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2020 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.

Contractual provisions

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

Length of restrictive covenants imposed on employee-shareholder under SHA

The Court of Appeal decided that a twelve-month non-competition covenant imposed on employee-shareholders under a shareholders' agreement (SHA) applied to an employee/consultant after the expiry of his consultancy agreement. It did not matter that there was a time gap before he sold his shares under the compulsory transfer provisions in the articles of association which were triggered when his consultancy terminated.

S had founded a business producing maps for luxury hotels, which G subsequently acquired. S stayed on as employee and, later, consultant, and took shares in G. G alleged that S had breached the non-competition covenant in the SHA which applied to an Employee Shareholder while a shareholder and for twelve months after they ceased to be a shareholder. "Employee Shareholders" included "*any Shareholder who is also an employee... and those... who are Employee Shareholders as at the date of the Agreement are identified... [in] Schedule 1*" (which included S). S argued that he should not be treated as an Employee Shareholder, because the time gap between his consultancy terminating and transferring his shares meant he could be locked in indefinitely, which the parties could not have intended. The Court of Appeal decided that S was still an Employee Shareholder subject to the non-compete covenant, overruling the previous High Court decision that the definition of "Employee Shareholder" only applied to the period over which a person was both a shareholder and an employee. You had to apply general principles of construction, ascertaining the objective meaning of the words used in the

Key lessons

- **Clear and express drafting**: Clear and express drafting is advisable on the scope of restrictive covenants.
- **Test for enforceability of restrictive covenants**: The test for applying restrictive covenants in SHAs (or sale and purchase agreements) is likely to be lower than under an employment contract, particularly where a shareholder was the founder of the business and actively involved in it – the court stated it is likely to be less vigilant in these circumstances.

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SHA, considering the contract as a whole and the parts of it that provided its context. The Court of Appeal said it made no commercial sense if the restrictions could be avoided altogether with immediate effect by someone terminating their employment or agency. That would generally make the twelve-month duration meaningless. It was irrelevant that an Employee Shareholder might also be caught by whatever restrictions were in their employment contract. That was no reason to interpret the non-compete covenant in the SHA in a way which gave it no force. The effect was that S remained subject to the non-compete covenant for 12 months following his ceasing to be a shareholder. The Court of Appeal also decided that the twelve-month duration was not unreasonable to protect G's legitimate interests, given the nature of the business and that the SHA was between experienced commercial parties. The clause should not be declared unreasonable on the basis of the unlikely possibility that there may be considerable delay or the extreme, and very unlikely, possibility of indefinite lock-in. (*Guest Services Worldwide v Shelmerdine* [2020] EWCA Civ 85)

Dual requirement to notify claims as soon as possible and within seven years

The High Court decided that a notice of claim mechanism in a share sale and purchase agreement (SPA) imposed a dual condition precedent to bringing an indemnity claim, requiring that a claim should be notified both as soon as possible and, in any event, within seven years. This meant that the buyer's indemnity claim was time-barred because it had failed to notify the claim as soon as possible, even though it had notified it within the requisite seven years.

The target company (C) gave financial advice to retail customers. The seller (S) sold C to buyer B. There had been mis-selling before the sale. Under clause 5.9 of the SPA, S agreed to indemnify B for all losses and liabilities from mis-selling. Under the lead-in wording to clause 6.7 of the SPA, notice of an indemnity claim had to be given to the warrantors as soon as possible and, in any event, under clause 6.7.3, on or before the seventh anniversary of the agreement. B served notice of indemnity claim just before the seventh anniversary. The High Court decided that clause 6.7 imposed a dual condition precedent to bringing an indemnity claim. The effect was that B's indemnity claim was time-barred for failing to notify it as soon as possible, even though the seven-year long stop date for formal notification had been met. The court said that clause 6.7.3 depended on the introductory words of clause 6.7 for its context and sense, and one could not make sense of it without the words "as soon as possible". This interpretation was consistent with the commercial purpose of the clause, which was to afford S a prompt defence, whilst the seven-year formal notification requirement set a long stop or limitation period. This also had synergy with the separate third party claims mechanism in the SPA, which allowed S to defend and mitigate a third party claim and depended on early notification. The requirement to notify "as soon as possible" meant when B knew of a matter which it knew, or any reasonable person would know, might give rise to an indemnity claim. B had notified its insurers more than a year before, and should have notified S then. (*Towergate Financial (Group) Ltd v Hopkinson* [2020] EWHC 984 (Comm))

Key lesson

- **Do not converge dual notification requirements in one clause**: As a drafting matter, the judgment shows the risk in converging in one clause a notification requirement as soon as becoming aware of a claim (commonly treated in case law as permissive, in the absence of express language to the contrary) with a long stop date for formally notifying a claim (always treated as mandatory). The effect of combining these two concepts in one clause here was that both elements were treated as mandatory.

