January 2020

2019 Half-year in review M&A legal and market developments

In this issue...

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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.

Contractual provisions

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

Rectification of contracts for common mistake

The Court of Appeal decided that the written terms of a contract could be rectified for common mistake where, based on the parties' communications, it could be shown that the terms did not reflect their subjective intention.

F and G had entered into a corporate acquisition which required F to provide security over a shareholder loan which was part of the funding arrangements. Some years later it came to light that the relevant security documentation had either never been entered into or was lost. F instead provided security under two accession deeds. By common mistake of the parties, F assumed far more onerous obligations under those deeds than was needed. The Court of Appeal allowed the deeds to be rectified. It applied a subjective test for rectification for common mistake, declining to follow past comments in the House of Lords advocating an objective approach.[1] The Court of Appeal stated that you had to distinguish two scenarios. In the first, the parties enter into a binding contract to execute a document containing particular terms, but actually execute a document containing different terms. There, you have to objectively determine the terms of their original contract. In the second scenario, which was the position here, the parties had a common continuing intention in respect of a matter in a document for which rectification was sought. In this second scenario, a party would not be allowed to enforce the objectively-determined terms of a contract when to do so was inconsistent with the parties' subjective intentions as communicated between them (including through telephone conversations) and understood by them. (*FSHC Group Holdings Ltd v GLAS Trust Corporation Ltd* [2019] EWCA Civ 1361)

Key lessons

- **Helpful clarity but raises the test**: The judgment provides some helpful clarity on the doctrine of rectification. Potentially though it raises the bar for claimants seeking rectification of contracts for common mistake, given the need to demonstrate both a common subjective intention and the necessary outward expression of accord.
- **Clear and accurate drafting**: The judgment highlights the importance of clear and accurate drafting to reflect the parties' intention.

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1 In *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38.

Automatically generated name in email was a valid electronic signature

The High Court has decided that a binding property contract could be formed by emails signed with a solicitor's email signature block.

N and R were in dispute over a right of way. To settle the issue, proposals were set out in an email from R's solicitors offering to transfer land to N. The purported signature of the solicitor here, on behalf of R, was inserted by automatic generation of his name, occupation, role and contact details at the foot of the email. The question was whether this amounted to a valid contract for the sale of land for the purposes of s.2(1) of the UK Law of Property (Miscellaneous Provisions) Act 1989, which requires such contracts to be in writing and signed by or on behalf of each party. N argued that the email was "signed" for the purposes of s.2 provided that the name had been included for the purpose of authenticating the document. The High Court decided that the document had been "signed" for the purposes of s.2(1). The ordinary usage of words had a tendency to develop. Many an ordinary person would consider that what was produced when one stored a name in the Microsoft Outlook "Signature" function, with the intent that it was automatically posted on the bottom of every email, was indeed a "signature". In the current age, that would be capable of encompassing the wording of the footer to this email. Although the relevant words had been added automatically to every email without any individual action or intention each time on the solicitor's part, the original process of generically setting that up had involved the conscious action at some stage of a person entering the relevant instruction and settings in Microsoft Outlook. The sender of the email was aware that their name was being applied as a footer. The recipient had no way of knowing whether details were added pursuant to an automatic rule (as here) or by the sender manually entering them. Looked at objectively, the presence of the name indicated a clear intention to associate oneself with the email, to authenticate or sign it. The fact that the solicitor had used the words "Many thanks" before the footer showed an intention to connect the name with the contents of the email, as did the display of the name and contact details in the conventional style of a signature, at the end of the document. (*Neocleous v Rees* [2019] EWHC 2462 (Ch))

Key lessons

- **Authentication of document**: The judgment demonstrates that the necessary intent to authenticate a document can be shown where an electronic signature is generated automatically.
- **Subject to contract**: Where this is not intended, it is essential to include negating wording, such as "subject to contract", in communications.

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Invalid notice of tax covenant claims

A letter from the buyer (B) to the seller (S) under a share sale and purchase agreement (SPA) did not amount to a valid notice that B intended to bring a claim under the tax covenant in the SPA. A unilateral notice had to make clear that a claim was going to be made, which had not happened here.

The share SPA provided that S would not be liable under the tax covenant unless B had notified S by an agreed date that it was bringing a claim against S in respect of tax liability of the target company (C) (paragraph 6.3, Schedule 4). Later the same month, HMRC issued a claim against C in relation to conditional employee share schemes. Some years later, shortly before expiry of the time limit for notifying claims, B wrote to S indicating C's potential liability to tax for this and asking S if they wanted to have "*continued conduct of discussions with HMRC in relation to the Claim.*" B then brought proceedings against S for a sum equal to C's tax liability to HMRC, and maintained that this letter had amounted to a valid notice of claim for this purpose. The Court of Appeal decided that the letter did *not* amount to a valid notice of claim against S, with the effect that any claim was now time-barred. It had only amounted to a "soft" initial

Key lessons

- **Distinction between permissive and mandatory notices**: It is important not to confuse an initial notice of awareness of a potential claim (the requirements for which are usually permissive) with formal notice of a claim against a seller (the requirements for which are treated as mandatory).
- **Clear and unambiguous drafting**: Notices of claim (such as under SPAs) must be clear and unambiguous, expressly identify the types of claim and cite the notice of claims provision in the SPA pursuant to which the notice is given.
- **Comply with SPA**: It is crucial that notices of claim comply in full with the requirements of the SPA, including requirements as to providing an estimate of the amount claimed.
- **Risk that claims time-barred**: The decision highlights the severe risk that failure to adhere to the requirements of the SPA can result in potential claims being prohibited and further claims time-barred.

