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2022 Summer review M&A legal and market developments

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We set out below a number of interesting English and European 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

Interpretation of pre-emption procedure under articles of association

The High Court rectified retrospectively an offer for sale notice served under a pre-emption procedure in articles of association, both to correct the number of shares offered and also to specify that the recipient could apply for shares in excess of its offered proportion.

Majority shareholder M held 85 out of the 100 shares in issue in company C. Minority shareholder N held 15 shares. M wanted to sell all his shares to third party W, and served a transfer notice on N, pursuant to the articles, that he intended to do so. As required by the articles, C served an offer for sale notice on N as M's agent. However, this only offered to sell N 13 of M's shares (being 15% of 85). N subsequently purported to accept the offer in respect of all 85 of M's shares. The pre-emption provisions in the articles required sale shares to be offered to members (other than the seller) *"in proportion to the number of shares held by* ***them*** *respectively"*. The High Court decided that the only logical way to interpret the provision was that all a selling party's shares had to be offered to the non-selling shareholders in proportion to their shareholdings, meaning, where there was only one shareholder, M's entire 85 shares. The court rectified the offer for sale notice to specify that it covered 85 rather than 13 shares. A key interpretation issue was whether the word "them" in the pre-emption provision meant either all the members or all the members other than the proposed seller. The court decided there would be no point in having the pre-emption provisions on the first interpretation. The clear intention behind them was that a seller could only

> **Key lessons**
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> - **Clear and unambiguous drafting:** The judgment highlights the need for clear and unambiguous drafting of pre-emption provisions in articles of association, and interaction between related articles.
> - **Factors in taking up pre-emption rights:** The judgment confirms that shareholders may act in their own interests in responding to pre-emption rights.

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be compelled to sell to the other members if those other members were prepared to take up all his shares. This could never happen on the first interpretation. It was bolstered by the fact that the articles only appointed C as agent for the sale of all (but not some) of a seller's shares. The court also rectified the offer for sale notice to invite N to apply for shares in excess of its offered proportion, although it decided the relevant article independently created this right anyway either on its terms or by implication or incorporation by reference into the offer for sale notice. Finally, the court denied M's argument that N had breached an implied term not to act arbitrarily, capriciously or irrationally[1] in taking up its pre-emption rights, on the basis W was offering a better deal for creditors. A party could generally respond to pre-emption rights in its own interests, not what might be better for someone else, unless perhaps in extreme circumstances it knew it could not pay for the shares or otherwise perform its contractual obligations. (*Standing & Anor v Power* [2021] EWHC 1744 (Ch))

Impact of articles on quorum requirements at board meetings where sole director

The High Court decided that a sole director lacked the power under the company's articles of association to commence a counterclaim, where it interpreted a requirement in the articles for a board quorum of two as setting a minimum number of two directors to run the company.

Company C had been set up by W, who was initially its sole director. H subsequently became a shareholder and was appointed director. When their relationship broke down W removed H as director and treated him as a bad leaver. H brought an unfair prejudice petition and C brought a defence and counterclaim to that. The High Court struck out the counterclaim, deciding that W did not have power under the UK Companies Act 2006 (the CA 2006) as sole director to direct C to commence it. The High Court interpreted the provision in C's articles requiring at least two directors to constitute a quorum at board meetings as amounting to a requirement for C to have at least two directors to manage its affairs. Critically, C's articles were based on the UK statutory private company model articles (MA). These included article 7(1) of the MA, which requires directors to act either through majority decision at a meeting or by unanimous decision and article 7(2) of the MA, which disapplies article 7(1) where a company only has one director and no provision of the articles requires it to have more than one director. They also included an adapted version of article 11(2) of the MA (which provides the quorum at board meetings should never be less than two and, if not fixed by the directors, is two) to set absolutely a quorum of two directors comprising one investor director plus the executive. The court specifically stated that, not only did that bespoke article require there to be two directors of the company, but that in any event companies with a sole director should amend the MA, including by deleting article 11(2). This marks a departure from past market practice, where generally articles setting a quorum for board meetings have been treated as only applying where there are multiple directors and not setting a minimum number of directors to manage the company. (*Re Fore Fitness Investments Holdings Ltd, Hashmi v Lorimer-Wing & Anor* [2022] EWHC 191 (Ch))