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Distinction between covenant to pay and indemnity under SPA

The High Court decided that a clause in an SPA was a covenant to pay rather than an indemnity, and that the buyer did not have to pursue defences. It also held that the seller limitation on conduct of third party claims did not apply to insurance mis-selling claims the subject of the clause.

B indirectly acquired from S the entire issued share capital of underwriter T, which underwrote payment protection insurance (PPI) for store cards. Bank X marketed and sold PPI on T's behalf to customers of high street retailers under an agency agreement. Under clause 10.8 of the SPA, S covenanted "*to pay on demand*" to B an amount equal to 90% of all losses from customer redress payments arising from PPI mis-selling claims. T received complaints over mis-selling, and the parties knew that it had an inadequate claims handling system. B claimed under clause 10.8 and S alleged that B should have first asserted defences and also that B had breached the seller limitation on third party claims in the SPA. The court emphasized that it had to construe the language used in clause 10.8 against the factual matrix and context of the SPA. It decided that the language used was a covenant to pay, not to indemnify, in other words a debt claim. It was an absolute obligation to pay on demand, for which there was no obligation to assert defences. This was also consistent with the likely intention of the parties, given that regulatory complaints handling requirements strongly discouraged regulated entities from asserting defences against customers. There was no express provision anywhere in the SPA requiring B to advance all reasonable defences and no implied term to that effect. Any such term would have been inconsistent with the entire agreement clause and would also fail to meet the established test for implication of terms. The High Court also decided that S's consent was not required before customer redress payments could be made. Customer mis-selling complaints were not "third party claims" for the purposes of the third party claims mechanism in the seller limitations in the SPA. On the wording, the court decided this mechanism only applied to civil claims for damages, not determination of regulatory complaints by the Financial Ombudsman Service. This was particularly so given the vast volume and low value of the mis-selling complaints received. The parties would have expressly provided for these to come within the third party claims mechanism if they had intended such a broad and burdensome scope. (*AXA SA v Genworth Financial International Holdings Inc* [2019] EWHC 3376 (Comm))

Key lessons

- **Covenant to pay versus indemnity**: The decision shows the merits to a buyer of expressing a seller's payment obligation as a covenant to pay (on demand) rather than an indemnity for loss, with a view to enforcing it as a debt claim rather than a damages claim.
- **Clear and express drafting**: The judgment highlights the need for clear and express drafting of contractual payment triggers and the scope of any intended limitations on liability.

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Indemnity under SPA in relation to excess liabilities

A buyer (B) was entitled to be indemnified under a share SPA in respect of excess liabilities of the target company (C). The analysis hinged on the construction of the definition of "Liabilities" in the SPA when applied to the indemnity for excess liabilities.

B acquired C from seller S for £1 and repayment to S of unsecured loans he had made to C during his period of ownership. Under clause 7.1 of the SPA S agreed to indemnify B from all losses arising from C's liabilities exceeding £6.6 million as at 31 December 2016 (the Relevant Date). "Liabilities" was defined as the aggregate amount of all liabilities of C on or prior to the Relevant Date "*(and only to the extent such liabilities relate to such period)*" and whether or not due for payment at the Relevant Date. S provided a database of financial information, including a trial balance sheet. B alleged after completion that C's liabilities exceeded £6.6 million and claimed under the indemnity. The Court of

Key lessons

- **Clear and express drafting**: The judgment shows the importance of clear and express drafting of definitions, how calculations will be determined and any seller limitations on liability.
- **Natural meaning of words used**: Once the context had been considered, the judge at first instance should have focused on a textual analysis of the definition, including the words in parenthesis.

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Appeal decided in B's favour. It held that the "Liabilities" should be calculated in accordance with FRS 102, being on an accruals basis. This had been the basis on which C had prepared the trial balance sheet and its other accounts. The Court of Appeal disagreed with the trial judge's findings that this approach had been modified by the definition of "Liabilities" in the SPA so as to exclude those which C had incurred before the Relevant Date but which related in part to a subsequent period, in the sense that services C was obliged to pay for extended beyond the Relevant Date. This interpretation had been based on the wording in parenthesis in italics in the definition of "Liabilities". The Court of Appeal said this misunderstood the purpose of the indemnity, which was to strike a balance in terms of the amount of disclosed debts and other liabilities that B was prepared to assume, given the short time to conduct due diligence, without further adjustment of sums payable to S. The aim had not been to change the whole basis of accounting under the indemnity in a way which made the calculation of excess liabilities unworkable on the facts. Indeed, if the judge's interpretation had been applied to all the liabilities at the Relevant Date, including those disclosed in the trial balance sheet, it is likely the total would not even have reached the £6.6 million stated in the trial balance sheet. (*Al-Hasawi v Nottingham Forest Football Club Ltd*. [2019] EWCA Civ 2242)

Indemnity in SPA allocating risk for pre-completion damage

The High Court considered the interpretation of an indemnity in an SPA allocating risk in relation to damage "prior to completion". It decided on the facts that its scope was limited to damage caused in the period between signing and completion.

