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2021 Summer Review
M&A legal and market developments

In this issue...

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We set out below a number of interesting English court decisions and market developments which have taken place and their impact on M&A transactions. This review looks at these developments and gives practical guidance on their implications. Summaries feature below, and you can click where indicated to access more detailed analysis.

Company law

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

Parent company liability for activities of subsidiaries abroad

The Supreme Court has overturned an earlier Court of Appeal judgment and decided that there was an arguable case to go to trial over whether a UK holding company had owed and breached a duty of care to third parties over the activities of its subsidiary in Nigeria.

Residents in Nigeria claimed against UK parent company R and a Nigerian company in its group (S), alleging environmental damage by a joint venture (JV) which S operated in Nigeria. R was neither a member of the JV, nor a direct shareholder in S, nor even licensed to conduct operations in Nigeria, although it was S's ultimate holding company. Applying its earlier judgment in *Vedanta Resources Plc and another v Lungowe and others*[1], the Supreme Court found that there was a triable issue here. It stated that the Court of Appeal had allowed itself to be led into a mini-trial rather than focusing on whether the pleaded case disclosed an arguable claim. It had also underestimated the relevance of various internal corporate documents which would not be disclosed until a later stage. In the Vedanta case it had been significant that available evidence had shown that the group there was organised, and decisions taken, on business and functional lines which cut across company lines. The Court of Appeal had also focused wrongly on whether R had exercised material control over S's operations. Control was just a starting point, and a proximity test was not the right

Key lessons

- **Clarification of test for duty of care:** The judgment clarifies that, in the context of a parent-subsidiary relationship, the key question is whether, and how far, the parent intervened in the subsidiary's relevant operations.
- **Regulatory and reputational drivers:** There are important regulatory and reputational drivers for groupwide policies on environmental, health and safety and human rights matters. Parent companies should keep such policies under review and monitor implementation.

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1 [2019] UKSC 20.

one to apply for determining whether a duty of care arose in the context of a parent-subsidiary relationship. Instead the correct test was whether the parent company had taken over the relevant activity or shared it with the subsidiary (here, an oil pipeline operation by the JV). The Court of Appeal had also been wrong to suggest that just promulgating groupwide policies on health and safety and environmental matters was not enough to trigger a duty of care if not implemented and that they had never been imposed here. (*Okpabi and Others v Royal Dutch Shell Plc and Another* [2021] UKSC 3)

Shareholder and director liability for unlawful distributions

The High Court has considered the characterisation of a management charge payment from subsidiary to parent company and whether, along with an interim dividend, it amounted to an unlawful distribution of capital. It also considered related parent company and director liability.

After going into liquidation, company C claimed against its sole shareholder (P) and various directors in relation to a management charge and interim dividend payment. The aim of the payments was to reduce a debt P owed C and then sell P debt free. As a result of making these payments, C became insolvent and subsequently went into creditors' voluntary liquidation. The High Court decided that two of C's directors and also P were liable to compensate C for the difference between the amount of the payments and C's available distributable profits at the time. It was accepted that liability of a member was limited to the part of the distribution which they knew or had reasonable grounds for believing was unlawful. Significantly here, these two directors were also only held liable to repay to the extent that the distribution was unlawful. The High Court treated the management charge as a disguised distribution, despite P's attempts to justify it as, among other things, payments for seconding staff and meeting invoices for shipping C's produce. The court took into account that: there was no contractual legal obligation to pay it; charges had not been levied before for the services; and the true aim here was to reduce the debt from P. The court decided that the support had been provided as shareholder to company, not creditor to debtor. P's benefit in providing it had been as shareholder (via dividends or increase in value of its shares). By assuming liability to pay for the support other than by dividend C had made a voluntary distribution for no consideration, for which it did not have sufficient distributable reserves. Shareholders and directors would be liable to repay if they knew the facts which constituted the unlawful dividend, whether or not they knew the dividend was unlawful. Here, the two directors in question were highly experienced business people and knew the relevant facts. In particular, they knew that, prior to their approving the management charge, there had been no discussion, let alone agreement, that C would reimburse P. They also should have known that there were insufficient distributable profits. Another director was relieved from liability as he had no financial or accounting expertise and had played a limited role in the relevant decisions. (*SSF Realisations Limited (In Liquidation) v Loch Fyne Oysters Limited and Others* [2020] EWHC 3521 (Ch))

Key lessons

- **Contractual obligations to pay for intra-group services and goods:** The judgment shows the significance of establishing a legally enforceable contractual right to receive payment for intra-group services and goods. P's right to receive payment would not have been susceptible to challenge if contractual arrangements had been in place here.
- **Liability to repay unlawful distribution:** The judgment confirms the test for liability on shareholders and directors to repay an unlawful distribution, and is interesting in that director liability here was limited to the difference between the amount of the distribution and the available distributable profits.
- **Preparation of proper interim accounts:** It demonstrates the risks to directors in failing to ensure that proper interim accounts are prepared to enable a reasonable judgment to be made as to available distributable profits. Here, the interim accounts had understated liabilities and overstated assets.
- **Other considerations for directors:** The outcome demonstrates that it is crucial for directors to consider whether a proposed payment or transaction amounts to a distribution, availability or otherwise of requisite distributable profits and both the current and future solvency of the company when arranging such payments.
- **Relief from liability:** The judgment shows that the court may consider a director's own skill and experience when assessing whether to grant relief from liability for breach of duty.

