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UPDATE

Royal Court refuses to sanction a scheme of arrangement compelling a share buy-back

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The Royal Court of Guernsey has refused to sanction a scheme of arrangement that sought to impose a compulsory buy-back of shares on minority shareholders.

In a judgment issued on 24 February 2017, Sir Richard Collas, Bailiff, found there was no jurisdiction to sanction the proposed scheme of arrangement (**Scheme**) under Part VIII of the Companies (Guernsey) Law, 2008 (the **Companies Law**) as the Scheme failed to comply with the statutory share buy-back provisions. Those provisions require the company to obtain the consent of shareholders whose shares are to be acquired. The Bailiff also decided that even if he had jurisdiction, he would not have sanctioned the Scheme in the exercise of his discretion as he was not satisfied that the majority of shareholders were acting bona fide in the best interest of the class they represented as a whole.

The decision is the first time a scheme of arrangement has been contested in the Royal Court, and is a rare example of a scheme of arrangement failing on both jurisdictional and discretionary grounds. It confirms that while the meaning of 'arrangement' for the purposes of Part VIII of the Companies Law is broad, any proposed arrangement must still comply with any applicable specific statutory provisions before the Royal Court will approve it.

Background

The Scheme was proposed by Puma Brandenburg Limited (**Puma**), a Guernsey unlisted company incorporated in 2006 for the purposes of raising capital to invest in German real estate. Puma had previously been involved in two restructurings, firstly in 2009 when it was amalgamated with Shore Capital Group Limited (**Shore Capital**) and then in 2012 with its demerger from Shore Capital.

Puma's year-on-year financial performance had been very good and the board considered it had a 'strong future' specifically advising shareholders in the Scheme document that it 'intended to pursue long term growth by holding and improving investment assets whilst at the same time seeking to take advantage of cheap long term finance'. They had however identified a 'divergence' of interests between the majority shareholders (Mr Howard Shore (who is also a director of Puma) and his wife) (**Majority Shareholders**) who wanted to continue and expand the investments of Puma, and most of the various minority shareholders, who they said had not intended to invest in a real estate company, having acquired their shares via the demerger in 2012. As an unlisted investment company, there was no liquid market for the shares, and the board said it was looking at means to provide a 'liquidity event' to those shareholders who were not aligned with the long-term interests of the company.

The Scheme of Arrangement

The proposal by the board of Puma was to undertake a selective buy-back of its shares from all shareholders other than the Majority Shareholders.

The structure of the proposed Scheme was relatively simple. Puma would acquire all shares in issue other than those held by the Majority Shareholders. The consideration to be paid to shareholders by Puma for

the buy-back shares valued Puma at a 43.6 per cent discount to its net asset value (NAV). There was to be a single member class, comprising all minority shareholders.

At an *ex parte* hearing on 10 November 2016, the Royal Court ordered that a meeting of minority shareholders be convened to vote on the proposed Scheme. The Scheme was approved by the required majorities at the Scheme meeting on 1 December 2016. In all, 95.88 per cent by value (comprising 25.89 per cent by number) voted in favour of the Scheme. A separate special resolution to approve the share buy-back was also passed, as required by section 314 of the Companies Law.

Where a scheme is approved by the requisite majorities, section 110(2) of the Companies Law provides that the Court 'may' sanction the scheme. As such, the Court has an overarching discretion whether or not to sanction the scheme. The Companies Law says that in exercising its discretion, the Court may consider:

- whether the majority is acting in good faith in the interests of the class of members it professes to represent, and
- the different interests of members are such that they should be treated as belonging to a different class of members.

Opposition to the Scheme

Two minority shareholders voted against the Scheme, and Mourant Ozannes was instructed by one of those shareholders to oppose the Scheme at the subsequent sanction hearing before the Royal Court.

The shareholder asserted that the Royal Court had no jurisdiction to grant the Scheme as Puma had not (and indeed could not) comply with the statutory requirement to obtain the consent of shareholders whose shares are to be acquired.

The shareholder also opposed the Scheme on discretionary grounds, including that the Scheme was not fair and not reasonable, was disproportionate to the aims of the board and the Scheme document contained material non-disclosures.

Lack of Jurisdiction

The opposing shareholder submitted that the Royal Court could not sanction the Scheme as Puma had not complied with section 313(3) of the Companies Law, which requires that it 'must obtain the consent of the shareholders whose shares are being acquired to that acquisition'. As a matter of normal statutory construction, a general provision cannot override a specific provision. It was argued that the Royal Court did not have the power to sanction a scheme of arrangement the effect of which is to authorise a company to acquire its own shares from a member who has not consented to sell those shares to the company. While Puma had the consent of those who voted in favour of the Scheme, there was no consent from those voting against the Scheme or those who did not vote at all.