B acquired from S a company (C) that owned and operated the electrical transmission link between a wind farm and the national grid and included four subsea export cables. Two of the cables failed after completion and B incurred significant repair costs. It turned out that they had been damaged some considerable time before, probably on manufacture. An indemnity in the SPA provided that S would indemnify B from the full reinstatement cost if any assets "are destroyed or damaged *prior to Completion*". The High Court decided that the words "*prior to Completion*" in the indemnity meant the period between signing and completion and that damage which had already occurred at the date of the SPA was not covered. The use of the word "are" in the indemnity was significant in this interpretation, and was reinforced by the context of the provision. Without having regard to the headings in the SPA (which it was agreed did not affect its interpretation), it was relevant that the indemnity was located in between clauses dealing with signing and completion respectively. It was also relevant that the SPA contained a separate, detailed warranty on the condition of the assets at signing, including that no defect had been discovered in relation to them that was reasonably likely to cause material disruption, with monetary limitations. The court said it would be remarkable, and unlikely, that such a carefully structured and limited warranty was subsumed and rendered largely obsolete by an all-embracing indemnity. The claim failed because no damage had occurred to the cables in the period between signing and completion. (*Gwynt Y Mor Ofto Plc v Gwynt Y Mor Offshore Wind Farm Ltd & Ors* [2020] EWHC 850 (Comm))

Key lessons

- **Clear, express and unambiguous drafting**: The decision highlights the need for clear, express and unambiguous drafting of the exact scope of an indemnity.
- **Inter-relating contractual provisions**: It shows the importance of making sure that inter-relating and overlapping provisions work together. The effect here of dual warranty and indemnity cover prompted the court to interpret the indemnity narrowly.

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Company law

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

Scheme explanatory statement adequate and fairness test met

The High Court confirmed that an explanatory statement sent to shareholders in connection with a proposed scheme of arrangement had been adequate, the scheme was fair and there had been no material change of circumstances after shareholders had approved the scheme.

I was a global provider of mobile satellite services. L was a US satellite communications business. I had granted L a series of options to use some of its radio frequencies in return for scheduled payments. L subsequently wanted to develop a terrestrial communications network, and needed a licence modification to use I's radio frequencies for this purpose. This required US regulatory approval, and was largely opposed in the US and UK. Whilst the application was outstanding, certain payments due to I were deferred. A scheme of arrangement was proposed in relation to I, under which its shareholders would get a price representing a 46% premium over the undisturbed share price. The chairman's letter to shareholders had specified that, whilst I had growth opportunities, it also faced some challenges reflected in the undisturbed price, such as the impact of additional capacity and technologies. The scheme was approved by the requisite majority of shareholders at the court meeting, despite some objections that it undervalued I. A press article was published after the court meeting speculating that progress had been made with L's application. Some objecting shareholders called for a delay to sanctioning the scheme, to negotiate a contingent value right (CVR). The High Court had to consider the adequacy of the explanatory statement sent to shareholders. It decided that the explanatory statement had been clear, fair and sufficient. It had met the statutory requirement for it to explain the effect of the scheme. It was significant that the deferred payments consistently had been reported in I's annual reports since at least 2014, the latest of which were incorporated by reference into the explanatory statement. Nothing could have shed further light on this. The court also rejected that a CVR should have been negotiated and that this impacted on the fairness of the scheme. At the sanction hearing the test was simply whether an honest and intelligent member might reasonably approve the scheme, which had been met. It was not relevant whether a better deal could have been negotiated. The scheme did not need to be the best scheme possible or the only fair scheme. The court also decided that there had been no material change of circumstances since the court meeting. Further concerns had been voiced in the US over L's application and the situation was as unclear as before. The decision is in line with other recent case law[1] that disputes over whether there are better alternatives are not properly within the scope of a sanctions hearing and also showing the court's reluctance to review the decision at the court meeting on the basis of alleged changed financial circumstances. (*Re Inmarsat Plc* [2019] EWHC 3470 (Ch))

Key lessons

- **Adequacy of explanatory statements**: The appropriate level of detail may vary depending on the facts, and may be impacted by information publicly available.
- **Fairness test at sanction hearing**: The question for the court at the sanction hearing is whether the scheme is one that an honest and intelligent member might reasonably approve. The court is not concerned with whether the proposed scheme is the best scheme possible or the only fair scheme.
- **Material change of circumstances**: Press speculation alone is not enough to justify a material change of circumstances.

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1 *Re Premier Oil PLC and Premier Oil UK Limited* [2020] CSOH 39.

