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2022 Half-year in review M&A legal and market developments

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We set out below a number of interesting English court decisions and market developments which have taken place and their impact on M&A transactions. This review looks at these developments and gives practical guidance on their implications. Summaries feature below, and you can click where indicated to access more detailed analysis.

Company law

There have been particular cases of interest on a number of company law issues

Existence and content of creditors' interests duty and trigger point

The Supreme Court has confirmed the existence and content of the common law creditors' interests duty and that the duty can be engaged before a company is actually insolvent.

A was a wholly-owned subsidiary of S. A was liable to indemnify B for certain environmental liability. A provision in A's accounts reflected the directors' best estimate of that liability. On the basis of interim accounts, A's directors resolved in December 2008 to reduce A's share capital and pay an interim dividend. In May 2009, the directors resolved to pay a further interim dividend to S. A was then sold to a third party. Both dividends were effected by setting off substantial intra-group debt. At the time the May dividend was paid, A was solvent. However, the environmental clean-up costs turned out to be much higher than expected. A went into insolvent administration in October 2018. As assignee of A's claims, B sought to recover the amount of the May dividend from A's directors on the basis that they had breached the creditors' interests duty by not considering or acting in the interests of A's creditors. The Supreme Court

Key lessons

- **Existence and content of creditors' interests duty:** The judgment is helpful in confirming that the common law creditors' interests duty exists and giving guidance on content. Despite some differences of opinion on certain aspects, the Supreme Court was unanimous on core elements. The nuanced approach on content of the creditors' interests duty may give directors flexibility to adopt the most appropriate approach on a given set of facts.
- **Trigger point for creditors' interests duty:** The Supreme Court was unanimous in rejecting suggestions in the Court of Appeal that a sufficient trigger would be mere likelihood of insolvency at some point in the future. On the other hand, the test set by the Supreme Court clarifies that the creditors' interests duty can be engaged before a company is actually insolvent, being earlier than the test for wrongful trading.

rejected that and unanimously dismissed B's appeal. The Supreme Court confirmed that the common law creditors' interests duty exists. It is not a self-standing duty, but instead modifies the general duty to act in the company's interests, now embodied in the statutory duty to promote the company's success. As such, the duty is not owed direct to creditors and the directors do not have to consider separately the interests of creditors in a special position. The majority of the Supreme Court decided that the creditors' interests duty is triggered when the directors know or ought to know that the company is insolvent or bordering on insolvency or when an insolvent administration or liquidation is probable. Here, there was only a real risk of A's insolvency in the medium to long term, which was not enough to trigger the duty. The Supreme Court unanimously agreed that likelihood of insolvency at some point in the future was not enough. The majority held that, once the creditors' interests duty is triggered, directors should consider and balance the interests of the general body of creditors with those of members. The weight to give to creditors' interests will increase as the company's financial problems become more serious. Where an insolvent liquidation or administration is inevitable, creditors' interests become paramount and those of members cease to bear weight. (*BTI 2014 LLC v Sequana SA & Ors* [2022] UKSC 25)

- **Payment of lawful dividends**: The Supreme Court confirmed that the creditors' interests duty can apply to a directors' decision to pay an otherwise lawful dividend, because the statutory rules on distributions apply subject to any contrary rule of law and there may be a directors' breach of duty in making a distribution where the company is cash flow insolvent or would become so as a result of the distribution.

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Conduct that was unfair but not prejudicial and interaction with directors' "proper purpose"

On a petition for unfair prejudice brought by a minority shareholder in private company C, the High Court decided that C's implementation of a debt for equity swap, involving an open offer that diluted the holding of the minority shareholder who did not accept it, was unfair but not prejudicial, whilst also giving interesting guidance on the lawfulness and effect of mixed purposes on the part of directors.

C was funded by substantial loans from majority shareholder T, who held a 94.22 per cent. shareholding. T had pledged publicly to reduce C's debt. Minority shareholder M held a 3.97% shareholding. T and M's relationship broke down. Following a board resolution, C made the open offer which T was the only shareholder to accept. This increased T's shareholding to 98.3 per cent. whilst reducing M's to 1.18 per cent. T paid for his new shares by writing off £68 million of debt that C owed him. M petitioned for unfair prejudice, alleging that T had been driven by personal vindictiveness rather than a justifiable business purpose and that the two directors (B and D) had just followed his lead without exercising independent judgment nor acting for a proper purpose. The High Court dismissed M's petition. Whilst it accepted that T had been driven by mixed intentions, it decided the pledge to reduce C's debt made business sense and was genuine. Even if T had used his position to pressurise the board, that conduct could not found an unfair prejudice petition as he was not a director and was just acting in a private capacity as shareholder. By contrast, the conduct of directors B and D could in principle found an unfair prejudice petition, but the court decided it did not on the facts. First, they had both had commercial motivations and exercised independent judgment. Secondly, although D (who was T's nominee) had mixed purposes, and had therefore breached his statutory duty to act only for a proper purpose, he would have come to the same decision anyway. The High Court discussed the mixed purposes test advocated by Lord

