panel Code Committee, 'Review of Certain Aspects of the Regulation of Takeover Bids', 1 June 2010; House of Commons Library, Briefing Paper, Number 07682, 31 January 2017, Industrial Strategy, Federico More, 2.6.

³ Leading up to the review of the Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, see C. Gerner-Beuerle, D. Kershaw, David and M. Solinas "Is the board neutrality rule trivial? amnesia about corporate law in European takeover regulation" (2011) *European Business Law Review*, 22 (5) 559 and opposing view see PL Davies, E van de Walle de Ghelcke and E. Schuster 'The Takeover Directive as a Protectionist Tool?' in WG Ringe and U Bernitz (Eds) *Company Law and Economic Protectionism* (Oxford: Oxford University Press, 2010).

⁴ The Kay Review of UK Equity Markets and Long-Term Decision Making, Final Report, July 2012, 60-61 available at http://www.ecgi.org/conferences/eu_actionplan2013/documents/kay_review_final_report.pdf

have attracted limited scholarly attention⁵, despite it having become an increasingly popular and preferred means of restructuring. As LexisNexis provides, of the 27 firm offers announced in the first half of 2017, 52% were structured as a scheme and 48% were structured by way of an offer, and from the firm offers announced in the first half of 2016, 65% were structured as schemes and 35% were structured as contractual offers, concluding that schemes remain the preferred structure on the larger deals.⁶ Its popularity can be mainly attributed to the fact that via a transfer scheme, dissenting members can be forced by a 75% in value majority of members to sell their shares, thereby offering certainty of acquisition of 100% of the target to the bidder.⁷

The present article addresses the under-discussed issues relating to the use and abuse of power during the scheme approval process, and the reasons why these require closer attention than they have hitherto received. It begins by providing an overview of how transfer schemes are regulated and proceeds with an examination of the case of *Re Dee Valley Group plc*,⁸ which raises whether share-splitting is an objectionable practice, how the notion of ‘class interests’ should be interpreted, and what the nature of the shareholders’ meeting that approves a scheme is. Further on, the article examines the practical and policy considerations underlying the procedural rules, which further allows to consider their efficacy in today’s socioeconomic context. Proposals for reform centre on revisiting the power provided to the majority in number and majority in value respectively and revisiting the divide between conflicting and diverging interests within the context of the interpretation of the notion of “class interests” at the sanction stage.

The article concludes that the *process* observed for the purposes of effecting a change in corporate control via a scheme *matters* for the *substance* of corporate governance. Following more holistic proposals to the understanding of corporate governance⁹, it is argued that the process followed in effecting transfer schemes should be seen in new light, namely to be understood as a process which is a publicly driven phenomenon and not merely a contractual one.

I. Regulating Member Transfer Schemes

The two main methods of implementing a takeover of an English company is either by means of a takeover offer under section 974 of the Companies Act 2006, henceforth CA 2006, or by means of a scheme of arrangement under Part 26 CA 2006.¹⁰ According to the statutory process regulating the

⁵ For a scholarly analysis of schemes of arrangement refer to J. Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge: Cambridge University Press, 2014) and for a comparison of schemes to other deal structures see D. Kershaw, *Principles of Takeover Regulation* (Oxford: Oxford University Press, 2016) Chapter 2; For a practitioners’ contribution see C. Pilkington, *Schemes of Arrangement in Corporate Restructuring* (London: Sweet & Maxwell Publishers, 2nd Ed, 2017) and O’Dea et al., *Schemes of Arrangement: Law and Practice* (Oxford: Oxford University Press, 2012).

⁶ LexisNexis PSL Corporate Market Tracker Report ‘Trends in UK public M&A deals in H1 2017’ available at <http://blogs.lexisnexis.co.uk/corporate/wp-content/uploads/sites/14/2017/08/Trends-in-UK-public-Mand-A-deals-in-H1-2017.pdf>

⁷ See Companies Act 2006, ss 974-991 on squeeze-out mechanism which applies to takeover offers.

⁸ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch).

⁹ M. Moore, ‘Private Ordering and Public Policy: The Paradoxical Foundations of Corporate Contractarianism’ (2014) 34(4) *Oxford Journal of Legal Studies* 693, 728.

¹⁰ The Takeover Panel Code Committee, Schemes of Arrangement: Statement PCP 2007/1, RS 2007/1 with the addition of Appendix 7 to the Takeover Code.

scheme, a company can agree to a compromise or arrangement with its members or creditors¹¹ and one of the forms that the 'arrangement' can take is that of a 'transfer scheme', whereby all the existing shares in the target are transferred to the bidder in exchange for the agreed purchase price.¹² The basic structure of a scheme of arrangement involves four stages: (i) an application to the court for leave to call a general meeting to consider the arrangement¹³, (ii) obtaining the necessary approval of the shareholders of the company subject to the scheme at what is known as the 'court meeting' or if more than one class, at each class court meeting respectively¹⁴ (iii) an application to the court to sanction the arrangement¹⁵ and (iv) registering the court order approving the scheme with the Companies Register, which renders the scheme effective.¹⁶

Obtaining the necessary approval of the shareholders of the company subject to the scheme at what is known as the 'court meeting'¹⁷ appears to be a straightforward process and section 899(1) CA 2006 lays out the approval threshold requirements. First, the scheme must have been approved by a majority in number, either present or by proxy, of the shareholders or class of shareholders accordingly and secondly the majority must represent 75% in value – cash flow rights – of the class of shareholders voting at the meeting or class meeting accordingly. In theory, it would normally be the first stage of the test which would prove to be a challenge to pass, considering that a minority comprising of shareholders that hold less of a stake in the company could prevent shareholders with higher cash flow rights from being able to approve the scheme. However, in practice, it has hardly ever been a problem to achieve these thresholds.

An application and determination of the scheme meeting also involves identifying the existing classes of shares or identifying shareholders with specific rights or privileges.¹⁸ It is the applicant's responsibility to determine the class of meetings that are required to be held. Leave to convene hearing is held at the outset of the process to avoid the problem which used to exist that the applicant could get all the way through the meetings to discover a problem with the constitution of classes. Issues which are surrounded with some controversy however concern the determination of the separation of class meetings and the situation in which shares that have the same rights include shareholders with different interests. The definition of "class" within the scheme context does *not* correspond with the company law definition.¹⁹ Within a scheme context, in deciding whether or not meetings of separate classes of members ought to have been directed, the test applied is that set out in the judgment of Bowen LJ in *Sovereign Light Assurance Company v Dodd*²⁰, which provides that: "[a class] must be confined to those persons whose rights are not *so dissimilar* as to make it impossible for them to

¹¹ Companies Act 2006, s 895.

¹² Cancellation schemes of arrangement have been abolished since 2015, CA 2006 (Amendment of Part 17) Regulations, SI 2015/Draft.

¹³ Companies Act 2006, s 896.

¹⁴ Companies Act 2006, s 899(1).

¹⁵ Companies Act 2006, s 899(1).

¹⁶ Companies Act 2006, s 899(4).

¹⁷ Companies Act 2006, s 899(1).

¹⁸ On class rights see *Cumbrian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd* [1986] BCLC 286; On privileges see Panel Statement of the Takeover Panel Hearings Committee, 'Eurotunnel P.L.C. (2007) available at <http://www.thetakeoverappealboard.org.uk/wp-content/uploads/2016/12/2007-02.pdf>

¹⁹ Companies Act 2006, s 629; Also see *Re Robert Stephen Holdings Ltd* [1968] 1 WLR 522.

