CLEARY GOTTLIEB

ALERT MEMORANDUM

UK Bid Activism – Two Recent Examples of Disclosure and Fairness Objections in Schemes of Arrangement

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Bumpitrage in UK bids being implemented by scheme of arrangement

So-called "bumpitrage" refers to the intervention of a shareholder activist in a public bid to attempt to force the bidder into improving the terms of the bid.

Most public bids in the UK market are implemented by scheme of arrangement. When it becomes effective, a scheme of arrangement results in the transfer of all of the shares of the target to the bidder including the shares of target shareholders who decided not to vote on the scheme or to vote against the scheme.

Given that a scheme binds all of the target shareholders, the scheme has certain inbuilt features which are designed to ensure fairness. These features include the fact that a scheme must be approved by: (i) by target shareholders at a target shareholders meeting[1]; and (ii) by the court.

After the target shareholder meetings have been held and at the end of the scheme process, the court will hold a hearing to determine whether to approve the scheme. The function of the court in exercising its power of approval is principally to determine whether:

— The applicable regulatory requirements have been complied with (the first condition);

— There has been coercion of the minority shareholders by the majority of shareholders (the second condition); and

— The scheme is such that a target shareholder might reasonably approve (the third condition).

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

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[1] By a majority of at least 75% by votes cast, and a majority in number, of target shareholders present and voting at the target shareholder meeting.

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In relation to the first condition, if the scheme documentation sent to target shareholders does not comply with the requirements of:

— the UK Companies 2006 Act, which requires that target shareholders be given sufficient information to reach a sensible decision on the bid, or

— the UK Takeover Code, which sets out detailed disclosure requirements in respect of documents issued in connection with a Code transaction,

there is a risk that the court could determine that the first condition has not been satisfied. The court will not normally refuse to approve a scheme on the basis of de minimis inadequacy in the disclosure. However, the court is likely to refuse to approve a scheme in circumstances where the evidence establishes that target shareholders would have voted in a different way had the relevant matters been duly disclosed to them before the target shareholders meeting.

In relation to the third condition, the court will not readily depart from the decision on the commercial merits of the bid taken by target shareholders particularly in circumstances where the bid has been recommended by target directors having taken advice on the financial merits. The question for the court is not whether the scheme under consideration is the best transaction potentially available to target shareholders – it is whether a target shareholder might reasonably approve it.

One of the tactics undertaken by bumpitraging activists in UK bids implemented by scheme of arrangement is to seek to exploit the minority protections in schemes in an attempt to force the bidder into increasing its bid price. One of the methods of doing this is to make objections at the court hearing to approve the scheme.

Recent examples of bumpitrage in schemes

There have been two interesting examples of shareholder activists seeking to bumpitrage recent UK bids implemented by scheme of arrangement by arguing at the court hearing that the relevant schemes failed:

— the first condition, on the basis that the disclosure in the scheme documentation provided to target shareholders was defective and inadequate; and

— the third condition, on the basis that the bid undervalued the target and its prospects.

In each of these examples, the bumpitraging activists appeared to have been concerned that the board of the target did not negotiate a sufficient premium and that the bid therefore undervalued the target. These concerns manifested themselves in objections made by the activists that the scheme documentation was inadequate and that the scheme was unfair.

The first example related to the consortium bid for Inmarsat PLC implemented by scheme of arrangement. Inmarsat is a provider of global satellite services. Prior to the bid arising, there had been some uncertainty as to the payments due to Inmarsat under one of its material long term customer contracts. Inmarsat had also made certain disclosures in relation to these uncertainties prior to the bid arising.

The Inmarsat shareholders approved the scheme to implement the bid but activists made objections at the court approval hearing. The activist shareholders argued, amongst other things, that the court should not approve the scheme on the basis that the proposed scheme failed:

— condition one, in that the scheme documentation contained inadequate and unclear disclosure relating to the long term customer contract referred to above; and

— condition three, in that the bid generally undervalued the target and in particular, the target should have negotiated a contingent value right in relation to the long term contract referred to above.