Key lessons

- **Sole director companies should amend the model articles:** In light of this judgment, sole director companies should amend article 11(2) of the model articles, or individually adapted versions of that article, to provide expressly that the quorum at board meetings is one at any time when there is only one director.
- **Express provision on minimum number of directors:** It would also help to state expressly in the articles that in these circumstances the minimum required number of directors to run the company is one.
- **Ratification of past decisions:** Sole director companies which have previously relied on the model articles unamended should consider ratifying key past decisions of their sole directors, such as entry into key agreements. Buyers may want to investigate whether this has happened when doing due diligence on share acquisitions of a group comprising such companies.

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1 Under *Braganza v BP Shipping Ltd & Anor* [2015] UKSC 17.

Force majeure clause did not require party to accept non-contractual performance

The High Court decided that a party did not have to accept a non-contractual performance to meet a reasonable endeavours obligation, where a contract provided that an event would not amount to force majeure if it could be overcome by the affected party's reasonable endeavours.

Shipowner (Dutch company, O) entered into a contract in 2016 with charterer (Jersey company, C) for the shipment of goods from Guinea to Ukraine. A couple of years down the line the US government sanctioned certain Russian entities, including C's parent company. The contractual currency was US dollars, for payment in the Netherlands. The effect of the sanctions was that payment could not be effected in US dollars. The definition of force majeure event in the contract included one which prevented or delayed loading or discharge of cargo by reference to restrictions on monetary transfers and exchanges or rules or regulations, acts or directions of governments, save where it could be overcome by the affected party's reasonable endeavours. O refused C's request to accept payment in euros. The issue was whether O had failed to use reasonable endeavours to overcome the effect of sanctions. The High Court decided that it had not and that a force majeure event had indeed arisen. The agreed contractual currency was an important obligation. It was a contractual right of O's and reasonableness did not apply. It made no difference that O's Dutch bank would credit a euros payment with a dollar equivalent. The actions of an intervening third party should not be taken into account and there could be costs or losses anyway on currency conversion. The court also decided that O's response to the relevant event here, in deciding not to accept euros, did not break the chain of causation between the event and the failure to perform the contract, as long as the response was reasonable as in this instance. Leave has been granted to appeal the decision. (*MUR Shipping BV v RTI Ltd* [2022] EWHC 467(Comm))

Key lessons

- **Scope of force majeure clauses:** The decision gives interesting guidance on the scope of force majeure clauses in the context of sanctions.
- **Endeavours obligations:** For parties seeking to apply an endeavours obligation, express wording to itemise steps that should be taken to meet the obligation may give clarity around the scope of the obligation.

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Buyer breached SPA earn-out clause but no earn-out due

The High Court decided that no earn-out was due under a share sale and purchase agreement (SPA) despite finding that the buyer had breached the requisite procedure in the SPA for preparing the relevant earn-out statement.

The SPA provided for three possible earn-out payments, based broadly on revenue less costs. The sellers (S) alleged that buyer B had agreed orally to adjust the revenue streams required to trigger the second and third payments. B denied this and argued that would have been invalid anyway due to a "no oral modification" (NOM) clause in the SPA stating that no variation of the agreement would be effective unless in writing and signed by the parties. The High Court decided that there had been no oral agreement. Even if there had been, it would have contravened the NOM clause and been invalid, taking into account that the SPA continued to co-exist with continuing rights and obligations for both parties. Interestingly, although no earn-out was due anyway, the court decided that B had breached the process requirements of the SPA for preparing the earn-out statement. These required B to provide reference accounts for the earn-out period and a statement "*prepared by [B's] auditors*" calculating the earn-out payment, where "reference accounts" was defined as including "*an audited balance sheet and profit and loss account*" for the relevant financial period. When B's statutory auditors declined to act over independence concerns, these had been prepared by B's chief financial officer. The High

Key lessons

- **Importance of following process mechanisms in SPA:** The decision serves as a reminder of the importance of following exact process mechanisms in SPAs for preparing and agreeing price adjustments.
- **Binding nature of "no oral modification clauses":** The judgment also reinforces the binding nature of "no oral modification" clauses under English law and the high hurdle to raise an estoppel against a party relying on such a clause.

