

# THE BRICKWORKS-SOUL PATTINSON CROSS- SHAREHOLDING - OPPRESSION DECISION HANDED DOWN FOLLOWING A PERPETUAL BATTLE

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Legal Briefings - By **Paul Branston** and **Jarred Lockhart**

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The Australian Federal Court has recently delivered judgment in a highly publicised case in which institutional investor Perpetual Investment claimed that the maintenance of the cross-shareholding by two of its publicly traded investee companies, Brickworks Limited and Washington H Soul Pattinson and Company Limited, was oppressive to minority shareholders.

## IN BRIEF

- Perpetual was a long-term shareholder in both Brickworks and Soul Pattinson and was of the view that the cross-shareholding of c.40% between the companies had the effect of depressing the Brickworks and Soul Pattinson share prices and that value could be unlocked for shareholders by unwinding the cross-shareholding.
- Perpetual had presented a number of proposals to the Brickworks and Soul Pattinson boards that were designed to unwind the cross-shareholding. Perpetual was dissatisfied with the boards not progressing the proposals and contended that the maintenance of the cross-shareholding was oppressive because it disenfranchised minority shareholders

and entrenched the incumbent boards. Perpetual sought orders that the cross-shareholding be unwound.

- After undertaking an in-depth analysis of the history of the cross-shareholding and the interactions surrounding Perpetual's proposals, Justice Jagot held that the maintenance of the cross-shareholding was not oppressive or unfair in all of the circumstances and dismissed Perpetual's claim with costs.
- Key to Justice Jagot's decision was the Brickworks and Soul Pattinson boards' active consideration of the Perpetual proposals, which demonstrated the directors' seeking to act in the interests of all shareholders and their continuing awareness of their duty to do so.

## **GENERAL BACKGROUND**

Brickworks (a supplier of building products) holds 42.7% of the shares in Soul Pattinson (a diversified investment house with its roots in owning and operating pharmacies) and Soul Pattinson, owns 44.23% of Brickworks. The cross-shareholding was created in 1969 via a share swap as part of a long-term strategy of both boards to achieve diversification of earnings and a degree of takeover protection at a time when takeovers were becoming more common in the Australian market.

The current Corporations Act would prevent the cross-shareholding now being created. However, the maintenance of the cross-shareholding is not unlawful given it was in existence prior to the relevant amendments to the Corporations Act.

At the time the cross-shareholding was established James Millner was the Chairman of Soul Pattinson. He was also appointed Chairman of Brickworks upon creation of the cross-shareholding. The nephew of James Millner, Robert Millner, is currently the Chairman of both Soul Pattinson and Brickworks. Certain relations of Robert Millner are also directors of the companies - Robert Millner's cousin Michael Millner is on the Brickworks board, and Robert's son Thomas Millner and brother in law David Wills are on the Soul Pattinson board. The Millner families and their associated entities hold in aggregate a small percentage (<10%) of the shares in each of Soul Pattinson and Brickworks.

## **THE FACTS**

Perpetual acquired an interest in both companies in the 1980s, after the cross-shareholding was established, and owned around 8.95% in Brickworks and 6.49% in Soul Pattinson at the time the action was commenced.<sup>1</sup>

From 2011 onwards, Perpetual presented five different proposals to the boards of Brickworks and Soul Pattinson that were primarily designed to unwind the cross-shareholding in order to unlock the contended unrealised value:

1. That Robert Fraser be appointed to the board of Soul Pattinson as an independent director following Soul Pattinson appointing Thomas Millner (the son of Robert Millner). Mr Fraser's appointment was not approved at the 2011 AGM of Soul Pattinson.
2. An in specie distribution of Brickworks' shares in Soul Pattinson such that only Soul Pattinson would be left holding shares in Brickworks. This did not proceed due to adverse tax implications.
3. A nil premium merger between the companies. This did not proceed as Brickworks considered that a nil premium merger would result in a transfer of value from Brickworks to Soul Pattinson as its shares were trading at a low point due to conditions in the building industry.
4. A multifaceted restructure (proposed by Perpetual together with another shareholder, Mark Carnegie) that involved the cancellation of all shares in Soul Pattinson held by Brickworks and the appointment of Elizabeth Crouch as a director of Brickworks. This proposal was never put to shareholders because of an unfavourable ruling from the ATO.
5. Perpetual then continued to press for the unwinding of the cross-shareholding through variants of the nil premium merger.

Perpetual contended that the maintenance of, and failure to take steps to unwind, the cross-shareholding entrenched control with the incumbent boards (and therefore the Millner family), thereby disenfranchising shareholders other than the companies and the Millner related entities and that failure to dismantle the cross-shareholding was not in the interests of shareholders as a whole and was therefore unfair and oppressive.