At the contested sanction hearing, Puma did not deny that there was a need to comply with the provisions in section 313(3) of the Companies Law, rather it argued that the approval by the statutory majority of the class of members in the court meeting, together with the sanction of the Royal Court, supplies the consent needed to complete the share buy-back.

In his judgment, the Bailiff readily accepted that in order for a scheme of arrangement to give effect to the acquisition by a company of its own shares, it must be in accordance with *both* the scheme of arrangement provisions and the share buy-back provisions of the Companies Law. However, he did not agree that the mechanism of the Scheme was sufficient to meet the requirements of section 313(3) for 'consent of the shareholders'. The Bailiff accepted the opposing shareholder's submissions that the natural meaning of the words 'must obtain the consent of the shareholders' means it is from those individual shareholders that the consent must be obtained.

Accordingly, Puma had not complied with the provisions in the statute and it was held that the Court had no jurisdiction to sanction the Scheme.

Discretionary arguments

Having accepted that there was no jurisdiction, the Bailiff went on to consider whether he would have sanctioned the Scheme if he had the jurisdiction to do so.

The opposing shareholder had raised a number of arguments that it said weighed against exercising the discretion in favour of the Scheme. These included:

- That the Scheme was not fair and not reasonable. The rationale for the Scheme was said to be disproportionate and the Scheme itself was unnecessary. If Puma wanted to achieve a liquidity event for those shareholders wanting to sell, it could conduct a selective buy-back from those individual shareholders – there was no need to make it compulsory.
- The offer price proposed under the Scheme amounted to a 43.6 per cent discount to NAV with no justification for such a discount and no explanation as to how the offer price had been arrived at.
- A number of minority shareholders who had given irrevocable commitments to vote in favour of the Scheme had undisclosed business relationships with Mr Howard Shore through Shore Capital and its associated entities, and this included Mr Shore's brother.

In his comments on the question of discretion, the Bailiff focussed on whether the majority who voted in favour of the Scheme had acted in good faith in the interests of the entire class of which they represented, a point he described as the 'real issue' in the case on discretion.

The Bailiff noted that the onus is on the company to satisfy the Royal Court that the statutory majority is acting bona fide in the interests of the class of members it represents. By pursuing a scheme of arrangement rather than seeking the consent of each and every shareholder to the acquisition of shares, Puma was, in the view of the Bailiff, exposed to the criticism that the Scheme was designed to 'coerce the minority'. The onus was on Puma to show this was not the case and in the Bailiff's opinion, it had failed to do so. Irrespective of whether he found that he had jurisdiction, the Bailiff said he would have rejected the Scheme on discretionary grounds.

Commentary

The decision reinforces the protections offered to minority shareholders against share buy-backs. Shareholders must consent to an acquisition by the company of their shares – the court cannot order them to do so, nor can it substitute its consent for that of the shareholder. That the Royal Court sought to enforce these requirements is unsurprising, given the requirement that schemes of arrangement comply with relevant statutory restrictions or procedures, which is a well-settled principle both in the UK and internationally.

In its submissions, Puma cautioned the Royal Court that adopting the interpretation suggested by the opposing shareholder would effectively place Guernsey out of step with accepted practice for schemes of arrangement. Any such concerns are unfounded. Of course, there are circumstances where a dissentient shareholder (or those who give no opinion) will be 'dragged along' with the majority favouring a transaction and this regularly occurs in Guernsey on takeover schemes, where there is a third party bidder. The difference here regarding the Puma transaction is that while the specific takeover provisions in the Companies Law provide a mechanism to compel shareholders to sell in certain circumstances, they do not impose any restrictions or special requirements for effecting takeovers by other means. That is the important distinction that the Royal Court was careful to recognise.

The transaction proposed by Puma was highly unusual and not one seen either here in Guernsey or in the UK before – it was in effect a 'takeover' by the Majority Shareholders paid for by the company. Puma did not identify any examples from other jurisdictions where schemes of arrangement have been used to give selective share buy-backs compulsory effect. It is also highly unusual for a scheme of arrangement to be refused sanction on discretionary grounds, as schemes of arrangement are normally carefully constructed to avoid these problems.

The fact that the Bailiff was, in any event, not satisfied on the evidence that the majority of shareholders voting on the Scheme had acted bona fide in the interests of the class as a whole is a significant finding. While fact sensitive, it makes clear that the court sanction process is not simply a rubber stamp exercise and the Royal Court's discretion to approve a scheme of arrangement should not to be taken lightly by those promoting these arrangements.

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