Conduct of the investigation

The cases that follow illustrate aspects of the working of the investigatory powers in practice.

In reaching a decision whether to appoint inspectors to investigate the affairs of a company, the Secretary of State is not bound by the rules of natural justice.

[14.01] Norwest Holst Ltd v Secretary of State for Trade [1978] Ch 201 (Court of Appeal)

The facts appear from the judgment.

> LORD DENNING MR: Ever since 1948 there has been a valuable provision of the Companies Act by which the Board of Trade can appoint inspectors to investigate the affairs of a company. Many investigations have been held by inspectors, usually one of Queen's Counsel, and the other an accountant. In a case we had fairly recently, *Re Pergamon Press Ltd* **[14.02]**, we had to consider the position of the inspectors under such an inquiry. It was held by this court that the inspectors were under a duty to act fairly in the conduct of their inquiry.
>
> Now we have to consider a different point. It is said that the minister himself has done wrong. His conduct is challenged. It is said that the minister has acted beyond his powers in appointing inspectors. He ought, it is said, to have warned the company beforehand and given them a chance of being heard. Furthermore, it is said that the minister exercised his discretion erroneously. He ought to have had sufficient reasons, and he had none in this case. It is said further that he is acting on the information of informers, which is inadmissible as being against the public interest.
>
> On these grounds the company has brought an action to try to stop the inspectors proceeding with the inquiry. The minister applied to strike it out. Foster J struck it out. The company appeal to this court …
>
> On 11 March 1977, the Secretary of State ordered the inquiry now in question. He did it under s 165(b)(ii) of the Companies Act 1948 [CA 1985 s 432(2)]. On 25 March 1977, the secretary of the group wrote:
>
> > I am authorised to say that it does not appear to my board that there are any circumstances which would justify the exercise of your discretionary power under the section to appoint inspectors.
>
> He asked: What were the circumstances? Would they be disclosed? The Secretary of State declined to give that information …
>
> As the minister gave no information, the company started this action. They delivered a statement of claim, which they afterwards amended. The burden of the statement of claim is that the company know of no wrongdoing which has been done by them or any of their people; and therefore it is wrong that the minister should appoint inspectors without, as they say, any proper justification. They put it in these words in their final amended pleadings:
>
> > … It is implicit in the provisions of s 165(b)(ii) of the said Act that the discretionary power to appoint inspectors is to be exercised fairly and/or in accordance with the principles of natural justice.
>
> **(p. 733)** They ask for a declaration that the appointment or purported appointment was ultra vires and invalid.
>
> It is important to know the background of the legislation. It sometimes happens that public companies are conducted in a way which is beyond the control of the ordinary shareholders. The majority of the shares are in the hands of two or three individuals. These have control of the company's affairs. The other

shareholders know little and are told little. They receive the glossy annual reports. Most of them throw them into the wastepaper basket. There is an annual general meeting but few of the shareholders attend. The whole management and control is in the hands of the directors. They are a self-perpetuating oligarchy: and are virtually unaccountable. Seeing that the directors are the guardians of the company, the question is asked: Quis custodiet ipsos custodes—Who will guard the guards themselves?

It is because companies are beyond the reach of ordinary individuals that this legislation has been passed so as to enable the Department of Trade to appoint inspectors to investigate the affairs of a company. Mr Brodie, who appears for Norwest Holst Ltd, drew our attention to the practice of the Board of Trade from 1948 to 1962. It was given in evidence to Lord Jenkins' Company Law Committee (1962) (Cmnd 1749). The Board of Trade said (at p 79) that it was very necessary to hear both sides before deciding whether or not an inspector should be appointed. By so doing it is often possible in cases where no fraud is alleged to bring the parties together or for them to reach a mutually satisfactory arrangement so that an investigation is not necessary.

That was the practice before 1962. Mr Brodie submitted that that practice was required by the common law. He said that the principles of natural justice are to be applied; and, accordingly, both sides should be heard before an inspector is appointed.

