January 2022

2021 Half-year in review M&A legal and market developments

In this issue…

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We set out below a number of interesting English and European 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

Warranty claim under share SPA – buyer's knowledge and duty to mitigate

The High Court decided that share seller S was liable for breach of warranty under a share sale and purchase agreement (SPA) and that neither the buyer's knowledge limitation nor its confirmation of no knowledge of a claim had been triggered, nor had the contractual duty to mitigate been breached.

Target company C was an energy company that supplied steam generated by two biomass boilers to a single customer (G). G terminated its contract with C in the year following completion for numerous stoppages and poor performance standards. Buyer B alleged that various warranties in the SPA had been breached, including on: the state of repair of C's plant and equipment and failure to use it in accordance with its environmental permit; the status of its material contracts; the condition and standard of service of the boilers; and the accuracy of the projections in its financial model. A buyer's knowledge limitation in the SPA stated that B was not entitled to bring a claim where B had actual knowledge of the facts and circumstances giving rise to it "*which for this purpose means the actual knowledge of [Mr C] and [Dr A]*" (both directors of B) at the date of completion. Separately, B confirmed that, save for the disclosed matters, it was not actually aware of any fact, matter or circumstance amounting to a breach of warranty at

Key lessons

- **Clear and express drafting:** The judgment demonstrates the importance of clear and express language to delineate the scope of a buyer's knowledge limitation and related provisions.
- **Buyer's and seller's knowledge/awareness definitions:** A party seeking a broad contractual definition of the other party's knowledge should express that knowledge to *include* any element of awareness or enquiries of named individuals, to try to broaden the scope. Conversely, a party seeking to contain the scope will seek the reverse and may expressly exclude constructive or imputed knowledge from the definition.
- **"No knowledge" confirmations are soft provisions:** It is interesting that the main debate here was an interpretation issue on a "soft" buyer's confirmation of no knowledge of a claim. This is a weak provision for a seller, to be distinguished from a true knowledge limitation on liability which expressly prohibits a buyer from bringing a claim where it had the requisite knowledge.
- **Express duty to mitigate:** This is a rare judgment giving guidance on the scope of an express contractual duty to mitigate.

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the date of the SPA, where the SPA stated differently: "*For this purpose [B] … shall be deemed to have knowledge of anything which any of [Mr C] and [Dr A] are actually aware of …*" at the date of the SPA. Finally, a separate seller limitation expressly required B to "*take all reasonable action*" to mitigate its loss. The High Court decided that various warranties had been breached, the true position kept from B and that none of the above seller limitations on liability applied. S had alleged that B's confirmation of no knowledge of a claim had been breached because it caught imputed knowledge of agents. It had argued that, unlike in the buyer's knowledge limitation, the reference in it to Mr C and Dr A was an additional "deeming" provision, not a limiting provision. The court rejected this. It was not a deeming provision but delineated the class of people whose actual awareness counted. Factors the court took into account included that: there would otherwise be an inappropriate imbalance, as the seller's awareness qualification to the warranties did not catch imputed knowledge of agents and it would be surprising if B's "no knowledge" confirmation was broader; it was for S to prove B's knowledge not for B to disprove it; and, in a professionally drawn legal document, there was a strong presumption that the expressions actual, constructive and imputed knowledge were used in their ordinary legal meanings. This interpretation made sense as Mr C's and Dr A's knowledge would have been attributed to B anyway, as they were its directors. The court also found that the contractual duty to mitigate did not impose any higher standard of conduct than that under the common law. The burden of proof was on S, as the party in breach. Take "*all reasonable action*" meant action that it would be unreasonable not to take and did not oblige B to start proceedings against a third party nor pay for remedial works. (*Equitix EEEF Biomass 2 Ltd v Fox & Ors* [2021] EWHC 2531 (TCC))

Disapplication of time limit for notifying warranty claims for negligent non-disclosure

The Court of Appeal decided that sellers S could rely on information provided to buyer B outside the disclosure letter to rebut a clause in the SPA that disapplied a contractual seller limitation where there had been fraud or negligent non-disclosure.

Company C's main business provided private landlords the facility to advertise properties for rent through online platforms. C did so through its residential lettings membership of the platforms, for which it paid a fee. B alleged that S had breached the warranty in the SPA that it was not in default under any agreements to which it was a party, because it had breached a restriction in the platforms' contractual terms which precluded it from advertising lettings on behalf of other commercial letting agents. The SPA imposed a time limit for notifying warranty claims of six months from the completion date, but with a carve-out if there had been fraud or negligent non-disclosure (clause 6.2). B was outside the time limit but alleged this did not apply as the contractual breach was not disclosed in the disclosure letter. S argued that clause 6.2 did not apply because they had disclosed the platforms' contractual terms to B outside the disclosure letter and it was open to them to rely on those disclosures to rebut the fraud or negligent non-disclosure proviso to the limitation. The Court of Appeal decided that C was not prevented from placing advertisements on behalf of other commercial letting agents. It also discussed the interpretation of clause 6.2. It stated that the meaning of "disclosure" for the purposes of the carve-out in clause 6.2 was not confined to disclosure through the disclosure letter. Disclosure elsewhere could rebut an allegation of negligent non-disclosure. It pointed out that there was no reference to the disclosure letter in clause 6.2, whereas it was expressly referred to in other clauses. This suggested that the reference to "disclosure" in clause 6.2 was intentionally broader. It would also make little sense to ask whether there was negligent non-disclosure by reference to the disclosure letter if in fact there was disclosure in another communication. The Court of Appeal also denied that clause 6.2 should be construed narrowly as it was part of a limitation provision, being a form of exclusion clause. On the contrary, it was actually an exception to the seller limitations in the SPA. (*Butcher & Anor v Pike* [2021] EWCA Civ 1407)

Key lessons

- **Fixing buyer with knowledge from outside the disclosure letter:** The decision in this case to fix the buyer with knowledge from outside the disclosure letter only applied in the context of a narrow interpretation point on a carve-out to a seller limitation. It also hinged on the drafting of this particular SPA. It is not as significant as the separate line of case law on whether or not a buyer's knowledge from outside the formal disclosure process qualifies the warranties.
- **Clear definitions in SPAs:** The judgment does though show the importance of clearly defining in the SPA what is meant by "disclosure" and explicit drafting of seller limitations.

