WHITE & CASE

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# 2019 Summer 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.

## Company law

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

### Parent's duty of care in relation to pollution caused by subsidiary

The Supreme Court decided that there was an arguable issue to be tried over whether a UK parent company (P) had owed and breached a duty of care to individuals in Zambia in respect of alleged pollution and environmental damage caused by a copper mine in Zambia operated by its Zambian subsidiary (S). This is the first Supreme Court judgment giving guidance on when a UK parent company may owe a duty of care for a subsidiary's operations overseas.

The claimants (C) were individuals in Zambia who brought proceedings against P and S in England on the basis of P's domicile in England. They alleged that they had suffered personal injury and damage to property from the mine's operations. It was claimed that P had breached a duty of care to them through control it had exercised over S's activities. The Supreme Court decided that liability of a UK-domiciled parent company cannot be shoehorned or pigeonholed into specific categories. Whether or not a duty of care is owed depends on how far the parent has taken the opportunity to intervene in, control or supervise management of the relevant

### Key lessons

- **Court of Appeal decision upheld**: The Supreme Court judgment upholds the earlier Court of Appeal decision and indicates that a parent company's duty of care for a subsidiary's activities can extend beyond employees to other affected third parties.
- **Promulgating group-wide policies which are not implemented**: The judgment potentially extends the scope of the *arguable* duty of care by suggesting that promulgating group-wide policies may be enough even if they are not implemented.
- **Regulatory and reputational drivers, and reviewing group policies**: There are important regulatory and reputational drivers behind group policies on environmental and human rights matters. Parent companies should review group policies and procedures, including the level of detail and how far they implement them.

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operations of the subsidiary. The starting-point is that there is no duty of care and that a mere parent/subsidiary relationship is not enough. Relevant factors in establishing a duty of care include laying down group-wide policies and guidelines which are implemented by subsidiaries; not just proclaiming such group-wide policies, but taking active steps by training, supervision and enforcement to see they are implemented; and holding itself out in published materials as exercising that degree of supervision and control of its subsidiaries, even if it does not in fact do so, as that very omission may constitute the abdication of a responsibility which it has publicly undertaken. The Supreme Court found that the last two scenarios applied here. P's published materials asserting its responsibility over proper standards of environmental control and sustainability standards, and their implementation and enforcement, made it arguable a duty of care was owed. A series of cases has been brought against other UK parent companies, on different facts arguing that a UK parent company owes a duty of care to third parties in relation to the activities of its subsidiaries abroad, and this subject is expected to come before the Supreme Court again. (*Vedanta Resources Plc and another v Lungowe and others* [2019] UKSC 20)

## Directors' duties and collective decision-making by a board

The High Court decided that a director had been in breach of duty and justifiably dismissed where, among other things, he had approached significant shareholders to criticise the board's management and try to oust the chairman. The judgment contains interesting discussion of the duty to exercise independent judgment and act for a proper purpose and the requirement for collective decision-making by directors.

S's former chief executive officer (T), who was one of its original founders, was disaffected with S's management. He openly campaigned for the chairman (F) to be replaced. Acting by committee, the board dismissed T as an employee and removed him as director under S's articles of association. At S's AGM the following month, T was re-elected onto the board by shareholders. The board then removed him again. Before the AGM, the committee had also approved a transfer of shares (which had been disenfranchised pending their transfer out of treasury) to an employee benefit trust (EBT), whose revived voting rights affected T's support at the AGM. The effect was that F was re-elected. The High Court decided that T had breached his director's duty to exercise independent judgment. This does not entitle an individual director to go off and do his own thing, independently of the board, on matters relating to management of the company's business. A director should only discuss those matters with shareholders in the presence of the rest of the board or with its prior approval. An individual director should act at board level, either as part of the majority or as a dissenting voice. Directors are under an equitable duty to provide shareholders with sufficient information to enable them to make an informed decision on a matter to be voted on. This is judged by reference to information provided to *all* shareholders, without discriminating between any factions.