That may have been the practice of the Board of Trade in those years; but I do not think that this was required by the common law. There are many cases where an inquiry is held—not as a judicial or quasi-judicial inquiry—but simply as a matter of good administration. In these circumstances there is no need to give preliminary notice of any charge, or anything of that sort. Take the case where a police officer is suspected of misconduct. The practice is to suspend him pending inquiries. He is not given notice of any charge at that stage, nor any opportunity of being heard. The rules of natural justice do not apply unless and until it is decided to take proceedings. Other instances can be given in other fields. For instance, the Stock Exchange may suspend dealings in a company's shares. They go by what they know, without warning the company beforehand.

Equally, so far as s 109 [CA 1985 s 447] is concerned, when the officers of the Department of Trade are appointed to examine the books, there is no need for the rules of natural justice to be applied. If the company was forewarned and told that the officers were coming, what is to happen to the books? In a wicked world, it is not unknown for books or papers to be destroyed or lost.

So also with the appointment of inspectors, under s 165(b)(ii). The inspectors are not to decide rights or wrongs. They are to investigate and report. This inquiry is a good administrative arrangement for the good conduct of companies and their affairs. It is not a case to which the rules of natural justice apply. There is no need for them to be given notice of a charge, or a fair opportunity of meeting it. I would say that, so long as the minister acts in good faith, it is not incumbent upon him to disclose the material he has before him, or the reasons for the inquiry.

ORMROD and GEOFFREY LANE LJJ delivered concurring judgments.

Inspectors appointed by the Secretary of State must act fairly, but their function is not judicial or quasi-judicial.

[14.02] Re Pergamon Press Ltd [1971] Ch 388 (Court of Appeal)

Maxwell and others, the directors of a company which was the subject of an investigation ordered under s 165(b) of the Act of 1948 [CA 1985 s 432(2)] had declined to answer questions unless they were first given assurances that, in effect, the proceeding would be conducted as if it were a judicial inquiry. The inspectors, acting under CA 1948 s 167(3) [CA 1985 s 436(2), (3)] referred **(p. 734)** this refusal to the court. The Court of Appeal, affirming Plowman J, held that the directors were not entitled to the assurances.

LORD DENNING MR: [Counsel for the directors] claimed that they had a right to see the transcripts of the

evidence of the witnesses adverse to them … [and] to cross-examine the witnesses [and] that they ought to see any proposed finding against them before it was included finally in the report. In short, the directors claimed that the inspectors should conduct the inquiry much as if it were a judicial inquiry in a court of law in which Mr Maxwell and his colleagues were being charged with an offence.

It seems to me that this claim on their part went too far. This inquiry was not a court of law. It was an investigation in the public interest, in which all should surely co-operate, as they promised to do. But if the directors went too far on their side, I am afraid that Mr Fay, for the inspectors, went too far on the other. He did it very tactfully, but he did suggest that in point of law the inspectors were not bound by the rules of natural justice. He said that in all the cases where natural justice had been applied hitherto, the tribunal was under a duty to come to a determination or decision of some kind or other. He submitted that when there was no determination or decision but only an investigation or inquiry, the rules of natural justice did not apply …

I cannot accept Mr Fay's submission. It is true, of course, that the inspectors are not a court of law. Their proceedings are not judicial proceedings … They are not even quasi-judicial, for they decide nothing; they determine nothing. They only investigate and report. They sit in private and are not entitled to admit the public to their meetings … They do not even decide whether there is a prima facie case …

But this should not lead us to minimise the significance of their task. They have to make a report which may have wide repercussions. They may, if they think fit, make findings of fact which are very damaging to those whom they name. They may accuse some; they may condemn others; they may ruin reputations or careers. Their report may lead to judicial proceedings. It may expose persons to criminal prosecutions or to civil actions. It may bring about the winding up of the company, and be used itself as material for the winding up … When they do make their report, the Board are bound to send a copy of it to the company; and the Board may, in their discretion, publish it, if they think fit, to the public at large. Seeing that their work and their report may lead to such consequences, I am clearly of the opinion that the inspectors must act fairly. This is a duty which rests on them, as on many other bodies, even though they are not judicial, nor quasi-judicial, but only administrative: see *R v Gaming Board for Great Britain, ex p Benaim and Khaida*.[16] The inspectors can obtain information in any way they think best, but before they condemn or criticise a man, they must give him a fair opportunity for correcting or contradicting what is said against him. They need not quote chapter and verse. An outline of the charge will usually suffice.