Cancellation scheme of arrangement – restructuring exception applied

The restructuring exception applied to the prohibition under the UK Companies Act 2006 (the CA 2006) on a capital reduction as part of a scheme for the acquisition of all the shares in a company, where a group reorganisation was aimed at separating existing businesses of the company, following which two subsidiaries would be sold to a third party.

Buyer B wanted to acquire only certain divisions of company G, including subsidiary L but not G's construction business. The proposed scheme of arrangement was a cancellation and reissue scheme. G would cancel all of its shares in a reduction of capital, and the resulting reserve would be applied in paying up new ordinary shares in a Jersey holding company (J), in consideration of which J would issue new shares to scheme shareholders on a one for one basis. G would then distribute its shares in L to J. Following this, J would undertake a bonus issue to issue further shares to scheme shareholders on a one for one basis. J would undergo a reduction of capital involving cancellation of the bonus shares and transfer its shares in G to a new UK holding company (H). In exchange, H would issue shares to J's shareholders on a one for one basis. B would then acquire J, thereby assuming control of L, and acquire another subsidiary of G's for cash. G would be owned by H and hold the retained businesses. Technically the restructuring exception applied, because a new holding company was inserted into the group and all or substantially all of G's members became members of the holding company in the same or substantially the same proportions. The question was whether the court would refuse to allow the exception to be used on the basis of the *Ramsay* principle of purposive interpretation of tax legislation, which involves asking whether the relevant statutory provision was intended to apply to the transaction, viewed realistically. The High Court allowed the exception to apply. It was satisfied that the wider transaction was an internal reorganisation not driven by the stamp duty avoidance mischief that the prohibition on reductions of capital in cancellation takeover schemes was aimed to curtail (being avoiding stamp duty on a transfer of shares to a bidder). The scheme here was undertaken for proper commercial purposes, to facilitate the sales of the subsidiaries. Whilst the scheme would effect a transfer of control in relation to G, that was a necessary step to enable the wider transfer of the subsidiaries to take place. (*Re Galliford Try Plc* [2019] EWHC 3252 (Ch))

Key lesson

- **Restructuring exception**: The decision demonstrates that the court will support cancellation schemes on reorganisations where they are motivated by a legitimate commercial purpose and are not driven by stamp duty avoidance on an acquisition of control by a third party.

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Directors' duties when company goes into administration or creditors' voluntary liquidation

The High Court decided that the general statutory duties owed by directors under the CA 2006 were not extinguished when the company went into administration or creditors' voluntary liquidation (CVL). It did not matter that insolvency legislation imposed additional duties on directors and limited their management powers in these circumstances.

D was sole director and shareholder of company C when it went into administration. This was converted into a CVL, then C was dissolved, and subsequently it was restored to the register to claim against D for past transactions at an undervalue and for no consideration which he had implemented. These included: a property sale from C to D; payments by C to a creditor (S) with which D had associations; and a series of payments by C to an associated company of D's (A). The High Court decided that a director's general duties under the CA 2006 continue after the company enters into an insolvency process, and had been breached here. They are independent of, and parallel to, the duties an administrator or liquidator owes under insolvency legislation. Key elements in the analysis were: the statutory directors' duties do not depend on the exercise of a given power as

Key lessons

- **Guidance in distressed situations**: The judgment gives useful guidance to directors in distressed situations and confirms that directors' general statutory duties continue after a company enters into an insolvency process.
- **Duty to promote success**: The judgment contains useful discussion of the limited qualifications, which particularly arise in the context of an insolvency, to the general rule that the duty to promote the success of the company is ordinarily regarded as a subjective one, such as the requirement to treat creditors' interests as paramount once a company is actually insolvent.

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director (for example, the duty to avoid a conflict of interest is triggered just by holding or having held the office of director); the CA 2006 expressly states when particular provisions do not apply in the context of a particular insolvency process (such as shareholder approval for substantial property transactions with a director); the CA 2006 duties are based on common law rules and equitable principles which are flexible enough to extend beyond a company's entry into a formal insolvency process; and the CA 2006 expressly preserves the creditors' interests duty whereby the interests of creditors are paramount when a company is actually insolvent. It is also clear from insolvency legislation that a company's entry into administration or CVL does not result in removal of directors from office. D had breached the creditors' interests duty in effecting the property transfer at a significant undervalue when C was insolvent, without placing the property for sale on the open market. Consequently, he held the property on trust for C. An intelligent and honest person in the position of a director could not reasonably have believed it was in the interests of creditors as a whole for D to buy the property off market at an undervalue. D had also breached the duty to exercise reasonable care, skill and diligence and was guilty of misfeasance for causing or knowingly allowing the payments to S when C was in administration (again, without giving proper consideration to the interests of creditors as a whole) and had to repay them with interest. Some of the pre-administration payments to A had been for no consideration, which A also had to repay. (*Re System Building Services Group Ltd (In Liquidation)* [2020] EWHC 54 (Ch))

Payments into employee benefit trust were unlawful distributions

Payments from a company's capital reserves into two employee benefit trusts (EBTs) and an interest in possession fund (IPF) for making payments to three director/employee-shareholders (D) were held to be disguised distributions which were void and repayable, as they did not meet the statutory requirements for distributions under the CA 2006. There were also related breaches of directors' duties, including for making large expense payments when the company was insolvent.

