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How do companies 'merge' in the UK? Schemes of arrangement under Part 26 Companies Act 2006 & Shareholder voting practices examined

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Main methods and Schemes of Arrangement

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. According to the statutory process regulating the scheme, a company can agree to a compromise or arrangement with its members or creditors *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. 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 arrangement, (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 respectively (iii) an application to the court to sanction the arrangement and (iv) registering the court order approving the scheme with the Companies Register, which renders the scheme effective.

The 'court' meeting

Obtaining the necessary approval of the shareholders of the company subject to the scheme at what is known as the 'court meeting' 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. The first stage of the test may 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.

Sanctioning the scheme

Regarding the actual sanctioning of the scheme by the court at the second stage, the discretion stage, the CA 2006 does not provide the Court with any guidance of relevance for exercising its discretion in sanctioning the scheme. Courts will try to establish whether there is a sensible account of why the scheme benefits the members. At common law it has been established that the court will consider whether it is satisfied with the following: (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 represent, (iv) an

intelligent and honest person, a member of the class concerned and acting in respect of his own interest, might reasonably approve the scheme (v) that there is no blot on the scheme.

Controversial aspects: Majority versus Minority dynamics

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.

With respect to the objective of protecting the minority from a powerful majority, a legal issue worth discussing is that which relates to the general principles that have been established by English law in relation to the exercise of powers conferred upon a majority to bind a minority within a class generally, and whether these also apply to the 'court meeting' specifically. 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.

The power of the supermajority to amend the company's articles of association (s. 21 CA 2006) 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.' (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.)

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. It was made explicit in *Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 WLR 1133, 1144, 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.' (Pender *v. Lushington* (1877) 6 Ch. 656, paras. 75-76; *Allen v. Gold Reefs of West Africa Ltd* [1990] 1 Ch. 656.) In Re Charterhouse Capital Limited [2015] EWCA Civ 536, [2015] BCC 574 ("Charterhouse Trust"), 90, 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 person could consider it was for the benefit of the company as a commercial entity.

In the controversial case of *Re Dee Valley* Group plc [2017] EWHC 184 (Ch) *t*he Court reasoned at [27] 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.[1] 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, at [42] and [44], with the Court's objective being that of determining fairly the views of the class as to the interests of the class.

The case of varied, diverse and conflicted interests among shareholders addressed

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. 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].) Elements addressed as part of the subjective test addressed in *Re Charterhouse Capital Limited* [2015] 2 BCLC 627, 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. In my article - G. Tsagas 'Use and Abuse of power in changes of corporate control: Shareholders' voting practices in unchartered waters' concerning the Re Dee Valley Group plc [2017] EWHC 184 (Ch) *Journal of Business Law* (2019) (4) 282-303-, the topic is developed in academic depth and detail, I suggest that applying an objective test, rather than a subjective one, would also allow for a more balanced assessment of what is meant by 'class interests'. Free download of earlier draft version available here on SSRN.