WHITE & CASE

October 2014

# 2014 Autumn Review – M&A Legal Developments

We set out below a number of interesting English and European court decisions which have taken place and their impact on M&A transactions. This Insight 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.

## Duties of Good Faith

**A number of cases have looked at contractual duties of good faith or wider issues relating to the relationship between contracting parties**

### Validity of Obligation to Hold Friendly Discussions to Resolve Dispute Before Invoking Arbitration

*The High Court recently decided that a contractual obligation to try to resolve disputes by friendly discussion before invoking an arbitration clause operated as an enforceable condition precedent to arbitration. Such provisions are common in M&A documents. The case raises issues of duty of good faith in the context of such discussions and drafting considerations where it is intended that a requirement of this nature should operate as a condition precedent.*

A dispute arose between the parties to a purchase contract. The contract said that the parties should try to resolve any such dispute or claim by friendly discussion, but that if no solution could be reached in a continuous period of four weeks the non-defaulting party could refer the matter to arbitration. The question was whether on the facts arbitrators had jurisdiction. The High Court decided that the requirement to hold friendly discussions was an enforceable condition precedent to arbitration, but that this had been satisfied on the facts. The actual discussions could last for less than four weeks, but if they did the claimant would in any event have to wait for the four-week period to expire before starting arbitration. It did not matter that there is no bare duty to negotiate in good faith under English law. The clause was sufficiently certain as it set a time limit on negotiations and defined parameters for any arbitration. The court imported into the obligation to hold friendly discussions an implied duty to do so in good faith, in line with the basis on which limited term exclusivity agreements are enforceable. Where a requirement to try to reach amicable solution is intended to operate as a condition precedent to arbitration, the case highlights the need for clear drafting to impose a time limit on the discussions and identify when arbitration can be commenced. (*Emirates Trading Agency LLC v Prime Mineral Exports Private Limited* [2014] EWHC 2104 (Comm))

Key lessons

- **Speed and costs:** Consider the appropriateness of a requirement to seek to resolve disputes amicably before starting arbitration – it could delay matters and increase costs.
- **Clear timeframe required:** Clear and express drafting is required to put a time limit on the discussions and identify when arbitration may be commenced.

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# Duties of Good Faith contd.

## Duty of Good Faith Implied into Long-Term Contract

*The High Court has implied a duty of good faith into a commercial contract for producing electronic training materials for air pilots. In doing so it followed the previous case in 2013 in which it had implied good faith obligations into a distributorship agreement and made broader comments about parties' duties under long-term "relational" contracts although, unlike in that earlier case, it said there had been no repudiatory breach here entitling termination.*

X alleged that Y had breached their agreement to produce and distribute training materials for commercial pilots by failing to provide technical support and declining to include new training materials. The Court found in X's favour on these issues and that Y had infringed X's copyright in artwork included in the materials by reproducing it. However, the Court decided on a counterclaim that a duty of good faith should be implied into the agreement, which X had breached by downloading materials from Y's systems to use on its own behalf (amounting to a criminal offence under applicable legislation). The Court decided that this was a "relational" agreement of the kind discussed in a previous case in 2013, requiring a particularly high degree of communication, co-operation and predictable performance based on mutual trust and confidence. Good faith at the very least required honesty. The test was whether conduct would be regarded as "commercially unacceptable" by reasonable and honest people in the context involved. (*Bristol Groundschool Limited v Intelligent Data Capture Limited and Others* [2014] EWHC 2145 (Ch), following *Yam Seng Pte Limited v International Trade Corporation Limited* [2013] EWHC 111 (QB))

### Key lessons

- **Requirement of honesty:** The need for honesty is key. A significant factor in implying a duty of good faith was that the conduct was commercially unacceptable.
- **Exclusions:** The implied duty may be expressly excluded or varied, which may be advisable in certain long-term relational contracts.
- **Express drafting:** Express provisions delineating the scope of any such duties may also help.