### Key lessons

- **Collective decision-making by the board**: The judgment highlights that directors' duty to exercise independent judgment needs to be assessed in the context of the expectation that they should act as a member of the board, supporting the board's management of the company and conducting their activities at board level.
- **Objective test for proper purpose**: It also confirms that directors may be treated as having acted for an improper purpose even if they believed they were acting in the company's best interests.
- **Sharing information with shareholders**: The judgment shows that care is needed when sharing information with shareholders and that individual directors must not pick off particular shareholders for private meetings to promulgate their own views on the board's management.

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Further, individual directors are not entitled to "pick off" particular shareholders, in advance of a general meeting, to air their own views on board matters. The court also decided that the board committee had in one respect only breached the duty to act for a proper purpose, by transferring one of the tranches of shares into the EBT (which was not motivated by an urgent need to meet a deficit in relation to share entitlements). The court confirmed that the objective duty to act for a proper purpose takes precedence over the subjective test for acting in the best interests of the company. Leave to appeal has been refused. (*Stobart Group Limited v William Andrew Tinkler* [2019] EWHC 258 (Comm))

## Unlawful dividends, creditors' interests duty and transactions at an undervalue with intent to defraud creditors

The Court of Appeal decided that a dividend can amount to a transaction at an undervalue for the purposes of the rules in the UK Insolvency Act 1986 on transactions at an undervalue with intent to put assets beyond the reach of creditors. It also held that the directors' duty to take into account the interests of creditors is engaged when directors know or should know that the company is or is likely to become insolvent.

A was a wholly-owned subsidiary of S and was liable to indemnify B for certain environmental clean-up costs in the US. A provision in A's accounts reflected the directors' best estimate of that liability. On the basis of interim accounts, A's directors paid a first interim dividend and, subsequently, a second interim dividend five months later. Both were effected by setting off a substantial amount of intra-group debt owed by S to A. A was then sold to a third party. Against this backdrop, the environmental clean-up costs ultimately were much higher than expected. The Court of Appeal decided that the second dividend had been declared for the purpose of putting assets beyond the reach of creditors under the relevant Insolvency Act rules. It had been made in contemplation of, and to facilitate, A's sale to a third party whilst saving S from having to fund the indemnity itself. The aim had been to eliminate the debt owed by S and remove it as an asset of A. The Court of Appeal confirmed that the payment of a dividend was a "transaction" for this purpose. It did not matter whether it involved an agreement or arrangement between the company and its shareholders (although, on the facts here, it did). Further, it was a transaction which was at an undervalue. It was not a gift (as dividends are rights attaching to shares for which consideration was provided by the original holders), but was a transaction on terms that provide for no consideration to be received when the company pays the dividend. The statutory purpose of intent to put assets beyond the reach of creditors is a question of fact, of what the directors aimed to achieve when approving the dividend as a matter of their subjective intention. The specific purpose need not be the sole or dominant purpose. It is enough if it was something positively intended, rather than a consequence. However, the directors were not in breach of duty in relation to the second dividend, as no duty to take into account creditors' interests had yet been triggered. This duty is engaged when the directors know or should know that the company is or is likely to become insolvent, whereas A was neither insolvent nor likely to become insolvent at the relevant time. (*BTI 2014 LLC v Sequana SA* [2019] EWCA Civ 112)

### Key lessons

- **Dividends can be transactions at an undervalue**: A dividend can amount to a transaction at an undervalue for the purposes of the Insolvency Act rules on putting assets beyond the reach of creditors.
- **Creditors' interests duty**: The judgment gives helpful guidance on when the creditors' interests duty is engaged.
- **Whether or when creditors' interests are paramount**: The judgment leaves open whether or not, once engaged, creditors' interests are paramount, whilst noting that it is hard to see how they would not be where a company is presently and actually insolvent.

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## Cancellation scheme of arrangement – scope of restructuring exemption

The High Court decided that a cancellation scheme of arrangement fell within the restructuring exemption under s.641(2B) of the UK Companies Act 2006 (CA 2006) and was allowed, even though the company's preference shares were excluded from the scheme.