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Court decided that, where B's statutory auditors could not act, a term would be implied to give business efficacy to the contract. That implied term should be that B appoint a suitably qualified independent firm, which had not happened here. The effect was that the earn-out statement did not comply with the SPA. This meant that the subsequent provisions in the SPA for S to challenge B's draft within a set time period were not engaged, although on the facts no earn-out was due anyway. (*Asher & Ors v Jaywing Plc* [2022] EWHC 893 (Ch))

Whether variations clause permitted oral modifications

In an application for summary judgment, the High Court decided that a facility agreement was ambiguous over whether or not it prohibited oral modifications and that this was a question for trial.

Company C entered into a finance facility agreement with bank B to finance the purchase of commodities. Two years later some commodities were heavily delayed and C suffered penalties from its suppliers. It became in arrears under the facility agreement and B applied for summary judgment for unpaid principal and interest. C alleged that B had agreed orally to extend the maturity dates in several telephone conversations. B: denied this; said that any change would only have had effect as part of a wider restructuring, including improvements to its security, which had not been agreed nor happened; and that it would have been invalid anyway due to a no oral modification (NOM) clause in the agreement. This stated that amendments needed to be "*with the agreement of the borrower and lender in writing*". The High Court considered the natural meaning of this language in the factual context. It decided the clause was ambiguous over whether it meant a variation would not be valid unless agreed to in writing or that an oral variation would be valid if evidenced in writing. It would have been clearer if the word "shall" had been used. Whilst the latter interpretation might give no meaning to the words "in writing", the real question simply was what "in writing" meant here. There was only limited evidence available on this application for summary judgment. To determine the issue the matter should go to trial. (*Integral Petroleum S.A. & Ors v Bank GPB International S.A. & Ors* [2022] EWHC 659 (Comm))

Key lessons

- **Clear and express drafting needed:** The decision demonstrates the importance of clear and express drafting of "no oral modification" clauses. The real question here was whether the provision amounted to such a clause at all.
- **Estoppel against a party relying on a no oral modification clause rare:** Whilst in limited circumstances a purported oral variation might, on certain facts, give rise to an estoppel against the party seeking to rely on a no oral modification clause, those situations would be the exception.

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Directors' duties in entering into new loan to repay indebtedness and interaction with SHA

The High Court decided that it was within the range of reasonable decisions of the directors to enter into a new loan to repay company C's existing indebtedness, even though this breached the reserved matters in the shareholders' agreement (SHA) relating to C.

M was majority shareholder in C and party to the SHA. The other parties were C and the directors (D). The SHA contained a series of reserved matters requiring M's approval. Under the SHA D were obliged to abide by the reserved matters to the extent lawfully able to do so and taking into account their fiduciary duties exercisable in their capacity as directors of C or any other member of its group. M's associate G made a secured loan to C, guaranteed by intermediate holding company K and various operating subsidiaries (opcos). When the parties' relationship broke down, G demanded repayment of his loan. D then applied for insolvency moratoria in respect

Key lesson

- **Creditors' interests duty and SHA reserved matters:** The judgment gives guidance on director duties in an insolvency or near insolvency situation, particularly on the interaction with a reserved matters structure in an SHA.

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of C, K and some of the opcos. The application in relation to C subsequently became subject to an administration order. D proposed to take out a new loan to repay G and refinance other liabilities. This would be at a lower interest rate and on more borrower-friendly terms. M challenged this on the basis it would breach the reserved matters in the SHA. The High Court refused M an injunction to prevent D taking out a new loan. Where, as here, a company was insolvent, or likely to become insolvent, the creditors' interest duty was triggered. The court would not accept any suggestion that the reserved matters in an SHA should influence a director's decision-making once that duty was triggered, which would be *"particularly unattractive"*. The creditors' interest was now the paramount one to which the directors must have regard. Here, that interest was in being paid. It was significant that the proposed new loan would provide funds for other creditors to be repaid, not just G. It was strongly arguable that the decision to enter into the new loan was within the range of reasonable decisions open to D, even though it was not the only proper course. The court rejected the suggestion that D had acted for an improper purpose to try to disrupt an orderly sale of C by its administrators. (*MI Squared Ltd v King & Ors* [2022] EWHC 331 (Comm))

Company law

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

Interaction between "ultra vires" doctrine, directors' duties and knowledge of company

The Court of Appeal declined to reopen a single appeal judge's refusal of permission to appeal. The effect was that director-members of a company limited by guarantee could not rely on shareholders' unanimous consent to ratify their actions as directors over pension arrangements for their benefit which breached the company's memorandum of association.