Key lessons

- **Directors' duty to act for a proper purpose:** The judgment serves as a reminder on the need for directors to exercise their powers for a proper purpose and not for the benefit of one particular shareholder.
- **Interaction between proper purpose and unfair prejudice:** The judgment is interesting for its application of the directors' "proper purpose" test, and the effect of mixed purposes, in the context of an unfair prejudice petition. The issue was not the validity of the share allotment (which was not sought to be unwound) but whether it was unfairly prejudicial. The High Court decided it was not because, despite the director's breach of duty giving rise to unfairness, there was no prejudice to M as he would have come to the same decision anyway.

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Sumption in the Supreme Court in *Eclairs Group Limited v JKX Oil & Gas Plc*[1] that distinguished between the lawfulness of an act and the consequences of any unlawfulness. On lawfulness, a director's duty to act for a proper purpose is breached if there is a single improper purpose. However, on consequences, a decision with mixed purposes will stand if the director would have reached the same decision "but for" the improper purpose: in other words, without it. Here, the High Court applied the same test in the context of the unfair prejudice petition. Despite the breach of the statutory directors' duty to act for a proper purpose which caused unfairness, there was no prejudice because there was still a proper purpose for the share allotment and D would have made the same decision anyway. (*Re Cardiff City Football Club (Holdings) Ltd, Isaac v Tan* [2022] EWHC 2023 (Ch))

Administrators validly appointed by sole director where unamended private company model articles applied

The High Court decided that an appointment of administrators by a sole director of a company with unamended private company statutory model articles was valid, despite a previous High Court decision[2] that the model articles should be amended for a sole director to run a company.

The sole director of private company C appointed administrators. C had only ever had one director since its incorporation. Further, the private company statutory model articles (MA) applied to C in their entirety, and had never been altered or adapted in any way. The High Court applied general rules of contractual construction and said you had to read the articles as a whole. It decided that the administrators had been validly appointed. This differed from the approach in the previous High Court decision in *Re Fore Fitness Investments Holdings Ltd*[2], where the court had held that the MA should be amended for a sole director to run a company, to expressly specify a quorum of one at board meetings and allow a minimum number of directors of one. The decision in *Re Fore Fitness* had been out of line with prior market practice which had given precedence to article 7(2) of the MA (which provides that if the company only has one director, and no provision of the articles requires it to have more than one director, the director may take decisions without regard to any provisions of the articles on decision-making) over article 11(2) (which provides that the quorum for directors' meetings should never be less than two and, if not fixed by the directors, is two). By contrast in *Re Fore Fitness* the court had decided that an article requiring at least two directors to form a quorum at board meetings amounted to a requirement for two directors to manage the company's affairs. In the present case, the court distinguished *Re Fore Fitness* on the basis that the company there had not always had a sole director and had adapted the MA to include some bespoke provisions. The court said it could not have been the legislature's intention that the MA would need to be amended in all circumstances before a sole director could run a company. (*Re Active Wear Ltd* [2022] EWHC 2340 (Ch))

Key lessons

- **Best practice remains to amend the private company model articles where there is a sole director:** Pending any Court of Appeal clarification of these issues, it remains best practice for a sole director company to amend the model articles to expressly specify a quorum, and minimum number, of one director. It also remains advisable to consider whether any key historic decisions of sole directors should be ratified.
- **Significance of appointment of administrators:** In upholding the sole director's action, the court may have been influenced by the desirability of ensuring the validity of the administrators' appointment.
- **Ongoing uncertainties:** The decision continues to raise uncertainties, particularly where a sole director company has had multiple directors at any time and/or combined the model articles with bespoke provisions in the past. Taken literally, it would require investigating the company's past registration profile.
- **Retrospective analysis of validity of past actions:** This nonetheless is a helpful decision, should a retrospective analysis be required on the validity of past actions of sole directors where a "model articles only" sole director company has never had multiple directors.

