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COURT REJECTS VOTE-SPLITTING DESIGNED TO DEFEAT TAKEOVER

The High Court has delivered its landmark judgment on whether a shareholder can split its votes to defeat a takeover structured as a scheme of arrangement.

WHAT HAPPENED?

On 23 November 2016, the board of Dee Valley Group plc received an offer by Severn Trent to acquire its entire share capital, which it recommended. The offer, which followed a series of competing offers by Severn Trent and Ancala Partners, was to be structured as a scheme of arrangement.

To be effective, a scheme needs to be approved by the target's shareholders at a meeting convened by the court. There are two thresholds to satisfy. First, the scheme must be approved by shareholders present at the meeting (in person or by proxy) who collectively hold 75 per cent or more by value of the shares being voted.

Second (and critically in this case), it must be approved by a majority in number of the shareholders present at the meeting.

The court convened a meeting of Dee Valley's shareholders to take place on 12 January 2017. However, on 3 January 2017, one of the company's shareholders (Mr Cashmore) transferred 434 of his shares to 434 different individuals, who all became new shareholders of Dee Valley.

The intended effect was that, if Mr Cashmore and all 434 individuals were to vote against the scheme, the scheme would fail, because it would not receive the approval of a majority in number (as described above). In essence, Mr Cashmore was splitting his votes in order to defeat the takeover.

The company obtained an order allowing the chairman of the meeting to provisionally disregard the votes of these 434 individuals. The court would then decide whether these votes should be counted (in which case, the takeover would fail), or whether they were cast improperly and should be ignored (in which case, the takeover would proceed).

WHAT DID THE COURT DECIDE?

Unusually for a scheme, the court hearing lasted three days and engaged several legal principles.

Ultimately, the judge approved the scheme, allowing the takeover to proceed.

He decided that the individual shareholders' votes should be disregarded and the chairman of the meeting was right to do this. In doing so, he had regard to the principle that the shareholders at the court-convened meeting to approve a scheme must vote in the interests of the class of shareholders as a whole. They cannot take their own personal or extraneous interests into account.

In the judge's view, Mr Cashmore's shares had been split solely for the purpose of defeating the scheme. This naked share-splitting was evidence that the individual shareholders' votes had not been cast with the entire class in mind.

However, he rejected the idea that shareholders voting on a takeover scheme of arrangement may only take financial motivations into account (in practice, the price being offered on the takeover). It is entirely legitimate for shareholders to consider other interests, such as those of the company's employees and customers and the environment.

PRACTICAL IMPLICATIONS

The decision is an important clarification and good for bidders and the M&A market generally. Share-splitting has often been a concern on takeovers structured as schemes. Had the splitting been effective, bidders might have become reluctant to choose a scheme over a traditional contractual offer.

However, the judgment also creates some uncertainty and throws a spotlight on what it means to vote in the interests of the class as a whole. The court recognised that financial motivations are not the only relevant factor when voting. Shareholders can consider the interests of employees and customers (and, presumably, other stakeholders) and the environment. In this case, it was the share-splitting that determined the matter. It seems that, if the splitting had not taken place, and the 434 individuals had already held their shares before the meeting was convened and voted as they did, the scheme may well have been defeated.

But beyond this, the lines are blurred. The decision potentially leaves the door open to challenge votes cast by other types of shareholder (including those with a sizeable holding) who act with their own interests in mind. This would, in theory, be relevant not just for the majority in number test, but also when deciding whether the 75 per cent threshold has been satisfied.

The individual shareholders who objected at the hearing have decided not to appeal the judge's decision. For now, the issue of share-splitting has been laid to rest.

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