C was the parent company of a group which proposed redomiciling to Ireland by inserting a new Irish company as C's holding company. C had two classes of shares in issue. These were ordinary shares and redeemable preference shares. The preference shares carried a fixed cumulative preferential dividend of 5%, and so were not equity share capital for the purposes of the CA 2006. The reorganisation was to be effected by a cancellation scheme of arrangement applying only to the ordinary shares. The High Court had to consider the breadth of the general prohibition on cancellation schemes in s.641(2A) CA 2006 and the scope of the exemption for restructuring schemes in s.641(2B) CA 2006. This allows reorganisations where "all or substantially all" of the members of the scheme company become members of

### Key lessons

- **Guidance on scope of restructuring exemption**: The judgment gives helpful guidance on the scope of the restructuring exemption to the prohibition on cancellation schemes of arrangement under the CA 2006.

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the new parent undertaking, and the pre-existing members have "the same or substantially the same" proportionate ownership of equity share capital in the new parent. The court decided that it was clear from the words "*substantially all*" that a cancellation scheme was allowed despite a small difference in the members of the scheme company and the new parent before and after the scheme. Further, the proportionality requirement was specifically worded to apply to equity share capital. Technically, the preference shareholders held an identical proportion of equity shares before and after the scheme anyway, namely, zero. In any event, the preference shareholders only represented a very small proportion of company members (about 1% at the date of the court meeting, and only 0.1% of overall nominal value). The High Court adopted a similar approach in a subsequent case where deferred shares were excluded from a cancellation scheme, albeit that they did amount to equity share capital, taking into account that they only represented an even smaller proportion of the members in that case. (*Re Steris Plc* [2019] EWHC 751 (Ch), followed by *Re Man Group Plc* [2019] EWHC 1392 (Ch))

### Modern Slavery reporting: changes on the horizon

On 9 July 2019, the Government published its **response** to the **independent review** of the Modern Slavery Act, including transparency in supply chains. The independent review, laid before Parliament in May 2019, made more than 80 recommendations to strengthen elements of the legislation and its implementation. In its detailed response, the Government has accepted certain recommendations, such as the creation of a central registry of all published statements, updating statutory guidance, requiring organisations to consider due diligence beyond first and second tier suppliers and encouraging companies to express commitments for future steps on specific due diligence. However, the Government rejected proposals to designate responsibility for the statement to an individual board member, preferring to maintain collective board responsibility. It also rejected the recommendation to amend the Companies Act 2006 to place a duty on companies to refer to their modern slavery statement in their annual report to Companies House, and rejected the creation of an offence under the Company Directors Disqualification Act 1986. On a number of the recommendations, including the impact of a single reporting deadline, the detail of the contents of statements, potential enforcement options and public sector supply chains, the Government has launched a **consultation**, open until 17 September 2019. On enforcement options, the Government emphasised that it was already working to tackle non-compliance by carrying out an audit of thousands of companies; further to this audit, non-compliant organisations risk being publicly named.

#### Key lessons

- **Ensure** that all subsidiaries covered by a statement are clearly identified.
- **Review** current risk assessment for modern slavery in your supply chain.
- **Consider** responding to the public consultation to have your say on the proposed changes.

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## Contractual provisions

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

### Alleged breaches of warranty – notice of claims, fair disclosure and warranties on financial projections

The High Court recently considered the level of detail required to comply with the warranty notice requirements in a share sale and purchase agreement (SPA). The court also considered the requirements for fair disclosure and the effect of a warranty as to "careful" preparation of financial projections.

