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2018 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

Attempt to circumvent right of first refusal mechanism in SHA failed

The High Court decided that a shareholder had not been entitled to instigate a right of first refusal (ROFR) clause under a shareholders' agreement (SHA). The ROFR procedure could not be engaged by an underlying offer from any of the investors or their affiliates, but only from a true "third party" for the purposes of a contractual requirement in the SHA for the price to be that proposed by a "bona fide third party purchaser". In any event, the ROFR notice failed to comply with other requirements of the SHA.

An English law-governed SHA in relation to company C regulated the relationship between the two majority shareholders (W and U) and minority shareholder I. Under the SHA, I could sell shares in C, subject to first giving W and U a ROFR to buy its shares pro rata to their shareholdings. The ROFR clause stated that I's obligation was to "*grant to [W] and [U] the right of first refusal*", and one permitted basis of pricing was "*the price proposed by a bona fide third party purchaser*". W and I agreed that a subsidiary of W (S) would acquire 3.99% of I's shares. I served an ROFR notice on W and U offering to

Key lessons

- **Attempt to circumvent ROFR structure failed:** The judgment shows that the court will be rigorous in applying the specific requirements of an SHA in relation to a ROFR/buyout mechanism and related notice.
- **Rules of construction of SHAs:** It also shows the willingness of the court to apply general rules of construction to SHAs, not special rules of interpretation in relation to articles of association.
- **Clear drafting and commercial rationale in recitals:** The judgment is a reminder of the importance of unambiguous drafting of share transfer restrictions. It may also help to set out the commercial rationale for a ROFR in the recitals to an SHA (such as maintaining certain shareholding proportions) to minimise the risk of a restrictive interpretation.

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sell that percentage of shares at the price conditionally agreed with S. The notice gave "each of" W and U the right to acquire "all (but not some only)" of the offered shares. The High Court emphasized that it had to consider the objective meaning of the language used, considering the SHA as a whole and the parts of it that gave its context. On this basis, it decided that I had not been entitled to initiate the ROFR procedure and the ROFR notice was invalid. Neither W nor U was entitled to acquire shares from I other than by exercising the ROFR, which they had to do jointly. In any event, neither W nor U were third parties for the purposes of the pricing clause. The expression bona fide "third party" meant an outside person unconnected with the SHA and was used to distinguish other persons from the investors and their affiliates. The principle of case law that restrictions on transfer in articles of association require clear language and are construed narrowly did not apply to the SHA, which was a commercial inter-shareholder agreement on how they would deal with their shares. This did not affect the intrinsic rights attached to the shares, but was a matter of private agreement. This was particularly so as the restrictions on transfer were not mirrored in the articles and reflected I's role as independent investor and "honest broker" between the other parties. In any event, the proposed price had been inflated in an effort to deter U from exercising the ROFR. (*United Company Rusal PLC v Crispian Investments Limited and another* [2018] EWHC 2415 (Comm))

Drag-along clause in shareholders' agreement triggered by arm's length sale and non-cash consideration allowed

The High Court decided that shareholders had successfully complied with, and implemented, a drag-along clause in an SHA as the words purchase monies "or any other consideration" in the clause were wide enough to include a non-cash consideration and the transaction met the requirements of the clause for an underlying bona fide arm's length sale as a pre-requisite to exercising the drag.

Landowning company C had three syndicate shareholders, acting together, and two independent shareholders who included M. The three syndicate shareholders and M were also directors of C and members of its separate operating company (O). C had acquired the quarry on which O operated through funding entirely from the syndicate shareholders. Those shareholders also had ultimate control under the governing SHA.