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## "Good Faith" Negotiations and Exclusivity Agreements

*A recent case on negotiations during an exclusivity period has confirmed that there is no general duty under English law to conduct negotiations in good faith and that costs incurred as a result of failed negotiations are not recoverable from the other party unless the parties agree otherwise, although they are free to come to such an arrangement if they so desire. Although in rare circumstances the Court may imply good faith obligations into a long-term "relational" contract or enforce a contractual duty to negotiate in good faith expressed by reference to something ascertainable, there remains no overriding duty to negotiate in good faith under English law.*

A hedge fund (S) launched a bid to buy out a charity (C) from a joint venture which C owned jointly with a third party. The proposed deal was designed to help that venture refinance a bank loan. S and C entered into a term sheet which was non-binding save for the provisions on exclusivity and costs. There was a six-month exclusivity period, during which C had to conduct negotiations with S in good faith. S underwrote C's costs in certain circumstances. After the exclusivity period expired without reaching agreement, C arranged for the bank loan to be repaid through an alternative scheme, ceased further negotiations with S and claimed its costs. S alleged C had breached an implied duty to conduct negotiations in good faith while negotiations continued after the exclusivity period expired and that C's activities in pursuing an alternative arrangement had impeded the deal with S and disentitled C to its costs. The High Court decided that the express contractual duty of good faith here was limited to the exclusivity period, and there was no legal duty beyond its expiry. Whilst some general duties may apply to negotiations conducted under English law, such as the duty not to misrepresent the facts, the position remains that there is no overriding English law duty to negotiate in good faith nor to resist conducting negotiations with more than one party. Further, although as a general rule costs for failed negotiations are not recoverable, even where a party acts unreasonably, the parties are free to agree otherwise. However, on the facts the agreed trigger events for the costs undertaking to apply were not met here. (*Knatchbull-Hugessen and Others v SISU Capital Limited* [2014] EWHC 1194 (QB))

### Key lessons

- **Good faith:** The position remains that there is no general duty to negotiate in good faith under English law.
- **Contractual duties:** Although rarely a contractual duty to negotiate in good faith delineated by reference to something discernible may be enforceable, this principle is very limited in scope.
- **Wasted costs:** Costs incurred from failed negotiations are not recoverable unless parties expressly agree otherwise.

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# Duties of Good Faith contd.

## When is an Obligation to Use Reasonable Endeavours Enforceable?

*The absence of a general duty to negotiate in good faith under English law, and the unenforceability of agreements to agree, both affect the workability of a contractual arrangement between parties to use a particular level of endeavours to enter into a subsequent agreement. The High Court has confirmed in this context that an obligation to use reasonable endeavours is unenforceable unless both the object of the endeavours is sufficiently certain and there are sufficient objective criteria for evaluating performance of the endeavours.*

It was a condition precedent to a settlement agreement between D and B that D should use reasonable endeavours to enter into a subsequent contract with a third party. Although the subject and scope of the proposed contract were clear (to carry out clearly-specified works), no other contract terms were identified, such as price or payment terms. The High Court decided that the obligation to use reasonable endeavours here was insufficiently certain and did not give rise to enforceable obligations. It was no better than an agreement to agree. It was not enough that the subject matter was defined with some precision. As there is no general duty to negotiate in good faith under English law, the parties would be free to have regard to their own commercial interests and make the best bargain that they could for themselves. The effect was that the Court was not in a position to decide whether a proper subjective reason existed for terminating negotiations. By contrast, an obligation to use reasonable endeavours to become a party to an agreement which already exists is likely to be enforceable. (*Dany Lions Limited v Bristol Cars Limited* [2014] EWHC 817 (QB))

### Key lessons

- **Enforceability of obligations to use reasonable endeavours:** An obligation to use reasonable endeavours is unenforceable unless the object of the endeavours is sufficiently certain and there are objective criteria for evaluating performance.
- **Objective criteria:** The reason you need objective criteria is so that the Court can assess whether or not it was reasonable to fail to agree a contract.
- **Agreements to agree:** The Court will not enforce an agreement to agree or substitute terms which the parties have failed to include.

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# Listed Companies

**A number of decisions have examined issues crucial to listed companies, in particular in relation to market abuse**

## Market Abuse in relation to Improper Disclosure of Inside Information

*The Upper Tribunal held that a senior banker, in sending two emails, engaged in market abuse as an insider who disclosed inside information to another person other than in the proper course of his employment.*

The Upper Tribunal held that Ian Hannam, former senior banker at JP Morgan, engaged in market abuse within s. 118(3) FSMA by disclosing inside information other than in the proper course of his employment. The inside information was about a client of the bank, a listed oil company, for which Hannam was the lead corporate adviser. Hannam had been instructed to secure a substantial corporate transaction for the company and had sent two emails, which the Tribunal determined disclosed inside information, to another client who he believed may be interested in the company. The first email concerned a potential bid for the company and the second indicated that the company had found oil which was not accurate. Hannam did not obtain an explicit confidentiality undertaking from the recipient of the emails. The Tribunal stated there was no suggestion that Hannam is not a fit and proper person and the information was not traded on.