²⁰ *Sovereign Light Assurance Company v Dodd* [1892] 2 QB 573.

consult together with a view to a common interest”.²¹ Furthermore, the test was refined by Chadwick LJ in *Re Hawk Insurance Co Ltd*²² allowing for a shift in emphasis, so that consideration was henceforth given to whether the rights are sufficiently *similar* as *not* to require class separation.²³ Subsequent case law provides that the test should be based on the similarity or dissimilarity of *rights*, and *not* the similarity or dissimilarity of *interests*.²⁴

Regarding the sanctioning of the scheme at the discretion stage, the CA 2006 does not provide the Court with any guidance of relevance for exercising its discretion in sanctioning the scheme.²⁵ Courts will try to establish whether there is a sensible account of why the scheme benefits the members.²⁶ At common law it has been established that the court will consider whether it is satisfied with the following²⁷: (i) that the provisions of the CA 2006 have been complied with, (ii) that the members of the class of shareholders voting at the meeting were fairly represented by those who attended the meeting, (iii) that the statutory majority is acting *bona fide* and not coercing the minority in order to promote interests adverse to those of the class they purport to represent²⁸, (iv) an intelligent and honest person, a member of the class concerned and acting in respect of his own interest, might reasonably approve the scheme²⁹ (v) that there is no blot on the scheme. In relation to the assessment of the power of the majority to bind the minority, a restriction exists in relation to *how* such powers are exercised. In *British America Nickel Corporation v O’ Brien*³⁰ Viscount Haldane described the restriction as follows: “[votes]... *must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities; namely, that the power given must be exercised for the purpose of benefitting the class as a whole, and not merely individual members only*”. It is not necessary for the scheme to represent the best possible arrangement for the shareholders however.³¹ The current status quo is that the Court will not judge whether the scheme is the only fair scheme or even the best scheme available.³²

II. The Paradigm of the *Re Dee Valley* transfer scheme

²¹ Ibid 583.

²² *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241; [2002] BCC 300 at [30].

²³ Payne, n 5, 48-49 on a discussion of class separation and the position of the common law on ‘rights’ and ‘interests’.

²⁴ See *Re UDL Holdings Ltd* [2002] 1 HKC 172 for a complete review of English and Commonwealth law by Lord Millett on class separation; On the distinction between rights and interests see *Re Hellenic & General Trust Ltd* [1975] 2 All ER 382 and *Re BTR Plc* [1999] All ER 96; *Re BTR Plc* [2000] 1 BCLC 740; Also refer to the case of *Re SABMiller plc* [2016] EWHC (Ch) 23, 40 on latest on class separation.

²⁵ Kershaw, n 5, 54-55.

²⁶ Kershaw, n 5, 56; For the traditional English test for the exercise of the discretion, see *Re Alabama, New Orleans, Texas and Pacific Junction Railway Company* [1891] 1 Ch 213 and *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385.

²⁷ Reference made by Courts to Buckley on the Companies Act, 13th Edn, 1957, 409, cited first in *Re National Bank Ltd* [1966] 1 WLR 819.

²⁸ Per Richards J in *Re Telewest Communications plc* (No 2) [2004] EWHC 1466 (Ch); *Re Telewest Finance (Jersey) Ltd* (No 2) [2005] 1 BCLC 772.

²⁹ Per Lindley LJ in *Re Alabama, New Orleans, Texas and Pacific Junction Ry. Co.* [1981] 1 Ch. 213

³⁰ *British America Nickel Corporation v O’ Brien* [1927] AC 369, 371.

³¹ Kershaw, n 5, 56-57.

³² Payne (2014) n 5, 77-78 reference to *Re Telewest Communications plc* (No 2) [2004] EWHC 146; [2005] BCC 36.

Facts

In February 2017, a water utility FTSE 100 company, Severn Trent, successfully completed the takeover of its supplier, a Welsh water company, Dee Valley Water, for £84m. Dee Valley water was one of two water companies in Wales and supplied water to around 125,000 customers in North-east Wales and North-west England having been in business for 150 years. At the time the deal was progressing there were fears that it would compromise the existing operational customer service of Dee Valley, lead to higher costs incurred for water usage for consumers and to a significant amount of job losses.³³ A bidding war for the company of Dee Valley took place prior to the deal with Severn Trent commencing, as an investment fund, Ancala, had first agreed to buy Dee Valley in October 2016, which prompted Severn Trent to increase its offer from £78.5m to £84m in November 2016.³⁴

During the process of the transaction, Mr Cahsmore, an employee and shareholder of the Dee Valley Group, had purchased 461 shares on 20-21 December 2016 and had transferred 443 of those shares to 443 employees, customers and other individuals on 3-4 of January 2017 for nil consideration. At an ex parte hearing before Registrar Derrett on 10 January 2017, two days before the Court meeting was to take place on the 12th of January 2017, the company obtained a direction permitting the Chairman to *reject* the votes of members who had derived their votes from Mr. Cashmore, on the condition that the Chairman should also set out what the result of the meeting would have been if the votes had not been rejected. The assumption made was that the late coming shareholders would be motivated by their own personal interests of job security and customer service, local community and environmental concerns and hence, likely to oppose the scheme. Some evidence to this effect could be found in members' responses to requests made under section 793 CA 2006. The new shareholders that came onto the register as a result of the share-splitting represented 0.01% in value of the shares in total and 0.03% in value of the shares voted at the scheme meeting.³⁵ The exclusion of the votes led to a legal dispute over whether the votes of these 'individual members' had been rightly excluded by the Chairman. The transfer scheme was approved by the Court in *Re Dee Valley Group plc*³⁶ and the appeal against the High court decision was withdrawn,³⁷ with the main reason being that of the inability or unwillingness of the individual shareholders to raise between them c. £80,000 needed to fund the appeal.³⁸

The judgment of *Re Dee Valley Group plc* [2017]³⁹

Share-Splitting: an objectionable practice?

³³ BBC News, 'Jobs fears as firms compete for Dee Valley Water takeover' 29 November 2016; See BBC News, 'Severn Trent gets go-ahead for Dee Valley Water takeover' 8 February 2017.

³⁴ E. Gosden 'Severn Trent raises offer for Dee Valley Water in bidding war' The Telegraph, 26 November 2016

³⁵ Herbert Smith Freehills, Legal Briefings 'M&A Standpoint: Share Splitting fails to derail scheme' 08 February 2017, London available at <https://www.herbertsmithfreehills.com/latest-thinking/ma-standpoint-share-splitting-fails-to-derail-scheme>.

³⁶ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch).

³⁷ G. Wyan-Williams 'Opponents of Dee Valley Water £84m takeover drop appeal after jobs reassurance given' *The Daily Post* 12 February 2017.

³⁸ For likely reasons behind an appeal not being made see <http://www.erskinechambers.com/dee-valley-group-plc/>

³⁹ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch), [25].

A key issue which concerned the Court in *Re Dee Valley Group plc*⁴⁰ related to the evaluation of the 'share-splitting practice' undertaken prior to the 'court meeting' and what test needs to be applied to determine if the votes of the members at the court meeting were valid.⁴¹ The votes of the 'individual members' were excluded on the basis that such shareholders could not and would not be voting in the interests of the class, having acquired their single shares from a person who gifted them with the intention of defeating the scheme.⁴² Sir Geoffrey Vos highlighted important dicta of the three-full judgments delivered by the court in the Hong Kong case of *Re PCWW Ltd*⁴³, which held that share-splitting is an objectionable practice that undermines the underlying spirit of the sanction stage of the statutory scheme of arrangement, as it is used to artificially "boost the number of shareholders voting in favour of a scheme of arrangement".⁴⁴ Counsel representing the 'individual members' in the Dee Valley case called on the support of authoritative academic textbooks⁴⁵ on the issue of share-splitting. All scholars, essentially support the claim that, if transfers are made to thwart, rather than support, the scheme with the use of the 'majority in number' requirement, the Court cannot easily exercise its discretion to allow the exclusion of the votes of members from the court meeting, no matter what the motives of the creditors or the members are.⁴⁶

In the Hong Kong case, the judge of first instance allowed the votes, despite evidence of share manipulation, because the judge considered that share splitting *does not* necessarily lead to an outcome that does not fairly represent the interests of the members of the class as a whole, whilst at the same time expressing a concern about the impracticalities of investigating into suggestion of share splitting in every case.⁴⁷ On appeal, the Court held that the majorities obtained at the adjourned court meeting were not fairly reflective of a majority of the class as a whole in numerical terms and it was hence open to the court to have regard to the fact that there was such substantial opposition to the scheme, on grounds which would appear to be far from irrational or unreasonable, and on this basis, declined to sanction the scheme.⁴⁸ Despite the Dee Valley Court's reliance on the dicta of *Re PCCW Ltd*, *Re PCCW Ltd* concerned a reverse reason share split used in order to save the scheme, rather than defeat it. There is hence a distinct difference on the issue of whether the jurisdictional requirements had or had not been met respectively. In the case of *Re Dee Valley*, had not the votes of the individual members been discounted, the requisite statutory majorities would *not* have been achieved and the Scheme would have *not* passed onto the sanctioning stage, at which point only could the Court have legitimately exercised its discretion.