C was a company limited by guarantee which met certain criteria in the CA 2006 for exemption from using the word "limited" in its name. Connected to this, clause 5 of its memorandum of association (MoA) stated that its income and property could be applied only towards promoting its objects and no portion could be paid to members save as payment for services rendered. Under the MoA, clause 5 could only be amended by unanimous vote of all members at a general meeting. There were only two directors (D), who were also the only members. D made employer's contributions for themselves into self-invested personal pensions (SIPPs). They funded these by transferring C's premises to the SIPP provider and arranging for C to pay rent into the SIPP. After D resigned, C claimed that the property transfer had amounted to a breach of their director duties. D argued they had acted lawfully on the basis the CA 2006 provides that the validity of a company's acts cannot be called into question on the ground of lack of capacity by reason of anything in its constitution and that there had been unanimous consent from C's only members. The Court of Appeal rejected this, emphasizing that the CA 2006 had only abolished the "ultra vires" rule, that a company did not have capacity to undertake acts outside the scope of its objects as set out in its constitution, as between the

Key lessons

- **Shareholders' unanimous consent to amend constitution:** There is a clear line of case law that shareholders' unanimous consent can be used to amend articles of association informally. By contrast, the issue in this case was that the members had not followed the correct processes in the case of a company limited by guarantee, and exempt from using the word "limited" in its name, to cease to avail itself of that exemption and then remove the related restriction on distributions to members in its memorandum.
- **Absence of entrenched provision:** Were it not for the failure to follow the correct process for an exempt guarantee company to cease to avail itself of that exemption, the restriction on distributions to members in this company's memorandum could have been removed by unanimity of members in accordance with its terms. In a different case where an equivalent restriction on distributions was instead entrenched in a guarantee company's articles, and members could not use standard decision-making procedures to remove it, the court sanctioned a scheme of arrangement as an alternative method to do so (*Re Credo Care Ltd.* [2021] EWHC 3701 (Ch)).
- **Breaches of director duties:** The Court of Appeal also found that the directors here had: failed to act within their powers; breached the duty to promote the success of the company; failed to act with reasonable care, skill and diligence; and put themselves in a position of conflict with the company in breach of duty.

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company and third parties and that acts ultra vires were not ratifiable by shareholders' unanimous consent. They had failed to amend C's name so that C ceased to avail itself of the exemption from using the word "limited" and then to amend the MoA to remove the clause 5 restriction. Instead they had simply effected these particular distributions in breach of the existing MoA. The Court of Appeal also followed a previous line of case law that knowledge of a director's breach would not be attributed to the company to preclude a claim against them for breach of duty, even where the director was the only shareholder. (*Ceredigion Recycling & Furniture Team v Pope & Anor* [2022] EWCA Civ 22)

Court sanctioned scheme of Bermudian company designed to amend SHA

The High Court sanctioned a scheme of arrangement in respect of Bermudian company W designed to amend the English law SHA relating to W. The aim was to provide that certain corporate actions would no longer need unanimity, where one shareholder could no longer exercise voting rights.

