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2016 Half-year in review
M&A legal 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, particularly in a private M&A or joint venture context.

Interpretation of SPA: Restrictive covenants, further assurance, treatment of successors and third party rights

The High Court recently considered a range of substantive provisions commonly seen in a sale and purchase agreement (SPA). In a judgment which puts the spotlight on a number of drafting issues, it decided that restrictive covenants had been breached and the further assurance clause continued to give rise to substantive obligations years after the agreement was entered into, whilst adopting a broad interpretation of the rights of successors to the ownership of the target's assets and the operation of the third party rights provisions.

S sold her fashion business by a share sale of Karen Millen Holdings Limited (KMHL) to a consortium comprising two buyers. Five years later, the consortium companies went into administration. KMHL's business was sold to F under an assets SPA in a pre-pack administration save for the business in the US, which was owned and operated by M, and KMHL was dissolved. S subsequently announced plans to return to the fashion business using the name "Karen", and F and M alleged that this would breach restrictive covenants in the SPA (RCs). These included restrictions on using or attempting to use any intellectual property rights (IPRs) relating to the business of the KMHL Group or using the "Karen Millen" name, or any confusingly similar name, in connection with a competing business. The High Court found in favour of F

Key lessons

- **Clarity when drafting restrictive covenants and related definitions**: Parties should specify expressly whether the business should be assessed at the date of the SPA or a later date when measuring a party's conduct against the restrictive covenants in the SPA.
- **Scope of "full effect" wording in further assurance clauses**: The breadth of the "full effect" wording meant that the further assurance clause was triggered around ten years after completion.
- **Successor entity provisions in SPAs**: Sellers should beware of extending these beyond just successors by operation of law to wider categories such as successors in title, and should make sure the assignment clause reflects what is agreed.
- **Third party rights**: Expressly provide that compliance with identified boilerplate provisions is a condition of enforcing third party rights.

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and M. Among other things, it decided that the RCs applied to goodwill at both the date of the SPA and at the date of S's proposed future acts, even though this was not specified expressly in the drafting. One factor was that certain other clauses in the SPA catching goodwill were prospective. F and M also relied on the further assurance clause in the SPA to require S to consent to applications to register certain trade marks in their names around ten years after completion. The Court decided on the facts that this was reasonable. The clause had required parties to do all necessary things reasonably required to give "full effect" to the SPA. A transfer of the shares alone may not have achieved the core aim of putting the buyers in control of the business and S's name, as a key asset. Separately, the SPA said that it would be binding and enure for the benefit of the parties' successors in title (unusually, rather than just referring to sucessors), and also allowed assignment to transferees of the share capital of a group member. The Court decided that F was a successor in title both for this purpose and under clauses expressly granting third party rights to the buyers' successors in title, even though it had acquired title through an assets purchase of KMHL's business rather than by buying its shares. Finally, the Court confirmed that enforcement of third party rights under the SPA was subject to compliance with the jurisdiction clause in the SPA, because third party rights had been granted "subject to and in accordance with" the terms of the SPA. An appeal hearing is awaited in relation to the judgment. (*Millen v Karen Millen Fashions Ltd and Anor* [2016] EWHC 2104)

When warranties also amount to representations

A High Court decision demonstrates again that clear and express drafting is needed if it is intended that warranties should additionally amount to representations, and the need to reflect the agreed approach in how you word the related entire agreement clause.

B acquired T Limited (T) from S and one of S's subsidiaries (U). T held offshore oil and gas interests. After completion, B discovered various warranty breaches. The operative warranties clause in the SPA said that each seller "warrants" to B. "Warranties" were defined as "the warranties given by" S and U. All relevant clauses and definitions used the term "Warranties". The entire agreement clause in the SPA said that B had not relied on or been induced to enter into the SPA by any representations, warranties or undertakings other than the Warranties. As the time limit for notifying warranty claims had expired, B alleged instead that: the statements of fact within the warranties could found an action for misrepresentation; and S had also made actionable misrepresentations to B before B entered into the SPA. B argued that, by providing it with an execution copy of the SPA and signing or offering to sign it, S represented in the terms of the statements of fact contained in the warranties and that B had relied on those representations. The High Court gave summary judgment dismissing B's claim. The High Court stated that the act of concluding a contract amounts to a communication only of assent to, and intention to be bound by, the terms agreed. There is no representation without an express provision to the contrary, and any other interpretation here would require a very forced construction. Whilst it would be possible in principle for language used to communicate that a negotiating position or draft contract amounts to a pre-contractual representation, the Court said that had not been done here. In any event, this would have been precluded by the entire agreement clause in the SPA, because the reference to "representations...other than the Warranties" in the non-reliance acknowledgement within that clause was not enough to show that the parties had intended the Warranties to operate as representations. The entire agreement clause excluded reliance on pre-contractual representations, and the saving for "Warranties" in it was restricted to contractual warranties. (*Idemitsu v Sumitomo* [2016] EWHC 1909)

