

# Schemes of Arrangement, Takeovers and Minority Shareholder Protection



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# Introduction



- The purpose of this paper is to compare and contrast takeover offers and schemes of arrangement
- A scheme of arrangement involves “a compromise or arrangement...between a company and (a) its creditors, or any class of them, or (b) its members, or any class of them” (CA 2006, s 895(1))
- In recent years schemes of arrangement , as opposed to more traditional takeover offers, have become the structure of choice for recommended bids
- In particular this paper will consider the fact that there is less protection in place for minority shareholders in a scheme than in a takeover offer, and offer an explanation as to why this might be the case

# The use of a scheme as an alternative to a takeover: some important differences



- **The relevant parties**
  - A takeover offer involves a (contractual) relationship between the bidder and the target shareholders, supplemented by regulation
  - A scheme involves the bidder dealing with the target company
- **The outcome**
  - A scheme always involves the bidder acquiring 100% of the target
  - A takeover by way of offer can result in the bidder acquiring a much lower percentage of the target [NB If the bidder wants to acquire 100% he must get 90% of the shareholders to agree, cf a scheme which requires just 75% ]
- **The court's involvement**

# Minority protection for target shareholders in a takeover offer



- UK takeover regulation is shareholder-centered. It concentrates on regulating two relationships in the takeover situation:
  - First it regulates the relationship between the target directors and target shareholders by imposing the no-frustration principle: GP 3 and r 21 City Code
  - Second, it regulates the relationship between the bidder and the target shareholders by imposing the equality principle (GP1, City Code)
- Why is it thought necessary to treat shareholders in a bid situation equally, when elsewhere in general UK company law we accept that shareholders must be treated fairly, but not necessarily equally?

# Explanations for the equality principle in takeover offers



- **Undistorted choice**

Examples of undistorted choice in practice: rules requiring the same or comparable offers to be made to different shareholders (both within and outside the bid); rules requiring shareholders to have adequate information on which to make a decision and enough time within which to make a decision; the squeeze out rules

- **Protection of minority shareholders**

Examples of minority shareholder protection: mandatory bid rule and sell out rule

(i) Prevention of oppression

(ii) An exit right

# Minority protection in a scheme of arrangement



- There are three main steps involved in effecting a takeover by way of a scheme:
  - First, a compromise or arrangement is proposed between the company and its members. An application is made to court for an order that meeting(s) of shareholders be summoned to approve the scheme.
  - Second, meetings of the members will be held to seek approval of the scheme by the appropriate majorities.
  - Third, the scheme must be sanctioned by the court.
    - ✦ Have the statutory provisions been complied with?
    - ✦ Did the majority fairly represent the class?
    - ✦ Is the scheme one which a reasonable person would approve?

# The purpose of minority protection in a scheme of arrangement



- No undistorted choice issue since the relationship of the bidder is with the target company
- As regards minority shareholder protection there is no need to worry about an exit right since 100% of the shareholders are bound
- As regards the possibility of oppression, the only possible oppression is as regards the decision whether to accept the scheme

# Conclusion



- Greater minority protection is put in place for minority shareholders in a takeover offer than exists for minority shareholders where the takeover occurs by way of a scheme
- However, these differences are explicable when the different purposes of that protection are understood
- The protection needed in a scheme is most akin to the protection that needs to be put in place in relation to squeeze out rights
- In most circumstances it will be proper for the minority to be bound by the majority decision; only in exceptional circumstances should the court interfere