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1 [2015] UKSC 71.
2 *Re Fore Fitness Investments Holdings Ltd, Hashmi v Lorimer-Wing & Anor* [2022] EWHC 191 (Ch).

Headcount test for scheme of arrangement where nominee shareholders

The High Court has again considered how to apply the headcount test for approval of a scheme of arrangement where shares were held through nominee registered shareholders on behalf of multiple underlying beneficial owners.

The purpose of a proposed scheme of arrangement was to effect a business combination between company C and another business. The scheme was unanimously recommended by C's directors. C's ordinary share capital was held through only two registered holders, acting as nominees for those holding beneficial and economic interests in dematerialised form. The largest single beneficial shareholder held a beneficial interest in around 49.79 per cent. of C's ordinary shares. Under the Companies Act 2006 (the 2006 Act) a scheme of arrangement must be approved by a majority in number representing 75 per cent. in value of members or a class of members present and voting in person or by proxy at the court meeting. The question arose of how to apply the "majority in number" or "headcount" limb of this test where only two registered holders hold shares as nominee of multiple beneficial owners who may give different voting instructions. The High Court sanctioned the scheme, upholding the decision at the convening hearing to allow the nominee shareholders to vote in accordance with the majority wishes of their underlying beneficial holders. This applied the test from the earlier case of *Re GW Pharmaceuticals Plc*[3] that a shareholder that cast its vote both ways be treated as voting in favour of the scheme if it cast more votes for than against the resolution. This is in line with the rules under the CA 2006 on voting at general meetings, where a single registered shareholder may split its vote on a poll, or appoint multiple proxies, provided that voting rights are exercised in relation to different shares. Alternative approaches in past cases include treating a nominee which split its votes as having voted once for and once against, the scheme[4] (albeit the votes cancel out) and converting some dematerialised interests into certificated shares, to enlarge the constituency of votes for the purposes of the headcount test.[5] (*Re Ortho Clinical Diagnostics Holdings Plc* [2022] EWHC 1283 (Ch))

Key lesson

- **Headcount test for approving scheme of arrangement:** Another judgment giving useful guidance on how to apply the headcount test for approving a scheme of arrangement where there are just two registered shareholders and multiple holders of underlying beneficial interests who might give different voting instructions.

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Shareholder liable to pay up in cash for subscriber shares in public company

The Court of Appeal has upheld an earlier High Court decision that shareholder S was liable to pay up in cash for 840 million shares allotted to him on a public company's incorporation, but on a different basis from the High Court. S was liable pursuant to his undertaking in the memorandum to pay up in cash, not under the separate provision in the Companies Act 2006 requiring an independent valuation and report when a public company allots shares for a non-cash consideration.

Company C was incorporated as a public holding company to raise funds to develop a fibre optic telecommunications network in Malaysia. S was an investor in the Malaysian operating company (M) and a subscriber to C's memorandum. S was allotted 840 million shares in C and purportedly paid for them by transferring to C shares that he held in M. Under section 584 of the CA 2006 shares taken by a subscriber of a public company pursuant to their undertaking in the

Key lessons

- **Severity of consequences of breach of section 584:** The shareholder was obliged to pay up the shares in cash in full. The Court of Appeal decided that it could not grant relief under section 606 of the CA 2006 from making a payment in respect of shares where it is just and equitable to do so, as this is not available to a subscriber in relation to their duty to pay cash for shares taken pursuant to their undertaking in the memorandum.
- **Timing of share exchanges:** The judgment demonstrates that a public company should defer a share allotment as part of a share exchange until after incorporation.

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3 [2021] EWHC 716 (Ch).
4 *Re Equitable Life Assurance Society (No. 1)* [2002] BCC 319, on a creditors' scheme.
5 *Re Cardtronics PLC* [2021] EWHC 1617 (Ch).