Under a share SPA, B acquired the share capital of three of S's subsidiaries (T) who manufactured aircraft components. T's future profitability depended on the success of a strategy of transferring labour-intensive work to Thailand. After completion, B alleged breaches of warranties in the SPA given at both signing and completion. Under the SPA, B had to give written notice of a warranty claim within 18 months of completion, "*summarising the nature of the claim as far as it is known to [B]*" and the amount claimed. The High Court decided that this did not require full particulars of the claims. B just had to give formal, unambiguous notice of the basis of the allegations, so that S could investigate, respond to and make financial provision for claims and the parties could know where they stood. Warranties from S included that T had, and had materially complied with, "*all licences, consents, permits…necessary to the carrying on of its business*". The High Court decided that Nadcap accreditation, which is a recognised aerospace industry standard, fell within the ordinary meaning of these words, as it gave a business authority to hold itself out as complying with those standards. However, the warranty had not been breached because T had the accreditation at completion and had not received any notice of non-compliance, with the effect that any future loss of the accreditation was not relevant. Separately, operational warranties had been breached, but S was not liable as the subject matter had been adequately disclosed. The SPA required disclosures to be "*fairly and clearly disclosed in writing **in or under** the Disclosure Letter* (*with sufficient detail to identify the **nature of the matter** disclosed*)". This was complemented by disclosure of all documents in the online data room. The High Court said that the words "*in or under*" in the above formulation did not require every breach to be expressly set out in the letter, and that the words "*nature of the matter disclosed*" did not require details of the extent, or scope, of the matter. A separate claim succeeded for breach of a warranty that certain forward-looking projections had been honestly and carefully prepared. Careful preparation required that the projections should be credible and reliable by reference to evidence-based assumptions or subject to expressly identified risks. The projections had failed to take into account key operational and financial assumptions, including delay in the move to Thailand. (*Triumph Controls UK Ltd v Primus International Holding Co.* [2019] EWHC 565 (TCC))

#### Key lessons

- **Requisite level of detail for warranty notice**: To raise the test on the level of detail required for a valid warranty notice, sellers could specify in the SPA that full particulars must be given of the claim.
- **Fair disclosure**: This is a rare example of a recent judgment discussing fair disclosure. The judgment follows the established cases of *Infiniteland v Artisan* [2005] EWCA Civ 758 and *Man v Freightliner* [2005] EWHC 2347 (Comm) in adopting a seller-driven approach.
- **Raising the test**: More detailed express wording would be needed to raise the test of what amounts to fair disclosure to cover the extent or scope of the matter.

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### Construction of notice of claims provision in share SPA

The Court of Appeal decided that a notice of indemnity claim by a buyer (B) under a share SPA was valid and had not breached the requirements of the SPA. On the facts, B did not need to provide details of prospective claims, nor an estimate of the total amount of such claims.

S sold to B a company (C) providing financial advice to retail customers. A Financial Conduct Authority (FCA) investigation concluded that there had been mis-selling before the sale. B served on S notice of possible claims under an indemnity in clause 5.9 of the SPA covering loss from mis-selling claims. The notice related to customer claims which had not yet been made at the date of the notice. The notice of claims provision in clause 6.7 of the SPA excluded liability "*in respect of any matter or thing unless notice in writing of the relevant matter or thing (specifying the details and circumstances giving rise to the Claim or Claims and an estimate in good faith of the total amount of such Claim or Claims)*" was given, in relation to a claim under the indemnity, within seven years of the agreement. Other sub-clauses of clause 6.7 imposed time limits for other types of claim. B's notice of claims described the outcome of the FCA investigation and the types of prospective claims the FCA thought were likely. The Court of Appeal decided that the notice was valid. The issue was whether the bracketed wording in clause 6.7 had to be given for all notices under clause 6.7, whichever sub-clause they fell under. The Court of Appeal stated that the starting-point was to assume that parties who had entered into a professionally-drafted agreement in which terms had been "elaborately defined" intended to apply the definitions. However, you had to employ a contextual analysis here due to a series of inconsistencies in the use of definitions, and even the use of one undefined term within clause 6.7, whilst "Claim" was defined to mean only a warranty and/or tax claim. It decided that the bracketed words did *not* extend to a claim under the indemnity. It made good commercial sense to distinguish between warranty and indemnity claims over the level of detail that could sensibly be given. Circumstances such as the FCA enquiry fell within "*any matter or thing*" under clause 6.7, which might occur at a time when it was impossible to provide the information required by the bracketed words, and the words "any matter or thing" were wide enough to include a prospective liability. (*Hopkinson v Towergate Financial (Group) Ltd* [2018] EWCA Civ 2744)

#### Key lessons

- **Clear and unambiguous drafting**: The judgment is a useful reminder of the need for clear and unambiguous drafting, and consistent use of definitions, in notice of claims provisions in SPAs.
- **Drafting issues for sellers or other parties entering into contractual commitments**: Sellers could consider requiring a claims notice to include "full details" of the claim and defining "Claims" to include wider categories of claim than just warranty claims.
- **Time extensions for notifying contingent claims**: Where there is a time extension for contingent claims, consistency and clarity is needed that the claim terminates absolutely unless the postponement requirements are met.