Under a drag-along clause in the SHA, if the syndicate shareholders wanted to sell their shares to a "*bona fide arm's length purchaser*" they could drag-along the other shareholders, by requiring them to sell all their shares to the same buyer on the same terms. A further clause said that, if a dragged shareholder failed to execute share transfers on receiving the purchase monies "*or any other consideration payable for the shares*", the syndicate shareholders could sign instead. O suffered financial problems, and existing funder F agreed to increase funding on the basis of a restructuring through which it would take equity. This required shareholders to sell their shares in C to a wholly-owned newco subsidiary of F, in consideration of an issue of shares in newco. The syndicate agreed to this and dragged the other shareholders. M challenged this, alleging the drag clause did not allow a non-cash consideration and that the sale had not been arm's length. The High Court decided that a non-cash consideration was allowed. You had to focus on the meaning of the words "*or any other consideration*" in the factual commercial context of the SHA. This led to the conclusion that the language was permissive and deliberately wide to allow for unforeseen circumstances. The High Court was also satisfied that the sale had been arm's length. The requirement was for an arm's length purchaser at the time of the drag-along sale, not at or consequent on completing the purchase. There had been no prior connection between the syndicate and F before the sale was agreed, as newco had no interest in C until completion. The court said there was no evidence the transfer had been at an undervalue, as any value in the land owned by C was offset by huge potential liabilities which it could not meet. F had acted in good faith and all shareholders were treated equally and received a pro rata shareholding in newco. F was just trying to protect its original investment, which otherwise was in serious jeopardy given the enormity of C's liabilities and O's ultimate administration. (*Cunningham v Resourceful Land Limited and others* [2018] EWHC 1185 (Ch))

Key lessons

- **Clear drafting:** The case demonstrates the importance of express wording on the form of the consideration and other parameters around which such compulsory buyout clauses may be triggered.
- **Contractual requirement as to arm's length dealing:** The outcome suggests that a contractual requirement for a transaction to take place between unconnected parties may be tighter and less open to interpretation than one only imposing a requirement for a transaction at arm's length.

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Trigger of bad leaver provisions meant part of sale proceeds repayable and dishonest assistance to breach of fiduciary duty

A former director-shareholder of company C, who had set up a competitor company (M), had breached his fiduciary duties to C and was liable to repay the majority shareholders the difference between the amount they paid for his shares and what they would have paid under the bad leaver provisions in the underlying SHA. M was also liable for dishonestly assisting his breach of fiduciary duty.

The effect of the SHA, taken with C's articles of association, was that a shareholder in material breach of the SHA could be compulsorily bought out by the other shareholders under bad leaver provisions at a 50% discount to a profits-based share valuation. Director-shareholder D's relationship with the majority shareholders deteriorated. Knowing that they were on the verge of buying him out, D took initial steps towards setting up competing business M in conjunction with one of C's employees (E), who was ostensibly M's sole shareholder and director. D also arranged for E to email him copies of documents in C's possession to use for the advantage of the competing business. M was incorporated just over a week after D and E both left C. Separately, D arranged for one of C's IT consultants to transfer funds from C to an account he controlled. Various allegations of financial fraud had already been determined against D. The High Court decided that D had breached both his fiduciary director's duties to C and also various express obligations in the SHA, including: to promote the success of the business and, along with the other members, to conduct all transactions with C in good faith and not to compete with C. He had also breached restrictive covenants in the sale and purchase agreement (SPA) for the sale of his shares. The High Court said that the "line was crossed" well before D resigned as director. D's material or persistent breach of the SHA should have triggered the compulsory buyout mechanism at the bad leaver discount. This had not happened, and D was ordered to reimburse the majority shareholders the difference between what they had actually paid for his shares and the lower amount that they should have paid had the bad leaver provisions been applied. M was also liable for dishonestly assisting D's breaches of fiduciary duty (by undertaking a competing business, knowingly gaining from the use of information from C and concealing D's interests in M) and was liable for damages or an account of profits. It did not matter whether the assistance had taken place at the time of the breach, provided that a causal link was established. Permission has been granted to appeal the judgment. (*Keystone Healthcare Limited and another v Parr and others* [2018] EWHC 1509 (Ch))

Key lessons

- **Bad leaver provisions:** The decision shows the court's willingness to uphold bad leaver provisions and, more generally, the parties' contractual bargain.
- **Dishonestly assisting breach of fiduciary duty:** The case is an interesting example of a claim for dishonestly assisting a breach of fiduciary duty being made out.
- **When resigning director "crossed the line":** There is useful guidance on when the "line was crossed" on breach of a director's fiduciary duty by setting up a competing business. The precise point at which a director's preparations for establishing a competing business become unlawful will depend on the facts.