That is what the inspectors here propose to do, but the directors of the company want more. They want to see the transcripts of the witnesses who speak adversely of them, and to see any documents which may be used against them. They, or some of them, even claim to cross-examine the witnesses.

In all this the directors go too far. This investigation is ordered in the public interest. It should not be impeded by measures of this kind. Witnesses should be encouraged to come forward and not hold back. Remember, this not being a judicial proceeding, the witnesses are not protected by an absolute privilege, but only by a qualified privilege … It is easy to imagine a situation in which, if the name of a witness were disclosed, he might have an action brought against him, and this might deter him from telling all he knew. No one likes to have an action brought against him, however unfounded. Every witness must, therefore, be protected. He must be encouraged to be frank. This is done by giving every witness an assurance that his evidence will be regarded as confidential and will not be used except for the purpose of the report. This assurance must be honoured. It does **(p. 735)** not mean that his name and his evidence will never be disclosed to anyone. It will often have to be used for the purpose of the report, not only in the report itself, but also by putting it in general terms to other witnesses for their comments. But it does mean that the inspectors will exercise a wise discretion in the use of it so as to safeguard the witness himself and any others affected by it. His evidence may sometimes, though rarely, be so confidential that it cannot be put to those affected by it, even in general terms. If so, it should be ignored so far as they are concerned. For I take it to be axiomatic that the inspectors must not use the evidence of a witness so as to make it the basis on an adverse finding unless they give the party affected sufficient information to enable him to deal with it.

It was suggested before us that whenever the inspectors thought of deciding a conflict of evidence or of

making adverse criticism of someone, they should draft the proposed passage of their report and put it before the party for his comments before including it. But I think this also is going too far. This sort of thing should be left to the discretion of the inspectors. They must be masters of their own procedure. They should be subject to no rules save this: they must be fair. This being done, they should make their report with courage and frankness, keeping nothing back. The public interest demands it. They need have no fear because their report, so far as I can judge, is protected by an absolute privilege …

SACHS and BUCKLEY LJJ delivered concurring judgments.

➢ Notes

1. In later proceedings (reported as *Maxwell v Department of Trade and Industry* [1974] QB 523), Robert Maxwell claimed that the inspectors had not acted fairly in that, before making their report, they had not first formulated their criticisms of him in tentative form and given him an opportunity of meeting them. The Court of Appeal, affirming Wien J, held that this procedure was unnecessary: it was sufficient that, in the course of the inquiry, all the matters which appeared to call for an explanation or an answer by a witness should have been put to him; and in substance this had been done.

2. In *R v Secretary for Trade, ex p Perestrello* [1981] QB 19, Woolf J held that there was a similar obligation to act fairly, but, again, no requirement to observe the rules of natural justice, in exercising the power to demand production of a company's books and papers under CA 1967 s 109 (CA 1985 s 447).

[14.03] Re an Inquiry into Mirror Group Newspapers plc [2000] Ch 194 (Chancery Division)

Nearly 30 years after **[14.02]**, and after Robert Maxwell's death and the collapse of his business empire, his son Kevin was the subject of a DTI investigation. The Secretary of State had appointed inspectors to look into the affairs of the company (MGN) of which Kevin Maxwell had been a director. Their investigation was put on hold until criminal proceedings against him (in which he was acquitted) had been concluded. Meanwhile, he had been cross-examined at the trial and questioned under other statutory procedures for a total of 61 days. The inspectors required Maxwell to sign an undertaking that he would not disclose information put to him in the course of their questioning, which he was unwilling to do. He also objected that the course which the inspectors proposed to take was unfair and unreasonable (especially since he had no legal representation), and in particular that they intended to question him at length on matters which had already been covered in the previous interrogations. Scott V-C ruled that his objections were largely justified.

SIR RICHARD SCOTT V-C:… There are two issues in this case. First, there is the issue of confidentiality. Are inspectors who have been appointed under Part XIV of the Companies Act 1985 entitled **(p. 736)** to demand of a person who is placed under a statutory obligation to attend before them and answer their questions that the person enter into an undertaking of confidentiality on the lines of that which Mr Maxwell was asked to sign or, indeed, any confidentiality undertaking at all?