The court approved the scheme despite the objections.

In considering the objections to the scheme based on the alleged inadequacies in the scheme documentation, the court noted that scheme documentation must provide up-to-date information as to the effect of the scheme and the alternatives to the scheme. However, the court rejected the

objections. In particular, given the previous disclosures made by Inmarsat, the court determined that the scheme documentation did not need to go into detail about the uncertainties relating to the customer contracts for shareholders to be able to make an informed decision on the bid.

In considering the objections to the scheme based on the alleged failure to negotiate a better deal (and in particular a contingent value right), the court noted that its role is not to determine whether this was the best scheme possible. The court found that the objectors were simply arguing that a better deal might have been possible. The court emphasised that it was satisfied that that the scheme might reasonably have been approved by an Inmarsat shareholder and, that being the case, an objection would not succeed on the basis that some better deal might theoretically have been possible.

The second example related to the bid by Caesars Entertainment for William Hill PLC implemented by scheme of arrangement.

William Hill has material US operations, some of which are conducted through a joint venture with Caesars Entertainment. Under the terms of the US joint venture, either of William Hill or Caesars Entertainment had certain rights to identify prohibited acquirers in relation to the other and had a right to terminate the joint venture if any of the identified prohibited acquirers obtained control of the other.

Initially, Apollo Management showed some interest in acquiring William Hill. Subsequently however, Caesars Entertainment and William Hill announced a recommended transaction, following which Apollo announced to the market that it would not further pursue an acquisition of William Hill.

A number of William Hill's shareholders were apparently not happy with the bid price offered under the Caesars Entertainment bid and believed that the board of William Hill should have negotiated for more.

The scheme documentation sent to the William Hill shareholders contained a brief description of the prohibited acquirer provisions in the US joint venture between Caesars Entertainment and William Hill. The William Hill shareholders approved the scheme but a number of shareholders and holders of derivative interests in William Hill objected at the court hearing to approve the scheme.

The objectors argued that the court should not approve the scheme on the basis that the scheme was unfair and that the scheme documentation contained an inadequate and unclear description of the US joint venture termination provisions, which misleadingly presented William Hill's interest in the joint venture as a stranded asset with only one possible acquirer (Ceasers Entertainment). The objectors argued that this misleading description gave the incorrect impression that no other bidder other than Caesars Entertainment could realistically bid for William Hill.

The court did reject the objections and approved the scheme. In particular, the court determined that:

- whilst it may be material to disclose to the William Hill shareholders the existence of a termination right in relation to a key business relationship, it did not follow that it was necessary to disclose the precise terms of that termination right to enable William Hill shareholders to make an informed decision on the bid. In particular, while the precise terms of the termination right might have been of particular interest to a bumpitraging activist who bought into the bid to seek to force the bidder to improve the bid terms, disclosure of the precise terms was not necessary for the William Hill shareholders to make an informed decision;
- there was no evidence available that any other William Hill shareholder supported the objections made in relation to the disclosure made by the bumpitraging activists, was actively mislead or would have voted differently at the William Will shareholder meeting; and
- the bid was one which a William Hill shareholder might reasonably approve. The bid was made at a substantial premium and was recommended by the target board having taken advice on the financial terms of the bid. It was not necessary to demonstrate that this was the best possible bid.

Conclusions

Disgruntled shareholder activists frequently attack bids implemented by scheme of arrangement at the court hearing at the end of the scheme process on the basis that the disclosure was inadequate and the scheme unfairly undervalued the target.

Particular care does therefore need to be taken to ensure that the disclosure in scheme documentation does not open the door to criticism by bumpitraging activists. This is especially the case in relation to the description of the rationale for the transaction and the description of the bid process in the "background to and reasons for" section of the scheme documentation.

However, the UK courts have clarified in these recent decisions that the disclosure must be sufficient to enable target shareholder to take a decision on the bid. That does not require the scheme documentation to demonstrate that the bid was the best possible bid or contain inform information which would be necessary to determine whether or not that was the case.

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