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Majority not precluded from petitioning for unfair prejudice due to reserved matters in investment agreement

The High Court allowed a majority shareholder to petition for relief from unfair prejudice under the UK Companies Act 2006, because the scope of the reserved matters in the investment agreement requiring consents from the minority shareholder negated the effect of the majority voting rights which it technically held.

S owned 40% of the voting rights in C Limited and two other companies (together, I) owned the other 60%. P was controlling shareholder of S. Under the investment agreement (IA) relating to C, S was entitled to appoint two (out of five) directors to C's board. S appointed P and P's son. Subsequently, both S's appointees were dismissed on

Key lessons

- **Effect of reserved matters:** The judgment demonstrates that particular consent requirements under reserved matters in contractual inter-shareholder arrangements can override the significance of "majority" held voting rights when assessing who may bring an unfair prejudice petition.
- **Ability to block special resolution:** If a minority shareholder can block a special resolution which the majority shareholder seeks to have passed, this might indicate that the majority is not effectively protected from unfair prejudice by its voting control.

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grounds of misconduct, including allegations of conflicts of interest. S brought an unfair prejudice petition under the UK Companies Act 2006 challenging their dismissal on the basis C's affairs had been conducted in a manner unfairly prejudicial to its interests. I petitioned by way of counterclaim that P's and S's conduct in managing C's affairs had been unfairly prejudicial to I's interests and breached fiduciary director-duties owed to C. The High Court decided that I's majority voting rights in C did not preclude them from bringing an unfair prejudice petition. There was nothing in the statute to limit a petitioner to a shareholder holding a minority interest. The court emphasized that any unfairly prejudicial conduct by S or P could not be adequately remedied by I's voting rights, because instituting or settling material legal proceedings was a reserved matter under the IA requiring unanimous shareholder consent before a claim could be brought against directors for breach of duty. C's future management could be seriously disrupted by S's refusal to consent to reasonable proposals from the "majority" shareholders. The court also confirmed that the misconduct of a director appointed to the board by a corporate shareholder under a company's constitution could be attributed to that shareholder. Permission has been requested to appeal the judgment. (*Cool Seas (Seafoods) Limited v Interfish Limited and others* [2018] EWHC 2038 (Ch))

Non-reliance statement on its own failed reasonableness test

The Court of Appeal confirmed that a non-reliance clause amounted to an exclusion of liability for misrepresentation. This meant that it was subject to the reasonableness test in the UK Unfair Contract Terms Act 1977 (UCTA) which, on the facts, it failed.

A non-reliance clause is an acknowledgement by the parties that they have not relied on any representation or other statement which is not expressly incorporated into the subject agreement. It is a key element in negating liability for extra-contractual representations, a constituent element of which is that an untrue statement must have induced the contract. A standalone non-reliance clause in a lease stated: "*The tenant acknowledges that this lease has not been entered into in reliance wholly or partly on any statement or representation made by or on behalf of the landlord.*" Before exchanging contracts, the tenant's lawyers had raised standard pre-contract enquiries. These included a statement that the landlord would notify anything which might cause any of the replies to become incorrect before exchange or completion. One of the landlord's responses was that it was not aware of any environmental problems. The landlord's agents subsequently received a report that there was asbestos on the property, but they failed to inform the tenant before the lease and agreement for lease were concluded. The tenant terminated the lease and claimed for misrepresentation. The Court of Appeal decided that the non-reliance clause in the lease was subject to the reasonableness test in UCTA, which it failed. The effect was that the clause was unreasonable and void. The Court of Appeal took into account the importance of pre-contract enquiries in the field of conveyancing. It rejected arguments that a non-reliance clause amounts to a basis clause (defining the basis on which the parties are contracting and preventing liability from arising in the first place) rather than an exclusion clause to which UCTA applies. The question whether a term excludes liability or merely shows that no relevant obligation has been undertaken is one of contractual interpretation. The analysis on "basis" clauses did not apply to an attempt to exclude liability for the tort of misrepresentation, as parties can only contract-out of that subject to the reasonableness test in UCTA. As liability arises under the UK Misrepresentation Act 1967, the contract cannot be said to prevent liability arising in the first place. Permission has been requested to appeal the judgment. (*First Tower Trustees Limited and another v CDS (Superstores International) Limited* [2018] EWCA Civ 1396)