This issue is one of general importance. As I have said, it appears to be the general practice of inspectors to insist on being given confidentiality undertakings. Are those who appear before them obliged to comply?

Second, there is an issue as to what, if any, limits there are on the right of inspectors to require officers and agents of a company under investigation to attend before them and assist them in their investigation. Is there a point at which the demands made by the inspectors become so onerous that a witness's refusal to co-operate becomes excusable? If there is such a point, has it been reached in the present case?…

The confidentiality issue

… I do not accept that the inspectors have any legal obligation to those from whom they obtain information or documents to insist on confidentiality undertakings being given by others before whom, for the purposes of their inquiry, they wish to put the information or documents. If they wish to preserve and protect the confidentiality of the information and documents, they need do no more than make sure that every person to whom the information is communicated, or before whom the documents are put, is on notice of their confidential character. Such a person would not be inhibited by being given such notice from making use of the information and documents for the purpose of answering the inspectors' questions. He could take advice from lawyers and others. He could consult others who had been involved, in order to check his recollection or remedy his lack of recollection. In doing so he would not, in my judgement, be in breach of any duty owed either to those from whom the information and documents had originated or to the inspectors. If, on the other hand, the new witness were to disclose the contents of the documents or information for a purpose not connected with the purposes for which they had been supplied to him, he would, in my view, prima facie commit a breach of duty to those from whom the information or documents had been obtained …

Unfairness and oppression

The starting point is the statutory obligation of persons such as Mr Maxwell to answer relevant questions put to them by Companies Act inspectors … None the less, the assistance that those on whom the statutory obligation is placed must give is not unlimited. They must give the assistance that they are 'reasonably able to give'. The word 'reasonably' limits the extent of their obligation. To put the point another way, the inspectors cannot place demands on them that are unreasonable, whether as to the time they must expend or the expense they must incur in preparation for the questions or in any other respect …

In my opinion, the inspectors should do their best to avoid questioning Mr Maxwell on topics on which he has been questioned before. They should, so far as possible, rely on the answers he has given in previous interrogations …

All the circumstances must, in my judgment, be taken into account in deciding whether or not assistance which a person is, in an absolute sense, able to give is also assistance which he is reasonably able to give. But, if, in all the circumstances, the demands made on the person go beyond what he is reasonably able to give, his failure to comply with the demands will not be a breach of his statutory duty and should not be treated as a contempt of court …

[His Lordship accordingly declined to rule that Maxwell had been in contempt.]

➢ Note

In *Re Attorney General's Reference (No 3 of 1998)* [2000] QB 401, CA, the court was asked to rule on the meaning of the phrase 'to provide an explanation' of documents which had been produced to inspectors under CA 1985 s 447. It was held that this was not limited to giving an **(p. 737)** exposition of the text of the document, but covered 'not only the contents, but also the date of creation, the authorship, provenance, accuracy, completeness, intended purpose, destination and significance of the document or its contents, and of the use to which it was in fact put', and also (subject to a test of reasonableness) to explain discrepancies between the documents and other evidence.

Inspections and the privilege against self-incrimination

A person who is being interviewed by inspectors has no privilege against self-incrimination. In *Re London United Investments plc* [1992] Ch 578 it was held that this common law privilege had been impliedly abrogated by CA 1985 Pt XIV. This means that the person is compellable to answer questions put to him, on pain of punishment for contempt of court if he refuses. There is similarly no privilege where a person is being examined (eg as to the

causes of a company's insolvency) under the provisions of IA 1986 s 236: *Bishopsgate Investment Management Ltd v Maxwell* [1993] Ch 1, CA.

Indeed, in *Re an Inquiry under the Company Securities (Insider Dealing) Act 1985* [1988] AC 660, HL, a journalist, Jeremy Warner, declined to answer questions put to him by inspectors because he felt obliged as a journalist to protect sources of information which had been given to him in confidence. The House of Lords held that this fact did not of itself provide a reasonable excuse, and that he was liable to punishment for contempt.