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### Third party rights – successful designation of a class of beneficiaries and conferment of a benefit

The Court of Appeal has confirmed that, for the purposes of the UK Contracts (Rights of Third Parties) Act 1999 (the Contracts Act), it is sufficient to identify a class of beneficiaries in order to meet the statutory requirement to identify the third party beneficiary in the contract, and that the same provision can also meet the statutory requirement for purporting to confer a benefit on that third party.

The claimants were investors who had lost money in an overseas property development. They wanted to recover what they had lost by asserting third party rights under an alleged contract. This was a letter from the company (C) promoting the investment scheme written to a bank (B), instructing B to open a client account for the investments. The letter described this as a "segregated client account" and imposed conditions on when and how funds could be withdrawn. It did not expressly name the investors as parties

#### Key lessons

- **Purporting to confer a benefit**: The judgment confirms the rebuttable presumption that there is a third party right where a contractual term purports to confer a benefit on a third party satisfying the statutory identification requirements.
- **Knowledge of third party**: It demonstrates that the third party need not have known of the existence of the underlying contract when it was made or when they became a member of the designated class to be able to rely on it.
- **Express drafting advisable**: The judgment shows the importance of expressly excluding the statutory third party rights, save as expressly granted.

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paying into the account, and they were unaware of the letter when they invested. In fact the segregated client account was never set up and C went into liquidation. The Court of Appeal decided that the investors were entitled to rely on the Contracts Act to enforce the letter's terms. The reference in the letter to a segregated client account amounted to express identification of a class and the investors fell within that class. That was enough to meet the statutory identification requirements. The purpose of the letter was to protect investors and the requirement for the segregated client account was clearly intended to benefit them, noting that the property development was referenced in the letter as the sole purpose of the account. The letter also met the statutory requirements for purporting to confer a benefit on the beneficiaries identified. The criteria for meeting the statutory identification requirements and purporting to confer a benefit could be met by one and the same term. (*Chudley and others v Clydesdale Bank Plc* [2019] EWCA Civ 344)

### Property lease not frustrated by Brexit

In a judgment which gives guidance on what may constitute a frustrating event under English law contracts, the High Court decided that the European Medicines Agency (EMA)'s 25-year lease of premises in Canary Wharf was not frustrated by Brexit. There was no supervening illegality, nor frustration of a common purpose between the parties.

The EMA had a 25-year English law-governed lease and used the property as its headquarters. Under EU law the EMA was required to relocate to Amsterdam in order to remain in an EU member state after Brexit. The EMA argued that Brexit would frustrate the lease, on the basis it would lack capacity to pay rent under the lease after Brexit. The High Court rejected this because, even on a no-deal Brexit, the EMA would still have capacity to deal with immovable property it held in a third country. In any event, any illegality was a matter of EU law, whereas the English law doctrine of frustration generally discounts supervening foreign law illegality. Further, any frustration would have been "self-induced", because the legal effect of Brexit on the EMA could have been mitigated by the EU (such as by introducing transitional arrangements over the move to Amsterdam). The EMA alternatively argued that there had been frustration of a common purpose, on the basis the parties had a shared intention at the date of entering into the lease that the premises would be the EMA's headquarters for the next 25 years. The High Court rejected this. The parties held competing interests as landlord and tenant. They had expressly envisaged that events might require the EMA to involuntarily leave the premises by including subletting and assignment provisions, whilst the actual reason for leaving did not matter. It was also the EMA's own decision to enter into the lease without a break clause. (*Canary Wharf (BP4) T1 Limited and others v European Medicines Agency*) [2019] EWHC 335 (Ch))

#### Key lessons

- **Guidance on frustration**: The judgment gives useful guidance on what amounts to a frustrating event under English law contracts.
- **Fact-specific and high bar to reach**: It is clear that the analysis is always fact-specific. The decision shows that there is a high bar to reach. Frustration will not apply where a party has simply contracted on poor terms or at too high a price.
- **Effect of Brexit left open**: Having said that, the judgment does not rule out the possibility that frustration could be triggered by Brexit on different facts.