memorandum (together with any premium on them) must be paid up in cash. Separately, a public company must not allot shares for a non-cash consideration unless the consideration has been independently valued for the purposes of section 593(1). The High Court had decided that the shares had been improperly allotted for a non-cash consideration without an independent valuation as required under section 593. The Court of Appeal held that it was significant that S had agreed to subscribe for 840 million shares on C's incorporation and not in a post-incorporation allotment. A subscriber automatically becomes a member of the company as and when the company is registered. From that point it holds the number of shares specified in the statement of capital and initial shareholdings. It is clear from section 584 that shares taken by a subscriber on incorporation must be paid up in cash. Unlike under section 593, a subscriber may not subscribe for shares by transferring non-cash assets, there is no provision for non-cash valuation and there are no statutory exceptions. The Court of Appeal denied that wording in C's memorandum that "*Each subscriber … agrees to become a member of [C] and to take at least one share*" meant that they agreed to take only one share actually on incorporation. That would mean that every subscriber of every company was only obliged to take one share and that the words "at least" had no meaning. In any event, there is no mechanism under the CA 2006, other than the undertaking in the memorandum, for a subscriber to take shares after registration to constitute them as holder of the number of shares specified in the initial statement of capital and initial shareholdings. Section 593 does not apply because subscriber shares taken on incorporation are allotted under section 584 not section 593 and the general provisions of the CA 2006 on share allotments do not apply to them. (*Zavarco plc v Sidhu* [2022] EWCA Civ 1040)

Interested shareholders could vote to remove liquidators

The High Court has let the votes of shareholders stand at a series of general meetings where they had voted to remove joint liquidators of three companies and were themselves former directors or managers subject to claims brought by the liquidators.

On the application of a minority shareholder a dissolved corporate group was restored, and joint liquidators (L) appointed. A key driver was to allow L to pursue claims against various parties, including former directors and managers of the group (D) for breach of duty, where D were also shareholders. When some of D applied to court to remove L, the application was dismissed so there could be a shareholder vote. In their capacity as shareholders, D voted at subsequent general meetings of the companies to remove L. The High Court refused to discount D's votes as shareholders. It confirmed past authority that, generally, a member may vote their shares at a general meeting in accordance with their own interests or wishes. Even a vote to amend the articles of association may be cast in accordance with the member's own view of what is in the best interests of the company, and the court will only intervene with internal voting rights if no reasonable person could consider it such. The question was: whether the majority's decision had been obtained by unfair or improper means, fraud or illegality or was oppressive towards shareholders who opposed it; and whether no reasonable person could consider it for the company's benefit. The High Court decided it had not. There was no requirement under statute, the common law nor in the articles requiring the votes to be balanced or re-weighted. The claims were at an early stage, their funding was unclear and removing L would not affect them. The court took into account that D were willing for different liquidators to be appointed and would fund their challenge to the claims themselves. Having a fresh pair of eyes assess the merits of the claims could even be for the companies' benefit. (*Pagden & Anor v Soho Square Capital LLP & Ors* [2022] EWHC 944 (Ch))

Key lesson

- **Shareholders entitled to vote in their own interests:** The judgment is a reminder that shareholders may vote in their own interests and of the limited circumstances in which a shareholder vote may be open to challenge, as well as the general line of case law supporting this beyond the more limited scenario of shareholder votes to amend articles of association.

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Director not personally liable in respect of negligent corporate conduct

The Court of Appeal decided that a director was not an accessory to the company's negligent corporate conduct in failing to warn customers of a currency risk.

Company C was a property developer in Cyprus. Its agents recruited sales personnel (S) to market properties to prospective purchasers (P), who bought apartments to let to tourists. The purchases were funded by cheap mortgages, which involved borrowing money in Swiss francs where the rental receipts would be in sterling or the Cyprus pound. After the 2008 downturn, P never received completed properties (nor rent receipts) and sterling and the Cyprus pound fell against the Swiss franc. The High Court had decided that C had owed and breached a duty of care to warn P of the currency risk, but rejected the claim against director D on the basis that he had not assumed personal responsibility to customers and had no contact with them. To establish personal liability of an individual acting on behalf of a company you needed an assumption of personal responsibility by them such as to create a special relationship between them and the claimant and also reliance on that by the claimant. P argued instead on appeal that D was an accessory to C's liability in tort for the wrong committed. The Court of Appeal rejected that, saying that the test for accessory liability needed to be kept within realistic bounds. You had to balance the concept of separate corporate personality against the principle that someone should not escape liability just because they are a director. A person would not be liable as an accessory unless they had assisted the person with primary liability to commit a wrong against the claimant pursuant to a common design between them. Here, D had not dealt personally with the claimants, he had not assumed responsibility towards them, he did not have any primary liability for the wrong and the only common design was to market the properties through S and promote the Swiss franc mortgage. To establish accessory liability you would have needed a common design not to warn customers of the currency risk, which had not happened. (*Barclay-Watt & Ors v Alpha Panareti Public Ltd & Anor* [2022] EWCA Civ 1169)

Key lessons

- **Scope of potential director accessory liability:** The judgment clarifies the test for accessory liability in tort and demonstrates the difficulty in establishing accessory liability against a director, particularly where failure to pursue a particular cause of action is involved.
- **Director's assumption of personal responsibility:** The judgment is also helpful in confirming more generally the requirements that must be met before a director may be regarded as personally liable when acting on behalf of a company.