The Tribunal determined the emails contained inside information because (i) they were "precise" and (ii) "likely to have a significant effect on price" of the company's shares, concluding information could be "precise" despite inaccuracy and "specific" if it indicated the "possible effect" on price (i.e. direction of price movement, even without an indication as to extent). The Tribunal also concluded that information was "likely to have a significant effect on price" if it had a realistic (i.e. more than fanciful) prospect of having more than a trivial impact on the investment decisions of a "reasonable investor" based on price. The information in the first email referred to discussions with a potential acquirer as well as the expected price per share and the Tribunal concluded that a reasonable investor would take the information into account in making his investment decision. The Tribunal also concluded that, despite the statement that oil was found being wrong, it was specific in that it might have an effect on share price and the direction of a price movement was clear and on this basis, determined the second email contained inside information. The Tribunal further determined that it can never be in the proper course of a person's employment for him to disclose inside information to a third party where he knows that his employer and client would not consent to public disclosure, unless he knows the recipient is under a duty of confidentiality and the recipient understands that to be the case.

Hannam has not appealed the Tribunal's decision. The penalty was confirmed to be £450,000. (*Ian Charles Hannam v FCA* [2014] UKUT 0233 (TCC))

### Key lessons

- **Inaccurate information:** Information can be inside information despite being inaccurate.
- **Casual leaks:** Sharing pieces of confidential information, even if not wholly accurate, with potential investors to generate interest in a client is market abuse.
- **Confidentiality obligations:** An adviser must only pass on inside information if he knows the recipient is under duty of confidentiality and the recipient understands that to be the case.

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# Listed Companies contd.

## Market Abuse in relation to Market Manipulation

*The Court of Appeal held that a foreign non-FSA-authorised firm was guilty of market abuse for its use of the manipulative trading activity known as layering. The Court determined that effecting an order to trade contracts for difference in relation to shares quoted on the LSE was "in relation to qualifying investments" and constituted market abuse despite CfDs themselves not being qualifying instruments.*

The Court of Appeal upheld previous decisions against Swift Trade for engaging in market abuse in breach of s. 118(5) FSMA in relation to "layering". Market abuse is the behaviour of one person (or persons acting jointly) in relation to qualifying investments and falls within one of prescribed types of behaviour (s. 118(1)). One of these types of behaviour is effecting transactions which give or are likely to give a false or misleading impression as to the market, supply, demand or price of qualifying investments or secure the price at an abnormal or artificial level (s. 118(5)). Swift used direct market access providers (DMAs) to place orders for contracts for difference (CfDs) in relation to shares quoted on the LSE and once placed, the DMAs automatically hedged orders. Within a short time, Swift cancelled the orders and the DMAs automatically cancelled the hedges. In between, the share prices moved, allowing Swift to take advantage of this movement. This is known as layering. The Court concluded the layering was "in relation to" qualifying investments because the orders for CfDs were contracts in shares quoted on the LSE, even though CfDs are not qualifying investments. "In relation to" was interpreted widely. The Court was unsympathetic to Swift's argument that it had not undertaken the trades because it used DMAs, finding Swift acted jointly with the DMAs. Finally despite Swift being incorporated in Canada (without a place of business in the UK) and despite being dissolved prior to the FSA's first decision, the Court concluded that under foreign law the company had "an existence" and the proceedings against it could continue. Subsequently, the FCA Final Notice confirmed the £8 million fine, the largest fine ever imposed for market manipulation. (*7722656 Canada Inc (formerly Swift Trade Inc) v FCA* [2013] EWCA Civ 1662)

### Key lessons

- **Definition of market abuse:** The definition of market abuse encompasses conduct relating to shares as well as financial products that are linked to shares.
- **Broad jurisdiction of FSMA:** Firms without a territorial connection to the UK can face enforcement action by the FCA.
- **FCA's approach:** The FCA took the pragmatic decision to use the regulatory market abuse regime instead of criminal offences to reduce difficulty and cost.