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## Non-compete covenants in share SPA – restraint of trade doctrine did *not* apply to procurement obligation

The Scottish Sheriff Appeal Court decided that, whilst sellers' direct covenants not to compete themselves are subject to the restraint of trade doctrine, the same was not true of sellers' covenants to procure that their associates do not compete.

Restrictive covenants in a share SPA required the sellers to procure that their associates, defined to include family members, did not compete with the target (T) for three years after completion in any geographic area in which any business of T was carried on at completion. The buyer (B) alleged that the post-completion activities of a company 50% owned by a brother of one of the sellers put both sellers in breach. B claimed damages and that it was not obliged to pay certain deferred consideration. The sellers argued the restrictive covenants were in restraint of trade and void. The Scottish Sheriff Appeal Court upheld the covenants to procure that associates did not compete. Although the non-compete clause itself was a restraint of trade, it was not the kind of restraint that deprived the sellers of their ability to compete with the target. The public interest inherent in the restraint of trade doctrine lies in the effect which a party's surrendering its liberty to trade freely has in depriving the community of that party's skill and experience. By contrast, the covenants here did not restrict the sellers' liberty to trade. They were just an agreement by the sellers to secure, if they could, that their associates did not compete. Whilst in practice this might have deterred their associates from competing against the target, they were left free to ignore attempts by the sellers to get them to co-operate if they wanted to. This did not engage the doctrine of restraint of trade. (*Nekrews and another v PMAC Scientific Limited* [2018] SAC (Civ) 29)

### Key lessons

- **Status of procurement obligations**: The judgment supports the workability of procurement obligations in relation to observing restrictive covenants. It indicates that procurement obligations may not always be subject to the restraint of trade doctrine, although the analysis will depend on the facts.

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## Measure of damages for breach of warranty in share SPA

On a claim for breach of warranty in a share SPA the High Court confirmed that the established measure of damages applied, being the difference between the warranted value of the shares and their actual value. It denied that the measure could be the amount recoverable under a hypothetical indemnity which allegedly would have been negotiated had the accounts the subject of the claim been properly drawn up.

Under an SPA S sold the shares in target company T to B for US$1.466 billion. S warranted in the SPA that T's last accounts gave a true and fair view. Previously T had entered into equity derivative transactions under an ISDA master agreement with bank L. Under the ISDA agreement T was required to deposit cash collateral with L. L's subsequent bankruptcy triggered an event of default under the ISDA agreement. There followed a dispute between T and L over the early termination fee and set-off rights. T paid L US$14.5 million to settle. B alleged that S had breached the true and fair view accounts warranty, and sought to recover the US$14.5 million. The High Court decided that a claim for amounts which would have been recovered under a hypothetical indemnity which might have been negotiated had the accounts included provision for the potential liability to L was not recoverable on a share sale. In any event, B's case would have failed on causation, because it had not proved that, if it had known of the exposure to L, it would have sought and obtained an indemnity. Although it was not necessary to decide the issue, B had not established that the accounts did not give a true and fair view. The evidence failed to show that the accounts contained a material mis-statement. (*Oversea-Chinese Banking Corporation Limited v ING Bank N.V.* [2019] EWHC 676 (Comm))

### Key lessons

- **Measure of damages**: The case is a reminder that the correct measure of damages for breach of warranty on a share sale is the diminution in value of the shares (being the difference between warranted value and actual value).
- **Covenant to reimburse the diminution in value**: Depending on the circumstances, there may be merit to a buyer in obtaining a covenant from the seller to reimburse the diminution in value of the shares caused by the breach of warranty.

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### Contractual interpretation – futility principle did not apply to condition precedent

The Court of Appeal decided that a condition precedent on obtaining a senior debt facility was not satisfied by obtaining intra-group funding. The "futility principle" did not apply here (that, in certain circumstances, and in light of subsequent events, a condition precedent may no longer apply or cease to have effect).