Inspections and subsequent fair trials—criminal and civil cases

Prior to 1994, courts had ruled in a number of cases that evidence given by a person during an investigation could be used against him in a subsequent criminal trial, or in proceedings brought to have a disqualification order made against him. This was so notwithstanding the fact that he was compellable to give the evidence, even if it was incriminating, on pain of punishment for contempt of court. Evidence obtained under compulsion in other statutory procedures (eg IA 1986 s 236) was the subject of similar rulings.

However, in 1994 the European Court of Human Rights (ECtHR) ruled in the *Saunders* case (*Saunders v United Kingdom* (1996) 23 EHRR 313) that the use of such evidence in a *criminal* prosecution violated the individual's right to a fair trial under Art 6 of the European Convention on Human Rights. Following this decision, the Crown changed its practice and ceased to use evidence so obtained in subsequent criminal trials. Now the law itself has been changed to reflect this: see CA 1985 s 434(5A) and (5B). (Note that notwithstanding the ruling by the Strasbourg Court, Saunders' conviction was upheld by the Court of Appeal: *R v Saunders* [1996] 1 Cr App Rep 463, CA.)

The protection is not absolute, however. For example, both the European Court and UK courts have ruled that disqualification proceedings are not criminal proceedings, but civil proceedings 'of a regulatory nature', in which the use of such evidence involves no infringement of Art 6.[17]

Although *Saunders* prompted legislative change, there is a lack of clarity in the case as to whether the right to silence and the right not to incriminate oneself are absolute rights. Four decisions, *Brown v Stott* [2001] 2 All ER 97, *R v Kearns* [2002] 1 WLR 2815, *Gray v News Group Newspapers Ltd* [2012] 2 WLR 848, CA, and a decision of the ECtHR, *O'Halloran v United Kingdom* (15809/02) (2008) 46 EHRR 21, all suggest that Art 6 may be limited if national authorities have a clear and proper public objective.

(p. 738) Further Reading

ALCOCK, A, 'Five Years of Market Abuse' (2007) 28 *Company Lawyer* 163.
Find This Resource

DAVIES, PL, 'Liability for Misstatements to the Market: Some Reflections' (2009) 9 *Journal of Corporate Law Studies* 295.
Find This Resource

DUFFY, M, 'Fraud on the Market: Judicial Approaches to Causation and Loss from Securities Nondisclosure in the United States, Canada and Australia' (2005) 29*Melbourne University Law Review* 20.
Find This Resource

GILOTTA, S, 'Disclosure in Securities Markets and the Firm's Need for Confidentiality: Theoretical Framework and Regulatory Analysis' (2012) 13 *European Business Organization Law Review* 45.
Find This Resource

HAYNES, A, 'Market Abuse, Fraud and Misleading Communications' (2012) *Journal of Financial Crime* 234.
Find This Resource

HAYNES, A, 'Market Abuse: An Analysis of its Nature and Regulation' (2007) 28 *Company Lawyer* 323.

Find This Resource

VILLIERS, C, 'Implementing the Transparency Directive: A Further Step towards Consolidating the FSAP' (2007) 28 *Company Lawyer* 257.
Find This Resource

Notes:

[1] The government recently amended these provisions, to the effect that companies which are already subject to other disclosure requirements (see later) by virtue of their shares being traded on a 'regulated market', a 'prescribed market' or any other market outside the UK, become subject to less stringent requirements on disclosing shareholder information under CA 2006. See BIS Explanatory Memorandum to Companies Act 2006 (Annual Returns) Regulations 2011, available at:www.bis.gov.uk/assets/biscore/business-law/docs/e/11-813-explanatory-memorandum-annual-returns-regulations.pdf.

[2] See Chapter 5 on changes proposed by BIS on directors' remuneration and reporting on directors' pay. Consultation details available at:http://webarchive.nationalarchives.gov.uk/+/ http://www.bis.gov.uk/Consultations/directors-pay-revised-remuneration-reporting-regulations.

[3] See *Re Globespan Airways Ltd (In Liquidation)* [2012] EWCA Civ 1159, CA, where Arden LJ explained the significance of the filing system and described the role of the registrar within the process.

[4] Note that CA 2006 s 858(1) provides that 'for this purpose a shadow director is treated as a director'.