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notification of becoming aware of a claim by HMRC, from which it appeared C would be liable to tax, under a separate provision in the SPA requiring notice from B as soon as reasonably practicable after becoming so aware (paragraph 7, Schedule 4). The Court of Appeal stated that unilateral notices should be interpreted objectively, taking into account the relevant objective context. The question was how a reasonable recipient would have understood the notice. The judge had found no evidence as to what S's subjective understanding was. The starting point was the language used in the letter. This did not make it clear that a claim was being pursued against S: there was no reference to a "tax claim" nor to a claim by B under paragraph 6.3 nor against S. The letter only referred instead to paragraph 7, it was expressed in terms of a contingency, a "potential Liability to Taxation" and a "potential claim" and it only set out a "likely estimate" of the claim by HMRC and failed to indicate an amount being claimed under the tax covenant. Permission has been requested to appeal the judgment. (*Stobart Group Ltd v Stobart & Tinkler* [2019] EWCA Civ 1376)

Implied term of SPA that seller entitled to disclosure of full auditors' report on tax overprovisions

The High Court decided that it was an implied term of a share SPA that the sellers (S) were entitled to full disclosure of a report by the target's (T's) auditors on tax overprovisions, where the buyer (B) had been contractually obliged under the SPA to obtain the report at S's request and expense.

There was a mechanism in the SPA for B to pay additional consideration if T's last accounts had made over-provision for tax liabilities. The relevant provisions in the SPA allowed S to request B to instruct T's auditors to determine whether a price adjustment was due, at S's expense. Once the auditors had produced the report, they could subsequently be requested to review it to determine whether it remained correct. Either B or S could instigate the review clause, at their own expense. S instigated the primary clause to require an auditors' report on whether an adjustment was due, at S's expense. B refused to provide S with the full ensuing report, but only provided a one and a half page executive summary identifying a small overprovision. S argued it was entitled to disclosure of the full report because B acted as its agent in instructing the auditors and, in any event, a term to that effect should be implied into the SPA. S's claim on the implied term succeeded, but the claim on agency failed. The High Court emphasized that the wording of the clause envisaged B's acting in its own capacity, even though the cost was payable by S. There was no need for a fiduciary relationship, the SPA could work effectively without it and the parties' opposing interests strongly suggested otherwise. However, there was an implied term that S was entitled to the full report. This was both necessary to give business efficacy to the contract (meaning the contract would lack commercial or practical coherence without it) and also so obvious as to go without saying (meeting the test for implication of a term). It would be unfair for the report to be obtained at S's expense and not be provided to S in full. Further, in order to engage effectively in any review process, S needed to know the basis of the original determination. (*Zedra Trust Co (Jersey) Ltd and another v The Hut Group Ltd* [2019] EWHC 2191 (Comm))

Key lessons

- **Clear drafting**: Clear and unambiguous drafting is needed to specify expressly a party's information rights under an SPA.
- **Implied term more limited than agency**: Implication of the term led to a more limited right to information (the full report) than on agency (which would have entitled S to all documents provided by B to the auditors and communications between them, as well as the calculations underlying the figures in the report).

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Company law

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

Corporate attribution in relation to fraudulent conduct

The Supreme Court has declined to attribute the fraudulent conduct of a company's sole shareholder and chair to the company, rejecting the notion that actions of director-shareholders of "one-man companies" will automatically be attributed to the company. Three related defences by a bank failed in relation to breach of the "Quincecare" duty, regarding payment instructions given where a financial institution is put on enquiry by having reasonable grounds for believing that the instruction was an attempt to misappropriate funds.

S was a Cayman-incorporated company wholly-owned by M, who was also director, chair, president, and treasurer. Six further directors were not involved in S's management. Investment bank D held US$204 million on account for S. S's liquidators claimed against D to recover eight payments, executed by D and instructed and approved by M, in favour of various companies associated with M. The High Court and Court of Appeal had found on the facts that the instructions were obviously fraudulent, and held that D had breached its Quincecare duty to take reasonable care in executing the payments. On appeal to the Supreme Court, D argued that M's fraudulent conduct should be attributed to S and that S's claim should therefore fail for illegality, lack of causation, and D's equal and countervailing claim for deceit. The Supreme Court decided that corporate attribution had not been made out. It clarified that there is no principle that fraud should automatically be attributed to a company suing a third party for breach of a duty owed to it by that third party just because the fraud was carried out by a director-shareholder in a one-man company. In any event, this was not a traditional "one-man company", as there was a wider board and no evidence to suggest the other directors were involved in or aware of M's actions. The Supreme Court further emphasized that whenever it is proposed to attribute the thoughts and deeds of a person to a company the answer "is always to be found in consideration of the context and the purpose for which the attribution is relevant". The Quincecare duty was intended to protect companies from defraudment by their trusted agents holding authority to make distributions from their accounts. In that context, the court declined to attribute M's conduct to S, since to attribute the fraud of such agents to the company would denude the duty of any value in cases where it was most needed. The Supreme Court also explained why D's three defences would have failed anyway. Illegality could not be made out for a variety of policy reasons, including that it would undermine the careful calibration of the standard of the Quincecare duty and reliance on financial institutions to help combat financial crime. Further, neither lack of causation nor a countervailing claim in deceit against S could be established, as each would require D to rely on M's fraud as the cause of loss, whereas in fact it was that fraud which gave rise to D's duty of care and, consequently, D's breach which had exposed D to the claim for S's loss. (*Singularis Holdings Ltd (in liquidation) v Daiwa Capital Markets Europe Ltd* [2019] UKSC 50)