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Directors' conflicts and declarations of interest

The Court of Appeal has overturned an earlier High Court judgment and decided that a director had made a valid declaration of his transactional interest in a proposed management agreement with the company.

Company C was a members' club offering water skiing activities. D had been chairman and director until 2017. D was also a partner with his son in a separate unincorporated partnership which ran a water ski school and a shop selling related equipment. D and his son ran C from the partnership's shop premises. From 2007 the management fees paid to them were raised to £35,000 a year. This had been announced in D's chairman's report for the March 2007 AGM and confirmed in May 2007 board minutes, where this was expressed as having followed "earlier board discussions". Ten years later, with new directors on the board, C claimed repayment of the fees. It alleged that D had failed to declare his transactional interest in the relevant (unwritten) management agreement, as required under the applicable statutory regime. The Court of Appeal rejected this and decided that sufficient disclosure had been made. Where a director's interest is clear and obvious, as in the case of an uncomplicated contract between the company and a director, very little may need to be said. If a director's interest is more indirect, a fuller explanation may be needed. The key thing was for the board to be fully informed of the real state of things. Here, the Court of Appeal found that the potential conflict of interest had been expressly acknowledged in minutes of a January 2007 board meeting, including that the directors had taken due regard of it. If there is a series of board meetings to consider a proposed contract, disclosure must be made at the first meeting but need not be repeated subsequently. A general notice may be in very general terms, such as of being a member of a specified company or firm. The aim is to disclose a transactional interest, not to obtain approval. As such, the terms or amount of any payment are not needed, let alone a valuation or assessment of value for money. That would be more relevant to assessing the separate issue of whether an arrangement was in the company's best interests. (*Fairford Water Ski Club Limited v Cohoon and Another* [2021] EWCA Civ 143)

Key lessons

- **Context is key:** The level of detail and explanation that a director need give to effect a valid declaration of a transactional interest depends on the facts and context.
- **Disclosure needed, not approval:** A declaration of a transactional interest need not provide an independent valuation of the interest and consent is not required (unlike in relation to an underlying situational conflict). Here, this meant that valuation of the rent under the lease of the partnership's premises was not needed.

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Shareholders not misled by failure to disclose

The High Court confirmed that shareholders voting to approve a scheme had not been misled by a failure to disclose the precise terms of a "poison pill" and that the outcome of the scheme meeting could therefore be relied upon.

W operated betting shops, gambling companies and online gaming services. It had significant operations in the US, some of which were conducted through a JV agreement with C. Under the JV agreement, both W and C had the right to designate six "Restricted Acquirers" every six months, the effect of which was that the parties had the right to terminate the JV agreement in the event of an acquisition by a Restricted Acquirer (the "poison pill"). Following expressions of interest in the company, W announced it had received bid approaches from C and a third party, A. Shortly thereafter, C added A to the list of Restricted Acquirers and launched a recommended cash offer for W. The cash offer was to be implemented by way of a scheme of arrangement, under which shareholders would get a price representing a significant premium to the historical trading price and a placing price just three months earlier. The scheme was unanimously recommended by the board of W and approved at the court meeting by 81.3% in number, representing

Key lesson

- **Court unlikely to go against outcome of scheme meeting:** The grant of a sanction is not a formality but the court is likely to be reticent to go against the outcome of the scheme meeting, unless there has been a lack of proper consultation.
- **Inaccuracy and omission:** The court retains a discretion to sanction the scheme notwithstanding an inaccuracy or omission in the information provided to shareholders, having regard to the materiality of the inaccuracy or omission.
- **Wishes of statutory majority:** The court will consider whether arguments to "deficiencies" in disclosure are being deployed to frustrate the wish of the statutory majority.

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86.34% in value of those who voted. The explanatory statement in the scheme document disclosed the existence of the poison pill. However, some objecting shareholders argued that the explanation of the terms of the JV in the scheme document were materially inaccurate and inadequate and asked the court to withhold sanctioning the scheme until after another shareholder meeting had been held. The High Court dismissed these arguments and held that it could rely on the outcome of the original meeting. The High Court maintained that the explanatory statement contained sufficient information for an ordinary class member to make an informed decision and noted that if there was a deficiency it was not one of sufficient materiality to cause an ordinary class member to change its vote nor was there any evidence that any class members were misled. The High Court pointed out that, whilst it may be material to disclose to the ordinary class member the existence of a termination right in relation to a key business relationship, it does not follow that it is necessary to disclose the precise terms. The relevance of the precise terms would vary according to circumstances which each class member brought to bear on the decision process. The High Court concluded that any new meeting would be held upon the same basis as the original meeting and that it could therefore rely on the outcome of the original meeting. (*Re William Hill plc* [2021] EWHC 967 (Ch))

Class composition on scheme of arrangement

The High Court has considered class composition on a scheme of arrangement where the mix of consideration that different categories of members would receive varied.