The Court in *Re Dee Valley* blurred the lines between the two stages, in order to exercise its power to intervene at the jurisdiction stage, relying on the fact that since the class meeting is ordered by the

⁴⁰ Ibid.

⁴¹ Ibid, [27].

⁴² Ibid, [48].

⁴³ Ibid, [57].

⁴⁴ Ibid, [32] - [37].

⁴⁵ Ibid, [41], whereby reference is made to O'Dea, Schemes of Arrangement Law and Practice, Para. 4.29; J. Payne, Schemes of Arrangement: Theory, Structure and Operation (2014), 66 and Editors of Buckley on the Companies Act, Paras. 24-35.

⁴⁶ See O' Dea, n 5, para 4.29, according to whom in the context of splitting used to defeat a scheme, the Court has no jurisdiction to sanction.

⁴⁷ *Re PCCW Ltd* [2009] HKCA 178 at [137] and reference to Court of First instance at para [147] of the judgment and at [140] on the materiality of share-splitting.

⁴⁸ *Re PCCW Ltd* [2009] HKCA 178 at [204]

Court in accordance with the statute provisions, then it should be the case that the meeting is under the direct control of the Court more generally.⁴⁹ The Court acknowledged that the two stages are distinct in its reasoning, but did not proceed with a good justification as to *why* the distinction should *not* be followed. The Court opined that the broad statements of scholars brought forward should be set aside and that the matter needed to be otherwise approached, through what the Court accepted, were acknowledged principles.⁵⁰ Such principles related to the Court's power to exercise its discretion as to whether to approve a scheme.⁵¹ The Court in *Re Dee Valley* went beyond and above the legal requirements set out in statute in order to deal with the practice of share-splitting. There is however no discussion relating to the crucial factor of the timing of the share donation and its relevance in determining how the shareholders voting are representative of class interests or not. Although it was accepted that the decision made by the Chairman to exclude the votes was justified on the basis that the Chairman was entitled to protect the integrity of the Court Meeting against manipulative practices,⁵² it is highly questionable whether such authority complies with the law and the court has not sufficiently expanded on the legitimacy of the order in relation to the chairman's power. The Chairman cannot operate with the desired 'checks and balances' which a Court is subject to, and also lacks the required 'evidence' that would support such a decision were it to be made. Statute also does not provide a mechanism via which to hold the Chairman accountable within this context specifically, and hence an issue of accountability arises.⁵³

'Class interests'

In relation to the exercise of the court's discretion in approving the scheme, a passage from Buckley on the Companies Act⁵⁴ is often cited by the courts, which was approved by Plowman J, in *Re National Bank Ltd.*⁵⁵ It makes clear that the court undertakes a balancing act between assessing the voting practices of the majority of shareholders acting bona fide and not overruling the outcome of the meeting, unless there is good reason to, which reason would relate to the class not having been properly consulted, or the meeting not having considered the matter with a view to the interests of the class.⁵⁶

The controversial issue in *Re Dee Valley* does not relate to the assessment of whether the majority decision was "in the interests of the class", but in relation to the assessment of the individual votes of certain minority shareholders visa-a-vis "class interests". Yet, this issue constitutes a starting point for the Court to further elaborate on the notion of 'class interests' more generally and although Sir Geoffrey Vos *did* reflect on the issue, it was done neither in a comprehensive manner, nor in a definitive one. The discussion centres on the question of whether the notion to vote "in the interests of the class" is to be interpreted as merely an interest to vote in favour of the scheme, making any other interest which is opposed to the scheme 'adverse'. There was an acknowledgment that: "*The interests of the class may be very complex and are not always going to be purely financial.*"⁵⁷ It was

⁴⁹ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch), 42-43.

⁵⁰ *Ibid*, 42.

⁵¹ *Ibid*, 37.

⁵² *Ibid*, 58.

⁵³ Freshfields Bruckhaus Deringer 'Schemes of Arrangement: The End of the Numerosity test?' Oxford Business Law Blog, 20 March 2017.

⁵⁴ J.B. Lindon et al. (Eds), Buckley on the Companies Act (13th Edn, 1957), 409.

⁵⁵ *Re National Bank Ltd.* [1966] 1 W.L.R. 819.

⁵⁶ Passage approved by Plowman J in *In Re National Bank Ltd.* [1966]1 W.L.R. 819, 829.

⁵⁷ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch), 55.

also accepted that whilst Severn Trent's offer was in excess of that of Ancala Forna and hence the immediate financial interests of the class would seem to favour Severn Trent's offer, a shareholder acting in the interests of the class could indeed favour the rejection of a good financial offer thinking that the interests of employees, customers or the environment outweigh the financial interests of the class.⁵⁸ Despite Sir Geoffrey Vos raising the interesting point that shareholders' voting practices on environmental issues may well matter when target shareholders are to evaluate one bidder over another, he does not elaborate on this point further.⁵⁹

The Court in principle accepted that unless it can be shown that the members are motivated by their own interests and in quite a different capacity, as was the case in *British America Nickel Corporation, Limited v M.J. O'Brien Limited*⁶⁰ and *Re Holders Investment Trusts Ltd.*⁶¹, then the Court could not reject votes by looking into shareholders' minds.⁶² The two cases on which counsel for Severn Trent in the Dee Valley case relied on were *British America Nickel Corporation, Limited v M.J. O'Brien Limited*⁶³ and *Re Holders Investment Trusts Ltd.*⁶⁴, in support of the proposition that a class meeting must be exercised for the purposes of benefitting 'the class as a whole' and not for extraneous reasons. The cases however did not concern a class court meeting. *British America Nickel Corporation* concerned the power of a majority of debenture holders to modify the terms of the debenture issue so as to bind a minority and it was held that the minority was not bound, because it was found that the majority was not motivated by what was most in the interests of the class, but their own individual interests.⁶⁵ In *Re Holders Investment Trust Ltd* it was held that trustees voting at a class meeting of preference shareholders were not entitled to take into account their interests as holders of the majority of the ordinary shares in the company, but rather in exercising their voting to act in the bona fide belief that they were acting in the interests of the general body of members of that class.⁶⁶

The Court does not clarify whether it objects to the need for a court to 'look into the minds of shareholders' dismissing such an approach on the grounds of it being ill-founded or whether unusual cases, would indeed justify an attempt to "challenge the motives of the opponents of a scheme" where evidence to support such a claim exists.⁶⁷ In fact, in *Re Dee Valley*, despite the Court having declared that the exclusion of the individual members from the vote was *not* based on evidence which related to the imputed or expressed *motives* of the individual shareholders, but rather on the share-splitting practice, it paradoxically supports the exclusion of the votes based on that exact assumption. The assumption made was that the gifted shares deriving from a particular person, automatically demonstrated that votes from those shares would *not* be cast for the purpose of benefitting the class as a whole, and hence would *not* represent the class fairly and that the statutory majority, which would have been created, would have not been acting *bona fide* and would be coercing the minority.⁶⁸ The Court rightly identified that the factual circumstances surrounding the acquisition of one single

⁵⁸ Ibid.

