



Shareholder protection in takeover offers and schemes of arrangement

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Introduction

- In a number of jurisdictions, schemes of arrangement are an alternative to effecting a change of control via a traditional offer
- This includes England, Australia, New Zealand, Hong Kong, Singapore, Malaysia, BVI, Bermuda and the Cayman Islands
- This mechanism is increasingly common eg 15 of the 19 regulated change of control transactions announced in the year ended 31 December 2012 concerning target companies listed on the Main Market of the London Stock Exchange with a deal value of at least £100 million were effected by way of a scheme of arrangement
- However in some jurisdictions doubts have been raised about the use of schemes in this context

The use of schemes of arrangement to effect a change of control

- English schemes are located in Part 26 of Companies Act 2006
- A three stage process:
 - A compromise or arrangement is proposed between the company and its members/creditors
 - Meetings of the members/creditors are held to approve the scheme (by a majority in number representing 75% by value)
 - Definition of class: Bowen LJ in *Sovereign Life Assurance*; Chadwick LJ in *Re Hawk Insurance*
 - Members' rights, not their interests, are key
 - The court must sanction the scheme and the order is delivered to the Registrar of Companies
 - Every class must have approved it (no cramdown of classes)
 - Not a rubber stamping exercise by the court
- Until recently a UK takeover scheme could occur by way of a reduction scheme or a transfer scheme (but see Companies Act 2006 (Amendment of Part 17) Regulations 2015)

The use of a takeover offer to effect a change of control

- The bidder deals not with the target company, but with the target shareholders
- The dominant policies at work in the UK Takeover Code are
 - Giving the decision-making role to the shareholders (no-frustration principle: GP 3 and r 21)
 - Ensuring that the shareholders' decision-making is as undistorted as possible (GP 1, mandatory bid rule, squeeze-out rules)
- Procedure
 - Formal offer (nb new rules aim to reduce virtual bids)
 - Role of directors: rule 3.1
 - Offer becomes unconditional as to acceptances
 - Role of squeeze-out and sell-out rules

A comparison of schemes and takeover offers

Scheme of arrangement	Takeover offer
Scheme is under the control of the target	Bidder makes the takeover offer – relatively easy for it to amend offer
Until March 2015 no stamp duty payable on reduction schemes (this loophole has now been closed).	Stamp duty payable
A successful scheme always results in bidder acquiring 100% control	Bidder may acquire less than 100% control
To obtain 100%: each class must approve by 75% in value and a majority in number	To obtain 100%: bidder needs to acquire 90% and then use squeeze-out provisions
Two court hearings required (potential implications for costs and timing)	Court generally not involved
Some additional procedural complexity eg class meetings	No class meetings
Schemes are within the Takeover Code (see Appendix 7)	Governed by the Takeover Code

Minority protection in schemes and takeover offers

- Minority protection in a scheme
 - Members receive all the information they need in order to consider the scheme
 - Members meet in classes to approve it
 - The role of the court at the sanctioning stage
- Minority protection in an offer
 - The concept of shareholder equality (GP 1)
 - Mandatory bid rule (rule 9.1)
 - Squeeze-out and sell-out rules (Companies Act 2006, ss 983-985)
- Justifications for minority protection in an offer
 - Undistorted choice; minority protection
- Justifications for minority protection in a scheme

Should takeovers be allowed by way of a scheme of arrangement?

- In the UK, the courts and the Takeover Panel have adopted a neutral stance as between schemes and takeover offers see eg *Re TDG plc*
- Cf Australian legislation: Corporations Act 2001, s 411(17): a court will only have jurisdiction to approve a scheme of arrangement where either (i) the court is satisfied that the scheme has not been proposed to avoid the operation of the takeovers legislation; or (ii) a statement is received from ASIC indicating that it has no objection to the arrangement
- See also New Zealand provisions, as amended by Companies Amendment Act 2014
- Hong Kong New Companies Ordinance Cap 622, ss 674(2) & (3)
- Can the English approach of neutrality on this issue be justified?

Approval thresholds

- Schemes can allow a 75% majority to bind the minority in determining the outcome of the scheme (cf the position in an offer)
- Should the approval level be increased for a takeover scheme?
- See Hong Kong Companies Ordinance Cap 622 s 674(2): a requirement that in addition to 75 per cent by value voting in favour, not more than 10 per cent of the total voting rights attached to the “disinterested shares” may vote against it, if the approval threshold is to be reached
- BUT the approval level for schemes may be lower than it appears in practice
- In any case, different approval levels for schemes and offers may be justified

The use of schemes to bypass the takeover regime

- Does the use of schemes allow bidders to effect a change of control without having to comply with the requirements of the takeover regime?
- See eg Australian Corporations Act 2001 s 411(17)
- However, the UK Takeover Code applies to schemes
 - Often the requirements under the Code for offers and schemes are identical (eg in relation to disclosure obligations)
 - Where there are differences (eg the mandatory bid rule does not apply to schemes) these are explicable by reference to the structure and purpose of schemes

Maximising value for target shareholders

- Do schemes facilitate auctions of control, and thus maximise shareholder value for the target shareholders?
- Note that rival offers (and even rival schemes) are not uncommon
- No evidence that companies are sold at lower premia under schemes as compared to offers

Conclusion

- Schemes and takeover offers are structurally distinct
- Schemes will not always be the right mechanism to achieve a change of control, but it is striking how often they are chosen in practice for recommended bids
- Although doubts have been raised about the use of schemes to effect a change of control, these concerns tend to be misplaced
- The current stance of the English courts and the UK Takeover Panel, ie neutrality as to whether a change of control proceeds by way of an offer or a scheme, is justifiable