Key lessons

- **"One-man companies"**: Robustly shoring up the separate legal personality of companies, the judgment makes clear that the conduct of director-shareholders of one-man companies will not automatically be attributed to the company.
- **Contextual approach to attribution**: The judgment clarifies that attribution will turn on consideration of the context and the purpose for which the attribution is relevant. However, it may introduce greater scope for debate over its application. The purpose of a rule of law is not always clear and, once made out, it could be difficult to determine the extent to which attribution would accord with it.

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Directors did *not* owe fiduciary duties on an MBO

Although directors of company C were liable in deceit to C's former shareholders (S) for giving false information in the course of an MBO which had misled S into selling when they did and at too low a price, the directors had not owed and breached fiduciary duties to S.

C was in financial difficulties. Following a competitive process involving a competing potential buyer, S sold their 72% interest in C to a new company owned by its directors and a PE house (L). S believed they had been misled in the sale negotiations by a financial overview which the directors had given both to them and the competing buyer. This had related to C's current and forecast performance and had indicated that C was behind budget and its performance would decline. S claimed against the directors for deceit, breach of fiduciary duty and unlawful means conspiracy. The High Court decided that the directors had committed the tort of deceit. They had falsely represented that the figures in the financial overview represented their forecast of C's financial position and had been provided to, and used by, L in its offer. They had knowingly done this to bolster L's bid and reduce the risk of higher offers by the competing buyer. The claim for unlawful means conspiracy also succeeded, although it did not add to the claim in deceit. However, the claim for breach of fiduciary duty was rejected, meaning that a claim for an account of profits failed. The High Court confirmed the general rule that directors do not owe fiduciary duties to shareholders (as distinct from the company) just through holding the office of director. There is an exception whereby fiduciary duties can arise if there are special or unusual circumstances giving rise to a fiduciary relationship, such as where a person undertakes or is treated as having assumed responsibility to act on behalf of, or for the benefit of, another person. However, such circumstances were not present here. Just because a director has superior knowledge of the company's affairs, or the potential of their actions to affect shareholders, is not enough to give rise to the necessary special relationship. Nor is the fact that a director is acquiring shares from a shareholder. A fiduciary relationship is more likely to arise in a family context. The fact that false representations had been made was also not enough to create a fiduciary relationship. The court took into account that S had a degree of access to information relating to C and a regular channel of communication open to them. C was not a closely-held family company and the directors had not used their relationship with shareholders to push through the deal. Permission has been requested to appeal the judgment. (*Vald Nielsen Holding A/S v Baldorino* [2019] EWHC 1926 (Comm))

Key lessons

- **Limited circumstances in which directors owe fiduciary duties to shareholders**: The judgment affirms previous case law on when a fiduciary duty may arise on directors towards shareholders.
- **Directors' duties on an MBO**: It confirms that, on an MBO, special circumstances will be needed before directors may be taken to have assumed fiduciary duties towards selling shareholders, although it remains important to avoid steps which could be treated as giving rise to a special relationship.

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Limits on directors' ostensible authority but buyer put on enquiry

The Privy Council decided that an agreement for the sale of a company was invalid because the director-signatory lacked either actual or ostensible authority to execute it, and the buyer (B) would not have been able to rely on ostensible authority anyway as it had been put on enquiry of this.

Company E owned the entire issued share capital of company S, which was its sole asset. Both E and S were Bermudan companies. S was cash flow insolvent and E was in financial difficulties. One of E's three directors (J) executed sale and purchase terms for B to acquire S. These were set out in heads of agreement (HOA). A share transfer was also executed by J on E's behalf. Neither document was formally approved at a quorate board meeting of E, and only one other director (H) knew what was happening. The Privy Council decided that the HOA and share transfer were invalid. E had not authorised J (expressly or impliedly), nor held J out as having authority, to enter into the transaction. In any event,

Key lessons

- **Check execution authorities**: It is imperative to check execution authorities pre-signing on a transaction.
- **When buyer is put on enquiry**: The Privy Council's comments suggest a wider test than has been applied in recent case law on when a buyer is taken to be put on enquiry and the judgment demonstrates that, not only ostensible authority of an agent, but also the "indoor management" rule, will not apply in these circumstances.
- **Power of directors to bind a company under the UK Companies Act 2006**: Irrespective of these being Bermudan companies, the provisions in the UK CA 2006 on the power of directors to bind a company on a transaction with a good faith third party would not have applied anyway, where a director was acting individually and not as part of the board.