⁵⁹ Ibid.

⁶⁰ *British America Nickel Corporation, Limited v M.J. O'Brien Limited* [1927] AC 369.

⁶¹ *Re Holders Investment Trusts Ltd* [1971] 1 WLR 583.

⁶² *Re Dee Valley Group plc* [2017] EWHC 184 (Ch), 55.

⁶³ *British America Nickel Corporation, Limited v M.J. O'Brien Limited* [1927] AC 369.

⁶⁴ *Re Holders Investment Trusts Ltd* [1971] 1 WLR 583.

⁶⁵ *British America Nickel Corporation, Limited v M.J. O'Brien Limited* [1927] AC 369, 377-378.

⁶⁶ *Re Holders Investment Trust Ltd* [1971] 1 WLR 583 ("Holders Investment Trust"), 589E-F.

⁶⁷ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch), 46.

⁶⁸ For the legal reasoning of the court see *Re Dee Valley Group plc* [2017] EWHC 184 (Ch), 58.

share in the company at the crucial time *after* the court meeting had been directed, could well be a good indication of the *motives* underlying the voting of the individual members. The Court cannot however claim to have allowed for the votes to be rejected for any other reason besides having assumed that their *motives* were ‘against the interests of the class’. In terms of the actual voting that took place, as pointed out in the Skeleton argument on behalf of the opposing members, whilst the large majority of the opposing members *did* vote against the Scheme, some of the individual shareholders *did not* vote at all and *at least one* voted in support of the scheme.⁶⁹

In his statement⁷⁰, a member, Mr. Williams, was of the view that the Company should remain independent on the basis that it would generate more returns for shareholders in the future, as compared to Severn Trent, that the offer price should have been significantly higher, that the takeover was anti-competitive and not in the interests of competition for customers in the area and that the bidder was motivated to take over *Dee Valley* in order to have the benefit of its Welsh water license as protection against future legal and regulatory change following devolution.⁷¹ The Court however interpreted the interests of the class purely on financial merits on the assumption that the proposed scheme by Severn Trent provided for a cash acquisition of shares with a loan note alternative, at a price which was in excess of the pre-offer price of Severn Trent and in excess of the next best offer provided by the rival competing bidder Ancala.

Nature of a ‘Court meeting’

Certain general principles have been established by English law in relation to the exercise of powers conferred upon a majority to bind a minority within a class.⁷² The power of the supermajority to amend the company’s articles of association⁷³ for example, is subject to the limitation that the power ‘must be exercised, not only in the manner required by law, but also *bona fide* for the benefit of the company as a whole, and must not be exceeded.’⁷⁴ As per general company meetings, there is no legal basis on which a Court can rely on to direct a member of a company on *how to* exercise its voting rights.⁷⁵ It was made explicit in *Northern Counties Securities Ltd v Jackson & Steeple Ltd*⁷⁶ that shareholders do not vote as an agent of the company, nor as a fiduciary. Leading authorities which apply to ordinary general meetings establish that votes in general meetings are an *unconstrained right* of property that the holder is entitled to vote ‘from motives or promptings of what he considers his own individual interest.’⁷⁷ In *Re Charterhouse Capital Limited*⁷⁸, Sir Terence Etherton, MR stated that a Court would only determine that votes had not been cast for the benefit of the relevant company if no reasonable

⁶⁹ Refer to Skeleton Argument on behalf of the opposing members in the matter of the Dee Valley Group Plc and the Companies Act 2006 CR-2016-007570, 5.

⁷⁰ *Ibid*, 8.

⁷¹ *Ibid*, 8-9.

⁷² The generality of the principle was emphasised by Viscount Haldane in *British America Nickel Corporation Ltd v MJ O’ Brien Ltd* [1972] AC 369, a case concerning the power of a majority of debenture holders to modify the terms of the debenture issue in order to bind the minority.

⁷³ Companies Act 2006, s 21(1).

⁷⁴ *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656.

⁷⁵ See *The Children’s Investment Fund Foundation (UK) v Attorney General* [2017] EWHC 1379 (Ch). 46, referring to the following line of cases *Pender v. Lushington* (1877) 6 Ch. D. 70, 75-6, *North West Transportation Ltd v. Beatty* (1887) 12 App Cas 589, 593, *Allen v. Gold Reefs of West Africa Ltd* [1900] 1 Ch. 656, and *Re Charterhouse Capital Limited* [2015] EWCA Civ 536, [2015] BCC 574, para. 90.

⁷⁶ *Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 WLR 1133, 1144.

⁷⁷ *Pender v. Lushington* (1877) 6 Ch. 656, paras. 75-76; *Allen v. Gold Reefs of West Africa Ltd* [1900] 1 Ch. 656.

⁷⁸ *Re Charterhouse Capital Limited* [2015] EWCA Civ 536, [2015] BCC 574 (“Charterhouse Trust”), 90.

person could consider it was for the benefit of the company as a commercial entity. In *Re Dee Valley* the Court reasoned that the authorities which apply to ordinary general meetings are inapplicable to court meetings within the context of a scheme of arrangement, on the basis that the constituency at a class court meeting is different to that of a general company meeting.⁷⁹ The Court hence specifically pointed out that a class meeting under Part 26 of the CA is under the control of the court, is *sui generis* and the circumstances applicable to the company's own meetings do not automatically apply,⁸⁰ with the Court's objective being that of determining fairly the views of the class as to the interests of the class.

III. Practical and Policy Objectives

Provisions that afford various participants involved in a transfer scheme extensive power and discretion in relation to the approval of a scheme could be explained based on two strands. One concerns the practical aspect of the process and relates to the origins of the requirements set out in statute regarding the approval thresholds and to the real need to develop a practical test relating to the criteria used for class separation. The other concerns the policy aspect of the process and relates to the protection of the minority from a powerful majority, and the objective of facilitating schemes as opposed to remaining neutral towards them.

Practical Aspect

Numerosity Test: Path Dependence

The transfer scheme statutory provisions descended from ones first adopted in 1870 to permit companies in liquidation to enter into 'compositions' or arrangements with creditors and were extended in 1900 to members, so that the 1908 Act introduced a readily recognisable to its predecessor section.⁸¹ The origin of the test was Victorian legislation, the Joint Stock Companies Act 1870, when the scheme jurisdiction was limited to creditor protection within the context of a companies' winding up process.⁸² The previous section was presumably set in place to provide a check on the ability of creditors with large claims to determine outcomes.⁸³ Creditors' interests would crystallise at the time of the 'winding up' so that the 'majority in number' remained unchanged from that time to the time of the scheme approval process. Whilst the provision originated at a time when a scheme could only be applied to debt in a winding up, the intended protection was for a small in number creditors, who may well have been ruined by a compromise of their debt in a scheme of arrangement supported by a few large creditors, such as banks, who would benefit more from an elimination of a good amount of the company's debt as compared to minority creditors. The occurrence of share-splitting was hence unlikely. The question which is worth considering is whether a small in number set of shareholders within a context of a transfer scheme continue to require the same protection that the provision applicable to creditor schemes intended to offer.

A problematic yet practical test on class separation

⁷⁹ Ibid, [27].

⁸⁰ Ibid, [42] and [44].

⁸¹ Department of Trade and Industry Report, Company Law Review, 'Modern Company Law for a Competitive Economy: Final Report Nov 2000, para 11.3, 205.

⁸² V. Finch and D. Milman, Corporate Insolvency Law: Perspectives and Principles (Cambridge: Cambridge University Press, 2017), 409-410; For overview of the historical development of schemes see Payne, n 5, 7-12.

⁸³ See Company Law Review, n 81.