[5] Eg the Listing Rules require companies to state in their annual reports the extent to which they have complied with the UK Corporate Governance Code (see 'FRC and the UK Corporate Governance Code for listed companies', p 262).

[6] www.hm-treasury.gov.uk/fin_financial_services_bill.htm.

[7] Available at: www.hm-treasury.gov.uk/d/fin_fs_bill_policy_document_jan2012.pdf.

[8] See: http://ec.europa.eu/internal_market/securities/transparency/index_en.htm and http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/11/734&format=HTML&aged=1&language=EN&guiLanguage=en.

[9] See PL Davies, 'Liability for Misstatements to the Market: Some Reflections?' (2009) 9 *Journal of Corporate Law Studies* 295.

[10] The UK list of 'regulated markets' are all operated by RIEs. 'Regulated market' is also sometimes used to refer to markets which are protected from insider trading by the Criminal Justice Act 1993 Pt V (see 'Insider dealing: criminal protection (Criminal Justice Act 1993 Pt V)', pp 730ff).

[11] See: www.hm-treasury.gov.uk/fin_euintl_dossier_prospectus_directive.htm.

[12] This exemption applies in practice to debt securities and convertibles intended for the wholesale market (professional investors) rather than the retail market (general public).

[13] The Commission has made proposals for a Regulation on insider dealing and market manipulation (market abuse) to strengthen the current provisions contained in the Market Abuse Directive. It is aimed that the rules as amended will prove more fitting in the modern markets, especially in relation to market abuse practices that take place in commodity and derivative markets.

[14] Note also EC Commission proposals on a uniform standard of criminal sanctions across member states, in order to increase the effectiveness of the criminal regime, and thus increasing the deterrent effect of such sanctions: http://ec.europa.eu/internal_market/securities/abuse/index_en.htm.

[15] Although the CLR found the length of investigations to be often necessary and certainly difficult to control, CA 2006 Pt 32 nevertheless indicates a legislative desire to control proceedings more closely and terminate them when necessary (see the new CA 1985 ss 446A and 446B inserted by CA 2006 s 1035).

[16] [1970] 2 QB 417.

[17] See *DC, HS and AD v United Kingdom* [2000] BCC 710, ECtHR; and *Re Westminster Property Management Ltd* [2000] 2 BCLC 396, CA.

15. Reconstructions, Mergers and Takeovers

Chapter: **(p. 739)** 15. Reconstructions, Mergers and Takeovers
Author(s): Len Sealy and Sarah Worthington
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General issues

Companies can generally undertake the full gamut of normal business activities using no more than basic company and common law rules, assisted by market forces: they can expand and contract, change business focus, undergo shifts in corporate control, and make various advantageous contractual arrangements with members and creditors and the like. But when companies want to act rapidly and decisively, or enter into arrangements with large numbers of members or creditors, or effect mergers with other corporate entities, or de-mergers of their own conglomerate business, then some more efficient way of proceeding is essential.

Modern company law provides three formal mechanisms to facilitate major corporate reconstructions:

(i) arrangements or reconstructions under the Insolvency Act 1986 (IA 1986) ss 110–111 (see 'Schemes of reconstruction under IA 1986 ss 110–111', pp 741ff);
(ii) arrangements, reconstructions, mergers or divisions under the Companies Act 2006 (CA 2006) Pts 26 and 27 (see 'Arrangements and reconstructions under CA 2006 ss 895–901', pp 744ff);
(iii) takeovers under CA 2006 Pt 28 (see 'Takeovers', pp 753ff).

Companies make use of these provisions for a variety of reasons. They may want to restructure the mutual rights and obligations of the company and its members or creditors. Economic motivations may prompt them to expand the company's business, whether by diversification, vertical integration (with companies performing other functions in the production process chain) or horizontal integration (with companies at the same stage in the production process). Alternatively, financial or fiscal considerations may prompt changes that will reduce liability to tax or improve the balance sheet.

Meaning of the terms

The terms employed in this chapter are commonly used without any great precision, but some generalisations are possible.