The scheme of arrangement related to the acquisition of shares in company C and an associated acquisition of loan notes issued by a subsidiary of C. C's share capital was divided into A ordinary shares, B and C ordinary shares and preference shares. The A ordinary shares were all held, together with the loan notes, by one private equity investor. The remaining shares were held by managers and employees, save for the C ordinary shares, which were held by an employee benefit trust (EBT). Only the A and B ordinary shares had voting rights. Under the scheme, shareholders would receive the same proportion of consideration as on a return of capital, but in different forms. The existing investor and two leaver managers would only get cash. Rolling managers would get 50% cash and 50% shares in the bidder, but could elect to get shares only subject to a scale-back percentage. The EBT would only get shares as well as cash if that percentage was not reached. The High Court decided that three separate class meetings of rolling managers were needed in respect of their separate holdings of preference shares, B ordinary shares and C ordinary shares respectively. You had to analyse the rights of members (rather than interests), focusing on rights that were to be released or varied under the scheme and new rights conferred under it. The investor and leaver managers clearly formed classes of their own, likewise the EBT as its mix of consideration depended on other members' elections. As to the rolling mangers, there were fundamental differences between the rights attaching to the three different classes of shares that they held, and they did not have similar holdings across the three types. The preference shares were more in the nature of debt than equity, the B and C ordinary shares had different rights on a return of capital and under the scheme and only the B ordinary shares were voting shares. This meant that they did not have the same mix of existing rights that would be affected by the scheme. (*Re PA Consulting Group Limited* [2021] EWHC 29 (Ch))

Key lessons

- **Effect on rights of holders of each class of shares:** Whilst the court will not want an unncessary proliferation of class meetings, it will convene separate class meetings if rights of holders of different classes of shares will be affected differently.
- **Covenantors and warrantors:** Interestingly, the court decided that members giving covenants and warranties under separate implementation and warranty deeds were not in a separate class despite their related risk of a reduced cash consideration, as these would not cause them to vote differently from how they would otherwise have voted. The warranties were in any event subject to a £1 cap on liability save in respect of fraud, and the court regarded the exposure as de minimis.
- **Tax elections:** Elections that rolling managers could make to receive their consideration in a tax efficient manner for them were not relevant to class composition, as they were offered to them all.

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Access to register of members denied

The High Court has refused a member's request for access to a company's register of members where the request did not meet the statutory information requirements and was not made for a proper purpose.

The case concerned a request for access to its register of members received by charitable company C, which had been formed to promote an individual's legacy and memorabilia. C was closely connected with another company (the Club). They were not sister companies, but most of C's income came from voting members of the Club and the companies had some common members and had had common directors before (although not at the time of the hearing). The access request came from D, who was a member of both C and of the Club and also a past finance director of the Club. D was concerned that C's 2019 AGM had not been held. He also alleged serious wrongdoings in the Club's affairs, including by some then directors of the Club who were also directors of C. D's access request stated that the purpose was to requisition a members' meeting to, among other things, get an explanation over the lack of a 2019 AGM and distribution of the annual accounts and also to remove five directors. The request omitted to specify whether the information received would be disclosed to any other person, as required under the Companies Act 2006. C refused the request on this basis, and D responded 15 minutes later that he would not be making the information available to any other person and had no intention of doing so. The High Court said that the question was whether this supplementary information could validate the invalid access request and decided that it could not. First, the original request could not become retrospectively valid (nor valid from the date the supplementary information was provided). A company needed to know where it stood at the date of the request. Second, as a matter of construction, the supplementary information did not operate itself as a self-standing new access request. Third, you could not treat the two documents together as being the request, because the statute envisaged a request as a single event, not separate events combined together. The court commented that it would have refused the access request anyway, for failing to have a proper purpose. Whilst requiring an explanation over the lack of an AGM alone would have been proper, here there were multiple purposes given and the other purpose of removing the directors was not proper. This was because the allegations of wrongdoing were connected with another company (the Club, which had different members) and were not made against these directors in their capacity as directors of C. Leave has been requested to appeal the decision. (*Sir Henry Royce Memorial Foundation v Hardy* [2021] EWHC 714 (Ch))

Key lessons

- **Content and drafting issues on requests for access to register of members:** The judgment shows that a technical defect in the content of an access request can invalidate the request and may not be resolved simply by providing additional information separately.
- **Proper purpose:** The judgment is a reminder that one improper purpose of a person requesting access to a register of members can taint multiple other purposes.

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Duties of directors of charitable company

In a high profile case, the High Court considered the duties of non-executive directors of a charitable company. It also considered the separate issue of when a "de facto" directorship may arise.

K was a charitable company for children which eventually went into insolvent liquidation. It relied on private donations and funding from central and local government. The trustees were the directors and were unpaid volunteers acting in a non-executive capacity. They delegated day to day running of the charity to the chief operating officer (CEO) and her team, in line with K's constitution. The Official Receiver (OR) applied for director disqualification orders against the trustees and the CEO. Although the CEO was not an appointed director, the OR alleged that she was a "de facto" director as someone who had assumed that role. The allegation against

Key lessons

- **Guidance on directors' duties:** The judgment gives useful guidance on how to apply the law on directors' duties in the context of a charitable company.
- **Director delegation:** It supports the ability of charity trustees to delegate authority to executive management, subject to the company's constitution and applying appropriate supervision and control.
- **Supervision of executive team:** It shows it is important that charity trustees follow the delegation framework set in the company's constitution and exercise appropriate supervision and oversight over an executive team.