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Contractual provisions

A number of cases have looked at common contractual provisions in M&A deals

Valid notice of warranty claim under Share SPA

The High Court decided that a buyer's notice of warranty claim under a share sale and purchase agreement (SPA) was valid because it met the contractual requirement in the SPA to give reasonable detail of the nature of the claim.

One of the warranties in the share SPA was on the absence of non-routine governmental investigations against the target or seller groups or against officers or employees of either the target or the seller group of companies. In the form in which this warranty was repeated at completion, it was only triggered if any such investigation had or would have a material adverse impact on the operation of the target business (taken as a whole). The warranty was qualified by seller's awareness, which was defined as the actual awareness of eight specified individuals. Buyer B served a warranty notice alleging that this warranty had been breached. The requirement in the SPA was for a warranty notice to give "*reasonable detail of the nature of the [claim]*". Seller S argued that B's warranty notice was invalid because it failed either to identify which of the named individuals were alleged to have had the relevant knowledge or to state that the investigations in question had or would have a material adverse impact. The High Court denied that B had failed to meet the contractual requirement to give reasonable detail of the nature of the claim. The question was how a reasonable recipient would have understood the notice. The court stated that it had to ascertain the objective meaning of the language used, whilst applying past authority on unilateral notices.

Key lessons

- **Impact of knowledge:** The decision confirms that a seller's knowledge may be taken into account in assessing compliance with the contractual requirements for a valid notice and not just in interpreting a warranty notice.
- **What amounts to reasonable detail will vary with the facts:** What amounts to reasonable detail will depend on the circumstances and the pragmatic outcome in this case endorses the buyer's decision not to delay serving a notice of claim which was subject to a time limit pending further clarifications.

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This indicates that information conveyed in a unilateral notice to a reasonable recipient can in principle be affected by background context, which includes the knowledge that the actual recipient has. The High Court said that knowledge can be relevant to compliance with the contractual requirements for a valid notice as well as interpretation of the notice. What amounts to reasonable detail will vary with the circumstances, which must include what the recipient (here, seller S) already knows. Likewise there was nothing in the SPA to require notice of a claim to explain how an investigation had impacted the target business. (*TP ICAP Ltd v NEX Group Ltd* [2022] EWHC 2700 (Comm))

Temporary COVID-19 restrictions did not trigger force majeure clause

The High Court decided that a force majeure clause in a contract for the sale of a ship was not triggered by temporary governmental restrictions imposed in response to the COVID-19 pandemic.

Seller S entered into a contract to sell a ship to buyer B for scrapping or recycling. This provided for a delivery location in India. It also provided that, if the delivery location was inaccessible, B could nominate an alternative location or delivery could take place at a location where it was "*customary for vessels to wait*". COVID-19 restrictions imposed by the Indian government prevented the ship from reaching the specified delivery location just as it was due to arrive. B did not nominate an alternative delivery location and the ship just anchored where it safely could. The expected delay was two or three weeks. B purported to terminate the contract for force majeure. The relevant clause entitled either party to terminate if S was "*unable to transfer title of the Vessel*" due to "*restraint of governments*". The High Court found in S's favour and decided there was no force majeure.

Key lesson

- **Meaning of impossibility to perform:** The decision in *NKD Maritime* demonstrates that, in the absence of express wording, a force majeure clause is unlikely to be triggered by just a temporary delay. This will not generally amount to inability or impossibility to perform a contract for the purposes of a force majeure clause.

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Delivery was not a requirement of transfer of title. Whilst the COVID-19 restrictions could be described as a restraint of government, they did not render S unable to transfer title. In any event, the ship had anchored as close as possible and had therefore "arrived" for the purposes of the substituted delivery location. The High Court commented more generally that inability to perform a contractual obligation should not be judged simply by inability to perform by a buyer's contractual delivery or cancellation date, otherwise short-lived delays could trigger a force majeure clause. It was significant here that B intended to demolish the ship, which would take a year anyway and so the delay would not materially undermine the commercial venture. (*NKD Maritime Ltd v Bart Maritime (No. 2) Inc* [2022] EWHC 1615 (Comm)) Interestingly, in another recent force majeure case, where permission has been requested to appeal to the Supreme Court, the Court of Appeal decided that a contractual provision that an event would not amount to force majeure if it could be overcome by a party's reasonable endeavours did require that party to accept payment in euros rather than the contractual currency of US dollars, where payment could not be made in dollars due to the impact of sanctions. This was a question of interpretation, not principle. (*MUR Shipping BV v RTI Ltd* [2022] EWCA Civ 1406)

Informal novation not prohibited

The High Court decided that a clause in a contract preventing termination except by written notice did not preclude termination by informal novation, because the clause only applied to unilateral termination.