A '*reconstruction*' is usually the transfer of the undertaking and business of a company (or, sometimes, several companies) to a new company specially formed for the purpose. The old company is put into liquidation and its members, instead of being repaid their capital by the liquidator in cash, agree to take equivalent shares in the new company. The result of this is that the same members carry on the same or some part of the same enterprise through the medium of a new company. The simpler set of statutory provisions governing this procedure is contained in IA 1986 ss 110–111 ('Schemes of reconstruction under IA 1986 ss 110–111', pp 741ff).[1] The sanction of the court is not required, but a dissenting member may always **(p. 740)** require that he or she be paid out in cash rather than take the new shares. Creditors who do not agree to look to the new company for payment of their debts may prove in the liquidation of the old company.

This procedure is popular with private and family companies, and with investment trust companies undergoing restructuring. The process can enable the creation of a new company with wider or different objects, or a change in the rights of classes of members, or a necessary reorganisation prior to a de-merger which splits the company's businesses into more discrete units.

A '*merger*' or '*amalgamation*' takes place when the assets and undertakings of more than one company are brought under the ownership and control of a single company, which may be one of the companies involved or a

new one. The result is that the shareholders who were members of the several amalgamating companies now together own and control the same enterprises as one aggregated venture. In a straightforward case, the procedure laid down by IA 1986 s 110 may be used. In more complicated cases, the other procedures are used.

Much the same consequences of merger and amalgamation may follow from a '*takeover*', which is a general term used to describe the acquisition by one company (or by one or more individuals, or by a group of companies) of the share capital (all or part) and control of another, usually by buying all or a majority of its shares ('Takeovers', pp 753ff). In the ordinary case, the company taken over is the smaller; in a '*reverse takeover*', a smaller company gains control of a larger one.[2] An offer addressed to all the shareholders of a company to buy the shares of each member at a stated price is known as a 'takeover bid'. It is usually expressed to be conditional upon a designated percentage of shares being accepted by a given date. This is commonly set at 51%, which is a sufficient majority for the bidder to replace the board of directors. Alternatively, it may be as high as 90%, because CA 2006 s 979 permits a company that has acquired 90% or more of a company's shares by a takeover bid to buy the remaining shares compulsorily, and conversely s 983 empowers the minority shareholders in such a situation to insist on being bought out.

Where the company making a takeover bid offers to exchange its own shares for those in the company being acquired, rather than make a bid for cash, the result is to all intents and purposes an amalgamation of the two companies as described earlier.

A '*scheme of arrangement*' or a '*reconstruction*' under CA 2006 Pts 26 and 27 (additional requirements for public companies) enables a company to effect mergers and amalgamations, and also to alter the rights of its members *or its creditors*, with the sanction of the court. The provisions are sufficiently wide to accommodate schemes having a considerable diversity of objectives and range of complexity, which may involve more than one company. The more elaborate kinds of merger will usually need to be dealt with under these sections, as will any scheme of reconstruction which is intended to affect creditors (and especially debenture holders) as well as shareholders. Unless the court orders otherwise, the members or creditors who dissent are nevertheless bound to accept the terms of the scheme. In contrast with IA 1986 s 110, there is no liquidation of the company or companies involved.

Corporate businesses may, of course, be split up as well as aggregated. The most common procedure by which part of a company's assets and undertaking is sold off is usually referred to as '*hiving down*'. The company forms a subsidiary and vests the assets in question in its name, or transfers the assets to an existing subsidiary, and sells the shareholding in that subsidiary to new owners. These may include the managers of that part of the business who have hitherto been employees of the vendor (a '*management buy-out*'). Alternatively, there may be a simple sale of the assets, either for cash or in consideration of the allotment of shares in the purchasing company to the vendor, or to the shareholders of the vendor if it is a company. **(p. 741)** This last type of transaction, which is not common in this country, is known as a '*division*'[3] or a '*de-merger*'.

A merger or division that involves a public company and is achieved by a transfer of *assets and undertaking* in consideration of the allotment of shares in the transferee company to the former shareholders of the transferor must observe the requirements of CA 2006 Pt 27 (which modifies or excludes some of the provisions in Pt 26). These provisions implement the Third and Sixth EU Company Law Directives, although the independence requirements for experts and valuers in CA 2006 ss 936 and 937 are new, and correspond with the independence requirements for a statutory auditor (s 1214). The provisions have less impact than might be supposed, however, since the standard procedures for takeover and hiving down usually involve the purchase and sale of *shares* and not of assets.