Key lessons

- **Express drafting needed**: Clear and express wording is needed for a warranty to operate as a representation.
- **Entire agreement clause**: The drafting must be consistent throughout the SPA and, in particular, the agreed approach must be reflected in the entire agreement clause.
- **Seller limitations on claims**: A seller conceding that warranties will also operate as representations should expressly extend the seller's warranty limitations to catch representations too and address whether rescission rights should be excluded.

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Bad leaver provisions were not unenforceable penalties

In two recent decisions, both the English High Court and the Scottish Court of Session upheld in principle the enforceability of bad leaver provisions, commenting on the facts that they did not amount to unenforceable penalties. Both judgments supported the workability of bad leaver provisions on the facts, and both took into account that the parties in question had received expert advice.

The first case related to a bad leaver provision in articles of association and its application to two directors who were each also 30% shareholders. Each had a service contract with the company (C) entitling him to a salary and a quarterly bonus in certain circumstances. There was a dispute over whether the bonus was payable. One of these two directors arranged for them to be paid the bonuses. The other directors dismissed them, sending them notices to transfer their shares to C for £1 under the bad leaver provision. The High Court decided that they had not been entitled to dismiss these directors. It commented that in any event the bad leaver provision was a self-standing primary obligation, meaning that the rule against penalties was not engaged. Even if it had been a secondary obligation triggered on a contractual breach, the High Court said that the bad leaver provision would have been enforceable, taking into account that it had been arrived at between parties dealing at arm's length who had received expert advice. The second case related to a bad leaver provision in articles of association and in a shareholders' agreement (SHA), and its applicability to a director, D, who was a 64% shareholder with 34% voting rights. The company (C) identified that D had known of activities of its subsidiaries triggering offences under the UK Bribery Act. C purported to dismiss D, although steps were not taken to implement the bad leaver provision in the SHA. D petitioned for unfair prejudice, and the Court at first instance held some grounds were successful. The Court at first instance had ordered D's shares to be sold to C at nominal value, applying the valuation basis in the bad leaver provision.

Key lessons

- **Workability in principle of bad leaver provisions on the facts**: These decisions support the efficacy in principle of bad leaver provisions.
- **Distinction between primary and secondary obligations remains unclear**: The judgments demonstrate that the difference between primary and secondary obligations is not clearcut and it is important that parties can justify that a provision is proportionate without relying on its categorisation as a primary obligation.
- **Freedom of contract upheld between parties receiving expert advice**: It was significant that the provisions had been negotiated with expert advice.
- **Include acknowledgements from the parties in agreements**: It helps to include an acknowledgement from the parties on the proportionality of the provision and that it was negotiated and entered into with expert advice.

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D alleged that the bad leaver provision was an unenforceable penalty. The Scottish Court of Session decided that it had been correct to apply this valuation basis. It also commented unanimously that the bad leaver provision was a secondary obligation, triggered when D breached primary obligations in his service contract. However, a majority of the Scottish Court of Session took the view that the provision would not in any event have been a penalty. One factor that the Court took into account was that the bad leaver provision had been negotiated with expert advice. Another was that the parties had an interest in individuals' performance of their duties as employee/directors. Application has been made for permission to appeal the first of these two judgments. (*Richards v IP Solutions Group* [2016] EWHC 1835 (Ch); *Gray, Re Braid Group* [2016] ScotCS CSIH 68)

Effect of "no variation" clauses

The Court of Appeal held that "no variation" clauses do not prevent variation of a contract where the other requirements for variation of a contract are met and held, in this case, the practical benefit of not having a vacant property was fresh consideration for the variation.