S agreed to sell shares in a dormant copper mine to B for shares in B and deferred cash consideration. Under the master agreement, the deferred consideration was payable if B obtained both requisite permits and a senior debt facility to fund the restart of mining operations. The issue was whether S was entitled to receive deferred consideration where the first condition had been satisfied but B obtained the funding through intra-group loans rather than senior debt. The Court of Appeal decided that the obligation to pay deferred consideration had not been triggered. Whilst the first condition would have fallen away if the effect of regulatory changes was that permits were no longer needed to restart mining, the analysis was different on the condition on obtaining a senior debt facility. This was a matter of construction of the contract. There was no principle of law or contractual interpretation that allowed a contractual pre-condition to be disapplied just because a court considered it would serve no useful purpose. The Court of Appeal denied that the parties had never envisaged funds might be obtained otherwise than by senior debt and that the court should seek to give effect to their presumed common intention if they had contemplated that. The master agreement was a professionally-drafted contract between sophisticated commercial parties, who would have known well that senior debt was not the only way to raise funds. In any event, the court could not be confident what the parties would have intended in those circumstances. Further, equity fundraising was not equivalent to senior debt, the essence of which is that it ranks in priority on an insolvency. (*Astor Management AG v Atalaya Mining Plc* [2018] EWCA Civ 2407)

#### Key lessons

- **Contractual interpretation**: The question of whether the futility principle applied was a matter of contractual interpretation, applying the general rules on construction of contracts.

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## Good faith

Recent cases have looked again at contractual duties of good faith and the relationship between contracting parties

### Implied duties of good faith in relational agreements

The High Court has again implied a duty of good faith into a long-term relational agreement, following a previous line of case law on this issue. It also decided that some of the contracts under consideration contained standard contractual terms which were onerous and unusual and that insufficient notice had been given to incorporate them.

The Post Office contracted with certain sub-postmasters and postmasters on standard form agreements which were not subject to negotiation. Under these agreements, the sub-postmasters were liable for wide categories of losses. Accounting errors and financial shortfalls were discovered, for which the Post Office held the sub-postmasters personally responsible, despite their assertions that the errors were solely attributable to software the Post Office introduced many years before. A number of them sued the Post Office for, among other things, financial loss, duress and unjust enrichment. At an initial hearing on common issues, the High Court considered whether the contracts were relational contracts. The court decided that there is no general duty of good faith in all commercial contracts, but that a broad duty

#### Key lessons

- **Joint venture agreements**: The judgment is a further example of the court implying a duty of good faith into a long-term relational agreement. Although potentially relevant to long-term agreements, such as joint venture agreements, the High Court confirmed that length of term alone is not enough to trigger the duty.
- **Guidance on factors to consider**: The judgment gives helpful guidance and a (non-exhaustive) list of relevant factors to consider when assessing whether an agreement is relational.
- **Exceptional facts**: The case was decided on exceptional facts, but it is significant that the High Court has again implied a duty of good faith.
- **Express drafting**: For clarity, express drafting to include or exclude duties of good faith could be used in English law agreements.

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of good faith could be implied into "relational" agreements when this was in line with the presumed intention of the parties. This goes beyond a duty to act honestly. It requires the parties to refrain from conduct that reasonable and honest people would consider commercially unacceptable in relation to every power and discretion in the contract. In this case the High Court decided these were relational agreements and implied such a duty. It said this meant here a duty to keep proper records and not make claims for payment without properly investigating the facts. What amounts to a relational agreement depends on the circumstances of the case. Key factors here were: the length of the contract term; the collaborative nature of the contracts; the fact that the parties had put trust and confidence in one another; the size of the sub-postmasters' investment; and the non-commercial or quasi-public service aspect of the contracts. The right to terminate on "not less than three months' notice" also had to be exercised in good faith, because it created a discretion which must not be decided arbitrarily or considering irrelevant factors. Permission has been requested to appeal the judgment. (*Bates and others v Post Office* [2019] EWHC 606 (QB))

### Contractual discretions – guidance on duty to act rationally

Although the High Court decided that a lender was not subject to an implied duty to act rationally when exercising a contractual discretion to require repayment of an on-demand loan, it gave useful guidance on when such a duty arises.