The payments into the EBTs were made in 2009 and 2010 in proportion to shareholdings and were designed to defer pay as you earn (PAYE) income tax and national insurance arising from employment. The payments into the IPF were made in 2012 to avoid higher and additional rates of income tax on dividends. D also paid themselves significant payments, including expense payments, in 2013 while the company (C) was in financial difficulties and turnover was rapidly dropping. Significantly, Her Majesty's Revenue and Customs (HMRC) wrote to C in June 2011 stating that they were investigating the EBT schemes and would revert with formal assessments for PAYE and national insurance contributions, which they did in 2013, as well as then opening an enquiry into the IPF. By then C had ceased trading. Its latest accounts at the time did not make provision for the debt to HMRC. The High Court decided that the payments were unlawful and had to be repaid. Relevant factors in deciding that the payments into the EBT and IPF were returns of capital amounting to unlawful distributions included that: they were taken from C's reserves; they were effected in proportion to shareholdings; they were not paid for the benefit of non-shareholder employees; they always ended up in the hands of shareholders; the transactions were not reasonably incidental to carrying on C's business nor to promoting its prosperity; and as D were shareholders they were entitled to the entire surplus value in C anyway, so that the more likely motive was tax avoidance than incentivisation. The court decided that C was insolvent by June 2011, because it could not reasonably be expected to meet its liabilities to HMRC. The effect was that creditors' interests were paramount. Distributing assets after this date and effecting significant expense payments, without proper provision for creditors, were breaches of directors' duties. The court took into account that D had: failed to heed warnings from the scheme's promoter about the risk that paying amounts in excess of profits was likely to be treated as disguised distributions, and the same could be said for paying out the entire or near entire reserves; failed to read leading counsel's opinions provided by the promoter on risks associated with the schemes; failed to seek clearance from HMRC; and failed to take independent legal advice. This was not reasonable conduct for directors faced with such large financial decisions. (*Toone v Ross* [2019] EWHC 2855 (Ch))

Key lessons

- **Risk assessment**: The decision highlights the importance of directors' obtaining independent expert advice when considering complex structures and tax planning arrangements, conducting a risk assessment of possible outcomes and seeking clearance from HMRC.
- **Characterisation of transactions**: A company's actions will be characterised by the substance of the transaction, not how it is labelled.

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Directors' duties to promote success and to avoid and declare conflicts of interest

The High Court decided that three directors had breached their statutory duties under the CA 2006, including the duties to avoid conflicts of interest and to declare an interest in a proposed transaction or arrangement with the company.

Company C was a members' club offering water skiing activities and accommodation for leisure purposes. Father and son D1 and D2 had been directors until 2017. It was alleged that, with D3, they had breached a range of their statutory duties under the CA 2006. The claims included: misappropriating money and other property from C; procuring C to pay management charges and remuneration which it had not agreed to and they did not have authority to pay; failing to account to C for funds that had been or should have been collected from members; a substantial property transfer to D1 at an undervalue without shareholder approval; and breach of the duty to avoid a conflict of interest and to declare an interest in a proposed transaction or arrangement with C in relation to a separate water ski school and shop selling water ski equipment which D1 and D2 ran. The High Court decided that these actions had all amounted to breaches of directors' duties. In assessing the duty to promote success, whilst the court will not interfere with directors' subjective good faith decisions nor exercise commercial judgments, in extreme situations it will be prepared to challenge a director's professed belief as to the company's best interests where the company has suffered substantial detriment. It is also no answer to an alleged breach of duty to act within their powers (the test for which is objective) that a director says they were acting in the company's best interests. The burden of establishing a breach of the duty to promote success falls on the party alleging it, unless a director's decision is one that no reasonable director could have considered in the company's best interests. If a director has received company money, the burden of proof shifts to the director to show that this was proper. The court also emphasized that a director's duty to declare an interest in a proposed transaction or arrangement with the company requires disclosure of the nature and extent of their interest. Where the interest involves receiving a payment from the company, the amount of the payment must be disclosed. (*Fairford Water Ski Club Ltd v Cohoon* [2020] EWHC 290 (Comm))

Key lessons

- **Strict application of directors' duties**: The judgment demonstrates that the court will be strict in its application of the rules on directors' duties.
- **Managing conflicts of interest**: The court may reach a more favourable outcome where directors can show not only that they have considered, and managed, potential conflicts, but also that they have fully documented that process and related discussions, decisions and approvals.