Courts have been troubled with drawing a clear distinction between shareholders' motives, interests and rights in relation to the criteria applied to class separation.⁸⁴ Case law has evolved towards formulating a test with the distinguishing factor being that of the *rights* of shareholders, and not *interests*. This has undoubtedly been developed in such a manner at common law to offer a practical solution to a complex problem.⁸⁵ Applying the 'rights test', as pointed out by Payne, has a trade-off, as it may well result in fewer class meetings having to be held, and subsequently in the reduction of adequate minority protection. The rigid approach taken in relation to the criteria applied to class separation results in the Court's role becoming all the more important at the sanction stage, compelling it to take a more holistic view of the interests at hand.⁸⁶ As Chivers et al provide the practical test developed at common law in relation to class separation shows a clear case of courts *not* allowing small minorities with different commercial interests to identify themselves as a separate class, so as to have a veto power over the proposal.⁸⁷

A practical test rather than one that accurately reflects the reality of shareholders' diverging interests has been the one to prevail at common law. The test provides a number of practical advantages, which are according to Payne the following: (i) applying a test of separating classes based on rights, rather than interests, is a straightforward one for the company to undertake, (ii) applying a test of interests, rather than a test of rights, would require a considerable amount of information from shareholders, which is impracticable, and (iii) were a test of interests to apply, it could potentially lead to as many classes as there are members of a particular group.⁸⁸ What has however been considered to constitute an impractical test of 'interests based separation' at the stage of class separation, has been thought of as an acceptable test to be followed in the exercise of the court's discretion. Jurisprudence neither offers a coherent nor a common understanding of what may constitute 'voting in the interests of the class' however.

Underlying Policy Objectives

Minority in number protection against Majority Oppression

The value of the 'majority in number' requirement can also be found in its underlying objective, which is to protect the interests of members with a minority holding in the company from the abuse of the majority in value, which may want to impose a takeover on dissenting members. Proponents of the requirement would bring forward the problems that may arise in the extreme case of a single shareholder or creditor holding the requisite 75 per cent majority by value at the meeting and hence furthering his own agenda and oppressing the minority.⁸⁹

Questioning the utility of the numerosity test is nothing new, as it has troubled other common law jurisdictions, the company law review process⁹⁰ and expert scholars. The Company Law Review itself

⁸⁴ Ibid, 205, on problem of class separation.

⁸⁵ For the outlined criteria refer to Payne, n 5, 118-131.

⁸⁶ *Re BTR Plc* [2000] 1 BCLC 740 conflicting interests are to be considered at the time of the sanction of the approvals in the meeting.

⁸⁷ D. Chivers et al., *The Law of Majority Shareholder Power: Use and Abuse* (Oxford: Oxford University Press, 2nd ed, 2017, 99.

⁸⁸ Payne, n 5, 49-50.

⁸⁹ Payne, n 5, 64; Also see *Re PCCW Ltd* [2009] HKCA 178, 177, whereby Justice Barma outlines the purpose of the numerosity requirement.

⁹⁰ Company Law Review, n 81, which criticizes the requirement as being 'irrelevant and burdensome'.

observed that the requirement for majorities in number, as well as three-fourths in value, have become irrelevant and burdensome, particularly against the background of the increasing use of nominees and possible artificial sub-division of nominal shareholdings to reach the requisite majority in number.⁹¹ The test fails to reflect the reality of modern shareholding, insofar as it does not take into account the existence of nominee shareholders normally voting on behalf of dispersed beneficial owners. As shareholding does not crystallise until the vote, new incoming shareholders, prior to the vote taking place, could create an artificial minority capable of steering the success or failure of a scheme. Despite this problem having been highlighted by the Company Law Review in its review of section 425 Companies Act 1985, it was not addressed through reform, without there being any justification as to why reform was not pursued.⁹² Addressing the disjunction between beneficial and legal owners has not escaped the court's attention entirely. Regarding the 'majority in value' test, the English courts have offered the solution of split voting by allowing the person with the economic interest to dictate how his vote should be cast in a scheme.⁹³ And as Payne identifies, allowing a nominee to vote partly for and partly against the scheme, shows that the Court is indeed responding to the reality that those being asked to vote need to properly represent the views of the underlying economic-right holders.⁹⁴

Acknowledging the divide between legal and beneficial owners begs the question of why it has not been similarly acknowledged within the 'majority in number' test context. In order to minimise the adverse effects of the numerosity test, other common law jurisdictions do not make provision for it⁹⁵ or adopt it in a revised flexible form.⁹⁶ In Australia, Parliament gave the Court a statutory power to dispense with the test⁹⁷ and the Court has discretion to approve a scheme if it has been approved by a 75% majority in value, even if the numerosity test has not been met.⁹⁸ Scholars, such as Payne, have urged in favour of its complete abolition.⁹⁹ Despite the fact that the policy underlying the numerosity test was that it intended to provide protection to the minority from abuse of the majority, it is important to highlight that the 'majority in number' requirement can equally be abused by a minority in number wanting to either support or prevent a scheme. Were the 'majority in number' requirement to be abolished, the Court would need to assume more responsibility in providing protecting to the minority from majority oppression.

Minority in value protection against Majority Oppression

Another form of oppression relates to the tension between the minority in value and the majority in value. The law allows for an expropriation of shares of the minority, so long as a supermajority agrees to the scheme.¹⁰⁰ Payne explains that the form of oppression which occurs in a scheme relates to the

⁹¹ Company Law Review, n 81, para. 11.9, 207 and para. 11.34, 215-216

⁹² See Payne, n 5, 10.

⁹³ *Re Equitable Life Assurance Society* [2002] BCC 319, 326-327

⁹⁴ Payne, n 5, 41-42.

⁹⁵ New Zealand, Canada, India and South Africa (for member schemes).

⁹⁶ Singapore, Hong Kong, Australia, the Cayman Islands, the British Virgin Islands (BVI), Bermuda and South Africa.

⁹⁷ Herbert Smith Freehills, Legal Briefing 'Court Stops Share Splitting from De-Railing a Scheme of Arrangement' 27 February 2017, Australia, by Andrew Rich and Robert Moore.

⁹⁸ Australian Corporation Act 2001, s 411(4)(a) (ii) A.

⁹⁹ Payne, n 5, 39.

¹⁰⁰ See J. Payne "The Use of Schemes of Arrangement to Effect Takeovers: A Comparative Analysis" (August 15, 2014). Oxford Legal Studies Research Paper No. 51/2014, 18, available at <https://ssrn.com/abstract=2480941>

oppression in the process of deciding whether or not to accept the scheme.¹⁰¹ The *Dee Valley* case is evidence of there being a disjunction in interests and preferences between earlier and latecomer shareholders to the voting process. Within a public offer context, when an increase in the target firm's share price is marked upon announcement of a potential takeover bid, certain shareholders may choose to trade their shares at this early point in time, so as to transfer the risk of the bid not being successful to other shareholders willing to assume it.¹⁰² Hedge funds for example often deploy a strategy in public offer situations and form shareholders of the target firm to pose a temporal obstacle to the bidder's acquisition, improve the terms of the offer and sell once the target price has been reached.¹⁰³ Shareholder tactics of the sort have yet to occur in a scheme context, but it could nevertheless be the case that scenarios which involve a minority in value requiring the protection of the court from perverse shareholder strategies arises in the future.

Facilitating Schemes or remaining neutral towards them

The legislative intention of the requirements set out in the Companies Act is to promote schemes, and hence courts, will interpret the sections flexibly and purposively, in order to coincide with that intention.¹⁰⁴ The likelihood of a court proceeding to *not* sanctioning a scheme despite majority approval would arguably be minimal, seen through the prism of this legislative intention. In theory, courts could utilise the full extent of the discretion which the Act provides them with. Jonathan Parker J in *Re BTR Ltd* explains that the court's role: "...does not, as may have been suggested, involve using a rubber stamp. It involves a consideration of all the relevant circumstances. The court is not obliged to follow the majority decision at the meeting convened under [court meeting]."¹⁰⁵ So, it may well be the case that Courts would need to serve other objectives and remain neutral towards the objective of facilitating schemes, so as to better serve the role that statute has provided them with, namely that of balancing out the different interests at hand.

