

Shareholder Activism Dealt a Blow in Australia's Federal Court

IN SHORT

The Situation: In *RBC Investor Services Australia Nominees Pty Limited v Brickworks Limited* [2017] FCA 756 (10 July 2017), an institutional investor sought to dismantle a cross shareholding arrangement between two publicly listed Australian companies on the basis that the cross shareholding was oppressive to minority shareholders. It was alleged that the cross shareholding entrenched the incumbent boards, depressed both companies' share prices and disenfranchised minority shareholders.

The Result: The Federal Court of Australia emphatically dismissed the claim, holding that reasonable directors would not, in this situation, consider maintenance of the cross shareholding to date to be unfair or oppressive.

Looking Forward: In an environment of increased shareholder activism in Australia, the decision will serve as a cautionary tale to would-be activists that the court's role is not to step into the shoes of directors to make commercial decisions about matters where reasonable minds may differ. The judgment serves as an endorsement of long-term and well-documented commercial planning, notwithstanding the challenges presented by shareholder activists.

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The Background

The cross shareholding arrangement was entered into by Brickworks Limited ("Brickworks") and Washington H Soul Pattinson and Company Limited ("Soul Pattinson") more than 40 years ago. At the time of the Federal Court of Australia's decision, each of Brickworks and Soul Pattinson was the largest shareholder in each other.

In the 1980s, one of Australia's largest fund managers, Perpetual Limited ("Perpetual"), acquired shares in both Brickworks and Soul Pattinson. From 2011, Perpetual sought to dismantle the cross shareholding through a range of means, including:

- The proposed appointment of an independent director to the board of Soul Pattinson;
- A proposed *in specie* distribution of all of Brickworks' shares in Soul Pattinson to Brickworks' shareholders;
- A nil premium merger, whereby Soul Pattinson shareholders would be issued shares in Brickworks in exchange for their Soul Pattinson shares, and Brickworks would cancel the shares in it held by Soul Pattinson; and
- The cancellation of all shares held by Brickworks in Soul Pattinson and the appointment of an independent director of Brickworks.

None of Perpetual's proposals found favour with the board of either Brickworks or Soul Pattinson. Perpetual's case was that the boards' failure to dismantle the cross shareholding was not in the interests of members as a whole, unfair or oppressive.



Proof of mere prejudice to, or discrimination against, a member is insufficient. The test is objective and looks to the effect of the impugned acts, not the motives behind such acts.



The Decision

Her Honour Justice Jagot articulated the test of oppression to be conduct or a decision that reasonable directors would consider unfair. Proof of mere prejudice to, or discrimination against, a member is insufficient. The test is objective and looks to the *effect* of the impugned acts, not the motives behind such acts.

In dismissing the claim, the Court held that directors of both boards had diligently discharged their obligations to act in the best interests of the company and that the cross shareholding had facilitated long-term strategic decision-making and commercial stability. The claimant failed to establish that the cross shareholding had negatively affected the companies' share price or that the unwinding of it would deliver value for shareholders.

Implications of the Decision

In putting to the boards of Brickworks and Soul Pattinson its various proposals for the unwinding of the cross shareholding arrangement, Perpetual was able to bring great pressure to bear. In its capacity as a shareholder (of both companies) with at least five percent of the votes that could be cast at a general meeting, Perpetual was able to convene general meetings of both companies and require resolutions to be put to those meetings, including resolutions for the appointment of directors.

FOUR KEY TAKEAWAYS

1. Australia's corporations law can be utilised to great effect by shareholder activists to disrupt a company's agenda and generate the attention of the media and the market.
2. In this emerging era of robust shareholder activism, boards should be prepared for greater scrutiny of their decision-making by shareholders and the public alike.
3. Directors should diligently consider proposals put to them by shareholder activists, consistent with their obligations to act in the best interests of the company. Such decision-making should be carefully documented with a view to demonstrating that the directors have discharged their duties.
4. This approach by directors is important because, in an oppression suit, the court will not second-guess commercial decisions made by the board. Rather, the court will consider, through the lens of reasonable directors, whether the impugned conduct was unfair.

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