The Court of Appeal confirmed its *obiter dicta* earlier this year in *Globe Motors v TRW Lucas Varity Electric Steering* in which it concluded that, despite a no variation clause which on its terms required a formal agreement to achieve a variation, an agreement had been varied by the parties. Here, parties to an existing agreement, through an email exchange, agreed one party would make lower initial payments and higher later payments than required under the existing agreement. The first payment was made immediately but a couple of days later the other party sought to characterise the arrangement as a mere proposal, citing the no variation clause in the existing agreement: *"All variations to this licence must be agreed, set out in writing and signed on behalf of both parties before they take effect"*. The Court of Appeal concluded that despite the no variation clause, the agreement had been varied by the parties. In the decision Kitchin LJ considered both freedom of contract and party autonomy, echoing the view of Cardozo J that "[t]hose who make a contract, may unmake it. The clause which forbids change, may be changed like any other". The email exchange was evidence that the agreement had been varied despite the no variation clause. Those involved in the email exchange had the ostensible authority to vary the contract. In reaching this conclusion the Court of Appeal had to consider whether there was fresh consideration for variation of the agreement. Here, the "practical benefit" of avoiding a vacant premises and finding a new tenant was determined to be fresh consideration for the variation of the agreement. This overcame the issue that the revised payment schedule was not good consideration on the basis it was part payment in full settlement. (*MWB Business Exchange Centres v Rock Advertising* [2016] EWCA Civ 553)

Key lessons

- **Internal procedures**: Companies should have clear and well-understood internal procedures for discussing a possible contract variation and be scrupulous in flagging when discussions are subject to contract.
- **Email era**: While proving oral variation of a contract can be difficult on an evidential level, the same is not true where there is an email exchange.

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Company law

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

Unlawful dividends, directors' duties, transactions to defraud creditors and solvency statements

The High Court recently considered the point at which directors' duty to consider creditors' interests arises. It also confirmed that a dividend can amount to a "transaction" for the purposes of the Insolvency Act rules on transactions liable to be set aside for intent to defraud creditors and, separately, gave its first detailed consideration of the requirements for directors' solvency statements for private company reductions of capital.

A was a wholly-owned subsidiary of S. Through a series of corporate acquisitions B became liable to pay for part of an environmental clean-up operation in the US. A was liable to indemnify B for part of that liability. There was a provision in A's accounts to reflect the directors' best estimate of the extent of the liability. On the basis of interim accounts, A's directors decided in December 2008 to implement a reduction of capital of A by the private company directors' solvency statement route and pay an interim dividend to S. In May 2009 the directors resolved to pay a further interim dividend to S. A was then sold to a third party. Both dividends were effected by setting off a substantial amount of intra-group debt owed by S to A. A alleged that its directors were in breach of duty for deciding to pay the dividends and that the dividends contravened the UK Companies Act 2006. B alleged that the dividends were transactions at an undervalue with intent to put assets beyond the reach of creditors under the UK Insolvency Act, which would mean they were liable to be set aside. There was detailed discussion of directors' duty to consider the interests of creditors in an insolvency or near insolvency situation. The High Court decided that the "creditors' interests" duty had not arisen when the directors had decided to pay the dividends. This duty did *not* arise whenever a company was at risk of becoming insolvent at some indefinite point in the future. A's balance sheet showed no deficit of liabilities over assets and there were no unpaid creditors knocking on A's door. Indeed, there was a real possibility that A would never become insolvent or close to insolvent. To apply the creditors' interests duty here would be a significant inroad into the normal application of directors' duties. The Court also decided that a dividend in specie could amount to a "transaction" for the purposes of the Insolvency Act provisions on transactions at an undervalue liable to be set aside for intent to put assets beyond the reach of creditors. There is no insolvency requirement for these rules to apply, although there must be a "transaction", and it is sufficient if a majority of the directors have the necessary intent. (*BTI 2014 LLC v Sequana SA* [2016] EWHC 1686)

Key lessons

- **Directors' duty to take into account interests of creditors**: The creditors' interests duty is still good law, but the point at which the duty arises is fact-specific and will vary.
- **Transactions with intent to defraud creditors**: A dividend can amount to a "transaction" and be liable to be set aside under these rules if made with intent to put assets beyond the reach of creditors.