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them was that they had operated an unsustainable business model. They denied this and argued that they had agreed a valid restructuring plan which would have saved K, had not false allegations of impropriety against it led to withdrawal of funding. The High Court refused the OR's application. First, it decided that the CEO was not a de facto director. Neither the label nor the functions of a CEO role alone were indicators that someone had assumed to act as director. The CEO had not been on an equal footing with the trustees and, instead, had been accountable to them and subject to their supervision and control. The trustees had correctly delegated as provided under K's constitution. A higher degree of delegation was often required for charitable companies consisting entirely of volunteer directors. The test for disqualification was also not met against the trustees. The court took a benevolent approach where the directors were charity trustees and there were no allegations of dishonesty. The demand-led model that they had run, where children self-referred themselves, had been praised externally and was not itself a ground for criticism. It was more likely than not that the funding which the trustees had planned would have succeeded absent the unfounded allegations. The court commented that incompetent conduct that might make a director of a commercial company unfit might not do so in the context of a charitable company. A mere error of judgment would not amount to a breach of directors' statutory duty of care, skill and diligence and the trustees' decisions here fell within the reasonable range. Any other approach would deter suitable people from becoming charity trustees. (*Re Keeping Kids Company* [2021] EWHC 175 (Ch))

Consent of beneficial owner sufficient for unanimous consent

The Privy Council has followed other recent case law and decided that the consent of a beneficial owner of shares, who was the relevant decision-maker, rather than the registered holder was sufficient for the unanimous shareholder consent principle to apply.

It was conceded in October 2009 that BVI Company C was insolvent. Soon after that, it repaid a US$13 million loan owed to a related company of its ultimate beneficial owner (N) over a year before it was due. C's sole registered shareholder was company P, of which N was sole shareholder. Three weeks later, N put C into liquidation. C's liquidators subsequently claimed against N for breach of fiduciary duty and to restore an unfair preference under BVI insolvency legislation. N refuted this, alleging that she had resigned as director in May 2009. The Privy Council found in favour of the liquidators. First, it overturned the finding of fact in the lower courts that N had resigned. The Privy Council decided that she had continued to act as director as much after that date as before. A director could withdraw a notice of resignation with the company's consent. As sole shareholder in registered member P, N could consent on P's behalf by way of unanimous consent. Significantly, the Privy Council stated that N could also consent as sole ultimate beneficial owner of C. Having established that N had still been director, the Privy Council decided that she had breached her fiduciary duties. She had been sole director, sole beneficial owner, sole signatory on C's bank account and could have stopped repayment had she chosen to. The lender here had been an unsecured creditor and should not have been repaid in priority when there was no legal obligation to do so. A director may not knowingly stand by and allow a company's assets to be depleted improperly. (*Byers and Others v Chen Ningning (British Virgin Islands)* [2021] UKPC 4)

Key lessons

- **Consent of beneficial owner:** A helpful judgment in confirming that the consent of the beneficial owner, rather than registered owner, may be sufficient for the purposes of the unanimous shareholder consent principle.
- **Creditors' interests duty:** A reminder that it is critical, in an insolvency context, for directors to take heed of the creditors' interests duty. N had failed here to have proper regard to the interests of the other unsecured creditors.

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Unanimous consent of beneficial owner and exceptions to unanimous shareholder consent principle

The Court of Appeal has followed previous Privy Council rulings and decided that the unanimous shareholder consent principle could apply where the beneficial owner, rather than the registered owner, was the relevant decision-maker and consented to the relevant course of action.

D was sole director and shareholder of company C. The allegation against him was that he had breached his director duties by transferring properties out of C at an undervalue to a separate company that he owned. D alleged that he held his shares in C on trust for a Mr S, and had just been carrying out S's instructions. The trial judge had decided that C held the properties on trust for S too, meaning that only bare legal title had transferred and no loss been suffered, and that unanimous shareholder consent had applied anyway. The Court of Appeal agreed on unanimous consent, but decided the judge had erred in finding that the properties were held on trust, as neither party had pleaded that. On unanimous consent, the Court of Appeal affirmed that consent here of the ultimate beneficial owner S was sufficient. C argued various bases on which unanimous consent could not apply anyway. One was that shareholders could not authorise a transaction at an undervalue that amounted to an unlawful distribution. On this point, the Court of Appeal remitted the case back to the High Court to determine whether on the facts these had been genuine transactions that were a bad bargain or attempts to extract value, noting that C lacked distributable reserves. Another was that shareholders could not authorise a future fraud. Allegedly, this was an intention to represent dishonestly to a subsequent lender that the properties had been purchased at a higher price than had happened and that cash had changed hands (when it had not) to repay C's secured lenders, so as to raise new funds fraudulently. The Court of Appeal rejected this, emphasizing that the fraud bar to unanimous consent related instead to where members were acting dishonestly towards the company. (*Satyam Enterprises Ltd v Burton and Another* [2021] EWCA Civ 287)

Key lessons

- **Consent of beneficial owner:** Another affirmation that the consent of beneficial, rather than registered, owner may be sufficient for the purposes of the unanimous shareholder consent principle.
- **Exceptions to unanimous consent principle:** The judgment also gives general guidance on scenarios where authorisation or ratification by unanimous consent is not allowed.

