Article

Adventures in Wonderland

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Once upon a time, long, long ago, the Queen of Hearts would proclaim in a fanciful way: "Off with their heads!" at the slightest sign of difficulty with her subjects in Wonderland.

Over one-and-a-half centuries after those royal proclamations, the headcount test for shareholder schemes of arrangement has been axed in the Cayman Islands. The Companies (Amendment) Act 2021 (Commencement) Order 2022 sees the Companies (Amendment) Act 2021 in force on 31 August 2022, introducing a new section 86(2A) into the Companies Act (2022 Revision):

"If seventy-five per cent in value of the members or class of members, as the case may be, present and voting either in person or by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the members or class of members, as the case may be, and also on the company or, where a company is in the course of being wound up, on the liquidator and contributories of the company."

Members' schemes of arrangement for companies incorporated in the Cayman Islands, so oft used in privatisations of listed companies in the wonderland that is the M&A market, no longer need to be approved by a majority in number of the scheme shareholders. The jurisprudence[1] on the seemingly difficult issue of the headcount test or numerosity problem, in which some may find a comparison with the literary nonsense genre of Lewis Carroll's 'Alice's Adventures in Wonderland' (1865), can be put on the ceremonial bonefire (literally a fire of bones). Even the judiciary will surely be as happy as Alice to be freed from this particular rabbit hole and to stoke that bonfire, to use the modern derivation.

The very term 'scheme of arrangement' is somewhat archaic but, in this context, a scheme is simply an agreement between the target company and 75% of its shareholders whereby shares are compulsorily transferred to the offeror, or the shares are cancelled, in return for payment of the scheme consideration. The result is that the offeror ends up owning 100% of the target company.

The scheme must be sanctioned by the court but the court process is straightforward and involves a summons for directions, a petition and two hearings. At the first hearing, directions are obtained on the manner in which the meeting of the scheme shareholders is to be convened and held. The composite scheme document is then despatched by the target company to the shareholders. The shareholders meeting is held and the scheme approved. A few days later the second hearing, the petition hearing, is held and the scheme is sanctioned by the court. The scheme is effective when the court order sanctioning the scheme is delivered to the Registrar of Companies for registration, after the satisfaction of any conditions to the scheme.

The scheme shareholders will normally form one class of shareholders. A class will be created if shareholders have rights, against the target company pursuant to the scheme, which are so dissimilar as to make it impossible for them to consult together with a view to their common interest. The test is a test of the way in which those rights are affected by the scheme and does not depend upon the similarity or dissimilarity of their interests which derive from these rights[2]. Different commercial entitlements between members of the same class do not result in different classes[3]. Applying the test, the real question is whether the scheme is a single arrangement or multiple arrangements. Undertakings by scheme shareholders to vote, even if irrevocable, do not usually mean those particular scheme shareholders constitute a separate class unless those scheme shareholders receive special inducements or benefits pursuant to the scheme.

If the bidder already owns shares in the target company, the bidder's shares are unlikely to form part of the scheme shares, or if they do and the bidder does not undertake not to vote, then the bidder is likely to form a separate class and it will be difficult, but not necessarily

[1] Cases such as *In the Matter of Little Sheep 2012 (1) CILR 34* (in which the author acted; surely a crowning moment for Lamb to act in Little Sheep) and *In the Matter of Alibaba.Com Limited [2012] (1) CILR 272 and Practice Direction No. 2 of 2010 (GCR O.1,r.12)*.

[2] Bowen LJ in *Sovereign Life Assurance Company v Dodd* (1892) 2 QB 573; *Re Hawk Insurance Company Limited* [2001] EWCA Civ 241; *Re SABMiller plc* [2016] EWHC 2153 (Ch).

[3] *Re Hawk Insurance Co Ltd* [2001] 2 BCLC; *Eurobank Corporation (In Liquidation)* [2003] CILR 205; Re BTR plc [2000] 1 BCLC 740; Ocean Rig UDW Inc [2017] (2) CILR 495.

impossible, for the bidder to vote in the same class as the rest of the scheme shareholders. In this respect a scheme will be similar to a merger where a majority of the minority requirement has been agreed.[4]

From the buy side perspective, schemes of arrangement have many advantages including the fact that, unlike in most mergers of Cayman Islands companies, dissentient shareholders do not have an appraisal right whereby they can ask the Grand Court to assess the fair value of their shares. Almost any means to avoid the inevitable '238 appraisal litigation' which attends mergers these days must surely be welcome by buyers. Instead, in a scheme the court must merely be satisfied that the scheme is one that an intelligent and honest person, acting in respect of their interests in the relevant class of scheme shares, might reasonably approve. The Grand Court[5] has recognised that the scheme shareholders are the best persons to judge their own commercial interests and the reasonableness of the terms of the scheme such that the commercial details of the scheme are not a matter for the court, provided the scheme as a whole is found to be fair. This is far different from the valuation process the court undertakes if dissentient shareholders validly exercise their appraisal rights in mergerland.

In the U.S. market, where take-private mergers have been prevalent since Tongjitang Chinese Medicines Company first took advantage of the newly minted merger provisions in the Companies (Amendment) Law 2009, the risk of appraisal proceedings is often high and a scheme of arrangement may once again become a popular alternative for those companies traded on a U.S. exchange which are thinking about a take-private transaction for a variety of reasons, notwithstanding the recent agreement between the PCAOB and the CSRC. An added bonus for share exchange schemes is the availability of a '3(a) (10) exemption' from the registration requirements of the Securities Act of 1933.

Although the Cayman Islands has stolen a march on her competing jurisdictions, perhaps Bermuda and the British Virgin Islands will follow suit.

"Full scheme ahead!", said Alice in Wonderland.

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[4] The requirements of an applicable Takeovers Code will have a significant bearing on these requirements. For example, rule 2:10 of the Hong Kong Code on Takeovers and Mergers requires (a) the scheme to be approved by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy at the shareholders meeting; and (b) the number of votes cast against the scheme to be not more than 10% of the votes attaching to all disinterested shares. The term "disinterested shares" means shares in the company other than those which are owned by the offeror or persons acting in concert with the offeror. Persons acting in concert are persons who, pursuant to an agreement or understanding (whether formal or informal), actively cooperate to obtain or consolidate "control", defined to mean the acquisition of 30% or more of the voting rights of the company.

[5] Bestway Global Holdings Inc. (FSD 208 of 2021 (unreported)) citing Barclays Bank PLC [2019] EWHC 129 (Ch).