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Restrictions on when the Companies (Cross-Border Mergers) Regulations 2007 apply

The High Court decided that a proposed transaction to merge a number of UK companies and a Dutch company into a UK transferee company did not fall within the scope of the Companies (Cross-Border Mergers) Regulations 2007 (Cross-Border Mergers Regulations). The reason was that the presence of the Dutch company in the arrangement was just a device and that there was no true cross-border merger here.

The company (C) wanted the Court to confirm that it would have jurisdiction to approve a merger by absorption of several companies in its group structure under the Cross-Border Mergers Regulations. It also sought confirmation that there was nothing to suggest that the Court would not use its discretion to approve the merger. In order to fall within the Cross-Border Mergers Regulations, at least one of the

Key lessons

- **Purposive approach to interpreting the Cross-Border Mergers Regulations**: The Regulations should be interpreted having regard to the purpose for which they were enacted. The court will look beyond the technical criteria of the Cross-Border Mergers Regulations to see whether the transaction is of the kind which the Regulations are intended to facilitate.

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companies must be a UK company and at least one must be an EEA company. The Dutch company here, although fulfilling the criteria of being an EEA company, was a dormant company which had never traded and had no relevant assets, liabilities, employees or other obligations. The High Court decided that, although the necessary criteria were technically met, for the Cross-Border Mergers Regulations to apply the transaction must be truly cross-border in nature and cannot be artificially constructed so as to fit within the scope of the Cross-Border Mergers Regulations purely to meet commercial objectives. (*Re Easynet Global Services Limited* [2016] EWHC 2681 (Ch))

Merger by absorption to form Societas Europaea could involve shell company

The High Court decided that a merger by absorption to form a Societas Europaea (SE), involving a shell company as one of the merging companies, was nonetheless capable of complying with Council Regulation (EC) No 2157/2001 on the Statute for a European Company (SE Regulations). It affirmed the approach adopted in an earlier High Court decision that, in determining the validity of a merger, the court will consider the genuine purpose of the transaction and whether the shell company is being used as a device to effect the merger, but decided that it was not a device here.

A UK public limited company (PLC) and its wholly-owned French subsidiary (SA) sought to merge by absorption for the purpose of forming an SE and with a view to streamlining the group's European operations. Under Article 25(2) of the SE Regulations, the court must issue a certificate conclusively attesting to the completion of pre-merger acts and formalities. The High Court affirmed the approach in the recent High Court decision on the separate Cross-Border Mergers Regulations, and considered the true purpose of the transaction and whether the shell company was being used just as a device to bring the merger within the ambit of the SE Regulations. It decided that the use of SA was not just a device to achieve the merger but, rather, that SA was genuinely being used to achieve a reorganisation of the group's European structure. It was not a ruse to achieve a merger designed for other companies. Furthermore, the Court considered whether the SE Regulations prohibited mergers where one party was not actively trading. As the SE Regulations are silent on this point, it applied a purposive interpretation of them and, taking into account their recitals, decided that active trading was not a requirement to achieve a merger under the SE Regulations. (*Re Portman Insurance Plc* [2016] EWHC 2994 (Ch))

Key lessons

- **Purposive approach to interpreting regulations reaffirmed**: The case affirms the purposive approach taken by courts in ascertaining whether a transaction is genuine for the purposes of regulations under consideration. The court will consider the purpose of the regulations in question and determine whether the proposed transaction upholds that purpose or is a ruse falling outside their scope.

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Listed companies

A number of rulings by English courts, the FCA and the Takeover Appeal Board are of particular interest to listed companies.

Restitution of money paid under an unexecuted contract for insider dealing

The Supreme Court held that the claimant was entitled to the restitution of money paid under an unexecuted contract to buy listed shares on the basis of anticipated inside information despite the contract being a conspiracy to commit the offence of insider dealing.