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Majority shareholder right to acquire minority shareholder's shares for "fair value"

The High Court decided that a "fair value" buyout provision in a private company's articles of association entitled the majority shareholder to buy out the minority on a discounted basis, to reflect the minority nature of the interest.

G founded company C. He subsequently took on M as a sales representative, and later transferred 24.99% of his shares to M, retaining 75.01% himself. M resigned when their relationship broke down, but they could not agree the price for his shares. G decided to address this some years later. He caused C to convert his shares into A shares and M's into B shares, as well as amending C's articles of association to allow the A shareholder to buy out the B shareholder for fair value. G served a buyout notice on M one month later. M petitioned alleging unfair prejudice by the expropriation of his shares for what he regarded as less than fair value when G executed the stock transfer form under an agency provision introduced into the articles at the same time. M alleged fair value was a pro rata 24.99% proportion of the total value of C's issued share capital. G alleged a discount should be applied. The High Court found in G's favour. In line with previous case law, the starting point was to apply a discount to a minority interest unless the articles expressly provided otherwise. This reflected that a transferor should not be paid for something his shares did not entitle him to, being a proportionate part of a controlling stake or a pro rata

Key lessons

- **Valuation of minority shares:** The judgment confirms that the starting point is to apply a discount when valuing a minority stake.
- **Clear and express drafting:** The case highlights the merits of clear and express drafting of valuation provisions and providing for expert determination on a dispute.
- **Construction of articles of association:** The judgment gives helpful guidance on construing articles of association.

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portion of the company's net assets or business undertaking. The court also denied it should apply the meaning of "fair value" in the 2013 edition of the standards of the International Valuation Standards Council. These were not referred to in the articles and had been superseded by a later edition anyway. Articles of association were public documents and this limited admissible background to what any reasonable reader would reasonably be expected to know (for example, when inspecting them as a precursor to investing in or dealing with the company). (*Re Euro Accessories Limited* [2021] EWHC 47 (Ch)).

Contractual provisions

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

Adequate notice of tax covenant claim

The Court of Appeal decided that a buyer's notice of tax covenant claim under a share sale and purchase agreement (SPA) was valid and had complied with the requirements of the seller limitations in the SPA, overturning the earlier High Court decision.

The dispute was over potential tax liability relating to past transfer pricing practices of a member of the target group, where a post-completion investigation had been launched by Slovenian tax authorities. Representatives of seller S were informed of the investigation and of significant developments as it progressed, and also attended key meetings. Under the seller limitations in the SPA buyer B had to give written notice of a claim which, among other things, had to specify "*…in reasonable detail the matter which gives rise to such claim…*". Before the investigation completed, B served a notice of tax covenant claim on S, stating that it related to an ongoing investigation by the Slovenian tax authorities into the transfer pricing practices of a member of the target group and that B claimed an amount equal to any tax liability imposed following the investigation. The High Court had held that the notice was invalid for failing to give reasonable detail of the matter giving rise to the claim, because it was not the investigation which gave rise to any tax liability, but the underlying events the subject of the investigation. Significantly, the High Court had decided that S's existing knowledge was not relevant. The Court of Appeal overturned that decision and denied that the recipient's knowledge was not relevant when construing the notice. The question was whether reasonable detail of the underlying matters, that is the transfer pricing practices, had been given on the facts. The Court of Appeal stated that, if a contract prescribes that certain information must be included, a notice which fails to do so will be invalid whether or not the recipient already knew it. By contrast here the SPA simply required "reasonable detail". What is reasonable will vary with the circumstances, and those circumstances must include what the recipient already knows. The notice did enough to convey that the tax authority was investigating charges for services to group companies and might impose a tax liability if it decided they were too low. The only further information available at the time about the investigation was at a high level and generic, the recipient of the notice already knew it and it would have served no commercial purpose to include it. (*Dodika Ltd and Others v United Luck Group Holdings Ltd* [2021] EWCA Civ 638)

Key lessons

- **Content requirements for notices of claim:** The judgment is a reminder that a seller seeking to raise the bar on the content requirements for notices of claim should negotiate more prescriptive wording in the SPA than a requirement to provide "reasonable details".
- **Seller's knowledge:** It establishes that a seller's knowledge will be relevant in assessing whether "reasonable details" have been given in such a notice of claim under an SPA.

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Expert determination on completion accounts valid

The High Court gave guidance on what amounts to a manifest error for the purposes of an expert determination under a share SPA where the expert's decision was on a matter of contractual interpretation.