New supplier S applied for summary judgment against customer C for sums due under an agreement to provide services for managing and operating an aircraft. Originally, a written agreement had been entered into in 2008 between S's group company J and C. Following a group reorganisation, J became a subsidiary of S. S and J alleged that the 2008 agreement had been informally novated from J to S in April 2017. One reason was that J was now S's subsidiary. Another was that the aircraft had been moved to Bermuda, where it was S that held the regulatory authorisation to service aircraft there. S then provided the services and C began paying S, which it did for nearly two years until January 2019. C alleged that any informal novation was precluded by clause 1 of the 2008 agreement, which said broadly that either party could terminate on not less than three months' notice in writing to the other party. The argument was that, because novation involves termination of an original agreement and its replacement by a new agreement, compliance with clause 1 was a pre-requisite. The High Court decided that this clause did not prevent novation by agreement, that it only applied to unilateral termination and that it had no bearing on mutual termination. The court confirmed that novation can be inferred from conduct and had taken place here. The test is an objective one of whether that inference is necessary to give business efficacy to what actually happened and provide a lawful explanation or basis for a party's conduct. The court had to look at the words used in the clause in their factual background. Three months' notice of termination was unnecessary where termination was mutually agreed. In any event, clause 1 did not specify anyone to give notice on a mutual termination. The High Court commented that C would have been estopped from relying on clause 1 anyway, because it had encouraged S to believe that it was treating the 2008 agreement as novated, and S had provided services and incurred expenses on this basis. (*Gama Aviation (UK) Ltd & Anor v MWWMMWM Ltd* [2022] EWHC 1191 (Comm))

Key lessons

- **Express language on when novation is allowed:** The case highlights the merits of express provisions in a contract on when novation is or is not permitted.
- **Guidance on estoppel:** Although not necessary to decide the case, this is a rare example of the court applying the Supreme Court's past reasoning on estoppel in the context of "no oral variation" clauses.

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Test for common mistake

The High Court decided that a party could not avoid a collaboration agreement for common mistake, because the risk of the common understanding between the parties turning out to be wrong had been allocated to that party in the contract.

L was a family-owned company incorporated in England. Separate company S had also been incorporated in France to develop the family business there. L sought a declaration that a purported collaboration agreement between them was void from the outset for common mistake. L alleged this was a mistaken belief that S owned a range of trade marks purportedly licensed to L under the agreement, whereas L now contended it was beneficial owner of all the marks except the French trade mark. Recital G stated that S was legal and beneficial owner and registered proprietor of the trade marks throughout the world. Clause 1 licensed L to use them in its UK business. In clause 1.3, L specifically acknowledged S's ownership rights in the trade marks. The High Court granted S summary judgment, deciding L had no reasonable prospect of success. Key aspects of the test for common mistake include: a common assumption as to the existence of a state of affairs; no warranty by either party that the mistaken state of affairs exists; non-existence of the state of affairs must not be either party's fault; and it must render the contract impossible to perform. The second limb was not met here, as the common understanding from Recital G and clause 1.3 was that the risk of the assumed state of affairs being wrong had been allocated to L. As it happened, the fourth limb was not met either, as the contract terms were not impossible to perform anyway by the mistake as to ownership. (*John Lobb S.A.S. v John Lobb Ltd* [2022] EWHC 2306 (Ch))

Key lessons

- **Test for common mistake:** The judgment clarifies the test for common mistake.
- **No warranty on assumed state of affairs:** The judgment confirms that the requirement for common mistake as to no warranty by either party that the relevant state of affairs exists is not confined to an express warranty by a party but also applies where a party has more broadly undertaken responsibility in the contract for that state of affairs being true.

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Listed companies

The following decisions are of particular interest to listed companies

FCA fines Chair for unlawful disclosure of information to major shareholders

The FCA has fined the former non-executive Chair (G) of a premium listed company (C) for unlawful disclosure of inside information to two of C's major shareholders (S1 and S2).