IV. Proposals for Reform

The *process* observed for the purposes of effecting a change in corporate control via a scheme matters for *the substance* of corporate governance, which is made most evident through the examination of the use and abuse of power by involved parties in *Re Dee Valley*. With reference to the practical and policy objectives underlying the law, reform is proposed in relation to how authority, discretion and accountability should be determined between different actors henceforth.

Power of the Majority in number

In *Re Dee Valley*, the Court disregarded legislation insofar as the requisite approvals were *not* rightly achieved at the jurisdiction stage by illegitimately disenfranchising the votes of the 'individual members'. The importance of the distinction between the two stages has been highlighted by the judge in *Re PCWW Ltd.*, who acknowledged that a strict numerosity test does not provide for a level

¹⁰¹ Ibid, 17-18.

¹⁰² A.S. Kalirai, "Post Cadbury–Kraft Takeover Changes Force Advisers to Rethink Strategies" *Legal Week* (15 September 2011) <http://www.legalweeklaw.com/abstract/sweet-deals-post-cadbury-kraft-takeover-changes-8790>

¹⁰³ M. Kahan and E.B. Rock, 'Hedge Funds in Corporate Governance and Corporate Control' (2007) Scholarship at Penn Law, Paper 99, 1022, at 1037 <http://lsr.nellco.org/upenn_wps/99>

¹⁰⁴ *Re SABMiller plc* [2016] EWHC (Ch) 23, 50; Also see Payne, n 5, 141 and *Company Law Review*, n 81, para. 11.9, 207 on comparison between schemes and offers.

¹⁰⁵ *Re BTR Ltd* [1999] 2 BCLC 675, 680.

playing field, since while it would permit the court to review share splitting in favour of the proposal, it does not enable the court to have regard to similar behaviour in opposition to the proposal.¹⁰⁶

The Court in *PCWW Ltd* explicitly acknowledges that the lack of a level playing field suggests that legislative reform may be necessary, pointing to Australian legislation.¹⁰⁷ The flexibility that the Australian Corporation Act provides is apparent, as it makes provision for the case in which the requisite majorities have *not* been met, allowing for a Court to nevertheless sanction a scheme in exercising its discretion in assessing the requirements more generally. From a policy perspective, what *Re Dee Valley* did aim to address, is the relevance of the numerosity test in today's socioeconomic environment. What *PCWW Ltd* shows is that a shareholder wishing to support the scheme, would have equally been able to abuse the test to his advantage, by making certain that shares had been distributed to the requisite number of shareholders. The labelling of such voting as manipulative is hence open to debate and begs the question of whether if the shares had been bought and split *before* the court meeting was ordered, voting manipulation would have been established. Furthermore, whether a time frame can be imposed in relation to share-splitting, irrespective of examining the motivation behind it, needs to be considered. Calls for reform along these lines have been made in relation to takeover offers.¹⁰⁸ The disenfranchisement of shares bought during an offer period, had been a proposal for reform of the Code initiated in 2010, which was not however endorsed. In *Re PCWW Ltd* it was recognized that a shareholder who had acquired shares in the company some considerable time *prior* to the announcement of the scheme as compared to a shareholder purchasing a share *after* the announcement of the scheme, and hence able to realise his investment in the company for a reasonably attractive short term gain, may result in shareholders voting at the meeting having very different views of the commercial merits of the proposition put before them.¹⁰⁹ It is ultimately a question of whether latecomers to the company vote with the right mind-set, namely that of having in mind the interests of the company or class interests accordingly.

The 'majority in number' requirement also proves to be problematic in circumstances where a large number of the shares in the target are held indirectly in the form of depositary interests through a nominee company. For the purposes of the test the company counts as one shareholder. This problem had been raised by the Hong Kong Court of first instance, which had sanctioned the Scheme. In that case 93.7% of the shares of independent shareholders in PCCW and HKSCC Nominees Limited counted as one member for the purposes of test.¹¹⁰ Similarly, in the UK, most large shareholders hold their shares through nominee accounts within CREST and nominee entities, and no matter how many accounts they hold, will only count as one shareholder for the purposes of the test.¹¹¹ In cases where a nominee entity must vote part in favour and part against, as representing varied instructions of their respective shareholders, the entity will cancel itself for the majority in number requirement.¹¹² In *Re Dee Valley* a substantial number of small shareholders held shares through a single, or two, nominees.

¹⁰⁶ *Re PCCW Ltd* [2009] HKCA 178, 147 and 191, see Court comment on argument of those in support of the scheme.

¹⁰⁷ *Ibid*, 192.

¹⁰⁸ In relation to drawing parallels between the two types of acquisition refer to Payne, n 100.

¹⁰⁹ *Re PCCW Ltd* [2009] HKCA 178, 202.

¹¹⁰ *Re PCCW Ltd* [2009] HKCA 178, 28.

¹¹¹ Slaughter and May 'Share-splitting and takeover schemes: The Dee Valley case' February 2017, available at <https://www.slaughterandmay.com/media/2536304/share-splitting-and-takeover-schemes-the-dee-valley-case.pdf>

¹¹² *Ibid*.

Had their shares been 'dematerialised', they would have exceeded in number the opponents of the scheme, which begs the question of whether there is such a thing as "good" as distinct from "bad" share splitting.

Practical options for reform are either to explicitly disallow share-splitting as a practice once the court meeting has been directed, so as to avoid a practice which is assumed to undermine the spirit of the Scheme legislation, or alternatively to revise the conditions of s. 899 CA 2006, so that the majority in number pre-condition does not apply.¹¹³ The 'majority in number' requirement should hence be abolished altogether or another less radical alternative could be considered, namely to follow the flexible approach that the Australian Corporations Act 2011 provides. In that case, it would remain important for a Court to take into account movements within the share register preceding the court meeting, as well as certain elements of transparency in relation to nominee accounts.¹¹⁴ Minority protection could be added as one of the factors that the court necessarily needs to place weight on when exercising its discretion to sanction a scheme. The notion of 'class interests' must be well understood, otherwise Courts may be disinclined to interfere with shareholder choice, thus compromising their role in protecting the interests of the minority.

Power of the Majority in value

In most cases there will be a clear rationale for the proposal of the scheme and how it benefits the shareholders, in the Scheme Document. The Court is not empowered to substitute its view of the scheme of that of members and so long as the scheme is fair and equitable it will not judge it on its commercial merits.¹¹⁵ In practice however, at the discretion stage, the Court will indeed closely assess whether the interests of the class have been served by the majority, which can only be undertaken via a 'quality control' assessment of the majority approval.

A decision from the Court of Appeal of Guernsey, *Puma Brandenburg Ltd. v Aralon Resources and Investment Company Ltd. and Nortrust Nominees Ltd*¹¹⁶, qualifies as a rare, yet important example of the majority 'interests' being assessed at the discretion stage by the Court whereby the Court refused to sanction the scheme on both jurisdictional and discretionary grounds.¹¹⁷ The 'divergence' of interests concerned the interests of the majority shareholder, who wanted to continue and expand the investments of the company subject to the scheme, *Puma*, and most of the various minority shareholders, that had not intended to invest in a real estate company after having acquired their shares via a demerger in 2012.¹¹⁸ Broader implications cannot be made, as the case is unique on its facts and concerned a novel situation of a scheme which was effectively a 'takeover' by the majority shareholders paid for by the company itself. The Court did however proceed to examine the 'real and unstated objectives' of the majority shareholders, making clear that a Court, must be satisfied that there is nothing about the Scheme which makes it oppressive of, or unfairly prejudicial to, persons

¹¹³ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch), 59.