The Supreme Court reconsidered the illegality defence that a claimant cannot pursue a legal remedy in connection with his own illegal act. The claimant (C) paid the defendant (D) £620,000 to buy listed shares on D's receipt of information from an insider. D did not receive the inside information and so did not buy the shares but did not return C's money. C brought a claim against D for unjust enrichment. D raised the illegality defence. The contract for insider dealing was illegal under the Criminal Justice Act 1993. Lord Toulson concluded that a claimant who satisfies the ordinary requirements for an unjust enrichment claim should not be debarred because the money he seeks to recover was paid for an unlawful purpose. Here, the contract amounted to a conspiracy to commit the offence of insider dealing. In lieu of the "doctrine of illegality", courts should assess whether allowing a claim is harmful to the integrity of the legal system using a "trio of considerations" including assessing: the underlying purpose of the prohibition transgressed; whether denying the claim would impact other public policies; and, whether denying the claim would be proportionate to the illegality. The Supreme Court determined that the policy underlying the offence of insider dealing would not be hampered if C's claim was allowed. The mischief at which the offence of insider dealing is aimed is to prevent market abuse through the exploitation of price sensitive information. In light of this purpose, there was no logical basis why public policy should require C to forfeit the money paid to D and which was never used. It would not be a just and proportionate response to the illegality. C sought to unwind the arrangement rather than to profit from it. (*Patel v Mirza* [2016] UKSC 42)

Key lessons

- **Unlikely outcomes will be different**: It is unlikely the change in legal reasoning will have a significant impact on outcomes in similar cases.
- **Certainty**: The decision recognises that parties must be able to arrange their affairs with the certainty that courts will enforce them but tempered by the court's discipline of applying overarching policy considerations and administering criminal punishment appropriately.

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Failure of systems and controls in providing sponsor services

The FCA fined a sponsor £530,500 for "particularly serious" failures of its systems and controls in its sponsor services which posed a threat to market confidence in the sponsor regime and for its failure to use due care and skill in advising on a transfer to a Premium listing.

The sponsor (S) acted for its client (C) on C's proposed transfer from AIM to a Premium listing. C targeted its transfer, which was ultimately abandoned as C did not meet eligibility criteria, for June 2014. In relation to S's systems and controls in respect of its sponsor services, the FCA found that within S there was no one person or committee who had overall responsibility for the oversight of sponsor services. While the new business committee approved new clients and mandates, it relied on information from deal teams and did not have Listing Rules expertise. The deal teams themselves were unchallenged and inadequately supervised. Within deal teams, the use of regulatory checklists was not mandated and the manuals used were inadequate. As such, the FCA determined that S's sponsor services were inadequate, stating it expects "robust" sponsor systems and controls. On the proposed transfer, S represented that C was eligible without adequate due diligence. The FCA determined that S did not use "due care and skill" or ensure its communications with the FCA were "accurate and

Key lessons

- **Oversight**: Sponsors must establish a meaningful framework to provide their services with informed oversight being provided from the top down.
- **Legal advisers**: The decision indicates the value of the legal adviser's role in providing counsel on due diligence, responding to the FCA's questions and realistic timing.

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complete" in material respects. In relation to due diligence, S did not arrange a long form report with the intention of relying instead on other reports. However, by the target date only the legal due diligence report had been started. Additionally, the only risk that had been identified with the mandate was that C was "high profile" leading the FCA to conclude that the eligibility analysis had not been "sufficiently granular". S had also not addressed the FCA's "significant questions" on C's eligibility after reviewing the draft prospectus. Finally, S failed to re-evaluate the timetable in light of the FCA's questions and the timing of due diligence. (FCA Final Notice: Cenkos Securities plc dated 8 August 2016)

Shareholder may waive the right to vote at a scheme meeting

In the context of a scheme of arrangement to implement a takeover, the High Court confirmed that courts may order a meeting to approve a scheme, where certain shareholders agree to be excluded from the vote and undertake to be bound by the scheme's terms.