Perpetual sought to rely on a range of matters in attempting to establish that the maintenance of the cross-shareholding in the face of repeated attempts to have it unwound was unfair and oppressive, contending:

- the cross-shareholding was established as an anti-takeover mechanism and could not be created now and it continues to exist to protect the incumbent boards;
- the cross-shareholding depressed the companies' share prices; and
- the Millner family perceived the companies as their 'family business' and the cross-shareholding now exists to vest control in the incumbent boards of the companies, which are controlled or unduly influenced by the Millner family and that influence is used to protect the cross-shareholding and thereby the incumbent boards.

Perpetual sought orders from the Court under sections 232 and 233 of the Corporations Act that the cross-shareholding be unwound within 12 months by a method to be determined by the companies or otherwise the shares sold to reduce the cross-shareholdings to no more than 10% within a further 6 months. Perpetual also sought an order that its director candidates, Mr Fraser and Ms Crouch, be appointed to the boards of Soul Pattinson and Brickworks respectively.

## **THE DECISION**

Justice Jagot addressed Perpetual's submissions regarding the cross-shareholding in detail and in doing so systematically and forensically examined the history of the cross-shareholding and the long history of meetings and written communications between Perpetual and the boards regarding the cross-shareholding, each of Perpetual's proposals and the boards' responses to the proposals.

Her Honour found that whilst the cross-shareholding was established in part to make it more difficult for a takeover of the companies to succeed, it was also established as the companies considered the cross-shareholding to be a good investment including for reasons of diversification, and that the companies shared a view of long-term value creation. Neither company had indicated the cross-shareholding should be maintained irrespective of circumstances.

Her Honour acknowledged that the Millner family did have a history of involvement in the leadership of the companies (and a history of success in that role) but held that it had not been established that there was any undue influence by the Millner family, nor agreement, arrangement or understanding between members of the Millner family or the other directors to exercise their votes a certain way. There was no suggestion that the directors had subordinated their duties as directors to the maintenance of the cross-shareholding in order to entrench control by them and the Millner family.

Justice Jagot held that whilst the cross-shareholding structure could not now be created, that did not establish that any risks it posed had eventuated or unfairness had occurred. The possibility for conflict as a result of the cross-shareholding was recognised, with the key in this regard being that the boards of the companies must remain vigilant about the issues that such a structure might give rise to. In this case neither board could be accused of a lack of vigilance or prudence regarding the effects of the cross-shareholding.

Her Honour considered that Perpetual had not established that the cross-shareholding depressed the companies' share prices or, that if it did, the dismantling would have the effect of increasing the share prices. The cross-shareholding had a range of advantages and disadvantages for the companies and the effect on the companies' share prices could not be predicted with certainty.

Importantly, it was not established that the cross-shareholding had caused any decision adverse to the performance of the companies. There was no evidence of a poor decision affected by conflict of interest or any improvident transactions. The companies' share prices had in fact increased substantially in recent years despite the maintenance of the cross-shareholding and there was no suggestion that the directors and management of the company were not competent or that the cross-shareholding had resulted in the retention of poorly performing management.

Both companies' boards were found to have spent considerable resources actively considering the proposals and the financial and governance implications of the cross-shareholding, including receiving expert advice on the advantages and disadvantages of the potential unwinding of the cross-shareholding. Their decisions to maintain the cross-shareholding were not "kneejerk" reactions - each board had carefully considered the cross-shareholding, the restructuring options and the professional advice based on the circumstances at the time and had reached the view that no option to restructure the cross-shareholding had been identified which presented demonstrable benefits for shareholders compared to the existing structure which had been in existence for 40 years. In addition, the boards were found to be well aware of their obligation to continually consider the companies' structure, and the cross-shareholding, in order to discharge their duties as directors.

Ultimately, Justice Jagot held that reasonable directors or commercial bystanders would not consider the maintenance of the cross-shareholding oppressive or unfair in all of the circumstances and dismissed Perpetual's claim with costs.

## **CONCLUSION**

At a time when shareholder activism in Australia is on the rise, Justice Jagot's decision illustrates the limits of the oppression doctrine in the context of publicly traded, well managed and strongly performing companies. It suggests that in similar circumstances a Court would effectively need to be satisfied that there was conduct equivalent to a breach of directors' duties in order for it to consider entertaining oppression arguments. This indication of the relatively high bar for oppression in a case that involved a cross-shareholding structure unique to Australian markets should serve to steel the resolve of Australian boards in responding to proposals by activist investors in more typical factual scenarios.

## **ENDNOTES**

1. By the time of the judgment Perpetual had sold down and owned approximately 3.06% and 1.46% of Brickworks and Soul Pattinson respectively.

## KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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