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Strict application of principle of shareholders' unanimous consent

The Court of Appeal decided that, for the principle of shareholders' unanimous consent to apply, it is a strict requirement that all shareholders must assent to the matter in question.

Company C had entered into a series of transactions at an undervalue which had benefited its managing director and controlling shareholder (D) and his wife. These transactions had not been approved by the board of directors. D alleged that they had been authorised by shareholders' unanimous consent for the purposes of the principle in *Re Duomatic Ltd.*[2] The disputed transactions included: the transfer of C's factory to D for less than 40% of book value and its lease back for rent; and the buyback of most of C's shares from D, with the price left outstanding as a secured loan.

Key lessons

- **Strict application of the principle of shareholders' unanimous consent**: The decision demonstrates that the court will apply the shareholders' unanimous consent principle in *Re Duomatic* strictly. For the principle to apply, all shareholders who have a right to attend and vote at a general meeting must assent to the relevant matter. The trustees here were the registered shareholders but had not all approved the transfer, and so there had not been shareholders' unanimous consent.
- **Payment for share buybacks**: The judgment confirms the requirement in the CA 2006 for payment to be made "on purchase" for a share buyback.

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2 [1969] 2 Ch 365.

At the time of most of the transactions C had been facing large claims for environmental nuisance, and subsequently went into liquidation. The issue was whether the property transfer had been validly authorised. D owned 50.6% of C, with 39.2% owned by trustees of a settlement in D's name and 10.2% owned by a pension scheme. It was accepted that D could act in respect of the settlement as he had the authority of the other trustees. However, whilst D and his wife were sole members of the pension scheme, they were neither sole trustees nor sole potential beneficiaries. There was no evidence that the professional trustee overseeing the scheme had been told about the property transfer, let alone authorised it. The Court of Appeal decided that the property transfer had not been authorised by shareholders' unanimous consent. Neither all the trustees nor even all the beneficiaries had authorised D to act on their behalf. At a general meeting D could not have voted the pension scheme's shares without authority from the trustees as a body, which he did not have. The same principle applied to the requirements for shareholders' unanimous consent. The share buyback was also void, because it failed to comply with the CA 2006 requirement for payment for a share buyback to be made on purchase. (*Dickinson v NAL Realisations (Staffordshire) Ltd* [2019] EWCA Civ 2146)

Listed companies

The following English court and FCA decisions are of particular interest to listed companies

Directors not liable for recommending a Class 1 acquisition, despite disclosure failures

A shareholder class action against certain directors of a listed bank (L) in relation to a Class 1 acquisition has failed, despite the High Court finding that the Class 1 circular should have disclosed two additional matters.

L acquired another listed bank (H) through a Class 1 recommended takeover. L's Class 1 circular included a recommendation by L's board of directors that L's shareholders vote in favour of the acquisition, and a responsibility statement from L's directors in the usual form. A group of L's shareholders brought claims against the Chairman and certain executive directors of L. Their key claims were that L's directors should not have recommended the acquisition, and that L's directors should have provided certain further information in the Class 1 circular. L's directors conceded that they owed to L's shareholders a common law duty to take reasonable skill and care regarding their recommendation and the information in the Class 1 circular. They also conceded that they owed an equitable duty of disclosure, which required the circular to give a fair, candid and reasonable account of the circumstances to enable shareholders to make an informed decision.

The High Court held that L's directors did not breach their duty to shareholders to take reasonable skill and care regarding their recommendation. It applied the following test:

Key lessons

- **Provides guidance on directors' responsibilities**: This decision offers rare judicial guidance on directors' responsibilities in relation to disclosures and recommendations in Class 1 circulars.
- **Equitable duty of disclosure in circulars**: The directors' equitable duty of disclosure will be relevant for other circulars convening shareholder meetings.
- **Negligence claim based on directors' responsibility statement**: The inclusion of a responsibility statement in the circular led the directors to concede that they also owed a separate common law duty to take reasonable skill and care. Other documents containing a similar directors' responsibility statement (e.g. equity prospectuses and takeover offer and defence documents) can be expected to give rise to a similar duty.
- **Space for directors' judgment**: Directors must exercise judgement in relation to recommendations and disclosures. This decision provides them with considerable space to do so.
- **Keep good records**: However, it is important to keep good records of the bases for the directors' decisions relating to these matters, especially in a fast-moving environment. This includes any advice received, due diligence and verification output considered, and other information relied upon.

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"Could a reasonably competent chairman or executive director of a large bank reasonably reach the view… that the Acquisition was beneficial to [L] and its shareholders? Or would any such director so placed of necessity have reached the view that the Acquisition was not beneficial?"

Reasonably competent directors need to take a fair and balanced view on what they think are the realities, based on probabilities.