Key lessons

- **Application of UCTA:** This decision is consistent with past case law that exclusions or limitations of liability for misrepresentation in non-reliance and entire agreement clauses are subject to the reasonableness test in UCTA.
- **Exclusion not basis clause:** The judgment demonstrates that, particularly in an M&A context, a non-reliance clause in a contract will not be treated as a "basis" clause as it seeks to exclude statutory liability.
- **Updating due diligence information:** Particularly on a UK share sale, it is in any event important to update responses to due diligence enquiries as information or circumstances materially change, to avoid statutory liability under the UK Financial Services Act 2012 for false or misleading statements.

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Entire agreement clause in SPA failed to exclude liability for misrepresentation

The High Court recently overturned a master's first instance decision and decided that an entire agreement clause in a share SPA failed to exclude liability for misrepresentation. The clause had not included a non-reliance acknowledgement nor expressly excluded liability for misrepresentation.

The SPA stated: "*This agreement (together with the documents referred to in it) constitutes the entire agreement between the parties and supersedes and extinguishes all previous discussions, correspondence, negotiations, drafts, agreements, promises, assurances, warranties, representations and understandings between them, whether written or oral, relating to its subject matter*". Also under the SPA, the seller (S) indemnified the buyer (B) in respect of any losses incurred by B from S's mis-statement of the club's liabilities or failure to provide details of material contracts and associated liabilities. It was alleged that due diligence information provided to B by S had materially understated the target's liabilities. B brought a claim for misrepresentation. The High Court reversed the master's first instance decision that B could only claim under the indemnity and not for statutory misrepresentation despite the absence of an express exclusion of claims for misrepresentation and other shortcomings of the drafting. The master had construed the entire agreement clause in the context that the parties had set up an alternative contractual structure, instead of statutory misrepresentation, to deal with claims for misrepresentation or other mis-statement. Reversing that decision, the High Court said that you had to establish the intention of the parties as expressed in the agreement. Contractual language providing for one type of claim does not carry an implication that all other types of claim are intended to be excluded. The court should not go beyond the proper bounds of construction and improve the bargain the parties actually made. The mere possibility that words used might extend to matters that could found other claims was not enough to amount to an exclusion of such claims. (*Fawaz Al-Hasawi v Nottingham Forest Football Club Ltd and others* [2018] EWHC 2884 (Ch))

Key lessons

- **Express exclusion of liability needed:** The judgment is in line with past case law that express wording is required to exclude claims for misrepresentation.
- **Drafting issues on entire agreement clauses:** It is best practice for an entire agreement clause to contain an express non-reliance acknowledgement, a statement as to the entire agreement and understanding between the parties, express exclusions of claims for misrepresentation and mis-statement and a fraud carve-out.

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Company law

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

De facto and shadow directors and no dishonest assistance or unlawful means conspiracy

The High Court confirmed that whether an individual was a de facto or shadow director depended on the facts and was not subject to a clear legal test. Although on the facts the individuals in question were shadow directors, there had been no breach of fiduciary duty. Related claims against certain individuals and entities for dishonestly assisting a breach of fiduciary duty and unlawful means conspiracy were also rejected.