W was a Bermudian company which wanted to do a restructuring to reorganise its funding. Its six shareholders were parties to its SHA, which was governed by English law. One of these was an overseas special purpose vehicle (S) undergoing an internal dispute over who was authorised to act on its behalf. The effect was that S did not have anyone to vote for it nor take part in decisions. An English scheme of arrangement was proposed to substitute a 90 per cent. approval requirement in the SHA instead of unanimity for corporate acts relating to funding, provided that no member voted against them. Critically, W applied for a parallel scheme in Bermuda, both to ensure the amendments to the SHA would be binding in both jurisdictions, and to effect parallel amendments to W's bye-laws. Significantly, W gave undertakings to the English court not to deliver any sanction order to the UK Registrar of Companies unless and until the Bermudian scheme was sanctioned. The High Court sanctioned the English scheme. It noted that previous case law had indicated that generally a scheme between a non-UK company and its members should be governed by the laws governing such overseas company. However, distinguishing features here were that: a parallel scheme was proposed in Bermuda and the schemes were inter-dependent; there was reasonable doubt under English conflict of laws rules over whether amending the English law SHA under a Bermudian scheme would be enforceable under English law; W had sufficient connection with the English jurisdiction given the governing law of a key constitutional document was English law; and there was overwhelming shareholder support. (*Re West African Gas Pipeline Co. Ltd* [2022] EWHC 296 (Ch))

Key lessons

- **English court sanctioned solvent members' scheme of overseas company:** This is the first reported case in which the English court has sanctioned a solvent members' scheme of arrangement of an overseas company.
- **Use of scheme to remove constitutional roadblock:** This is an interesting example of use of a scheme of arrangement to facilitate shareholder approval where there would otherwise have been a requirement for unanimity under the SHA. This follows the use of a scheme to remove an entrenched provision in a company's articles of association in the earlier case of *Re Credo Care Ltd* [2021] EWHC 3701 (Ch).

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No class issues on scheme of arrangement after consideration of members with particular issues

The High Court decided on the facts that differences in the position of individual shareholders were insufficient to give rise to class issues on a scheme of arrangement.

A scheme of arrangement in relation to unlisted shares in company C would effect a merger between two investment management companies. One key issue was the mix and match facility for part of the consideration, involving consideration shares to be issued in the new company which would run the combined business. This would not be available to shareholders with holdings worth less than £45,000. For any amount of consideration above £45,000 shareholders could elect to receive cash and ordinary and/or preference shares insofar as available, after satisfying other shareholders' elections. Another issue was treatment of bad leavers down the line, who could be required to transfer their shares at a discount to fair value. There were some differences over the level of discount applying to different shareholders and some shareholders not previously subject to a bad leaver clip would be in respect of the share consideration. Immediately after the second directions hearing, 22 individual shareholders wrote to C's board expressing concern over the scheme. Notwithstanding this the court decided that separate class meetings were not needed and sanctioned the scheme. It took into account that overall there was overwhelming support for the deal as the best way forward. From analysing the voting figures, it decided the statutory majorities would in almost every case have been achieved even if the relevant members had voted in separate classes. Just because the mix and match facility was not available to all shareholders did not mean that shareholders could not consult together. Differences in rights could be material without leading to separate classes. The difference from the mix and match facility could be characterized as one of enjoyment of the rights attaching to the shares rather than the rights themselves. The court was comfortable that the meeting was fairly representative, the statutory majority was acting in good faith and the scheme was one that an intelligent and honest member of the class concerned might reasonably approve. (*Re Smith & Williamson Holdings Ltd* [2020] EWHC 3931 (Ch))

Key lessons

- **Analysis of voting figures key:** In deciding that separate class meetings were not needed it was key that, from analysis of the voting figures, it appeared that in virtually every case the statutory majorities would have been achieved anyway.
- **Other factors:** The court took into account that the scheme was fully explained to shareholders and had been unanimously recommended by the directors.

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Duties of non-executive director of private company

The High Court disqualified a non-executive director and chair of a private company which went into insolvent liquidation after entering into 28 transactions that subsequently were held to have been connected to a fraud on Her Majesty's Revenue & Customs (HMRC).

D was a non-executive director who worked one day a month for private company C. D did not have a service contract defining his role. He perceived this as introducing investors, leveraging contacts and getting C ready to list on AIM. D was not involved operationally and three other individuals were directors or shadow directors in the relevant period. After expanding into a new business line, C entered into 28 transactions in a six-month period that were held to involve a VAT fraud on HMRC. C subsequently went into creditors' voluntary liquidation. The High Court disqualified D for four years, even though he was not involved in the fraud. It emphasized that directors' duties are owed equally by executive and non-executive directors, whether full or part-time. A director who has delegated remains responsible for supervising that delegation and assessing the reasonableness

Key lessons

- **Duties of non-executive directors:** The decision demonstrates that directors must be proactive in fulfilling their statutory duties, which apply equally to non-executive (part-time or otherwise) as to executive directors.
- **Director delegation:** Directors who delegate should supervise delegatees and keep written records of information provided and relevant dialogue, to help demonstrate appropriate supervision and refute allegations of breach of duty against the delegating director.