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## Prospectus Publication in Electronic Form must be Easily Accessible

*The European Court of Justice held that certain access restrictions on websites publishing a prospectus contravene the "easily accessible" requirement under the Prospectus Directive and incorporated into the Prospectus Rules.*

Prospectus Directive Regulation (Article 29), incorporated in Prospectus Rule 3.2.9, requires the publication of a prospectus in electronic form be easily accessible when entering the website. In this case, Michael Timmel applied for securities and subsequently declared that he wanted to withdraw from the subscription on the basis, among others, the offer was made without the required information being lawfully published. The documents were available on the Luxembourg Stock Exchange website but access required a registration process (with acceptance of disclaimer and provision of email address); the payment of fees; and restricted free access to two documents per month. The Court concluded the obligation to register, entailing acceptance of a disclaimer and the provision of an email address, does restrict access and is incompatible with the requirement for easy access. Not only would they deter a certain number of potential investors but the disclaimer constitutes a condition giving rise to inequality between the issuer and potential investor running counter to the Prospectus Directive's objective of ensuring investor protection. Likewise, charging for access to a prospectus on a website is contrary to provisions in the Prospectus Directive. The effect of not providing easy access to the prospectus available on a website was that there had not been lawful publication. The Austrian court which referred these issues to the Court will now determine whether the investor can withdraw, setting a precedent for similar cases in member states. (*Michael Timmel v Aviso Zeta AG* (C-359/12))

### Key lessons

- **Selecting a website:** Issuers publishing a prospectus on a website with restrictions similar to those discussed by the Court, should consider additional publication routes including on its own website.
- **Disclaimers:** A disclaimer or click-through without related requirements to register and provide an email address should not be problematic.
- **Effect of breach:** If a prospectus is not properly made available to the public, there is a breach of the Prospectus Rules and, in the UK, the FCA has the power to sanction the issuer (by way of financial penalty or public censure).

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# Company Law

**There have been three particular cases of interest on different company law issues**

## Board's Purpose Irrelevant when Disenfranchising Shareholders for providing Inaccurate Responses to s. 793 Notices

*The Court of Appeal held that the board's power to prevent shareholders from voting, based on its reasonable belief that their responses to requests for information on their interests in the company's shares were inaccurate, did not depend on the purpose for which the power was exercised so long as the board's right to restrict voting rights had arisen.*

The Court of Appeal held that the board's power to disenfranchise shareholders, based on its reasonable belief that the shareholders' responses to s. 793 notices under the Companies Act 2006 were inaccurate, did not depend on whether the power had been exercised to obtain accurate information or to prevent those shareholders from voting at a general meeting. The board of JKX, an LSE-listed oil and gas company, suspected an arrangement between two beneficial shareholders and a raid by them to acquire JKX at less than proper value. To ascertain information about their arrangements, the board sent s. 793 notices to involved individuals and holding companies. The responses did not reveal the arrangements that the board reasonably believed to exist and they were determined to be materially inaccurate. Under the power in JKX's articles, the board issued restriction notices based on the failure to provide accurate responses, preventing the shareholders from voting at the upcoming general meeting.

The majority of the Court of Appeal determined that the purpose for which the board exercised its power was irrelevant so long as the board's right to restrict voting rights had arisen. The majority held that the board's sanction had been properly imposed on shareholders and any other interpretation of the law would encourage deceitful conduct by shareholders. Sir Robin Jacob and Longmore LJ concluded that where questions were fairly asked and the shareholders or interested persons could have (but did not) answer them, it is their own choice which results in disenfranchisement. Requiring the board to exercise their power for a "proper purpose" was not the right test because it would allow the shareholders (or interested persons) to make victims of themselves. The Supreme Court has granted permission to appeal on the issue of the board's purpose from the decision of the majority of the Court. The Court of Appeal agreed with the findings of the High Court that the s. 793 notices properly included questions getting to other interests in the addressee's shares and that the board had reasonable cause to believe the responses provided were materially inaccurate on the basis of conflicting information and known circumstances. (*JKX Oil & Gas plc v Eclairs Group Limited* [2014] EWCA Civ 640)

### Key lessons

- **Proper purpose:** Until the Supreme Court renders its judgment, it would be prudent for a board to note that it is issuing restriction notices to collect better information if that is the case.
- **Onus on recipient:** Shareholders or interested persons who receive a s. 793 notice and who are given an appropriate opportunity to respond, must either respond with accurate information or be disenfranchised.
- **Increase in s. 793 notices:** Given premium listed companies now have an obligation to enter relationship agreements with controlling shareholders (a person controlling on his own, or with concert parties, 30% or more of votes) and take "all necessary steps" to identify concert parties, the scope and importance of s. 793 notices, as well as their use, may well increase.