The issue arose when applying a working capital adjustment under a completion statement mechanism in a share SPA. The expert had found in favour of the buyer (B). Seller S challenged the determination, alleging it was not binding due to manifest error. The parties agreed that the test for manifest error was an error which is obvious or easily demonstrable without extensive investigation, but disagreed over how to apply this. B argued you needed oversights and blunders that were obvious. S argued you needed an error demonstrated from the face of the record. The High Court decided that there had been no manifest error and that the expert determination stood. A key element of the dispute had been over how to interpret the accounting hierarchy in the SPA. This provided that the completion statement should be prepared, first, by applying the specific accounting policies in the SPA, second on a basis consistent with the accounting principles and policies used in the last audited accounts and, third, in accordance with UK GAAP. The issue was how far (if at all) you imported concepts of UK GAAP when applying the consistent basis requirement in the second limb. The expert had determined that it depended on whether those concepts had been applied in preparing the target company's management accounts, because "consistent basis" was defined separately in the SPA by reference to the management accounts. The High Court rejected S's argument that an expert's decision on contractual interpretation was only susceptible to one correct interpretation, with any other being a manifest error. The analysis depended on the scope of the expert's engagement. Here, that covered any dispute arising in connection with the completion statement, which included matters of contractual interpretation. The effect was that the usual manifest error test applied and had not been met here. (*Flowgroup Plc (in liquidation) v Co-operative Energy Limited* [2021] EWHC 344 (Comm))

Key lessons

- **Manifest error test:** The judgment confirms that the circumstances in which an expert determination can be challenged for manifest error are confined within narrow limits.
- **Scope of expert's engagement:** It shows the significance of clearly and expressly delineating the scope of the expert's engagement.

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Sellers successful in requiring payment of escrow funds

The High Court gave summary judgment for specific performance of payment of part of a purchase price under a share SPA. It also discussed the status of an anti-set-off clause in the SPA.

Sellers S sold their shares in company C to buyers B. C provided software for taxi and private hire businesses. Under the SPA part of the consideration was to be put into a retention escrow account, on the basis it would be released to S after 16 months if no warranty claims had been notified by then. The day after the 16-month period expired, B wrote to S alleging breaches of warranty amounting to fraudulent misrepresentations and refused to pay the requisite funds into the escrow account. The allegation was failure to have a licence to use certain data in C's systems and services. B sought to set off those claims against S's claim for release of the escrow. The SPA had an anti-set-off clause providing that all sums payable under it were to be paid free and clear of all deductions or withholdings unless required by law. B asserted that the 16-month deadline and the anti-set-off clause should be disapplied due to fraud by S. The High Court rejected the misrepresentation and set-off claims and ordered specific performance of B's payment obligation in relation to the escrow funds in the SPA (although it allowed a claim for fraudulent breach of warranty to proceed separately from the issue of release of the escrow). The High Court stated that B had not notified claims within 16 months and could not

Key lessons

- **Adhering to time limits and other requirements in the SPA for notices of claim:** To preserve its claim, a buyer must comply strictly with the requirements for notices of claim in the seller limitations in the SPA, particularly time limits, which will be treated as mandatory.
- **Anti-set-off clause:** The judgment shows the merits to a seller of a robust anti-set-off clause.
- **Status of contractual warranties:** The judgment confirms previous case law that clear and express wording is needed to raise the status of contractual warranties to representations.

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set-off the claims they now made against the escrow. The fraud carve-out from the exclusions and seller limitations in the SPA was irrelevant, because an anti-set-off clause was a defined payment obligation and not an exclusion clause. Clear and express language would be needed to elevate the status of contractual warranties to representations, which was not present in this SPA. Separately, the disclosure letter did not contain pre-contractual representations, and in any event expressly excluded any representation or warranty. (*Arani and Others v Cordic Group Limited* [2021] EWHC 829 (Comm))

Breach of environmental warranties and actionable misrepresentations

The High Court has found breaches of environmental warranties in a share SPA and actionable misrepresentations in sellers' written responses to due diligence enquiries which were not excluded by the entire agreement clause in the SPA.

In October 2015 buyer B signed and completed the acquisition of the entire issued share capital of company C from family sellers (S). C was a waste management company and subject to regulatory requirements imposed by Welsh Water (WW) under a discharge consent. Tests in the two years leading up to the sale revealed breaches of the discharge consent, by exceeding prescribed limits on levels of contaminants. C and WW commenced discussions to agree increased discharge levels, but these were not finalised. In responses to B's due diligence enquiries in August 2015 S failed to mention WW's investigation or the ongoing breaches of the existing discharge consent. WW wrote to C one month after completion stating that it was considering bringing a prosecution. B claimed damages for breach of warranty and pre-contractual misrepresentations. Although the SPA imposed a two-year time limit from completion for notifying claims, some of B's notifications were after that period expired. The High Court found in B's favour both breaches of warranty and actionable misrepresentations. The two-year time limit for notifying claims did not apply, because there had been both wilful misconduct and dishonesty by S in providing false information. The High Court rejected that the fraud carve-out only suspended the time limit until discovery. The clause did not say that and specified nothing about dates of discovery. The court also said that wording in the entire agreement clause that the SPA superseded "… *previous discussions, warranties, representations and undertakings*" failed to exclude liability for misrepresentation. To achieve this you would need express language. Here, the SPA did not expressly state there had been no representation, no reliance on a representation nor that liability for misrepresentation was excluded. The High Court also decided that several statements in the due diligence responses were actionable representations, including that there were no written complaints nor pollution incidents. There was a rebuttable inference of fact that a person who has entered into a contract after receiving a material representation of fact had relied on that representation. A provision in the SPA stating that B's sole remedy for breach of warranty was for breach of contract only related to claims for breach of warranty under the SPA and was not relevant to representations arising from due diligence responses. (*MDW Holdings Limited v Norvill and Others* [2021] EWHC 1135 (Ch))