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B had not relied on any representation by E as to J's authority, but only on representations and assurances from J himself, which were not enough. The Privy Council also commented that B would not have been entitled to rely on any ostensible authority of J anyway because it had been put on enquiry, taking into account the unusual features of the transaction (that E was a holding company in financial difficulty selling its only asset, where J and H stood to gain financially from it). To rely on the ostensible authority of an agent, the Privy Council said a third party must be able to show it made the enquiries a reasonable person would have made in all the circumstances to verify the agent's authority (a wider test than has been advocated in other recent case law). Further, the documents had not been validly ratified at a later purported board meeting. J and H had both failed to disclose their financial interest in the proposed sale (through which sums owing to them by S would be repaid which otherwise they had practically no hope of receiving) in breach of their fiduciary duties. They should have been disqualified from voting and counting towards the quorum, with the result that the meeting was inquorate. Likewise, B could not assume that there had been a valid ratification at a board meeting, nor that E had delegated power to J under its bye-laws. The "indoor management" rule, allowing a person dealing with a company in good faith to assume that acts within its constitution and powers had been properly performed, did not apply where B had been put on enquiry of an internal irregularity. (*East Asia Company Ltd v PT Satria Tirtatama Energindo* [2019] UKPC 30)

Court sanctioned scheme of arrangement rejecting shareholder opposition on class meetings and fairness

The High Court sanctioned a scheme of arrangement, rejecting shareholder opposition that there should have been more than a single class meeting and that the scheme was not fair compared to a return of cash to shareholders or a scheme with a cash option.

The company (C) announced that E, a Canadian company involved in drugs development, was to acquire its entire issued share capital by way of scheme of arrangement, with C's shareholders receiving new shares in E as consideration. Following a strategic review, C's policy had been to acquire or be acquired by a company in the life sciences sector. The court directed a meeting of a single class of shareholders, which approved the scheme by the requisite statutory majorities. Shareholder B appeared at the sanction hearing to oppose the scheme. B argued that there should have been two class meetings because a fund manager (F) which held a 19.15% interest in C also held a 9.2% interest in E and had enlarged its shareholding in C by acquiring shares from other shareholders who allegedly would have voted against the scheme. B also argued that F's votes should not be counted. The High Court sanctioned the scheme. It affirmed that a single class consisted of those whose rights were not so dissimilar as to make it impossible for them to consult together with a view to their common interest. Just because a class member had a cross-holding in the bidder did not go to class composition, but potentially was relevant to the exercise of the discretion to sanction. The High Court stated that it could not be said that F's shares in C were somehow not part of the scheme. E and F were truly distinct, neither was under the control of the other and there was no evidence that E and F were acting in concert. The High Court decided that the single class of shareholders in C was fairly represented at the scheme meeting. The question for all shareholders was whether they shared the board's view that reinvesting in a life sciences business with a large potential gain was better than a modest profit from some form of liquidation. When considering this, a class member was entitled to vote in accordance with their own economic interests in relation to the issues facing the class as a whole, but not in relation to some matter other than the issue raised for decision (in other words, not some matter that was not shared by the class as a whole). The evidence did not show that F's support for the scheme was primarily motivated by its cross-holding in E. Whilst the deal was a gamble, that was a question for the commercial judgment of investors and was one that an intelligent and honest class member might reasonably approve. (*Re Realm Therapeutics Plc* [2019] EWHC 2080 (Ch))

Key lessons

- **Effect of cross-shareholdings in bidder**: The judgment gives useful guidance on the effect of cross-shareholdings in a bidder on exercise of the court's discretion to sanction a scheme of arrangement.
- **Burden of proof**: It makes it clear that it is for the company to persuade the court of the good faith of the majority. Where there are two possible explanations for the casting of votes, the question is which predominates.

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Validity of court meeting on scheme of arrangement despite failure to give notice to some shareholders

The High Court has sanctioned a scheme of arrangement despite failure to give notice of the court meeting to some shareholders.

R was an English company with £78 million of ordinary shares in issue, traded in certificated and uncertificated form. A proposed scheme of arrangement would transfer all shares to T. Shareholders in R would receive 28 newly issued and fully paid shares in T in return for every 33 scheme shares. R's registrar maintained a mirror CREST register and a register of certificated shares. However, the registers sent to the printers as at the record time accidentally excluded five shareholders (representing 0.01% of scheme shares) who had bought uncertificated shares during that trading day but whose acquisitions had not yet been notified to the registrar. The effect was that these five shareholders did not receive notice of the court meeting, being the shareholders' meeting to consider the scheme. The scheme was overwhelmingly approved at the court meeting. The High Court sanctioned the scheme, on the basis it had the power to waive non-compliance. The omission here had had no serious impact, and it would not be right to have the inconvenience of convening further meetings. The votes of the five shareholders in question would have had no effect on the overall outcome. Furthermore, the shareholders had been fairly represented at the meeting and the commercial advantages of the scheme clearly explained. The scheme was one that an intelligent and honest class member might reasonably support for the reasons set out in the full explanatory document which had been sent to shareholders. R's articles of association stated than an accidental omission to send notice of a meeting would not invalidate a meeting, and the omission here was accidental. The effect was that the separate general meeting of shareholders to consider ancillary resolutions, such as to amend R's articles, had produced valid resolutions too. (*Re RhythmOne Plc* [2019] EWHC 967 (Ch))

Key lessons

- **Treatment of technical breaches**: It is helpful that the court was willing to waive a technical, accidental breach.
- **Impact on outcome**: It is likely that the decision would have been different if the failure to give notice could have had a material effect on the outcome of the vote.