The High Court considered the practice of certain shareholders agreeing to be excluded from voting on a scheme and undertaking to be bound by the scheme. This practice pre-emptively overcomes potential issues of class composition. Here, the takeover was to be implemented, in part, by a scheme under the Companies Act 2006. The consideration for the target's shares was either cash or cash and a partial share alternative structured for the target's two largest shareholders. While some shareholders took the position that these large shareholders should form a different class on the basis that they would have different rights due to the size of their holdings, at this hearing the challenging shareholder sought to have these large shareholders included in a single class of voting shareholders and objected to them being excluded from the vote. Snowden J held that the relevant provisions of the Companies Act 2006 permitted the Court to make an order summoning a meeting of only some shareholders with whom a scheme was proposed, on the basis that the other shareholders agreed and were prepared to give undertakings to the Court at the sanction hearing to be bound by the scheme. The legislation does not prevent a member from voluntarily giving up the right to participate in the scheme, nor does it require a member to attend or vote on a scheme. As Snowden J commented, this is common practice for good commercial reasons. It does not involve any confiscation of property rights, nor does it result in injustice to excluded (or included) shareholders. (*Re SABMiller plc* [2016] EWHC 2153 (Ch))

Key lessons

- **Pragmatic approach to schemes**: The decision confirms the use of a practical, and common, way to overcome difficult issues of correct class composition such that members may agree to be excluded from voting and undertake to be bound by the scheme.
- **Dealing with management**: This approach aligns with the practice of excluding from the vote on a scheme management who have broadly the same rights as other shareholders under the scheme but who have agreed to invest in the bidder which may raise potential class-related challenges.

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Cancellation scheme connected to a takeover permitted as within legislated exemption

The High Court interpreted Companies Act 2006 provisions, introduced in March 2015, prohibiting the use of cancellation schemes to implement takeovers as a means of avoiding stamp duty and the related exemption determining that, on the facts of this case, this cancellation scheme was permitted as within the exemption to that prohibition and as part of a wider transaction.

In broad terms, the wider transaction was that the target would dispose of part of its business for consideration which would be returned to its shareholders and the bidder would then acquire control of the target. The relevant steps were (i) the scheme under which target shareholders would have target shares cancelled and receive shares in

Key lessons

- **Pragmatic approach to schemes**: The courts continue to demonstrate a sensible and pragmatic approach to the use of schemes and the related legislative provisions which takes into account commercial realities.
- **Matrix of transactions**: A cancellation scheme that is part of a wider matrix of transactions involving a takeover should be permitted so long as the scheme is within the statutory exemption and facilitates a real commercial purpose.

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a new holding company (newco) on a one-for-one basis; (ii) the return of capital to newco shareholders in the amount of the consideration for the sale of part of the target's business; and, (iii) the bidder's acquisition of newco shares by mandatory transfer, contingent on the return of capital, in return for the takeover consideration. The target did not have sufficient capital to effect the return of capital itself. To this end, the target applied to the Court to convene a shareholder meeting in relation to the scheme as well as to obtain the Court's confirmation that the arrangements were not barred by the Companies Act 2006 prohibition by falling within the exemption. Broadly, a company is prohibited from reducing its share capital as part of scheme where the scheme's purpose is to acquire all the company's shares, except where the acquisition amounts to a restructuring that inserts a new holding company. Newey J held that this scheme was exempt from the prohibition based on both literal and purposive readings of the provisions. Read literally, the scheme in this case was clearly within the exemption. The purposive approach to the interpretation of tax legislation requires asking whether the "provisions, construed purposively, were intended to apply to the transaction, viewed realistically". The Court determined that whether or not this principle applied, it would not obstruct the proposed transactions. The scheme was part of a real world transaction having a clear commercial purpose. (*Re Home Retail Group plc* [2016] EWHC 2072 (Ch))

Publication of documents on a website under the Takeover Code

Overturning the Hearings Committee, the Takeover Appeal Board determined that agreements amending "ordinary course" agreements which were entered into to provide for the outcome of a merger must be published on a website under the Takeover Code on the basis they were outside the "ordinary course of business" and were made "in connection with" the merger.