D borrowed £20.4 million from bank B, to discharge a charge over property and then to be secured on the property. It was an on-demand five-year loan, subject to a condition that B could in its "absolute discretion" give three months' notice requiring repayment in full. B served an early termination notice and appointed fixed charge receivers, who brought possession proceedings. The High Court looked at the duty of rationality set in *Braganza v BP Shipping Ltd*.[1], whereby a party must exercise a contractual discretion in good faith and not arbitrarily or capriciously. It decided that B did not have a *Braganza* duty when exercising its absolute discretion to demand full repayment of the loan, but gave helpful guidance on when the duty would be implied. One example is contractual discretions that affect the rights of both parties to the contract, where the decision-maker has a role in the ongoing performance of the contract and a clear conflict of interest. That did not apply to a loan repayable on demand, where the power to demand repayment is exercised solely for the lender's benefit as a unilateral right. Another is "relational" contracts (such as employment contracts) where the parties do not have equal bargaining power, to protect the weaker party from abuse. Here, the court found relative equality of bargaining power. It took into account that the demand for repayment here had been made four years into a five-year term and decided that nothing irrational or in breach of a duty of good faith could be shown. A secured lender owes a different and more limited duty of good faith to demand repayment to enforce its security. That duty arises from the creation of the mortgage, rather than a contractual implication, and would not be breached where the lender calls in the loan for proper purposes. (*UBS AG v Rose Capital Ventures Ltd and others* [2018] EWHC 3137 (Ch))

#### Key lessons

- **Implications**: The judgment gives very useful guidance on the circumstances in which the *Braganza* duty will arise and serves as a reminder that not all contractual discretions are subject to the *Braganza* duty.

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1 [2015] UKSC 17.

## Listed companies

There has been an interesting FCA ruling in a competition decision in the context of an IPO and placing

### First FCA competition decision finds three asset managers in breach

The FCA determined that three asset management firms had breached competition law by bilaterally sharing strategic information. The firms had disclosed and/or received otherwise confidential bidding information shortly before prices were set during one IPO and one placing. This marks the first FCA decision under its competition law enforcement powers under the UK Competition Act 1998 (Competition Act).

Asset management firms H, R, N, and A were investigated by the FCA in relation to concerns about sharing of confidential information in primary equity market activities. Various communications had taken place between the firms concerned in relation to two IPOs and one placing during which the firms discussed their bids and their preferred prices for the transactions, generally on a bilateral basis. The FCA found that disclosure and/or acceptance of confidential information had taken place in relation to one of the IPOs and the placing shortly before order books closed, with the object of restricting competition. This had the effect of reducing the strategic uncertainty crucial to maintaining competition between firms competing for shares. This was so without there being any agreement to fix bids. H and R were each fined for infringing the Chapter 1 prohibition under the Competition Act and Article 101 of the Treaty on the Functioning of the European Union (the Prohibition) for participating in concerted practices which had as their object the restriction of competition in relation to the supply of equity capital, noting that both volumes and price points has been disclosed. From a recipient's perspective, the FCA noted that any request or acceptance of strategic information will be considered conscious and presumed to have an anti-competitive effect on subsequent market conduct. N was also found to be in breach of the Prohibition, but was not fined due to its co-operation with the FCA under the competition leniency programme. In relation to A no grounds for action were found, as only price ranges had been disclosed, those ranges varied significantly and the disclosures were made well before the order books closed. This had made it less likely that the parties could rely on the information shared. N's fund manager was fined in a concurrent personal action. (*Competition Act 1998: Decisions of the Financial Conduct Authority: Anti-Competitive Conduct in the Asset Management Sector* (Case CMP/01-2016/CA98, 21 February 2019)

### Key lessons

- **Risks involved with information-sharing**: This decision highlights the risks involved in exchange and receipt of strategic information from a competitor, particularly where price and/or volume is concerned and especially near the closing of a book-building process.
- **FCA as strong competition regulator**: That the FCA chose to target information-sharing indicates that it will be a strong competition regulator moving forward.

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