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Chair of meeting could not refuse to put forward resolutions at requisitioned meeting once called

The High Court decided that, once directors had called a meeting requisitioned by shareholders under the UK Companies Act 2006 (the CA 2006), the chair did not have power to refuse to put the resolutions to the meeting. The role of the directors was to consider the proposed resolutions before calling the meeting.

C was a property management company whose shares were held by the owners of a block of flats. Under C's articles of association the shareholders had the power to appoint a board of directors. Members requisitioned a meeting to consider resolutions to remove the directors and replace them with a new board. The current directors were the main defendants, and called the meeting. One of the defendants (D) chaired it. D had apparently been advised by counsel that the proposed resolutions were "vexatious" for the purposes of the CA 2006. He read out a statement at the meeting to that effect, and then declared the meeting closed. The remaining shareholders continued the meeting and passed the resolutions. The High Court decided that the board had been validly removed and replaced. Whilst section 303(5) of the CA 2006 entitled directors to decline to move a proposed resolution at a requisitioned meeting if it was defamatory, frivolous or vexatious, that judgment had to be made before the meeting was called. The defendants had considered the proposed resolutions and had in fact excluded one before calling the meeting. However, once the meeting was called, directors had performed their role and had no residual power to further consider the resolutions. Although it was the duty

Key lessons

- **Chair's residual common law powers**: The judgment demonstrates that a chair's residual common law power to adjourn or close a meeting where it is not possible to ascertain the wishes of the meeting does not extend to taking a view on the proposed resolutions.
- **Meaning of "vexatious"**: This is a rare decision giving comments on the meaning of "vexatious" under the CA 2006 where, interestingly, the court has suggested a fairly wide definition viewed from the company's perspective, not the directors'.

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and function of a chair to preserve order and ensure that the sense of the meeting was properly ascertained, they did not have power to refuse to put the resolutions to the meeting nor to stop the meeting after the business had been opened. You would at least need something in the articles of association to allow for a meeting to be postponed or cancelled, and there were no such provisions in them. Instead, the directors could and should have attended the meeting to voice their concerns and leave the meeting to decide. Moreover, the chair had to act in good faith and for proper purposes. Here, he had exceeded his power and it had been open to shareholders to appoint a new chair and continue with the meeting. The High Court rejected that the chair could close the meeting if they did it on legal advice and were acting bona fide and not neglectfully. The court noted that counsel's advice had been based on misleading instructions anyway and had related to the quality of the resolutions not conduct of the meeting. In any event, the resolutions were not vexatious. Appointing and removing directors was a fundamental right of members. Whatever actions the new directors might possibly take in the future did not make the resolution appointing them vexatious. The court commented that the resolutions could not be described as burdensome or troublesome or being for no proper purpose connected with the company (viewed from the standpoint of the company, not its directors) and so were not vexatious. Leave to appeal has been refused. (*Kaye v Oxford House (Wimbledon) Management Company Ltd* [2019] EWHC 2181 (Ch))

Chair of requisitioned meeting entitled to refuse to allow meeting to proceed where prior issue to be tried

The High Court decided that company C had an arguable case that purported director appointments at a general meeting requisitioned by members were invalid. The chair of the meeting had been entitled to determine that the meeting could not proceed where there was a serious issued to be tried over whether a person in attendance who purported to hold one-third of the shares in C was in fact a shareholder.

A former director (H) claimed that he held two shares in C (amounting to one-third of the total). C rejected H's claim. Two shareholders supporting H requisitioned a general meeting to consider resolutions to appoint additional directors, including H. The chair of the meeting indicated that he would not open the meeting or allow the business of the meeting to proceed if H remained in attendance. A proxy for one of the requisitionists then declared the meeting open and proposed the appointment of a new chair, who put the resolutions to the meeting. They were purportedly passed, using the disputed shares to swing the vote. The High Court decided that there was a serious issue to be tried over whether the purported resolutions appointing the new directors at the disputed meeting were valid, and granted an interim injunction to restore the position before the purported meeting. It was sufficiently arguable that the chair's residual power at common law to adjourn a meeting extended to circumstances where there was no practical utility in continuing with the meeting because the wishes of the meeting could not be validly ascertained where there was a serious issue over whether a person alleging to hold one-third of the voting power, and thus able to swing the vote, was in fact a shareholder. Whilst, in theory, the chair could have excluded H from voting, declared a deadlock and exercised a casting vote, that inevitably would have led to challenge. It also would not have resolved the underlying question of whether the result was representative of those entitled to vote. (*Findmyclaims.com Ltd v Howe* [2018] EWHC 1833 (Ch))

Key lessons

- **Chair's role in ascertaining the views of the meeting**: The judgment applies the principle from *Byng v London Life Association Ltd*[2] on the chair's common law power to adjourn a meeting beyond logistical issues (surrounding audiovisual links between spillover locations) to other circumstances where the wishes of the meeting cannot be validly ascertained.
- **Uncertainty over wishes of the meeting**: It was key to the decision that the chair felt that the result of a vote would not accurately demonstrate the views of the majority.

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2 [1990] Ch 170.