Company C's liquidator brought claims for fraudulent trading and breach of fiduciary duty against certain individuals (including Mr R and Mr M) and entities in relation to commission-sharing arrangements with other companies (O) of which R and M were ultimate beneficial owners. It was alleged that R and M were "de facto" directors of C (on the basis they were acting as directors without having been validly appointed) or shadow directors (on the basis the appointed directors were accustomed to acting in accordance with their directions or instructions) due to their involvement in recruitment, negotiation of service contracts, directions over contracts with developers and financial

Key lessons

- **Test for de facto and shadow directors:** The judgment reaffirms that the analysis on whether an individual is a de facto or shadow director, and what fiduciary duties a shadow director might owe, is fact-specific.
- **Unlawful means conspiracy/dishonest assistance:** The case is another example of the growth in claims for unlawful means conspiracy and dishonestly assisting breaches of fiduciary duty.

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reporting. Under Article 85 of C's articles of association, a director was permitted to be a party to a transaction with C without accounting for benefits, provided that any material interests were disclosed. Claims were also brought against C's advisers, who had been retained on R's recommendation and had advised on and drafted the commission agreements, for dishonestly assisting a breach of fiduciary duty and unlawful means conspiracy based on the alleged breaches of fiduciary duty.

The High Court first confirmed that there was no clear legal test for determining whether a person was a de facto or shadow director. You needed to focus on what the person actually did in relation to the company, not any job title they had. The court also discussed the difficulties in laying down a general principle as to what fiduciary duties (if any) a shadow director owed. The court said that, on issues of fiduciary duty, it may be more helpful to ask whether the individual has expressly or impliedly undertaken or assumed a position of trust and confidence or whether there is a legitimate expectation that they will not use their position in a way adverse to the company's interests. The High Court decided on the facts that R and M were shadow (but not de facto) directors in relation to some of C's activities. However, they were not in breach of duty and were not liable for the commission payments, as substantial services had in fact been provided by O. In any event, it would be difficult to establish breach of fiduciary duty by a shadow director in circumstances where a formally-appointed director would not be liable because the latter would be relieved from duty by statute or would have had the benefit of Article 85. The court said it would not impose liability on a shadow director to account for profits where a formally-appointed director would not be liable. Claims against the advisers for dishonest assistance and unlawful means conspiracy were also rejected, on the basis that the alleged breaches of fiduciary duty had not occurred and, in relation to dishonest assistance, that there had been no dishonesty. Claims for fraudulent trading also failed. (*Instant Access Properties Limited (in Liquidation) v Rosser and others* [2018] EWHC 756 (Ch))

Conditional cross-border merger approved by the court

The High Court has approved a cross-border merger by absorption of a wholly-owned subsidiary where completion was subject to a condition.

A cross-border merger was to take place under the Cross-Border Mergers Regulations 2007 in the form of a merger by absorption of a wholly-owned Luxembourg subsidiary (S) into its UK parent company (C). The effect was that C would be the only surviving entity following the merger. Before the cross-border merger, substantial assets worth €2 billion were to be transferred from another Luxembourg group company to S by way of a domestic demerger in Luxembourg. The only step required for the demerger to take place was for C, as sole shareholder of both Luxembourg companies, to go before a notary public in Luxembourg to get the demerger approved. Consequently, completion of the cross-border merger was expressed to be conditional on the demerger first happening. The court approved the conditional cross-border merger. The court was satisfied that everything had been done to make the process of getting the notary's approval as certain as possible. The necessary documents were all prepared and the cross-border merger would follow completion of the demerger virtually automatically in a very short space of time. The court took into account that there was very limited risk of the condition not being satisfied and that, as this was a merger by absorption of a wholly-owned subsidiary, shareholders would not be adversely affected. The surviving UK company C was in a good financial position, with shareholder assets of around £3.5 billion, whilst S had no employees to transfer. (*Re Chanel Limited* [2018] EWHC 1095 (Ch))

Key lessons

- **Conditionality:** The judgment indicates that the court may be willing to approve a conditional cross-border merger where it is satisfied that the parties have taken all reasonable steps to satisfy the condition, other than implementing the actual cross-border merger.
- **Analogy with restructuring schemes:** The decision is in line with previous case law, in the context of a restructuring scheme, on the court's ability to sanction a conditional scheme of arrangement in analogous circumstances where appropriate (*Re Lombard Medical Technologies* [2014] EWHC 2457 (Ch)).

