All Above Board on the Orient Express: Bermuda Share Structure Confirmed

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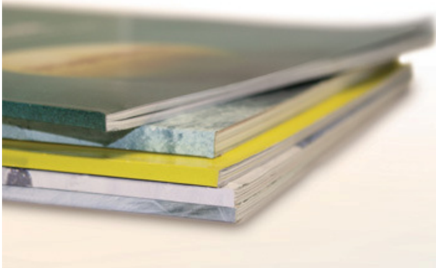

BY JOHN RIIHILUOMA

In DE Shaw Oculus Portfolios LLC et al v. Orient Express Hotels Limited et al [2010] BDA LR 32 the Supreme Court of Bermuda, Ground C.J ruled that it was not unlawful for a subsidiary to hold and vote shares in its parent. In doing so it confirmed the decision of the Supreme Court of Bermuda in Stena Finance B.V. v. Sea Containers Ltd [1989] BDA LR 71 ("Sea Containers"), where Astwood C.J ruled, "a Bermuda subsidiary may purchase for its own account shares in its parent."

Orient-Express Hotels Limited ("OEH") is a Bermuda company which is listed on the New York Stock Exchange. Prior to its listing OEH was structured so that it had two classes of shares: A Shares which were subsequently listed and sold to the public and; B Shares which were held by OEH's subsidiary Orient-Express Holdings No.1 Limited ("Holdings").

The B Shares were voting shares and were capable of controlling a general meeting of OEH. There were overlapping directorships between OEH and Holdings. OEH's prospectus warned:

> "*Those [overlapping] directors, should they choose to act together, will be able to control substantially all matters affecting Orient-Express Hotels, including those listed in the preceding paragraph, and to block a number of matters relating to any potential change of control of Orient-Express Hotels.*"

The Petitioners were investment fund companies and they purchased OEH's shares on the open market. The Petitioners brought proceedings in Bermuda under Section 111 of the **Companies Act 1981**, contending that the affairs of OEH were conducted in a manner oppressive or prejudicial to their interests as shareholders. By way of relief, the Petitioners sought orders from the court which would effectively dismantle the subsidiary

shareholding structure.

Preliminary Issues

The matter came before the court on a trial of preliminary issues to determine whether OEH's shareholding structure was lawful. OEH applied to strike out the Petitioner's claim. The trial of the preliminary issues and the strike out application were heard together.

The Petitioners' put forward three arguments in support of their contention that the OEH shareholding structure was unlawful:

1. That the **Sea Containers** case was wrongly decided. The purchase by a subsidiary of shares in its parent is an unlawful reduction of capital and defends the rule in **Trevor v. Whitworth** (1887) 12 App Case 504.

2. The OEH structure offended the common law rule that a subsidiary cannot vote shares that it holds in its parent.

3. Since the **Sea Containers** decision, the **Bermuda Companies Act** had been amended so as to allow a company to purchase shares in itself which are required to be held as non-voting treasury stock. The Petitioners argued that the purchase of shares by a subsidiary in its parent indirectly violated the non-voting provision requirement for holding treasury shares.

A regards the Petitioners' argument that the purchase by a subsidiary of shares in its parent was an unlawful return of capital, Ground C J ruled that he did not consider the subsidiary's capital should be regarded as its parent's. The court did not consider the subsidiary's use of its funds to purchase shares in its parent to be a reduction of the parent's capital, although the Petitioners' argued that this was the economic effect on a consolidated accounting basis. He noted that in England the **Companies Act** was amended to specifically provide that a subsidiary could not purchase shares in its parent. There is no equivalent legislation in Bermuda. Absent Bermudian legislation prohibiting a subsidiary holding shares in its parent, such a shareholding structure is lawful.

The Petitioner's argument that OEH's shareholding structure indirectly offends the non-voting requirement of treasury shares, Ground C J ruled that he did not think that the legislation cast any wider prohibition than a company not being able to vote shares that it purchased in itself as treasury shares.

Common Law Principles

The argument that Holdings voting its shares in OEH offended common law principles, the Petitioners' relied exclusively upon American authority. The Petitioners' were unable to point any English authority to support the proposition that there was a common law prohibition against subsidiary voting shares in their parent.

English legislation now prohibits a company voting shares it controls. Prior to the passage of the English legislation no such prohibition existed. In **Kirby v. Wilkins** [1929] 2 Ch 444, the transfer of shares to trustee on trust for the company was valid and the shares could be voted.

Ground C J ruled that Bermuda common law did not recognise the "*voting principle*" established in American authorities:

> "*… it seems to me that it is implicit in all of it that at that point [prior to statutory prohibition] the English common law did not recognise any common law 'voting principle', which, apart from the intervention of statute, would operate to prevent directors using shares held by a third party "towards maintaining themselves in office," and that similar concerns as those which led to the evolution of the principle in the United States, were in England being dealt with by statutory intervention.*
>
> *That being the case, I consider that the common law of Bermuda is that of England before the intervention of statute. I take it to be trite law that legislative acts of the English Parliament which are not expressly extended to Bermuda have no force here, and that the common law continues in effect until modified by local statute.*"

Ground C J having found the OEH share structure to be lawful struck out the Petitioners' claim. The Petitioners' complaint, absent unlawfulness, was held to be wholly insufficient to justify a winding-up on just and equitable grounds, which is a requirement under the **Companies Act** in establishing entitlement to alternative relief in minority oppression proceedings.

The OEH's decision is welcome. It confirms the **Sea Containers** decision that a subsidiary can hold shares in its parent. Following that decision, parties had structured their companies with subsidiaries holding shares in their parent in the belief that it is lawful to do so. The decision in **Orient Express Hotels Ltd** confirms that this practice is lawful.

John Riihiluoma appeared for Orient Express Hotels Limited.

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