At issue in this appeal was whether shareholders had been provided with adequate information under the Takeover Code. The appeal involved a proposed merger which was contemporaneous with a non-pre-emptive bookbuilt placing not conditional on the merger. The day before the merger announcement, one party to the merger (L) amended certain agreements with a service provider (P). The amendments were conditional on the merger and provided a £75 million payment to P. Without the amendments, P's remuneration under the original agreements would have been calculated by reference to the enlarged group and, as a result, P would have been rewarded for factors which were not due to its performance. P was also a non-scaled back cornerstone investor in the placing. P held shares in L but did not give an irrevocable undertaking with respect to the merger. While these agreements between L and P were summarised in the circular, only following the request of a shareholder were the amending agreements published on a website. This shareholder vigorously objected to the standard of disclosure regarding L's arrangements with P in the circular and on the website. In the Takeover Appeal Board's view, while the original agreements were made in the *"ordinary course of business"*, the amending agreements were not. As a result, this basis for the Code requiring the amending agreements to be summarised in the circular and to be published on a website was met. The term was given its ordinary meaning and because under the amending agreements the large payment to P was unrelated to P's

Key lessons

- **Not box ticking**: When assessing the requirements for disclosure under the Code, you must assess the substance of agreements and arrangements to determine whether they require disclosure rather than just their form.
- **Perceived special deals**: Parties to a takeover should be alive to possibility that a "package of arrangements" may unsettle shareholders by giving the appearance of a special arrangement from which they have been excluded and therefore lead to challenge if inadequately explained.

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future performance and was conditional only on the merger, this was "plainly outside the normal activity of the company and hence outside the ordinary course of business". The Board also determined that the amending agreements were made *"in connection with the offer"* and therefore this requirement for being published on a website was satisfied. They were entered into to avoid important effects of the merger had the amendments not been made. Again, the ordinary meaning of the term was applied and had paramountcy over considering the genesis of the term in the Code. The Board pointed out that the determination does not mean the term should be interpreted too widely – it does not include documents "occasioned by" an offer (e.g. corporate structuring) but rather those "in connection with the offer" (e.g. irrevocable undertakings, merger agreements and confidentiality agreements). Here, P did not give an irrevocable undertaking but did support the merger through the combination of the placing and the amending agreements. (Takeover Appeal Board statement 2016/3, Ladbrokes plc)

Good faith

An interesting decision has discussed duties of good faith.

No right to repudiate contract for anticipatory breach but not on basis of duty of good faith

The Court of Appeal decided that, where there was a repudiatory breach of contract entitling the innocent party to terminate the contract, the innocent party could not choose to keep the contract alive and claim liquidated damages where it was impossible for the defaulting party to perform its obligations. The judgment casts doubt on, and reins in, previous High Court decisions attempting to incorporate implied duties of good faith into long-term relational agreements.

A carrier (claimant, C) contracted with a seller (defendant, D) to supply containers of D's cotton to a consignee in Bangladesh (buyer, B). Under the bills of lading D had to return C's containers within 14 days of discharge from the ship, failing which a daily tariff (demurrage) would apply. A dispute followed between B and D and customs authorities would not allow the containers to be unpacked without a court order. The effect was that D did not return C's containers, which amounted to a repudiatory breach of contract. C claimed daily demurrage. The High Court had decided that C did not have a legitimate interest in keeping the contract alive, since the only basis for doing so was to claim unlimited liquidated damages. The High Court had said that, in the absence of very clear language to the contrary, a party must exercise an express contractual discretion in good faith for the purpose for which it was conferred, not arbitrarily, capriciously or unreasonably and that the same principles applied when deciding whether to terminate a contract for repudiatory breach. The Court of Appeal dismissed the appeal, but reached its conclusions on a different basis from the High Court. The Court of Appeal determined that the innocent party here did not even have the option to affirm the contract in the first place (meaning that the legitimate interest principle never came into play). This was because an innocent party's option to affirm the contract on a repudiatory breach by the counterparty did not arise where, as here, the contract was impossible to perform. The effect was that the agreement was terminated and C was only entitled to damages. The Court of Appeal said that good faith should not be seen as a "general organising principle" in contractual dealings. This would risk undermining the express terms agreed by the parties. This is in line with the strict approach to interpretation of contracts and the strict test for implying terms. (*MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt* [2016] EWCA Civ 789)

Key lessons

- **No general organising principle of good faith**: The Court of Appeal confirmed that there is no general organising principle of good faith under English law and reined in previous first instance decisions importing concepts of good faith into long-term relational agreements, albeit in rare scenarios.
- **Express drafting required**: In an English law agreement express drafting is needed to impose a contractual duty of good faith.

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