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# Company Law contd.

## Parent's Duty of Care to Employees of Subsidiary

*The Court of Appeal decided that a parent company had not assumed responsibility to employees of its subsidiary by appointing X as a director of the subsidiary with responsibility for health and safety matters. The intermingling of businesses and shared use of resources between subsidiaries were insufficient to trigger this. The case was clearly distinguishable from an earlier decision where the Court of Appeal had allowed a health and safety claim against a parent company by an employee of its subsidiary.*

T brought an asbestos injury claim against P, the parent company of its employer (S). P's only business was the holding of shares in other companies. P had appointed X as S's director with responsibility for health and safety matters, but was not involved in S's haulage business, although there had been some co-ordination of operations between S and P's other subsidiaries. The question was whether P had assumed responsibility to S's employees in health and safety matters and was responsible for protecting them from the risks from asbestos. The Court of Appeal decided on the facts that it had not. In running S's day-to-day operations, X was only acting pursuant to the fiduciary duties which he owed S, and no other company. The Court of Appeal said that a shareholder does not, by reason only of being a shareholder, owe a duty to anyone. The position could be different if what a parent company had done amounted to assuming a direct duty to the subsidiary's employees (for example, by intervening in its affairs on health and safety matters) and was better placed to protect employees on managing asbestos risk because of superior knowledge or expertise. Although no duty was imposed on P in this case, the analysis shows that parent companies still need to take steps to protect themselves from liability for a subsidiary's actions, particularly where there are centralised functions across corporate groups. (*Thompson v The Renwick Group plc* [2014] EWCA Civ 635)

### Key lessons

- **Three-stage test for parent liability:**
  - Damage foreseeable;
  - Sufficient proximity;
  - Fair, just and reasonable to impose liability.
- **No shareholder general duties:** A shareholder does not owe a duty of care to anyone merely by virtue of being a shareholder.
- **Centralised group functions:** It remains advisable for parent companies to run subsidiaries as separate operations and for central group functions to be advisory rather than directional.

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## Cross-Border Merger Compliant with Companies (Cross-Border Mergers) Regulations 2007 despite Shareholders of Transferor Not Receiving Shares

*The High Court classified two intra-group mergers as "mergers by absorption" under the Companies (Cross-Border Mergers) Regulations 2007 despite the shareholders of the companies transferring their assets waiving their entitlement to any shares or cash in exchange.*

Three UK companies applied to the High Court to order shareholder meetings to approve two cross-border mergers. The merging companies had the same ultimate parent company. Under the draft terms of the mergers, it was proposed that they would be "mergers by absorption" under the Companies (Cross-Border Mergers) Regulations 2007 (Regulations) where the UK companies would transfer all of their assets and liabilities to two companies registered in Germany within the same group. In each case, the shareholders of the UK companies would not receive shares or cash in exchange as the shareholders of the transferor companies waived their entitlement to receive consideration. All of the companies were under common ownership and completion of the merger was thought to benefit the group as a whole. The question for the Court was whether the mergers were "mergers by absorption" under the Regulations if shares or cash were not received in exchange. The High Court determined that the cross-border mergers were compliant with the Regulations, focussing on the Regulation's requirement that consideration be "receivable" by shareholders of the transferor. Accordingly a waiver of the right to consideration did not compromise one of the requirements necessary to qualify as a "merger by absorption", so long as the consideration was "receivable" even if not "received". (*Olympus UK Limited and Others* [2014] EWHC 1350 (Ch))

### Key lesson

- **Wholly-owned group structures:** This is a commercially sensible and pragmatic decision, useful to intra-group restructurings within wholly-owned European group structures in confirming that the formality of nominal consideration is unnecessary for the classification as a "merger by absorption".