G was the Chair of C. On 10 October 2018, G disclosed to senior executives at S1 and S2 that C was expected to announce on 15 October (depending on the Board's analysis) that C would be revising its financial guidance and C's CEO was retiring. C announced these two matters on 15 October. When the markets opened C's share price fell by 22%. On 8 October, S2 had asked its brokers to make enquiries about purchasing shares in C. After G made the disclosures, S2 instructed its brokers to pause and await C's announcement. At the relevant time, it was an offence under Articles 10 and 14(c) of the Market Abuse Regulation (EU) 596/2014 (EU MAR) to unlawfully disclose inside information, i.e. disclose it to any person

Key lessons

- **Limits on disclosing inside information:** The FCA cited the *Grøngaard and Bang* test that inside information may only be lawfully disclosed if it is strictly necessary for the exercise of an employment, a profession or duties, as well as MAR 1.4.5G(2) in the FCA Handbook. Issuer personnel should bear this in mind when they are considering selectively disclosing inside information to any person.
- **Cannot forewarn shareholders:** The FCA found that the primary purpose of G's disclosures of inside information was to forewarn (not genuinely consult) major shareholders, so that they were not surprised by an announcement. Disclosure for this purpose was not permitted.

except where the disclosure was made in the normal exercise of an employment, a profession or duties.

The FCA fined G £80,000 for unlawful disclosure of inside information. The FCA considered that the two matters disclosed to S1 and S2 constituted inside information. At that time, there was a realistic prospect that the financial guidance would be revised and the CEO would retire. The FCA considered that G acted negligently, pointing to G's training on EU MAR, his experience and position, and his failure to properly apply his mind to (and obtain clear, formal advice regarding) what information he might properly disclose, as well as when, how and to whom. This was despite the fact that: C had not formally classified the information as inside information; G was told that C's brokers' view was that the information was not precise enough to require announcement; G informed a Board-level executive of C that he intended to call S1 and S2; G informed a broker of C after calling S1, and the broker agreed he should call S2; S1 had a relationship agreement with C; and G imposed obligations of confidentiality and no-dealing on the senior executives he spoke to at S1 and S2. G's disclosures were not reasonable and were not necessary in order for G to perform his proper functions, nor was it a proportionate way for him to discharge his duties. Not wanting to "surprise shareholders of scale with announcements" was not a good reason. (*FCA final notice to Sir Christopher Gent* – 5 August 2022)

- **Article 17(1) permits a short period of time:** We welcome the FCA's recognition that the requirement to announce "as soon as possible" under Article 17(1) of EU MAR permits a short period of time before inside information must be announced, and the FCA's comments on the purposes for which this time may be used.
- **How long is a short period?** The FCA allowed C a surprisingly long time (5-6 days) to satisfy its announcement obligation under Article 17(1). Issuers should not assume the FCA will be this generous on different facts (e.g. where a CEO's retirement decision is not inherently bound up with whether the issuer needs to revise its financial guidance). Issuers should seek to establish the facts and prepare a non-misleading announcement as quickly as possible.

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FCA censures issuer and fines CEO and FDs for misleading announcements

The FCA has censured a premium listed company (C) and fined its former Chief Executive Officer (H) and two former Finance Directors (A and K) in relation to C's misleading announcements and failures to take reasonable steps to establish and maintain adequate procedures, systems and controls and to act with integrity towards holders and potential holders of C's shares.

H was C's CEO over the year to July 2017 and A and K were Finance Directors (A in 2016 and K in 2017). There were clear warning signs that the business of C's construction services division (CCS) was deteriorating, which led to an increasingly large gap between assessments within CCS of its financial performance and its performance as budgeted and reported to the market. This gap was bridged by the use of aggressive contract accounting judgements to maintain reported revenues and profitability. These judgements did not reflect the true financial position or risks and did not comply with accounting standards. The executives did not report the increasing risks and exposures to C's Board or Audit Committee. Three announcements made by C between December 2016 and

Key lessons

- **Accounting matters – Procedures and controls:** The FCA expressly stated that an issuer's obligations to maintain adequate procedures, systems and controls extends to ensuring compliance with applicable accounting standards.
- **Executive involvement – Procedures and controls:** The involvement of all of C's executive directors in concealing matters from the Board and Audit Committee emphasises some of the challenges that issuers may face in consistently implementing procedures, systems and controls. It also highlights the benefits of robust processes for internal audit and whistleblowing.
- **Limits on delegation of responsibility by directors:** Where information provided to a director puts them "on notice" of a potential problem (e.g. significant discrepancies between internal and reported information on financial performance), they should make enquiries and ensure the Board and Audit Committee are aware of the matter.