Finally, the *economic* consequences of a merger may be such as to create a monopoly or other situation or one which distorts competition. Both the EU and successive governments in the UK have enacted measures which have as their object the control of mergers, as part of the wider legislation designed to promote competition and regulate restrictive and anti-competitive practices. These statutes and the associated regulations often impose additional restrictions, especially on large-scale mergers.

Schemes of reconstruction under IA 1986 ss 110–111

Under this type of reorganisation, the company resolves, first, to go into voluntary liquidation (members' or creditors'), and, secondly, to authorise by special resolution the transfer by the liquidator of the whole or part of the company's business or assets to another company (or limited liability partnership (LLP)) in consideration of shares in that company (or membership of the LLP).

The procedure provides a relatively simple method for reconstructing a single company or effecting a simple merger or takeover. Its advantage is that court approval is not generally required.[4] But its use is limited. The liquidator must ensure that the creditors' proved claims are met, and cannot rely on any indemnity given by the acquiring company.[5] And in a members' voluntary liquidation, dissenting members have a right to veto the scheme, or to be bought out at a price determined by agreement or arbitration (*an appraisal right*).[6]

A company cannot by a provision in its constitution authorise a scheme of reconstruction which disregards the rights of dissentients under IA 1986 s 111.

[15.01] Bisgood v Henderson's Transvaal Estates Ltd [1908] 1 Ch 743 (Court of Appeal)

The company in general meeting resolved to carry out a scheme whereby each fully paid £1 share was to be exchanged for one £1 share in a new company, to be credited as paid up to an amount of 87½p. Under the scheme, the 'new' shares of those who dissented were to be sold en bloc for what they would fetch, and the proceeds distributed pro rata amongst them. **(p. 742)** The company's memorandum and articles purported to authorise such a transaction; but it was held to be unlawful.

> The judgment of the court (COZENS-HARDY MR and FLETCHER MOULTON and BUCKLEY LJJ) was delivered by BUCKLEY LJ: The question involved is whether by clauses even in the memorandum of association of a company limited by shares the limit upon the shareholder's liability can be raised—whether the constitution of the company can provide that the majority may impose upon the minority a scheme under which the member must either come under an increased liability or accept such compensation as the scheme offers him. Section 161 of the Companies Act 1862 [IA 1986 s 111] protects the dissentient member by securing him the value of his interest to be determined by arbitration or agreement. The purpose of schemes such as that here in question is to evade or escape the provisions of that section. Their object is to impose upon the shareholders what is generally called an assessment—to require that in a limited company after the shares are fully paid the shareholder must either come under liability to make further contributions to capital or submit to take, not the value of his interest to be determined by arbitration or agreement, but such satisfaction as the scheme offers him. That satisfaction commonly means, and in substance means in this case, the surrender of his interest in the company …
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> The question is whether the reorganisation scheme contained in the agreement and resolutions is intra vires. The argument is that it is because it is justified by clauses in the memorandum of association …
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> The purpose of the memorandum and articles … is not confined to defining and limiting the purposes of the corporation; it extends also within proper limits to defining and ascertaining the rights of the corporators. I have no doubt that within proper limits the memorandum and articles may provide how, as between the corporators, the corporate assets shall be dealt with after liquidation. But in this, as in many matters, there are limits imposed by the statutes. There are matters in respect of which the constitution of the company cannot provide that the corporator shall not enjoy rights and immunities which the statute gives him. For instance, s 82 of the Companies Act 1862 [IA 1986 s 124] empowers a contributory to present a winding-up petition. His right in that respect cannot be excluded by the articles: *Re Peveril Gold Mines* **[16.07]**… Upon a like principle the articles cannot exclude a shareholder from his right of dissent under s 161 of the Companies Act 1862… It is, therefore, not necessarily true that, because there are found in the memorandum and articles clauses such as those upon which the question here arises, the corporators as individuals are contractually bound by them. The question is not whether each individual corporator can bind himself in respect of his distributive share in the assets. The question is whether, consistently with the statutes, the constitution of the corporation can be such that every corporator shall in the matter of distribution—or a fortiori of distribution and further liability—be bound by the vote of the majority …