¹¹⁴ Slaughter and May Report, n 111, on importance of monitoring the share register; See A. Kornberg and S. Paterson 'Out of Court vs Court-Supervised restructurings' in R.O. Caminal et al. *Debt restructuring* (Oxford: Oxford University Press, 2nd Ed, 2016), 250-253, on how this is dealt with in *creditor schemes*.

¹¹⁵ See Payne, n 108, 4, who clarifies this point.

¹¹⁶ (18 May 2017, judgment 27/2017, Guernsey Court of Appeal).

¹¹⁷ Ibid.

¹¹⁸ *Mourant Ozannes'* Law Firm Update, Partner Abel Lyall, on appeal for the opposing minority shareholder, available at <https://www.mourantozannes.com/file-library/media---2017/2017-updates/guernsey-court-of-appeal-rejects--oppressive--scheme-of-arrangement.pdf>

who may be bound or affected by it and will proceed to exercise its discretion fully in order to ensure that their rights as a minority are protected.¹¹⁹ The case qualifies as a case in which there was clear evidence that the majority had been motivated by the wrong considerations. The issue of whether the majority shareholder was influenced in the exercise of his voting by a collateral motive, which could have enabled the court to disenfranchise the shareholder from voting in the *Re Dee Valley* case as well, was also addressed in *Linton Park plc*,¹²⁰ whereby it was decided that evidence needed to be cogent and strong before the Court would intervene in such a manner. A subjective test has been applied by the Court in the aforementioned cases and strong evidence that supported the argument was considered necessary in order to effectively allow for court intervention in overturning the majority vote approval. Creditor scheme cases have similarly addressed instances in which the potential abuse of power of the majority to bind the minority was considered by the Court and have applied a subjective test in doing so.¹²¹

Applying a subjective test means that the scheme would be seen to serve the interests of the shareholder body of the particular company, which would in theory prove helpful in identifying what 'class interests' amount to. As *Re Dee Valley* makes evident however, one need be mindful of the fact that shares continue to be traded after the announcement of a scheme, so that the members comprising the shareholder body may change, resulting in the existence of members with different interests to those of members with a longer term holding. Whether the test applied is subjective or objective is crucial. A valid concern brought forward by Chivers et al. is whether a purely subjective test, which involves whether the actual majority in place is acting in good faith in exercising its power to amend the articles, provides the minority with adequate protection.¹²² An examination of other instances outside the scheme context in which the Courts have been called to examine the limitations on the power of the majority to bind the minority further supports this claim. In *Allen v Gold Reefs*¹²³ regarding a special resolution to alter the articles of association of the company, the court was concerned with the interests of the company as a trading entity distinct from the interests of shareholders and an objective test was applied. Subsequent cases relating to this category of resolution have applied a subjective test however.¹²⁴ The more recent case of *Re Charterhouse Capital Limited*¹²⁵ provides a clarification of the *Allen v Gold Reefs* test and subsequent cases by setting out seven core principles, including emphasis being placed on the *subjectivity* of the test, complemented

¹¹⁹ See *Puma Brandenburg Ltd. v Aralon Resources and Investment Company Ltd. and Nortrust Nominees Ltd.* (18 May 2017, judgment 27/2017, Guernsey Court of Appeal); Related issues via-a-vis creditor schemes refer to *Assenagon Asset Management SA v Irish Bank Resolution Corpn Ltd* (formerly Anglo Irish Bank Corpn Ltd) [2012] EWHC 2090 (Ch), 82-85 and to Hildyard J in *Primacom Holding GmbH v A Group of the Senior Lenders & Credit Agricole* [2011] EWHC 3746 (Ch) at [57].

¹²⁰ *Linton Park plc* [2007] BCC 17.

¹²¹ For example Hildyard J in *Primacom Holding GmbH v A Group of the Senior Lenders & Credit Agricole* [2011] EWHC 3746 (Ch) at [57] on circumstance in which minority is being coerced by the majority and *Assenagon Asset Management SA v Irish Bank Resolution Corpn Ltd* (formerly Anglo Irish Bank Corpn Ltd) [2012] EWHC 2090 (Ch), 82-85, where Briggs J considered whether the exit consent resolution of the scheme at hand qualified as a form of coercion at variance with the purposes for which majorities in a class are given powers to bind minorities.

¹²² Chivers et al., n 87, 9.

¹²³ *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656.

¹²⁴ *Sidebottom v Kershaw, Leese & Co Ltd* [1920] 1 Ch; *Shuttleworth v Cox Brothers and Company (Maidenhead) Limited* [1927] 2 KB 9; *Greenhalgh v Aderne Cinemas Limited* [1951] Ch 286, as per Evershed MR, on the interpretation of the notion of 'the company as a whole'.

¹²⁵ [2015] 2 BCLC 627.

however by the 'reasonable person' test and the 'interests of the company' element, as distinct to the interests of shareholders.

A distinction which exists between the two parallel streams of cases, namely those relating to the power exercised to amend the articles and those relating to the power exercised to approve a scheme of arrangement, is that the common law test applied is different, but also that the respective tests applied concern the assessment of a very different constituency. The 'company as a whole' test can categorically be contrasted to 'class interests'. In relation to 'the company as a whole' notion being interpreted as one which means the company as a trading entity, Chivers et al. identify that such an interpretation may be inapposite in cases in which the interests of different groups of shareholders are affected in different ways, but that the company's interests as a trading entity are not affected at all.¹²⁶ Similar concerns can be put forward in relation to the interpretation of 'class interests' which in *Re Dee Valley* were also understood as the real time financial interests of the class voting. The policing by the Court of the way in which shareholders vote at a court meeting is also distinct to the policing undertaken in relation to general meetings. Within the context of transfer schemes, it is worth considering therefore whether the type of test applied in interpreting the notion of 'class interests' is contributing to the policy objectives that need to be furthered. It is questionable whether an application of a subjective test, which relates to the particular interests of the class at hand, guarantees that the business model of the trading company is being considered and that the minority in question is provided with the requisite protection.

Authorities on class separation showcase the problem of the existence of varied, diverse and conflicted interests among shareholders, which may not allow forming a homogenous set of class interests. In a case which involves an evaluation of what constitutes the 'interests of the class' there is a need to have an *objective test* applied to the interpretation of this notion.¹²⁷ Elements addressed as part of the subjective test addressed in *Re Charterhouse Capital Limited*¹²⁸, such as 'reasonable person' test and the 'interests of the company' element, as distinct to the interests of shareholders, could also form elements to be introduced for the purposes of developing the test within the scheme context further.

'Motives', 'Interests' and 'Rights': conflicting versus diverging

The existence of different motives and rights may not give rise to separate classes, but is taken into account by the court when determining what the interests of the class amount to. It has been established in *Re BTR Plc*¹²⁹ that in the case where some of the target shares are held by a subsidiary of the bidder, then such conflicting interests, despite not being a criterion for class separation, can be evaluated by the court in its interpretation of the 'interests of the class'. In *Goodfellow v Nelson Line (Liverpool) Ltd*¹³⁰, the Court reasoned that provided that full disclosure has been made to the rest of the class in relation to the *conflicting interests*, then the scheme could subsequently be sanctioned by the

¹²⁶ Chivers et al., n 87, 11.

¹²⁷ Creditor scheme cases provide some insight as per identifying what is meant by 'class interests' see for example *In the matter of DX Holdings Ltd and other companies* [2010] EWCH 1513 (Ch) at [7] and [8]; *In the case of Seat Pagine Gialle Spa* [2012] EWHC 3686 (Ch) at [14]-[22].

¹²⁸ [2015] 2 BCLC 627.

¹²⁹ *Re BTR Plc* [2000] 1 BCLC 740, came to reject the view previously held on the matter in *Re Hellenic & General Trust Ltd* [1975] 3 All ER 382, 385-85.