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Reverse cross-border merger did not qualify as a merger by absorption of a wholly-owned subsidiary

The merger by absorption of a Luxembourg parent company by its wholly-owned UK subsidiary did not qualify as a merger by absorption of a wholly-owned subsidiary under the Cross-Border Mergers Regulations 2007 (Regulations). The effect was that the merger did not qualify for the less onerous requirements applying under the Regulations to a merger by absorption of a wholly-owned subsidiary.

A merger by absorption was proposed whereby Luxembourg parent company (L) would be absorbed by its UK subsidiary (S), with its current shareholders receiving shares in S. S applied to court for the certificate that it had completed the pre-merger acts and formalities. Critically, it sought the benefit of provisions in the Regulations which impose less onerous content requirements for the draft terms of merger in the case of a merger by absorption of a wholly-owned subsidiary compared to those which apply to a general merger by absorption. The High Court decided that the reduced content requirements did not apply to a reverse cross-border merger and declined to grant the certificate. The court said that the argument that the exemption for mergers by absorption of a wholly-owned subsidiary applied was unsustainable. The Regulations were clear that a reverse cross-border merger only qualified as a general merger by absorption, not a merger by absorption of a wholly-owned subsidiary, and that there were no exemptions from the content required. (*Re GSI Group Holdings Limited [*2018] EWHC 1397 (Ch))

Key lessons

- **Consistent with past case law:** The decision is consistent with the outcome in *Re GET Business Services Ltd* [2017] EWHC 2677 (Ch), where it was held that a merger of two wholly-owned subsidiaries of the same parent did not qualify as a merger by absorption of a wholly-owned subsidiary.
- **Apply law of surviving entity:** It is the law of the surviving entity which applies when you are assessing the status of a reverse cross-border merger for these purposes.

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Court sanctioned proposed merger to allow UK plc to become an SE on the basis no abuse of law

The High Court has decided that the introduction of a Luxembourg company into a group structure specifically to allow a UK plc (P) to use the merger provisions of the Regulation on the Statute for a European Company (SE Regulation) was not an abuse of law.

P conducted insurance business from its registered office in London and its branches across Europe. It wanted to become a Societas Europaea (SE) in accordance with the SE Regulation, which requires the merger or formation of a new company by companies from at least two EEA member states. The advantage of an SE is that it is able to transfer its registered office to another member state under a simple and relatively quick procedure. To facilitate this, P incorporated a company in Luxembourg (L), with a view to merging L with P, on the basis P would acquire all of L's assets and liabilities and then be registered as an SE at UK Companies House. L, which did not trade and had limited assets and liabilities, would then cease to exist by operation of law. The court approved the merger. It did not matter that L had been formed with the specific aim of allowing P to become an SE under the SE Regulation. Even if L's involvement was just a means to enable P to produce the intended result under the SE Regulation, this was not an abuse of law. (*Re Liberty Mutual Insurance Europe Plc* [2018] EWHC 1445 (Ch))

Key lessons

- **Follows approach of case law on cross-border mergers:** In line with the approach in *Re Easynet Global Services Ltd* [2018] EWCA Civ 10, where the Court of Appeal held that the presence of a single non-UK (Dutch) company in a structure to facilitate a merger under the Cross-Border Mergers Regulations 2007 had not been an abuse of law.

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Two schemes of arrangement with separate purposes need not be treated as one composite scheme

An intra-group reorganisation involving two schemes of arrangement and reductions of capital was not precluded under s.641(2A) of the UK Companies Act 2006 (CA 2006), which prohibits a capital reduction as part of a scheme for the acquisition of all the shares in a company, because each scheme served a separate and real commercial purpose.