Key lessons

- **Excluding liability for misrepresentation:** The judgment follows previous case law that clear and express language is needed to exclude liability for misrepresentation and shows the importance to a seller of a robustly worded entire agreement clause.
- **Accuracy of disclosures:** The judgment is a reminder that a seller must expressly and specifically disclose known issues to a buyer and give full and accurate responses to due diligence enquiries.

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Restrictive covenants in services agreement reasonable and not a restraint of trade

The Court of Appeal has upheld the previous High Court decision that the restraint of trade doctrine did not apply to covenants in a services agreement entered into in connection with a restructuring and joint venture, and that the covenants were reasonable in any event, even though they could potentially run for 100 years.

The restructuring was of the businesses of several private companies providing actuarial and other services. When the parties' interests diverged they could not afford a buyout and restructured instead. Under the services agreement a new LLP (L) agreed to run the legacy business potentially for 99 years at cost (fixed permanently at 57% of fee income). L had use of existing staff, premises and brand name for servicing the legacy business and developing new business. It covenanted neither to service existing clients, nor solicit them, other than as agent for the existing owners during the term of the agreement and for 12 months after it terminated. The Court of Appeal decided that the restraint of trade doctrine did not apply and that the covenants were in any event reasonable. The services agreement had been created in very specific circumstances arising from a complex corporate structure. You had to look at the commercial background and rationale for L's creation and the services agreement, being the conduct of the legacy business. The restrictive covenants were ancillary to that purpose. The Court of Appeal considered the recent "trading society test" set by the Supreme Court[2] for determining whether the restraint of trade doctrine applies. Under this test, it would not apply if the covenant had passed into the accepted and normal currency of commercial or contractual relations. The Court of Appeal rejected that the trading society test was a single test of universal application. The services agreement was bespoke and had to be viewed in context. It would fit well anyway within the exception to the trading society test where covenants were given on the sale of the goodwill of a business. There had been no inequality of bargaining power and the parties had even acknowledged the reasonableness of the covenants in the agreement. The public interest in freedom of contract outweighed the effect of restricting L. (*Quantum Actuarial LLP v Quantum Advisory Limited* [2021] EWCA Civ 227)

Key lessons

- **Enforceability of covenants in commercial agreements:** The court will be more liberal in enforcing restrictive covenants in commercial agreements than in employment contracts.
- **Legitimate business interests:** As between sophisticated parties, the court will generally uphold restrictive covenants that are entered into between them to protect a legitimate business interest and are reasonable in the overall context of the arrangements.
- **Assessment of interests of contracting parties:** The court will be slow to substitute its own objective view of what is in the contracting parties' interests for their own subjective views on this.

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2 *Peninsular Securities Ltd v Dunnes Stores (Bangor) Ltd* [2020] UKSC 36.

Listed companies

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

Listed company not liable despite fraudulent misrepresentations in relation to a capital raising

A claim relating to an investment in a capital raising by a listed bank (B) has failed, despite the High Court finding that B had made fraudulent misrepresentations during the course of negotiations.

B announced a £7.3 billion capital raising including investments of £2.3 billion (ultimately £2.05 billion) by an investor (Q) and £3.5 billion (ultimately £3.25 billion) by three corporate special purpose vehicles (SPVs) owned by a firm (P) and described as representing the beneficial interests of another investor (M). P led the substantive negotiations with B and introduced M as a potential investor. Before closing P transferred its ownership of the SPVs to an entity whose Chair was M. As well as disclosed commissions, Q received £280 million from B under an advisory services agreement and a £66 million arrangement fee. B also provided a US$3 billion loan to Q. P claimed for deceit, alleging that B had fraudulently misrepresented (among other things) that: (a) P would get "the same deal" as Q in respect of its investment; and (b) the arrangement fee of £66 million was for overlooked fees in respect of Q's participation in B's previous capital raising.

The High Court held that B made these two fraudulent misrepresentations to P. The "same deal" representation captured whatever package of benefits, in terms of fees or otherwise, and whether in the subscription agreements or otherwise, was being provided to the investor in return for undertaking the subscription. This representation was false because the £280 million advisory services agreement, the £66 million arrangement fee and the US$3 billion loan were all part of the package offered or price paid to Q for its investment. B intended P to rely upon each of these representations, P did so, and B's lead negotiator was dishonest in that he knew these representations were false. However, P failed to prove its case on causation and loss and so its overall claim failed. If B had not made the misrepresentations, P would have discovered the truth about Q's deal, negotiated with B and obtained additional value of £615 million. However, to earn additional remuneration from M, P also needed to procure non-recourse debt finance for 60% of M's investment in B. The High Court found that there was no real chance of this. (*PCP Capital Partners LLP & Anor v Barclays Bank PLC* [2021] EWHC 307 (Comm))