¹³⁰ [1912] 2 Ch 324.

court. In the case of *Re Dee Valley* it could have been argued by the Court that those seeking to frustrate the scheme were voting in their capacity as employees, subject to requesting evidence to support such a claim, and hence conclude on the existence of conflicting interests. The share splitting exercise, although not objectionable on its own merits, would be an indication that those voting did not have an investment motive and must have been accepting the transfer solely for the purposes of frustrating the scheme in their capacity as stakeholders and not in their capacity as shareholders. A shareholder, who is at the same time an employee or a consumer, may well be voting with *those* types of interest in mind and *not* in the interests of the class as the common law so requires. Conclusive evidence would have however been required in order to adequately establish this and in any case would have still been problematic insofar as the Chairman, as well as the Court in this instance, lack the authority to intervene in such a manner.

Cases whereby the court has held that the majority has *not* voted in the interests of the class as a whole are fact specific and do not help inform the discussion more generally. In *Re NFU Development Trust Ltd*¹³¹ the court dismissed the company's petition to the court to sanction a scheme of arrangement on the basis that the scheme involved members surrendering their membership rights without being provided with compensation and in *Re Canning Jarrah Timber Company (Western Australia) Ltd*¹³² Cozens Hardy J. refused to sanction the scheme assented to by the statutory majority of the debenture-holders on the basis that the underlying underwriting agreements were considered illegal.¹³³ Creditor scheme case law has arguably developed better guidance in relation to comparable issues. In *the matter of DX Holdings Ltd and other companies*¹³⁴ and *In the case of Seat Pagine Gialle Spa*¹³⁵ for example it was made clear that a court will consider whether the fees that are paid to creditors in consideration for voting in favour of the scheme, consent fees, were available to all, whether it is unlikely that a creditor who considered any substantive aspect of the scheme to be against its interest would be persuaded to vote in favour by the existence of such fees and the size of the fee.

Marginally different to the notion of conflicting interests, is the notion of diverging interests that may exist among different types of shareholders, who may be voting with different conceptions of corporate benefit. The Court in *Re Dee Valley* acknowledges that class interests "may be very complex and are not always going to be purely financial".¹³⁶ *Re Waste Recycling Group plc*¹³⁷ concerned the assessment of non-financial interests relating to corporate purpose and whether the reasons underlying investment in particular companies need be evaluated within the process of sanctioning a transfer scheme. The claim made by a minority shareholder was that "particular companies with operations which have an environmental impact ... often attract the attention of shareholders who buy shares more with a desire to try to hold the directors to account in respect of environmental interests than just on dividend or other financial return"¹³⁸ and that such considerations, should form the basis for a shareholders' right to retain his share in the company. In this case the Court sanctioned

¹³¹ [1972] 1 WLR 1548.

¹³² [1990] 1 Ch 708, whereby the Court however had discretion to modify the scheme as a condition of its sanction and was subsequently sanctioned by the Court of Appeal.

¹³³ *Ibid*, at 713-714 as per Cozens Hardy J, on illegality of the underwriting agreements.

¹³⁴ [2010] EWCH 1513 (Ch) at [7] and [8].

¹³⁵ [2012] EWHC 3686 (Ch) at [14] - [22].

¹³⁶ *Re Dee Valley Group plc* [2017] EWHC 184 (Ch), 55.

¹³⁷ *Re Waste Recycling Group plc* [2003] EWHC 2065 (Ch), 17.

¹³⁸ *Ibid*, 10.

the scheme and held that despite the majority in this case acting in its own best interests, it was not coercing the minority in doing so. The problem with such types of interests relates to the subjectivity of the content of ethical investment policies and to problems relating more generally in defining what could be considered as more enlightened financial interests.¹³⁹ The disjointed thinking that exists between practice and legal reasoning in relation to ‘ethical investing’ has been pointed out by Thornton, who explains that even though in practice large amounts of monies are invested in assets following a positive and negative screening, the practice is of doubtful legality and considered suboptimal in terms of portfolio theory.¹⁴⁰

Enlightened investment choices relating to what is commonly understood as responsible or ethical investment have however been an issue which has troubled the Courts in relation to trust funds. The well-established notion that the interests of beneficiaries are purely financial was established in the case of *Cowan v Scargill*¹⁴¹ where it was held that where the purpose of a trust is to provide financial benefits,¹⁴² powers of investment under the trust must be exercised ‘so as to yield the *best return* for the beneficiaries’, taking into account risks of the investments in question and trustees must put their own personal interests and views to one side and adopt the most ‘beneficial’ investment.¹⁴³ However, the Court of Appeal in *Nestlé v. National Westminster Bank plc*¹⁴⁴ recognised that modern portfolio theory¹⁴⁵ altered the way in which the prudence of investments should henceforth be assessed, in that the risk level of *the whole portfolio* had become the relevant question, rather than that of individual investments. To date research projects address the need to understand how the integration of environmental, social and governance factors in investment decision-making works vis-a-vis the duties of financial intermediaries.¹⁴⁶ Through this prism the interpretation of ‘class interests’ within the context of transfer schemes will soon be outdated. The gaps that may exist relating to the time horizon aspect of varied shareholders and specifically to the long-term and short-term divide, to the risk assessment of the scheme and to the environmental, social and governance aspects underlying the transaction may well feature as criteria that should be examined in the assessment of whether the scheme is in the interests of the class. From a public policy perspective, furthering the agenda of ‘value creation’ rather than ‘best price’ attainment for the companies involved in the transaction should be the driver of reform and justifies statute providing the Court with the high level of discretion to sanction the scheme.

V. Conclusion

¹³⁹ R Thornton, “Ethical Investment: a case of disjointed thinking” (2008) 67(2) *Cambridge Law Journal* 398, 418.

¹⁴⁰ Thornton, n 139, 415.

¹⁴¹ *Cowan v Scargill* [1985] Ch. 270, 287 Sir Robert Megarry V.-C.

¹⁴² *Ibid*, 513.

¹⁴³ *Ibid*, 514-515.

¹⁴⁴ *Nestlé v National Westminster Bank plc* [1993] 1 WLR 1260, 1282; Also see UNEP Finance Initiative ‘A legal framework for the integration of environmental, social and governance issues into institutional investment’ Freshfields Burckhaus Deringer LLP (October 2005) available at http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf, 88-89 and 101.

¹⁴⁵ Also refer to E Ford, “Trustee Investment and Modern Portfolio Theory” (1996) 10(4) *Trust Law International* 102, 102.

¹⁴⁶ UNEP Finance Initiative, Generation Foundation and PRI ‘Fiduciary Duty in the 21st century - Progress Report (December 2017); Also see Report, [Fiduciary Duty in the 21st Century](http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf) (September 2015) available at http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf and its precursor, the UNEP Report, n 144; Also see UK Law Commission, in its report [The Fiduciary Duties of Investment Intermediaries](http://www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf), published in 2014.

The *process* observed for the purposes of effecting a change in corporate control via a scheme matters for *the substance* of corporate governance. It has been exemplified and emphasised that the CA 2006 provides for a clear distinction between the jurisdiction and the sanction stage. A regulatory solution which allows for the blurring of the lines between the two stages in order to correct this asymmetry can be found in the Australian Corporations Act 2001. By making provision for the case in which the requisite majorities have *not* been met and allowing for a Court to nevertheless sanction a scheme when exercising its discretion, the Australian case provides the desired flexibility. It is recommended that the UK should similarly revise its statutory provisions. A forward-looking approach is also suggested in relation to the interpretation of 'class interests'. Applying an objective test, rather than a subjective one, would also allow for a more balanced assessment of what is meant by 'class interests'. Drawing inspiration from ongoing debates on modern portfolio theory and integrating environmental, social and governance concerns in investment decision-making, it is argued that it is high time for the Courts to delve deeper into the meaning of 'class interests', in order to justify the wide discretion that legislation provides them with. Commercial courts are equipped with the legal toolkit relating to fairness and reasonableness, and can apply consistent standards across the board with reference to a more progressive outlook than the one currently in place.