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or otherwise of relying on the outcome from it. D had failed to inform himself of C's affairs and had not known of the 28 transactions in question even though he had signed C's accounts for a period covering 27 of them. He should have enquired into the huge uplift in C's turnover from the VAT fraud, both as part of protecting shareholders' investment and also to inform his role in ensuring C was in a position to go to market. D needed to know what the uplift represented, both so that he could explain to existing and potential investors all aspects of C's business and also to advise C on how a listing would be perceived. In further dereliction of duty he had failed to investigate further when told that two of the other directors had past convictions, leaving them to run C and deal with HMRC. This included failing to respond to correspondence specifically addressed to him. It was not relevant that D only worked for C part-time. (*Secretary of State for BEIS v Selby & Ors* [2021] EWHC 3261 (Ch))

Director liability for breach of financial promotion rules

The Court of Appeal allowed an appeal by a former director against a finding of liability following an unlawful financial promotion by the company. To be liable, a director would have needed to know the factual circumstances that prevented a potentially relevant disapplication from applying.

Company C had communicated an invitation to invest in its securities as part of a retail offering to raise capital. It raised £3.6 million but never traded and went into administration. Section 21(1) of the UK Financial Services and Markets Act 2000 (FSMA) prohibits financial promotions in the course of a business unless an exemption applies. Section 21(2) disapplies that prohibition if the communication is made or approved by an authorised person. The UK Financial Conduct Authority (FCA) brought proceedings against various individuals, including former director D, under s. 382 of FSMA. This allows the court to make a restitution order against a person who, although not a primary contravener, has been *"knowingly concerned"* in breaches of certain provisions, including s. 21(1). The issue here was that the invitation to invest had not been approved by an authorised person. D alleged she had not been "knowingly" concerned. The accountants acting on the fundraising had been tricked into approving the communication by another director. D had not known that they were not authorised by the FCA. The Court of Appeal allowed D's appeal. For a secondary party to be liable, not only must they know the facts that amounted to a breach of the legislation, but also the factual circumstances that prevented a relevant disapplication from applying. The legislature had clearly intended a different test for liability between a primary infringer (which had no knowledge qualification) and a secondary party (which did have one). It made no difference that the equivalent previous statutory provisions covering financial promotions, before s.21(1) was introduced, had structured the s. 21(2) disapplication within the same sub-section as the primary prohibition, rather than as a separate provision. The Court of Appeal also denied liability should be imposed to prevent a director from hiding behind the corporate veil. Conventional circumstances for piercing the corporate veil were far narrower, such as where a company has been set up as a sham for the purposes of a fraud. (*The Financial Conduct Authority v Ferreira* [2022] EWCA Civ 397)

Key lessons

- **Approval by authorised persons:** Directors should still make sure that a person approving a financial promotion has been authorised by the FCA.
- **Piercing the corporate veil:** The judgment contains interesting guidance on the limits on piercing the corporate veil.

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Listed companies

The following decisions are of particular interest to listed companies

Directors liable for misstatements and omissions in an issuer's published information

The High Court has found the former CEO and CFO of a listed UK software company (A) to be liable for statements in A's published information which were known by the CEO and CFO to be false.