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# Contractual Provisions

**A number of cases have looked at contractual provisions which are commonly seen on M&A deals**

## Contractual Discretion to Act in "Commercially Reasonable" Manner

*The Court of Appeal has upheld the earlier High Court decision and decided that a party can take account of its own interest in exercising a contractual discretion to withhold consent.*

B gave U guarantees in connection with a loan securitisation in return for quarterly premium payments and a fixed quarterly fee. U wanted to terminate the guarantees early under a clause which allowed it to do so with B's prior consent, which had to be determined in a "commercially reasonable" manner. The Court of Appeal confirmed that B had been entitled to withhold consent on the facts unless it received five years' fees. B's commercial interests here comprised its interest in earning profits from its fee income. B could give precedence to its own commercial interests above U's to protect these, unless the fees which it was demanding were disproportionate to the return which it could have expected had the contract run its course. It was relevant that U had a right to terminate in certain other circumstances without B's consent after a roughly equivalent period. U has applied for leave to appeal. (*Barclays Bank PLC v UniCredit Bank AG & Another* [2014] EWCA Civ 302)

### Key lessons

- **Contractual provisions for granting or withholding consent:** Clear and express drafting is desirable to minimise scope for dispute.
- **Delineate parameters for granting or withholding consent:** Consider specifying expressly the circumstances in which consent may be withheld, cannot be refused or is deemed given, or restricting the factors to take into account.

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## Construction of Claims Notification and Conducts Clause in Sale and Purchase Agreement

*The Court of Appeal has considered whether a contractual obligation to notify a tax claim from a third party which could found an indemnity claim within a set period after becoming aware of it was a condition precedent to liability under the indemnity.*

The case related to the sale and purchase of a 50% interest in a petroleum exploration licence, requiring Ugandan government consent and triggering a substantial capital gains tax charge. The seller (S) disputed the tax charge and issues arose as to the status of funds paid by the buyer (B) into an escrow account. The Ugandan government served agency notices on B requiring it to pay the tax on S's behalf, alleging that the escrow funds amounted to assets of S under Ugandan law. B paid the tax and claimed from S under the tax indemnity in the sale and purchase agreement (SPA). However, B had failed to comply with a contractual obligation in the SPA to notify such a third party claim which could give rise to a substantive claim under the tax indemnity within 20 business days of becoming aware of it. The Court of Appeal decided that this was not a condition precedent to a successful indemnity claim and that failure to comply was not a bar to bringing a claim. The Courts are reluctant to classify terms as conditions precedent where this could deprive a party of a contractual right because of a trivial breach which caused little or no prejudice to the other party. The effect is that clear words are needed before a term will be construed as a condition precedent, which had not happened here. The Court of Appeal said it was significant that, by contrast, the draftsman had clearly created conditions precedent elsewhere in the SPA. A key example was the prescriptive time bar for notifying an actual indemnity claim within seven years, which said the indemnities would not otherwise apply. It was also relevant that the indemnities were reciprocal, and so both parties had an interest in ensuring that a minor breach did not trigger loss of a valuable right. For the same reason a provision in a supplemental agreement giving S conduct rights in relation to third party claims was not a condition precedent to an indemnity claim. (*Tullow Uganda Ltd v Heritage Oil and Gas Ltd and Another* [2014] EWCA Civ 1048)

### Key lessons

- **Conditions precedent to indemnity right:** Clear and express language is needed before a term will be construed as a condition precedent to an indemnity right, particularly where the consequences of breach could be minor with little or no prejudice to the other party.
- **Different notification requirements can have different effect:** Distinguish notice requirements on becoming aware of third party claims from prescriptive time bars on notifying actual claims between parties (which are usually mandatory).

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# Contractual Provisions contd.

## Expert Not Bound to Follow Accounting Policies and Practices Incorrectly Applied in Last Accounts when Determining Completion Accounts Dispute

*The Court of Appeal has decided that an expert accountant determining a completion accounts dispute under a sale and purchase agreement (SPA) was wrong to conclude that the SPA required him to follow accounting policies and practices adopted in the company's last accounts even when these had been incorrectly applied and did not comply with the applicable accounting standards.*

S and B each held 50% of the shares in a company (C). S agreed to sell her 50% stake in C to B. The SPA had a completion accounts mechanism for calculating the final purchase price, including a provision for an expert determination by an independent accountant in the event of a dispute. The SPA set out the basis on which the completion accounts should be prepared, including "…in accordance with accounting policies, principles, practices and procedures adopted by the company in the preparation of the [last accounts]". A dispute arose over whether equipment leases should be treated in the completion accounts as operating or finance leases, and this was referred to an expert for determination. The expert decided that they were in fact finance leases, but that he could not treat them as such because he was bound to follow the approach in the last accounts, which had treated them as operating leases. The Court of Appeal decided that the judge at first instance had been right that there was no reason to carry forward an erroneous policy or practice and that the expert should have applied the correct policy. The word "practice" in the relevant clause was just as apt to refer to a rule as something actually done in practice and did not justify departing from the correct policy. The position of the word "practice" in the clause was also consistent with practices being used simply to fill in gaps not resolved by policies and principles. The word "adopted" was neutral and could mean "purported" or "stated" to be adopted, rather than "adopted in fact". The clause meant that the parties had intended to apply the correct accounting policy, supplemented if necessary by reference to practices adopted. (*Shafi v Rutherford* [2014] EWCA Civ 1186)

