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Is Orient Express Take Over Proof?

9 November 2012

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Index

1. Executive Summary

In order for the now rejected takeover offer made by Indian Hotels Company Limited for Orient Express Hotels Limited ("**OEH**") or indeed any other takeover offer to be successful, the offer would require the support of the OEH Board of Directors for at least 3 reasons namely:

- The unusual capital and ownership structure of OEH under which an OEH subsidiary owns the majority of voting shares in OEH;
- The law of Bermuda permits a subsidiary to hold and vote shares in its parent; and
- Three investment fund shareholders in OEH have already recently tested the OEH ownership structure and the law of Bermuda and failed dismally confirming not only the validity of the ownership structure but also the power of the OEH Board.

However, the matter does not end there. OEH directors have to exercise their powers in the best interests of the company and in so doing they must act honestly, diligently and for a proper purpose. So when confronted with a takeover offer they are required to give it serious, careful and fair consideration and take a measured view as to whether the offer is in the best interests of the company. If they bona fide reach the conclusion in exercise of their management powers that rejection of the offer is in the best interests of the company then it will be extremely difficult to successfully challenge that decision. Such a decision would have to be so manifestly and demonstrably in the interests of shareholders as to defy reason in order for any challenge to have any prospect of success.

2. OEH Investment Risks

OEH's 31 December 2011 Annual Report identifies the following OEH investment risks:

- A subsidiary of the Company, which has two Company directors on its board of directors, may control the outcome of most matters submitted to a vote of the Company's shareholders.
- Provisions in the Company's charter documents, and the preferred share purchase rights currently attached to the class A and class B common shares, may discourage a potential acquisition of OEH, even one that the holders of a majority of the class A common shares might favour.

This is the essence of the problem.

3. OEH Capital Structure & Board Structure

OEH is a Bermuda company listed on the New York Stock Exchange.

OEH has two classes of shares:

- A Shares which are listed voting shares owned by the investing public; and
- B Shares which are voting shares owned by an OEH wholly owned subsidiary namely Orient-Express Holdings No.1 Limited ("**Subsidiary**").

OEH's latest Quarterly Report disclosed that on 1 August 2012, OEH has issued 102,893,231 A Shares and 18,044,478 B Shares.

Each B Share confers voting rights on the holder which are 10 times the voting rights of the holder of an A Share and so the holder of B Shares can control a general meeting of OEH.

The present Board of Directors of the Subsidiary is made up of 4 directors of which two are also OEH directors namely Prudence M. Leith and John D. Campbell and two are independent directors. So at present OEH and Subsidiary Boards overlap. In any event OEH as the sole shareholder in the

Subsidiary determines the composition of the Subsidiary's Board and the OEH Board exercises that power.

On listing its securities in 2000, OEH's prospectus dated 9 August 2000 contained a warning with respect to the OEH directors on the Subsidiary Board in the following terms:

"Those 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."

This is a rather unusual state of affairs. In many jurisdictions around the world this type of structure is no longer lawful. For example in Australia, section 259D of the Corporations Act 2001 specifically prohibits a subsidiary controlling a parent and in the UK, section 136 of the Companies Act 2007 prohibits a body corporate from becoming a member of a company that is its holding company and prohibits allotment or transfer of shares to its subsidiary.

4. Investment Fund Litigation

In 2007, three investment funds associated with DE Shaw ("**Shaw Investment Funds**") acquired about 7% of the A shares in OEH for US$315 million which they purchased on the open market.

Shaw Investment Funds came to the existing voting structure in that they acquired their shares in the knowledge of it.

However, they objected to the control, which Shaw Investment Funds asserted that voting structure gave to the OEH directors and in particular how it enabled the OEH directors to resist any attempt to remove them.

Shaw Investment Funds also objected to certain business decisions of the OEH Board and raised these concerns with the company in writing and at an AGM and then represented an extraordinary general meeting to consider resolutions to dismantle the voting structure. At the extraordinary general meeting which took place on 10 October 2008, although a substantial majority of the A Shares voted in favour of the resolutions to dismantle the voting structure the B Shares were voted by the Subsidiary to defeat the resolutions and so the resolutions failed.

Shaw Investment Funds issued proceedings in Bermuda contending that the affairs of OEH were being conducted in a manner oppressive or prejudicial to their interests as shareholders and sought orders from the court which would effectively dismantle the Subsidiary voting structure.

The case is summarized in a supporting affidavit in the following terms:

".... the structure has been utilized by the Company's directors to amongst other things, assure their own perpetual re-election to the Board, quash a premium takeover offer, destroy an opportunity for a potential strategic transaction, stifle an opportunity for a potential bidding war for the Company at or near its all time high share price, and veto shareholder proposals favoured by 96% of the voting A Shares."

The reference to a takeover premium was to an expression of interest in a letter dated 10 September 2007 from Dubai Group LLC at US$60 per share and the reference to a potential strategic transaction was to an approach by Indian Hotels Company Limited also in 2007 both of which were summarily rebuffed by the OEH Board.

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 claim. Both matters were heard and determined together in **DE Shaw Oculus Portfolios LLC et al v. Orient Express Hotels Limited et al** [2010] BDA LR 32.