May 2017 made positive statements about C's financial performance which were not justified and did not reflect the true financial performance of CCS. On 10 July 2017, C announced an expected provision of £845 million, of which £375 million related to CCS. H stepped down as CEO. C's share price fell 39% that day. C went into liquidation in January 2018.

The FCA censured C. It would have fined C £37,910,000 if it was not in liquidation. The FCA fined H £397,800, A £318,000 and K £154,400 for being knowingly concerned in C's breaches. In the FCA's view a "knowingly concerned" director must have (a) been actually involved in the breach and (b) had knowledge of the facts upon which the breach depends. C committed market manipulation under Articles 12(1)(c) and 15 of EU MAR by disseminating information in the announcements that gave false or misleading signals as to the value of C's shares where it ought to have known that this was false or misleading. The executives were aware of a risk that the announcements were false or misleading and the FCA attributed their knowledge to C. C also breached LR 1.3.3R and failed to take reasonable steps to establish and maintain adequate procedures, systems and controls (DTR 7.2.1R, LP 1). The executives acted recklessly and the FCA attributed their state of mind to C.

- **FCA focus on misleading information:** This is another example of FCA civil enforcement action against an issuer and its executives for market abuse by disseminating false or misleading information. This has become an important enforcement tool for the FCA. In the last five years the FCA has used it against Redcentric plc, Tesco plc, and the CEO and CFO of WorldSpreads Group plc.

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As a result, C failed to act with integrity towards holders of its shares (LR 7.2.1AR, PLP 2). C's procedures, systems and controls were not sufficiently robust to ensure that contract accounting judgements were made and reported appropriately. There were "serious and systematic weaknesses" for over a year. The executives have referred their FCA decision notices to the Upper Tribunal. *(FCA decision notices to Carillion plc (in liquidation), Richard John Howson, Richard Adam and Zafar Khan* – 24 June 2022)

Good faith

A recent case has looked again at contractual duties of good faith and the relationship between contracting parties

No breach of contractual duty of good faith by exclusion from management

The Court of Appeal has allowed an appeal against an earlier High Court decision that exclusion of two minority founder shareholder-directors from management of a private company both amounted to breach of a contractual good faith provision in a shareholders' agreement (SHA) and unfairly prejudicial conduct.

S and F were the founders and former CEO and chairman respectively of private company C. Under the SHA between them and the majority shareholders (M) each shareholder undertook at all times to act in good faith in all dealings with the other shareholders and also with C. The articles of association contained a provision that the board could not resolve to remove S or F as directors. The High Court had decided that M's conduct in removing them from management had amounted to unfair prejudice. It had stated

Key lessons

- **Fact-specific analysis:** The judgment highlights that the interpretation of an express contractual good faith provision will vary with the facts. It is open to the parties to set out expressly in the agreement the parameters of a good faith obligation. The Court of Appeal stated that a contractual duty of good faith should not be applied in a formulaic way irrespective of context and without considering the other terms of the agreement in the round.
- **Entrenching position of directors:** In this case, the directors' position was not entrenched because the SHA did not impose an obligation on M as shareholders not to vote to remove them.

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that the good faith obligation was a balancing provision on the otherwise untrammelled rights of M to exercise their majority voting power as they chose. The Court of Appeal allowed the appeal and decided unanimously both that the judge had erred in finding unfair prejudice and had interpreted the good faith provision in the SHA too widely. The Court of Appeal made some general comments on a contractual duty to act in good faith. It certainly includes a duty to act honestly and not to act in bad faith. That could include conduct which would be regarded as commercially unacceptable to reasonable and honest people. However, beyond these obligations, any further requirements of an express duty of good faith must be capable of being derived from the agreement under consideration. In any event, the good faith clause in the SHA did not give S and F an entrenched right to remain as directors and the restriction in the articles on the board's ability to remove them did not apply to M as shareholders. The Court of Appeal rejected that the express duty of good faith in the SHA imposed a duty to act with fidelity. M's only procedural obligations in removing them lay in the requirements under the CA 2006. The contractual duty of good faith here did not require M to have regard to the interests of S and F in some undefined way beyond the general requirements to consider the interests of C in the absence of any other indication to that effect in the SHA. Permission has been requested to appeal to the Supreme Court. (*Re Compound Photonics Group Ltd , Faulkner v Vollin Holdings Ltd* [2022] EWCA Civ 1371)

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