Key lessons

- **Express wording in the SPA to limit the requirement to follow past policies and practices to the extent they comply with applicable accounting standards** would give clarity, although this case suggests that the Courts are likely to interpret such contractual provisions in such a way as to presume that this was the parties' intention.
- **A party wanting the approach in the last accounts to be followed whether or not the policies and practices comply with applicable accounting standards** would need to state so expressly in the SPA**.**

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## Meaning of Service of Legal Process under Seller Limitations in SPA

*There have been two recent and conflicting High Court decisions on a requirement to issue and serve legal proceedings within a set period of notifying a warranty claim under seller limitations in an SPA. In the first case the Court said that this had an ordinary, non-legal meaning and did not require service in accordance with the Civil Procedure Rules (CPR), whereas in the later case the Court decided that it did.*

In both cases, as is common, the SPA required the buyer to issue and serve legal proceedings within an agreed period of notifying a warranty claim, but had no specific mechanism on how legal proceedings should be served. Also in both cases, the sellers argued that the CPR applied and had not been complied with. In the first case, the High Court said it had to determine what the parties to the SPA had meant by the language used, taking into account a reasonable person and the context of the SPA. In this case it decided "serve" had its ordinary meaning of delivery in a form which brought the contents to the actual attention of the intended recipient. It also indicated that the general notices clause would have been wide enough to cover service of legal proceedings. By contrast, in the later case the High Court decided that a comparable provision required service in accordance with the CPR, being the English procedural rules where the SPA had an exclusive English jurisdiction clause. It found that the requirements of these rules had been met on the facts. (*Ageas (UK) Limited v Kwik-Fit (GB) Limited* [2013] EWHC 3261 (QB) and, subsequently, *T & L Sugars Limited v Tate & Lyle Industries Limited* [2014] EWHC 1066 (Comm))

Key lessons

- **Express service of legal process mechanisms:** In light of the uncertainties, it may be desirable to include an express mechanism in the SPA for service of legal process.
- **Civil Procedure Rules:** To apply the CPRs, it is best either to set them out or to expressly cross-reference and cite them in the SPA, to avoid disputes over which rules are relevant.
- **Applying the notices clause in the SPA:** For service to have an ordinary, non-legal meaning it is best to expressly apply the notices clause to service of legal process.

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# Contractual Provisions contd.

## Rebutting Presumption of Inducement in Fraudulent Misrepresentation

*The High Court concluded that to rebut the presumption of inducement in a claim for fraudulent misrepresentation, the representor must have positive evidence that the misrepresentation did not materially induce the representee to enter into the contract. That is, the misrepresentation must not have played a real and substantial part in the representee's decision to enter into the contract.*

E bought a nightclub from A and subsequently alleged that A had made fraudulent misrepresentations in his replies to the pre-contract enquiries which had induced E to enter into the contract. A dishonestly decided not to tell E about a complaint and, accordingly, E's lawyers had advised him that it was "okay to go ahead". The High Court outlined that, on a claim for fraudulent misrepresentation, a presumption arises that the misrepresentation materially induced the representee (E) to enter into the contract. The onus is on the representor (A) who made the fraudulent misrepresentation to prove on a balance of probabilities that the misrepresentation was not material. The High Court stated that it is necessary to provide positive evidence to rebut the presumption of inducement. This means that the representor must demonstrate that the misrepresentation did not play a real and substantial part in the representee's decision to enter into the contract. Here, the effect of A's replies was that, unless something negative emerged, E was likely to proceed with the contract and the High Court concluded that the presumption of inducement was not rebutted. A has applied for leave to appeal. (*Edwards v Ashik* [2014] EWHC 2454 (Ch))

Key lessons

- **Burden on representor:** Even if a buyer does not take particular account of the fraudulent misrepresentation and simply proceeds to contract, this is not sufficient to overcome the presumption that the buyer was induced by the misrepresentation.
- **Standard of proof:** To overcome the presumption of inducement, it must be more likely than not that the misrepresentation did not have a real and substantial impact on the buyer's decision to enter into the contract.

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