O Plc was the parent of a group of companies. Following a strategic review of its businesses, O's directors decided to carry out two schemes of arrangement to split the group into separate businesses. The first scheme would demerge a wholly-owned subsidiary of O (company Q). This would involve a reduction of share capital by O and cancellation of its share premium account to create distributable reserves. Part of these would be used to make a distribution in specie of shares in Q to O's members. The first scheme would also reclassify some of the ordinary shares in O and transfer some shares to nominees for the relevant shareholders in preparation for the second scheme. The second scheme would create a new holding company for O and the remaining group (holdco). It would provide for all of the shares in O after operation of the first scheme either to be transferred direct to the new holdco or cancelled. The reserve arising on cancellation would be applied in paying up new shares in O which would be issued to the new holdco. As consideration for the cancellation or transfer of their shares under the second scheme, O's members immediately before the second scheme would receive one share in holdco for every share they held in O. The High Court was satisfied that the schemes did not infringe s.641(2A). The prohibition did not apply to the reduction of capital in the first scheme, because no person would acquire all of the shares in O. The prohibition could apply to the cancellation reduction in the second scheme, because essentially that was a scheme by virtue of which all of the shares in O would be acquired by the new holdco. However, in practice the exception in s.641(2B) of the CA 2006 applied, which allows corporate reorganisations where a new holding company is inserted into the group and the pre-existing members have substantially the same equity ownership in the new holding company. The High Court decided that there was no reason to treat the two schemes as one composite scheme and reconsider whether that would trigger the prohibition in s.641(2A). This was because each scheme served a separate very real commercial purpose, not tax avoidance (which was the mischief that s.641(2A) was directed at). Indeed, the first scheme could be carried into effect independently of the second and was not conditional on the second scheme being approved. At the end of the first scheme, if the second scheme did not become effective "unwind" provisions would operate in relation to all the transfers and share reclassifications. This meant it was unnecessary to consider what the analysis would have been on a composite scheme. (*Re Old Mutual Plc* [2018] EWHC 873 (Ch))

Key lessons

- **Independent schemes:** The judgment confirms that there is no need to treat schemes as one composite scheme where the first scheme can take place independently of the second and they are not inter-conditional.
- **Unresolved issues:** The decision leaves open what the analysis would have been on a composite scheme as to: (i) whether only reductions of capital which directly facilitate an acquisition of shares in the company by a third party are prohibited; and (ii) whether, given the introduction of nominees into the structure, the requisite equivalence of membership and proportionate equity shareholdings for the exemption in s.641(2B) to apply could be created by the scheme itself.

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Listed companies

Several rulings by the London Stock Exchange are of particular interest to AIM-traded companies

Public and private censures and three companies fined for breaches of the AIM Rules

The London Stock Exchange (LSE) announced the public censure and fine of MBL Group Plc (M) and, separately, the private censure and fine of two further companies, for breaches of Rules 10 (Principles of disclosure), 11 (General disclosure of price-sensitive information) and 31 (AIM company and directors' responsibility for compliance) of the AIM Rules.

The LSE publicly censured and fined M for breaches of Rules 10, 11 and 31 of the AIM Rules, owing to failures to inform the market promptly of certain financial information relating to its subsidiaries. M published its annual accounts to the end of March 2017 in August of that year, with no mention of any material change in financial performance. Updated consolidated management accounts were made available to the board on 14 September, which highlighted significant deterioration in the financial performance of M's subsidiaries since the accounts date. Instead of immediately notifying the market of this material change, M's board delayed disclosure of this price-sensitive information and failed to consult with its nominated adviser (nomad) as to its disclosure obligations until 28 September. This course of action, and a general failure to have sufficient procedures, resources and controls in place to ensure compliance with the AIM Rules, was determined to be a breach of Rules 11 and 31. Further, the fact that M had released an announcement to the market on 25 September 2017 omitting to mention the relevant financial information, and instead referring to the subsidiaries only as "profitable and cash generative", was a breach of Rule 10.