The circular should have disclosed an emergency liquidity assistance facility provided by the Bank of England to H and a repo facility provided by L to H. These non-disclosures were both negligent and breached L's directors' equitable duty of disclosure. However, these non-disclosures did not cause any loss to the claimants, and so their claims failed. (*Sharp & Ors v Blank & Ors* [2019] EWHC 3096 (Ch))

FCA fines executive for failing to notify issuer and the FCA of share trades

The Financial Conduct Authority (FCA) has fined a former executive (G) of a premium listed company (B) for failing to notify B or the FCA of three sales of B's shares.

G was the Managing Director of the Logistics Division of B. While he was not on B's board of directors, he was a member of B's Executive Committee and a person discharging managerial responsibilities (PDMR), as defined in Article 3(1)(25) of the Market Abuse Regulation (MAR). Article 19(1) of MAR requires PDMRs to notify the issuer and the FCA of every transaction conducted on their own account relating to the issuer's shares promptly and no later than three business days after the date of the transaction. In July 2016 B provided G with a personalised briefing pack. This included a memorandum on MAR and B's share dealing code. In November 2016 he returned signed forms acknowledging that he had read this information. However, G stated to the FCA that he did not read or check the documents. On three occasions from August 2016 to January 2017, G sold shares in B with a total value of about £71,235. He did not notify B or the FCA as required by Article 19(1) of MAR. G also failed to seek prior clearance before trading, as required by B's internal share dealing policy.

The FCA fined G £45,000 for breaching Article 19(1) of MAR. Unsurprisingly, the FCA did not consider a claim of ignorance of the obligations outlined in MAR to be a defence for a breach. The first two trades occurred after G had received the briefing pack. Accordingly the FCA considered these breaches of Article 19(1) to be negligent. The third trade occurred after G had returned the signed acknowledgement forms. Accordingly, the FCA considered this breach of Article 19(1) to be reckless. The FCA expressly stated that it made no finding as to the adequacy of B's compliance with, and its policies and procedures in relation to, MAR. (*FCA final notice to Kevin Gorman* – 12 December 2019)

Key lessons

- **FCA enforces dealing disclosure requirements**: This is the first enforcement action by the FCA for a breach of Article 19(1) of MAR. Under the predecessor rule (DTR 3), it had fined one issuer but not a PDMR.
- **Significant fine for (non-director) executive**: PDMRs should note the significant size of the fine, and the FCA's comment that ignorance is no defence.
- **Issuer not fined**: It seems that B's actions were sufficient to show that it had established and maintained adequate procedures, systems and controls. It had internal policies in place and provided relevant documents to its PDMRs. Importantly, it followed up when G did not initially return the signed acknowledgement forms, and sent a reminder email to PDMRs about its policy. The FCA noted the absence of individual training for PDMRs, but did not labour this point.

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Good faith

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

Joint venture: no implied duty of good faith nor to act rationally when removing oil and gas operator

The High Court decided that parties had an absolute and unqualified right to remove the operator of an oil and gas joint venture (JV) on the terms of the clause entitling this and giving the requisite minimum notice. That right was not tempered by concepts of good faith nor a duty of rationality.

The parties operated a series of oil and gas field blocks as an unincorporated JV under a number of joint operating agreements (JOAs). One of the parties was appointed operator (O), whose activities were supervised by an operating committee comprising each of the other parties. Clause 19.1(a) of the JOAs allowed the operating committee to remove O on at least 90 days' notice following a unanimous vote. Due to concerns over O's performance, the claimants (C) voted unanimously to remove O as operator and appoint the first claimant in its place. O was given 365 days' notice of termination. The High Court decided that O had been validly removed. The High Court emphasized that, as JOAs are sophisticated, complex agreements drafted by specialist professionals, they should be interpreted principally with regard to the natural meaning of the words, unless a provision appears unclear, illogical or incoherent. Here, the language was clear and unambiguous. Clause 19.1(a) gave the operating committee an absolute and unqualified right to remove O on giving the minimum period of notice, provided there was a unanimous vote. That decision was binary – to remove or not to remove – and no evaluatory or adjudicatory exercise was required. It was relevant that, elsewhere in the JOAs, it was expressly stated when a right was qualified. The court also decided that no duty of "rationality" applied here, requiring the right to remove O to be exercised in a way that was not arbitrary, capricious or perverse. This is consistent with past case law that generally the court will not treat an unqualified termination right as a contractual discretion which is subject to such a duty. This is particularly so in a complex agreement between sophisticated parties, where it is hard to imply terms due to the strong inference that the parties have carefully considered the express provisions. The High Court also denied that there was an implied duty of good faith based on the argument that the JOAs were long-term relational agreements. Whilst the JOAs could arguably be treated as relational agreements, such an implied term was not necessary for the JOAs to work in accordance with the parties' presumed intentions. In any event, the court did not accept that any such implied terms had been breached. (*TAQA Bratani Ltd v Rockrose UKCS8 LLC* [2020] EWHC 58 (Comm))

Key lessons

- **Implication of terms**: The judgment shows the difficulty in implying terms into professionally-drafted contracts between sophisticated parties where the express terms are clear.
- **Duty of rationality**: The decision reinforces past case law that a duty of rationality will not be applied to an unqualified termination right.
- **Relational agreements**: The judgment demonstrates that the court will not imply a duty of good faith into an agreement just because it may be viewed as a relational agreement.
- **Clear and express drafting**: For clarity, express drafting to include or exclude duties of good faith may have merit in English law agreements.