Distributions: interim accounts, creditors' interests duty and putting assets beyond the reach of creditors

The High Court decided that a distribution in specie was lawful and had been validly justified by reference to interim accounts. The distribution had not involved a breach of directors' duties and there had not been a transaction with intent to put assets beyond the reach of creditors.

A company (C) and its liquidator (L) brought proceedings against two former directors, X and Y, who were C's majority shareholders and had almost exclusively funded C through loans. These related to a distribution in specie of C's shareholding in a subsidiary (S) and C's grant of security in their favour. 30% of the shares in S were then on-sold to a third party, whereupon X and Y immediately loaned half the sale proceeds to C's group. C went into administration about one year later, and into liquidation around one year after that. The High Court decided that the distribution in specie was lawful. L alleged that the interim accounts (which were only two pages long) were insufficient because to understand the entries you had to look to extrinsic evidence, such as monthly management accounts and forecasts. The court denied this. C was a non-trading holding company, and it was unsurprising that its management accounts were relatively simple, taking into account that the audience was the directors. The interims recorded on their face C's profits and losses, assets and liabilities, share capital and reserves. Just because you had to look to other documents for explanations of the entries did not mean that the interims were deficient. The court also held that there had been no obligation to impair the value of C's investment in one of its subsidiaries in the interims and that no realised loss was created, provided that the aggregate value of C's fixed assets was not less than the aggregate amount at which they were stated in the books. The interims were sufficient for a reasonable judgment to be made. In the case of a non-trading holding company, provided that there are sufficient distributable profits in one or more of its subsidiaries, it is open to it to create profits by procuring a dividend from those subsidiaries. The High Court also decided that directors' liability for unlawful distributions was fault-based, not strict liability. Even if the distribution had been unlawful, X and Y would not have been at fault in causing it to be made, as they had reasonably relied on the advice of external advisers and colleagues, including the group finance director and his team. L also alleged breach of the creditors' interests duty, which is engaged when a company is, or is likely to become, insolvent, based on guarantees C had provided for subsidiaries' liabilities, two of which were insolvent. The court denied this duty had been engaged because, if the guarantees were called, C would have a matching debt due to it from the relevant subsidiary. The court also denied that the transactions had been effected with intent to put assets beyond the reach of creditors for the purposes of the UK Insolvency Act 1986. The principle purpose behind the distribution had been a demerger to benefit S by separating it from C's other businesses. The grant of security also was not intended to defraud creditors and, in any event, was not a transaction at an undervalue for the purposes of these rules. It had not taken place for no consideration, and the company had not parted with anything of value. Permission has been requested to appeal the judgment. (*Burnden v Fielding* [2019] EWHC 1566 (Ch)).

Key lessons

- **Guidance on requirements for interim accounts and lawful distributions**: The judgment gives useful guidance on the statutory requirements for interim accounts and directors' liability for unlawful distributions.
- **Confirmation of recent case law**: The judgment confirms a series of recent case law on a variety of issues, including when the creditors' interests duty is engaged and when the test is made out for transactions with intent to put assets beyond the reach of creditors.

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Listed companies

A number of rulings of the Hearings Committee of the Takeover Panel, the English courts, the FCA and the LSE are of particular interest to listed companies

Cold-shouldering of Mr David Cunningham King

The Panel Hearings Committee ruled that Mr David King was a person who was not likely to comply with the UK Takeover Code and imposed the ultimate sanction available to the Takeover Panel, a so-called "cold-shouldering".

The Panel Hearings Committee found that Mr David King (K) should be cold-shouldered for a period of four years given that (i) K had behaved in such a way to demonstrate "a clear propensity to disregard the [Takeover] Code and to comply with its Rules only when forced to do so"; and (ii) K's "prolonged refusal" to procure a mandatory offer, along with his conduct in dealing with the Panel Executive, were offences of the "utmost seriousness" for which a statement of public censure would not be a sufficient sanction. The Takeover Appeal Board (TAB) had ruled that K should make a mandatory offer for Rangers International Football Club (R), having allegedly acted in concert with others to acquire shares carrying more than 30% of the voting rights. When the offer was not made, the Takeover Panel applied for a court order pursuant to its statutory enforcement right under section 955 of the CA 2006 to compel K to make the mandatory offer. The court granted the order sought by the Takeover Panel. However, notwithstanding this, no offer was made by K and the Takeover Panel was forced to initiate proceedings for contempt of court. It was only after these proceedings had been initiated that K made a mandatory offer, in accordance with the TAB's original ruling. Following the making of the mandatory offer, the Panel Executive requested that the Panel Hearings Committee convene to consider disciplinary sanctions against K. K did not dispute that he had contravened the rules as broadly set out (with certain limited exceptions). However, he argued that a statement of public censure should be sufficient punishment, in particular given that he had, by this time, made a mandatory offer to the remaining shareholders. The Panel Hearings Committee rejected the argument that a public censure was sufficient. However, it did consider certain of the mitigating facts raised by K when considering the length of sanction to impose. Specifically that K had not contravened the Takeover Code's rules prior to the events in question and had no previous disciplinary record; that there was evidence that K's actions were not motivated by the prospect of financial gain or commercial advantage; and that there was no clear evidence of significant detriment to shareholders as a result of K's non-compliance. (*Ruling of Hearings Committee of Takeover Panel*, 11 October 2019)

Key lessons

- **Compliance with a ruling will not absolve a party of disciplinary sanctions**: This is the first time that the Takeover Panel has both required a person to make a mandatory offer and imposed a cold-shouldering order on that person in relation to the same set of facts.
- **Motivating factors are not exculpatory but will be taken into consideration when considering disciplinary sanctions**: The Panel Hearings Committee commuted K's sentence from five to four years based on certain mitigating facts.