A subsidiary (Bidco) of a US IT company (H) acquired A through a recommended cash takeover offer announced in August 2011. A and Bidco subsequently alleged that A published information which was known by A's CEO and CFO to be false. This was based on the allegedly: (a) dishonest description of A as being a "pure software company"; and (b) dishonest presentation of A's financial performance, which disguised improper practices which A adopted to boost and accelerate revenue. It was contended that this resulted in A being of considerably less value than it appeared to be. Under Schedule 10A of FSMA, an issuer (such as A) is liable to compensate persons who make investment decisions in reliance on information published by the issuer and suffer loss as a result of untrue or misleading statements in, or omissions of required matters from, that information. Any other persons (such as the CEO and CFO) are generally protected from liability, other than to the issuer. To enable a claim against the CEO and CFO, A first admitted liability for H and Bidco's claim under Schedule 10A of FSMA. A then sued the CEO and CFO to recover this loss (on the basis that they had breached their duties as directors and employees). The parties accepted that the CEO and CFO would only be liable in respect of misstatements or omissions by A about which they themselves knew. It was not sufficient for the claimants to demonstrate that the transactions or the way that they were accounted for was improper. They also needed to prove personal knowledge and dishonesty in respect of the false accounting on the part of the defendants.

A's admission of liability did not bind the Court. The claimants had to first establish that A was liable to Bidco under Schedule 10A of FSMA, and then that the CEO and CFO were liable to A. Only Bidco acquired shares in A, and so only Bidco could bring a claim under Schedule 10A of FSMA.

Key lessons

- **First trial of a s.90A or Schedule 10A claim:** This is believed to be the first case to come to trial involving a claim under Schedule 10A of FSMA or its predecessor section 90A. Those provisions have applied since November 2006, and so the success of this claim is a noteworthy development for listed companies.
- **Claim against target directors not target:** In this case, the bidder (and target) of the takeover successfully used a two-part "dog leg" claim structure to pursue target directors. This got around the limitation of the directors' liability under Schedule 10A of FSMA. This structure is of potential interest in takeover situations.
- **Parent's reliance treated as Bidco's reliance:** The use of a newly-incorporated special purpose vehicle as the Bidco (which is common on takeovers) did not invalidate the claim under Schedule 10A.

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However it was H that claimed to have been influenced by A's published information and H undertook due diligence. The Court held this did not mean Bidco could not satisfy the reliance test. H could be treated as the controlling mind of Bidco, and H's reliance could be treated as Bidco's reliance. The factual basis of the relevant claims related to six areas of A's business and accounting. The Court found that liability was established in five of the six areas. The Court concluded that A "was a smaller company with a materially less attractive revenue mix, with lower growth and less success in the market and (overall) lower profit margins than it was represented and appeared from its published information to be." A separate judgment on quantum will follow. However, the Court provisionally considered that the claimants' loss, although substantial, will be substantially less than the amounts claimed. (*ACL Netherlands B.V. and Ors v Michael Richard Lynch and Anor* [2022] EWHC 1178 (Ch))

Information regarding an article reporting a market rumour can be inside information

The ECJ has provided guidance on whether information regarding the forthcoming publication of an article reporting a market rumour could be inside information, and when it can be disclosed.

A journalist (A) wrote two articles for the Daily Mail's website reporting market rumours regarding possible takeover bids for companies with securities admitted on Euronext. The French regulator (AMF) imposed a financial penalty of EUR €40,000 on A for unlawfully disclosing inside information relating to the forthcoming publication of the two articles to two of his usual sources of information. The AMF's decision was appealed to the Court of Appeal, Paris, which referred certain questions to the European Court of Justice (ECJ) for a preliminary ruling.

"Inside information" must be "of a precise nature" (Article 1(1) of the former Market Abuse Directive (2003/6/EC) (MAD)). Information is of a precise nature if it: (1) indicates circumstances or an event which exist or has occurred (or may reasonably be expected to); and (2) is specific enough to enable a conclusion to be drawn as to their possible effect on the prices of financial instruments (Article 1(1) of former Directive 2003/124/EC). The referring court considered condition (1) to be satisfied, because publication of the articles was reasonably expected to occur. Regarding condition (2), the ECJ held that information relating to the forthcoming publication of an article reporting a market rumour about an issuer is capable of constituting precise information. The ECJ held that both (a) the fact that the article mentioned the possible takeover bid price, and (b) the identity of the journalist (author) and the media organisation (publisher), are relevant factors for the purpose of assessing precision, if they were disclosed before publication. The actual effect of a publication on the prices of securities may constitute *ex post* evidence of precision. However it is not sufficient, in itself, without examining other factors known or disclosed before publication.