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No implied duty of good faith under joint venture agreement to disclose business opportunities to shareholder

The High Court declined to imply a duty of good faith into a joint venture agreement (JVA), where there was no express term to that effect and it was not necessary to give commercial or practical coherence to the contract.

R and the defendants (D) were shareholders in a property development joint venture company (JVCo). R alleged that D had not told him about, nor given him an opportunity to participate in, a particular development project which had been successfully executed shortly after he sold his shares. R's settlement arrangements when he left JVCo had included his retaining an interest in two of its existing projects, but he had indicated that he was only interested in those particular projects. R claimed that D had breached either express or implied duties arising under the JVA, either because the parties' relationship was fiduciary in nature or on the basis the JVA was a relational contract. R also claimed fraudulent non-disclosure, allegedly amounting to fraudulent misrepresentation or unlawful means conspiracy, for withholding information and failing to correct his misunderstanding. The High Court decided that the parties did not owe each other fiduciary duties. It would be exceptional for fiduciary duties to arise other than in certain settled categories of relationship, such as partnership. By contrast, the parties here were not partners but shareholders who were free to pursue their own interests. The only express duties of good faith in the JVA were on procuring business for JVCo and not competing with it, which had not been breached. There was also no implied duty of good faith just because the JVA was a relational agreement. The presence of express duties of good faith militated against implying further good faith terms. In any event, the requirement for an implied term to be capable of being clearly expressed was not met here. The High Court also decided that the test for implying a term requiring disclosure was also not met. There had been no positive duty to inform R of JVCo's suite of projects beyond the two he had expressed interest in and, if he had enquired, he would have been told. There had been no conspiracy to withhold information nor a culture to keep him in the dark, and no dishonesty had been shown. (*Russell v Cartwright* [2020] EWHC 41 (Ch))

Key lessons

- **Fiduciary relationships**: The court will be reluctant to extend the established categories of fiduciary relationship.
- **Implication of duty of good faith**: The judgment demonstrates again that the court is unlikely to imply a duty of good faith into a relational agreement in the absence of an express term unless the established test for implication of terms is met and the contract would lack commercial or practical coherence without it.
- **Express provisions on good faith**: Express provisions to include or exclude duties of good faith may have merit in English law agreements.

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No oral modification clauses affirmed

The Court of Appeal confirmed that an English law "no oral modification clause" (NOM) would be strictly applied, save in limited circumstances giving rise to an estoppel against the party seeking to rely on the NOM.

J entered into a franchise development agreement (FDA) with H. This contained a NOM, being a clause prohibiting varying the agreement otherwise than in writing. It was governed by English law and provided for arbitration in Paris. H subsequently became a subsidiary of K. A dispute arose under the FDA and arbitration was brought against only K (not H). The arbitrators inferred an English law novation by virtue of K's in effect having become the main franchisee, even though this had not been agreed in writing and despite the NOM. J brought proceedings in England to enforce the award. The Court of Appeal decided that English law governed the entire FDA, including the arbitration agreement. As a matter of English law, K had not become a party to the FDA, nor the arbitration agreement. It rejected arguments that K had become an additional party to the FDA despite the NOM on the basis the parties had expressly or impliedly consented to this. The Court of Appeal followed the latest Supreme Court guidance[3] that NOMs are binding under English law, with only a very limited exception where the facts give rise to an estoppel against the party seeking to rely on a NOM. For an estoppel to arise, in the very least there would need to have been a clear representation that the variation was valid despite its informality and some reliance on that over and above the informal promise itself. That estoppel test was not met in this case. The Court of Appeal also rejected arguments that contractual good faith and fair dealing provisions in the FDA could override the NOM. In any event, the good faith and fair dealing provisions in the FDA only applied to a party's performance of the FDA and could not turn a third party into a party. (*Kabab-Ji S.A.L. (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6)

Key lessons

- **Limited estoppel exception**: The judgment reaffirms the limited circumstances in which the doctrine of estoppel may be invoked to derogate from a no oral modification clause.
- **No "good faith" derogation**: The decision clarifies that a contractual good faith provision cannot be used to derogate from an English law no oral modification clause.

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3 *Rock Advertising Ltd v MWB Business Exchange Centres Ltd* [2018] UKSC 24.

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