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CREST shareholders may claim for losses resulting from information published by an issuer

A listed company (T) has failed to strike out two group litigation actions brought in relation to allegedly untrue or misleading statements or dishonest omissions made by T.

In 2014, T announced that its previously announced expected profit for the half year had been overstated. Subsequent announcements identified further overstatements in previous financial years. Certain institutional investors brought claims against T under section 90A and Schedule 10A of the Financial Services and Markets Act 2000 (FSMA 2000) to recover losses in respect of investment decisions which they made in alleged reliance on information published by T. All of the claimants had held their T shares in uncertificated (or "dematerialised") form through the CREST system. As is typical, the legal owner of each dematerialised share was a custodian bank or financial institution or a nominee. In most cases there was then a custody chain of other intermediaries between the legal owners and the ultimate investors (i.e. the claimants). T applied to strike out the claims, on the basis that no claimant in a custody chain with more than one intermediary had an "interest in securities" within the meaning of Schedule 10A of FSMA 2000, and that none of the claimants could properly be said to have "acquired, continued to hold or disposed of" an interest in securities as required by Schedule 10A.

The High Court held that the claimants had an "interest in securities" sufficient to enable them to maintain proceedings for the purposes of s.90A and Schedule 10A FSMA 2000. The "right to a right" which they held via the custody chain was, or could be equated to, an equitable property right in respect of the securities. The High Court also held that any process whereby, in a transaction or transactions on CREST, the ultimate beneficial ownership of securities falling within Schedule 10A comes to be vested in or ceases to be vested in a person constitutes the acquisition or disposal of any interest in securities. As neither limb of T's argument was sustainable, the High Court dismissed its strike-out application. (*SL Claimants v Tesco PLC* [2019] EWHC 2858 (Ch))

Key lessons

- **Preserves the legal status quo**: This is an important decision, because most UK-listed shares are held through CREST. However, it essentially confirms the existing general understanding of s.90A and Schedule 10A FSMA 2000.
- **Clarity for equity investors**: Equity investors will welcome the High Court's confirmation that s.90A and Schedule 10A FSMA 2000 apply to CREST shareholders. The High Court's decision also offers some reassurance to other investors holding UK-listed securities through intermediaries.
- **Implications for prospectus claims**: Similar arguments to T's could be made by issuers defending claims under s.90 of FSMA 2000, given similarities in the relevant wording. Section 90 allows investors who acquire securities to recover losses suffered in reliance on untrue or misleading statements or omissions in prospectuses or listing particulars.
- **Potential legal reform**: The Law Commission is currently studying issues relating to intermediated securities. It might agree with the High Court's suggestion that Schedule 10A of FSMA 2000 could be clarified by adding a tailored definition of "any interest in securities" for uncertificated securities.

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FCA fines issuer, CEO and FD for failing to announce inside information

The Financial Conduct Authority (FCA) has fined a premium listed company (C), its Chief Executive Officer (J) and its Finance Director (E) in relation to the company's failures to take reasonable steps to establish and maintain adequate procedures, systems and controls, announce inside information as soon as possible, and to deal with the FCA in an open and co operative manner.

C did not monitor how it was performing against market expectations of its financial performance in 2015. In August 2015, C also did not receive its usual year-end forecast from its 50.56%-owned listed subsidiary L, from which 70% and 80% of C's revenue derived. Around the same time, C's financial advisers raised concerns that C might significantly miss market expectations for its financial performance over the full year, and that this could be inside information. On 6 December 2015 C produced its first completed year-end group forecasts for 2015. These projected that C's year-end financial performance would be well below market expectations. C ultimately released a trading update on 29 December 2015 and its share price dropped by 18.2%. In 2016, C sent two letters to the FCA providing information which did not accurately reflect the forecasting procedures which it had actually followed in 2015, nor the forecasts actually provided to its Board in 2015.

The FCA fined C £411,000. It also fined J (C's CEO) £214,300 for being knowingly concerned in each of C's breaches, and fined E (C's Finance Director) £40,200 for being knowingly concerned in one of C's breaches. The FCA considered C's breaches to be "particularly serious" and (except for one breach) also "reckless". Its systems, procedures and controls "were so inadequate that it was unable to keep the market properly informed of its financial performance". In its decision, the FCA stated that it expects a premium listed company to: (a) regularly monitor changes in its financial performance and its expectations of year-end performance; (b) be aware of market expectations regarding its financial performance; and (c) check regularly whether its own expectations of financial performance are in line with market expectations. The two directors (J and E) were fined under section 91(2) of the Financial Services and Markets Act 2000, which empowers the FCA to impose an unlimited fine upon any director who is "knowingly concerned" in a contravention by a company. (*FCA Final Notices to Cathay International Holdings Limited, Jin Yi Lee and Eric Ka Chi Siu* – 28 June 2019)