Key lessons

- **Take care when saying it is the same deal:** Issuers should take care when representing that investors are all getting the same deal. This may be problematic if the issuer has additional arrangements or agreements with one investor which are commercially linked to their investment.
- **Regulatory investigations heighten risk of civil claims:** P only became aware of its potential claim against B in 2013 when it learned of investigations by the FCA's predecessor (the FSA) and the Serious Fraud Office (SFO) into B's advisory services agreement with Q (which had not been publicly disclosed in 2008). Regulatory investigations can result in the disclosure of non-public information which may encourage and assist potential civil claims.
- **Difficulty in proving damages:** P's claim failed because it could not prove causation and loss. However, this partly reflected an unusual set of facts. If an issuer made similar misrepresentations to an investor in a capital raising, then the investor may well find it easier to prove damages.

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Compensation payments and censure for issuer's misleading announcement regarding preference shares

A premium listed company (A) agreed to compensate investors, and was censured by the Financial Conduct Authority (FCA), for failing to take reasonable care that its preliminary results announcement was not misleading and did not omit material information in relation to preference shares issued by A and its subsidiary (G).

A and G's listed preference shares had certain disadvantageous features, but could be cancelled at par value through a reduction of capital. At a board meeting on 31 January 2018, A's directors requested a further review before making a decision. On 8 March 2018, A's preliminary results announcement indicated that A intended to reduce hybrid debt and target additional capital returns in 2018. A flagged the ability to cancel preference shares at par value through a reduction of capital, noted their disadvantageous features, and noted that it was considering how to balance the interests of ordinary and preferred shareholders. At a results presentation that day, A's CEO stated: "we're in a very fortunate position with our cash and capital that we now have the ability to do something about [the preference shares]. So we intend to." The market price of the preference shares fell substantially. On 23 March 2018, A announced that it had decided not to cancel the preference shares.

The FCA censured A for breaching LR 1.3.3R and DTR 1A.3.2R by failing to take reasonable care that its preliminary results announcement was not misleading, false or deceptive and did not omit anything likely to affect the import of the information relating to the preference shares. However, the FCA did not impose a fine. It took into account that A voluntarily paid out about £7.3 million compensation to preference shareholders. The FCA concluded that omissions from the announcement were reasonably capable of giving the misleading impression that A intended to retire some or all preference shares in 2018 and that it was probable A would seek to do so by exercising the right to cancel at par without compensatory measures. This was not the case. The FCA considered that, when preparing the announcement, A should have taken the intended presentation into account in considering how the market could be reasonably expected to understand the announcement. (*FCA final notice to Aviva plc* – 26 October 2020)

Key lessons

- **Risks when managing market expectations:** Issuers may wish to inform the market regarding options which they are considering. This may help to reduce the risk of sudden price movements in future, if investors are caught by surprise. However, issuers must take care not to imply that they are likely to take a particular course of action, if this is not the case.
- **Influence of presentation on FCA's analysis:** The FCA's use of the intended results presentation to assist in interpreting the preliminary results announcement seems hard to justify. The relevant rules did not apply to presentations.
- **Utilise scripts with care:** A's CEO's comment that "we intend to" do "something" about the preference shares was not in the script for the results presentation. The FCA seemed to attach some significance to this comment. On price sensitive matters, every word can be important.

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FCA proposes to take action against listed company and directors for misleading announcements

The FCA proposes to censure a premium listed company (C), which is now in liquidation, and take enforcement action against certain of its former directors, in respect of misleading announcements regarding C's financial position and deficiencies in C's systems, procedures and controls.

The FCA's warning notice statement summarised warning notices issued by the FCA to C and certain of its former executive directors. A warning notice is not a final decision of the FCA.

The FCA considered that: (a) certain announcements by C were misleading and did not accurately or fully disclose its true financial position. They made misleadingly positive statements about C's financial performance, which did not reflect deteriorations in expected financial performance and increasing financial risks; (b) C's systems, procedures and controls were not sufficiently robust to ensure that accounting judgements were appropriately made, recorded and reported to the Board and the Audit Committee; and (c) the former directors were aware of the deteriorating expected financial performance and increasing financial risks. They failed to ensure that C announcements accurately and fully reflected these matters. They also failed to make the Board and the Audit Committee aware of them. The FCA considered that C breached Article 15 of the Market Abuse Regulation, LR 1.3.3R, LR 7.2.1R (LP 1) and LR 7.2.1AR (PLP 2). The FCA considered that the former directors were knowingly concerned in C's breaches. The FCA also considered that C and the former directors acted recklessly. The FCA proposed to publicly censure C, but did not disclose its proposed enforcement action regarding the former directors. (*FCA warning notice statement 20/2 re: Carillion plc* – 13 November 2020)

Key lessons

- **FCA will scrutinise corporate collapses:** The FCA can be expected to closely scrutinise the actions of issuers and directors involved in a high-profile corporate collapse such as this.
- **Monitor developments:** We await further information regarding what, if any, enforcement action the FCA will take regarding this matter.

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