In a separate AIM Disciplinary Notice, the LSE privately censured and fined two companies for breaches of the AIM Rules. One of the companies concerned had breached Rules 10 and 31 by accidentally disclosing certain information in a social media post that should instead have been released to the market via RIS notification. The other company censured had failed to consult with its existing nomad concerning the company's progress towards appointing their replacement, after a breakdown of the relationship between the company and adviser, and in so doing had breached Rules 11 and 31. (*AIM Disciplinary Notice AD 18* and *AIM Disciplinary Notice AD 19*, dated 13 August 2018)

Key lessons

- **Importance of Rule 31 of the AIM Rules:** All three of these cases involved a breach of Rule 31 in some manner, whether it be a company's failure to have in place sufficient procedures, resources and controls to enable it to comply with the AIM Rules or failure to keep its nomad informed and seek advice from its nomad regarding compliance with the Rules.
- **Pressures on time and resources are no defence:** The LSE noted in its announcement of public censure against M that it recognised that the failure to disclose information was unintentional and that the board was operating in difficult circumstances and facing various challenges at the time, including frustration of an attempted sale of subsidiaries and a shareholder meeting requisition. Nonetheless, this was no excuse for non-compliance with the AIM Rules.
- **Social media strategy:** The private censure highlights the need to have proper controls in place to monitor effectively all disclosures made via social media.

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Public censure and fine for breaches of the disclosure requirements of the AIM Rules in relation to payment obligations under an exclusivity agreement

The London Stock Exchange (LSE) announced the public censure and fine of Bushveld Minerals Limited (B) for breaches of Rules 11 (General disclosure of price-sensitive information) and 31 (AIM company and directors' responsibility for compliance) of the AIM Rules.

The LSE publicly censured and fined B for breaches of Rules 11 and 31 of the AIM Rules resulting from failures to comply with a without delay obligation to inform the market of monies committed under an exclusivity fee arrangement, once a binding obligation arose. Around March 2016, B was considering acquiring a vanadium mine and plant in a transaction which would have constituted a reverse takeover, if completed. B entered into an exclusivity agreement on 24 March 2016, under which it was required to place US$500,000 on deposit with its lawyers, subject to a solicitor's undertaking to release the monies to the seller once certain conditions were met The undertaking was not given immediately. On consulting its nomad, B was informed that giving such an undertaking would create a binding obligation which, in turn, would give rise to a without delay disclosure obligation under AIM Rule 11, as the exclusivity fee was a material sum in relation to B. B wanted to avoid disclosure, as it would entail having to disclose the proposed reverse takeover, having its securities suspended pursuant to the guidance to AIM Rule 14, and would, it believed, jeopardise a related fundraising. B therefore sought advice from its lawyers on its disclosure obligations, whose advice conflicted with the nomad's. B asked the nomad to liaise with the LSE to discuss whether or not, on notification, a suspension was required. On 7 April 2016, without informing its nomad, B authorised its solicitors to give their undertaking in respect of the exclusivity fee, and therefore a without delay disclosure obligation arose under the AIM Rules. The nomad was only informed weeks later, when the undertaking was mentioned during discussions with B about fundraising. The effect was that it was not until 22 April 2016 that the undertaking and exclusivity fee were disclosed and B's securities were suspended from trading. The LSE determined that the failure to disclose the arrangements without delay once the undertaking was given was a breach of AIM Rule 11, and that B's failure to provide its nomad with full information in relation to the undertaking was a breach of AIM Rule 31, and had meant that both the nomad and the LSE were not in possession of the facts when in discussions. (*AIM Disciplinary Notice* AD 20, dated 7 December 2018)

Key lessons

- **Importance of Rule 31 of the AIM Rules:** This censure is yet another instance where a failure to comply with AIM Rule 31 has been central to the LSE's decision to impose sanctions on an AIM company. In this case, the LSE specifically stated that a nomad "should be able to have confidence" that it is being provided with all relevant information and that a failure to comply in this case had "potentially affected the Exchange's ability to make fully informed regulatory decisions".
- **Pressures on time and resources are no defence:** As with AD 18 and 19, the LSE once again noted that the company being censured was operating under challenging commercial conditions and that its attention was focused on the fundraising to mitigate the materiality of the exclusivity fee. This was not an excuse for non-compliance as B should have been aware, from the nomad's advice, that its actions constituted a breach of the Rules.

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