Key lessons

- **Promptly disclose inside information**: Failure to promptly announce inside information remains an important area of focus for the FCA. This core obligation continues to apply under Article 17(1) of the Market Abuse Regulation, which superseded DTR 2.2.1R in July 2016.
- **Monitor financial performance against market expectations**: Issuers need to ensure that they maintain adequate procedures, systems and controls to regularly monitor their financial performance against market expectations. Indicators of market expectations may include analysts' research reports and any guidance on outlook previously provided by the issuer.
- **Accurate communications with the FCA**: Issuers must provide clear, accurate and complete information to the FCA. The FCA takes a dim view of communications which do not provide a reasonable, full and accurate picture of events, or which are otherwise misleading or inaccurate.
- **Personal liability of directors**: The FCA will pursue directors personally where an issuer's breach of the UK listing regime is sufficiently serious. This is the first time since 2004 that the FCA or its predecessor has fined directors for being "knowingly concerned" in a company's breach of the UK listing regime.

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Issuer fined for failing to disclose the indictment of a director

The LSE has censured and fined an AIM company (T) £350,000 for failing to disclose an historic indictment of its CEO, and a previous variation of his name, over a period of 12 years. However, in the circumstances the LSE waived the fine.

T was admitted to trading on AIM in 2005. In 2017, T announced that O, its CEO since admission, had resigned from the board of directors and his employment had been terminated following an independent review. The review had found that the indictment had been issued in the US against the CEO under a previous variation of his name. The indictment had been knowingly withheld from successive nominated advisers (nomads). It had also not been disclosed to T's Board, which was only made aware of its existence through third parties. It was not disclosed in T's admission document in 2005.

In waiving the fine, the LSE recognised the real difficulties faced by T's Board and advisers. It also noted T's swift action when the matter came to light and the Board's full co-operation in the LSE's investigation. (*AIM Disciplinary Notice* AD 22, dated 1 July 2019)

Key lessons

- **Robust due diligence and verification by issuers**: For issuers, this decision underlines the importance of asking pertinent questions during due diligence and verification of the admission document, following up any inconsistencies or concerns which may arise, and maintaining adequate records of these processes. This will assist the issuer to investigate or respond if concerns subsequently arise.
- **Robust director due diligence by nomads**: For nomads, similar comments can be made regarding the process of investigating and considering the suitability of each director, when assessing the appropriateness of an issuer for AIM under Rule 14 and Schedule Three of the AIM Rules for Nomads.

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Good faith

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

Call notice under SHA enforced but no breach of good faith nor unfair prejudice

Following exercise of a call option under an SHA, a shareholder was ordered to specifically perform its contractual obligation to sell its 50% shareholding to the other party. An unfair prejudice petition and claims for breach of an implied duty of good faith were rejected.

There was a dispute under a shareholders' agreement (SHA) in relation to the holding company (B) of an operating company (S) which ran a football club. In addition to B and S, the parties to the SHA were X and Y, which were 50:50 shareholders in B, and their individual guarantors. Y also owned the property assets used by the club. S ran into financial difficulties and there was a dispute over who would bear the funding deficit. Y served a call option notice on X to acquire X's shareholding, not appreciating that X had reciprocal rights to buy out Y. X served a counter-notice to buy Y out at the same price and applied to enforce a related SPA. Under a separate provision of the SHA, S was obliged to acquire the property assets held by Y if X acquired 75% or more of B's issued share capital. X tried to circumvent this by transferring most of its shares in B to a newco nominee. Y applied for the SPA to be declared void. Y argued that B was a quasi-partnership and that X and Y consequently owed each other obligations to act fairly and in good faith, which X had breached. The High Court said Y would have had to show that the shareholders had intended to conduct their business affairs on the basis of mutual trust and confidence, and rejected this because the SHA contained an entire agreement clause. This prevented parties from introducing different or additional understandings which were not included as contract terms. In any event, B's affairs were governed by its articles of association and the very detailed terms of the SHA, rather than a personal relationship of co-operation and trust between the parties. The court also rejected Y's arguments that the SHA was a "relational" agreement into which obligations of fair dealing and good faith had to be implied. The SHA and associated contractual documents were extremely detailed and professionally drafted, making it difficult to imply terms. It was impossible to say here that the SHA did not function effectively without an obligation on both parties to act at all times in good faith. Any such obligation could not continue anyway once either party had exercised the right to serve a call option notice because, from then on, they had conflicting interests. Y's unfair prejudice petition was also rejected. A shareholder is not entitled to complain about the way in which another shareholder exercises rights in relation to their shares unless it amounts to management of the subject company's affairs, rather than a shareholder's own affairs (as here). However, X could not avoid the property acquisition by transferring shares to a nominee. Permission has been requested to appeal the judgment. (*UTB LLC v Sheffield United Ltd* [2019] EWHC 2322 (Ch))

Key lessons

- **Quasi-partnerships**: The judgment demonstrates that understandings of mutual trust and confidence are needed in order to establish a quasi-partnership, and may be precluded by an entire agreement clause.
- **Implied terms and relational agreements**: The judgment shows the need for clear and express drafting on inter-shareholder duties and responsibilities, and that terms associated with relational agreements will not be implied where the agreement can function effectively without them.

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