Key lessons

- **Relevance in the UK:** While this decision relates to the repealed MAD and the EU MAR, the equivalent wording in the UK Market Abuse Regulation is substantially the same. Accordingly, we expect the UK courts will have regard to this decision when interpreting it.
- **Significance of false rumours?** At least one of the reported rumours appeared to be false (as the target denied it). The ECJ's decision implies that information regarding the forthcoming publication of an article reporting a credible (but false) rumour may well constitute inside information. If followed by the UK courts, we believe this would surprise many City lawyers.
- **Limits on disclosing inside information:** The ECJ adopted 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. Issuer personnel should bear this in mind when they are considering selectively disclosing inside information to any person.

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The ECJ held that Article 21 of the Market Abuse Regulation (EU) 596/2014 (EU MAR) means that disclosure by a journalist, to a usual source, of information relating to the forthcoming publication of an article reporting a market rumour is made "for the purpose of journalism" where it is necessary for the purpose of a journalistic activity. Articles 10 and 21 of EU MAR mean that disclosure of inside information by a journalist is lawful where it is necessary for the exercise of their profession and complies with the principle of proportionality. (*Mr A v Autorité des marchés financiers (AMF)*, European Court of Justice, Case C-302/20, EU:C:2022:190)

Issuer fined in relation to bonuses paid to executive directors

The London Stock Exchange (LSE) has censured and fined an AIM company (S) for failing to properly consult its Nomad and comply with its obligations in relation to related party transactions with its executive directors.

S was admitted to trading on AIM in August 2018. In November 2018, S resolved to award one-off cash "post-IPO bonuses" to its CEO and CFO. S did not properly consult its nominated adviser (Nomad) regarding the bonuses. Two text messages from the CFO gave the impression that the award of the bonuses was a proposal. In fact, the bonuses were agreed and about to be paid. The Nomad unequivocally advised against proceeding and set out reasons. S did not pursue further discussion with the Nomad, and the bonuses were paid in December 2018. In August 2019, the Nomad became aware that S maintained its intention to award the bonuses. It advised S that they would likely be treated as related party transactions under AIM Rule 13. Over the next month, the Nomad and S engaged in extensive discussions and the Nomad continued to understand the bonuses to be proposals. The true status of the bonuses only became clear to the Nomad one month into the discussions. Following this, the details were announced in October 2019. The Nomad was unable to support the required statement that the terms of the transaction were fair and reasonable insofar as S's shareholders were concerned.

The LSE censured and fined S £406,000 for failing to make a disclosure (including a fair and reasonable statement) without delay as soon as the terms of the bonuses had been agreed (in breach of AIM Rule 13) and for serious failures in compliance with AIM Rule 31. These included failures to properly understand its AIM Rule obligations, to properly engage with its Nomad and provide it with accurate and not misleading information, and to have in place sufficient procedures and controls. S submitted that it did not recognise the AIM Rule 13 disclosure obligations arising. The LSE commented that this was indicative of an inherent failure in S's approach to ensuring that all members of its Board properly understood and took responsibility for S's compliance with the AIM Rules. An AIM company is required to engage openly and transparently with its Nomad so that the Nomad can advise on a fully informed basis. These obligations are not discharged by merely mentioning a matter or providing incomplete or misleading information. (*LSE AIM Disciplinary Notice AD 24 regarding Sensyne Health plc* – 30 November 2021)

Key lessons

- **Procedures, controls and training:** This decision underlines the importance of ensuring that all directors properly understand and take responsibility for an issuer's compliance with the AIM Rules. Sufficient procedures and controls must also in place, and need to be followed by all personnel, including senior executives.
- **Proper engagement with Nomads:** Issuers need to engage openly and transparently with their Nomads, especially in relation to potentially contentious proposals. Without this, proper advice cannot be given. Ignorance of the rules is not a defence.
- **Nomads should keep good records:** In this case, no enforcement action was taken against the Nomad. No doubt it helped that the Nomad responded to the CFO's initial text messages with a timely email providing clear, reasoned advice. A written record like this can be invaluable for anyone who finds themselves caught up in a regulatory investigation.

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