On 1 June 2010, the Supreme Court held that the OEH shareholding structure was lawful and struck out the claim by Shaw Investment Funds. In so doing the Court reaffirmed the decision of the Supreme Court of Bermuda in **Stena Finance B.V. v. Sea Containers Ltd** [1989] BDA LR 71

where it was held that "a Bermuda subsidiary may purchase for its own account shares in its parent", and also made the following findings:

- The purchase by a subsidiary of shares in its parent is not an unlawful reduction of capital because the subsidiary's capital should not be regarded as the capital of its parent.
- Under the law of Bermuda there is no common law or statutory rule that a subsidiary cannot vote shares that it holds in its parent and thereby for the parent to control its own affairs.
- The purchase of shares by a subsidiary in its parent does not indirectly violate the non-voting requirement for holding treasury shares, that is, those amendments to the Companies Act which allow a company to purchase shares in itself but if such shares are held as non-voting treasury stock.

As a result the Court found that the complaint was insufficient to justify a winding-up of OEH on just and equitable ground, which is a requirement under the Companies Act to establish entitlement to alternative relief in minority oppression proceedings as was the case here.

This decision provided not only confirmation of the validity of the OEH structure but also the power of the OEH Board.

5. OEH Directors Duties

Under the OEH Charter documents the OEH Directors are charged with the responsibility of making decisions concerning the management and affairs of OEH. There are very few matters which are reserved for a decision to be taken by a general meeting of shareholders. Generally, Courts will not allow shareholders to interfere with the proper exercise of management powers by the Directors.

In exercising those powers each OEH Director (and for that matter each Subsidiary director) has fiduciary duties which he/she must exercise in good faith for the benefit of the company as a whole. These fiduciary duties have four main aspects namely:

- Duty to act in good faith in the best interests of the company and not for any collateral purpose;
- Duty to exercise powers for a proper purpose;
- Duty to avoid conflicts of interest with the company; and
- Duty not to improperly use their position as a director to gain a personal profit for themselves or someone else.

A decision as to whether or not to reject, encourage or pursue a takeover offer are matters which are part of the "business and affairs" of OEH and therefore fall to be decided by the OEH Board under its management powers. Likewise a decision as to how the Subsidiary votes its shares in OEH is a matter which is part of the "business and affairs" of the Subsidiary and is therefore a matter for decision by the Subsidiary Board to decide under its management powers. However, in both cases the respective Boards of Directors are nonetheless each still subject to the proper limits of their fiduciary duties as outlined.

So rejection of a takeover approach motivated by a desire to protect the position of the Board would be an improper purpose and a breach of fiduciary duties whereas rejection of a takeover approach which in objective terms materially undervalues the company does not breach fiduciary duties. Of course rejection of the Indian Hotels' "opportunistic" offer is predicated on the latter. However, distinguishing between the two situations and providing evidence in support is not easy.

In the recent past OEH dismissed takeover approaches from Dubai Group LLC (pre GFC) at US$60 per share and now Indian Hotels at $12.63 per share.

In rejecting Indian Hotels' offer OEH said that it "significantly undervalues [OEH] and its unique assets and is not in the best interests of [OEH] and its shareholders" and the Chairman said that:

- The offer was "deeply unattractive from a financial perspective"; and
- The current macroeconomic environment, conditions in the luxury hotel business and factors unique to OEH would make this a highly disadvantageous time to sell OEH to realize its true value.

Various analysts have suggested values between $15 to $18 per share as being an appropriate value range for OEH. The formal response from OEH to the Indian Hotels offer would seem to be consistent with that view, however, even taking into account the unique nature of the hotel and leisure assets held by the company, the values of the underlying assets required to support such equity values are very difficult to rationalise commercially.

An obvious solution to the problem would be for the shareholders to decide if they wanted the Board to pursue the offer but as the OEH Annual Report states the Board has reserved to itself the right to "discourage a potential acquisition of OEH, even one that the holders of a majority of the class A common shares might favour".

Unlike the UK and Australia there is no "frustrating action" rule in Bermuda which would require OEH shareholder approval to any action which would have the effect of depriving OEH shareholders of the benefit of a takeover offer.

6. Conclusion

The OEH shareholding structure is lawful under the law of Bermuda and it is lawful for the controlling shares to be voted in the manner in which the Subsidiary decides. As a result, the OEH Board indirectly controls OEH shareholder meetings through voting B shares held by the Subsidiary.

Absent the decision in **DE Shaw Oculus Portfolios LLC et al v. Orient Express Hotels Limited** activist shareholders in OEH may have been encouraged to attack the structure but this approach would appear to have little to recommend it in light of the decision that was ultimately made by the Supreme Court of Bermuda.

Decisions about whether to pursue a takeover offer or whether to accept a takeover offer or not are matters which are within the management powers of the directors of OEH and the Subsidiary. Whilst the OEH and Subsidiary directors have to exercise their powers consistently with their fiduciary duties, in the absence of clear evidence of breach of duty it will be very difficult to interfere with the bona fide decisions of the relevant directors as to what actions are in the best interests of the company.

So any acquisition of or merger with OEH can only be friendly and parties who seek to do otherwise can most likely expect to find themselves before the Supreme Court of Bermuda seeking to make new law.

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