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Interpretation issues on equity commitment letter

On a trial of preliminary issues, the High Court has looked at the construction of an English law equity commitment letter (ECL), over whether party A was obliged under the ECL to fund its indirect subsidiary O ready to complete an acquisition where seller S had direct enforcement rights under the UK Contracts (Rights of Third Parties) Act 1999.

The underlying acquisition was the purchase of a company owning a hotel in Spain from S. The ECL was governed by English law, whilst the related SPA was governed by Spanish law. The condition to completion in the SPA, EC merger clearance, had been satisfied. However, completion had not taken place for reasons related to the COVID-19 pandemic, including allegations by O that S was in breach of warranty under the SPA and/or that O had already terminated the SPA. S had direct enforcement rights under the ECL and sought an order in the English High Court that A put O in funds to complete the acquisition, whilst an ongoing dispute in the Spanish court over specific performance of the SPA was still in progress. Under the ECL, A's funding obligation was expressed to be subject to O becoming "*obligated unconditionally under the [SPA] to effect the Completion*" and would terminate automatically on the earlier to occur of: consummation of completion; valid termination of the SPA; and 1 January 2021. The obligation was to fund O "*immediately prior to the Completion Date*". On the trial of preliminary issues the High Court found that A was contractually obliged to fund O. The court stated that O had to complete on the completion date and, under the ECL, A had to fund O immediately before that date (being by 11.59 pm the day before) unless the SPA was validly terminated beforehand. It decided that "*obligated unconditionally*" to complete meant satisfaction of the condition to completion in the SPA where, as here, this happened before 1 January 2021. Once satisfied, O's obligations under the SPA were unconditional, albeit that there were other obligations on S which fell to be satisfied at the same time. If subsequent to that, and before completion was effected, the SPA was frustrated or S could not or failed to perform its completion obligations, O would need to repay A. However, the funding had to be provided if, at the moment immediately before the completion date, the obligation to complete remained in being. If the SPA was validly terminated in accordance with its terms the obligation to fund would cease. However, without express wording to the contrary, a party (here, O) could not rely on its own wrongdoing (here, failure to complete) to terminate the SPA. A's assertions that funds could only be used to effect completion were correct, but that was not the issue. As the condition to completion had been fulfilled, A should already have funded O. The ongoing dispute before the Spanish court also did not justify A's failure to fund O. If O succeeded in the Spanish proceedings the funds could be returned to A. (*Lopesan Touristik SA v Apollo European Principal Finance Fund III (Dollar A) LP & Ors* [2021] EWHC 2141 (Comm))

Key lessons

- **Drafting clarity:** The judgment demonstrates the need for clarity of drafting over the circumstances in which, and timing for when, funding must be provided under an ECL and when it ceases.
- **Express provisions on remedies and termination:** It is noteworthy that the ECL under consideration conferred on S an express right to specifically enforce the obligations under the ECL. It also expressly stated that it would not terminate on claims by S under the SPA or to enforce O's rights under the ECL.

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Claim for unjust enrichment under share SPA

The Court of Appeal dismissed an unjust enrichment claim brought under a share SPA, because the basis underlying it was inconsistent with the express terms of the SPA.

Seller S agreed to sell company C to two buyers (B and P). C was a holding company through which S held a 34% interest in a Ukrainian company. The English law SPA expressly provided that the consideration for the sale of shares in C would be $950m. Before completion the parties exchanged drafts of a separate agreement under which additional assets of S, including two further Ukrainian companies (N and A), would be transferred to B and P on the conclusion of the acquisition of C. That agreement was never executed, but was a common

Key lessons

- **Express price allocation:** The judgment demonstrates the importance of including in an SPA an express price allocation among different assets being acquired and express language as to what those assets are.
- **"Wrong pockets" provisions:** It also shows the merits of including in an SPA a continuing "wrong pockets" provision covering assets intended to be included in the transfer.

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understanding. B never received an interest in N or A. It was accepted that the $950m price paid under the SPA relating to C represented $750m for the shares in C and $200m for additional assets. B claimed unjust enrichment in respect of $82.5m it alleged it had paid for 50% of N and A. The Court of Appeal rejected the claim. It noted that the core argument was "failure of basis", which presupposes that a benefit has been conferred on a joint understanding that the recipient's right to retain it is conditional. If the condition is not fulfilled, the recipient must return the benefit. However, the Court of Appeal pointed out that was not found anywhere in the SPA. It emphasized that where, as here, the basis of the consideration was expressly and unconditionally spelt out on the face of a valid and subsisting agreement, there was no proper scope for the court to enquire into an alternative basis. The parties had chosen knowingly to exclude the additional assets from the definition of consideration in the SPA. There had been no contractual obligation to transfer the interests in N or A. The court stated that a claim for unjust enrichment could not be used to override the express terms of an agreement on risk allocation. It had been agreed that the risk of not receiving the additional assets had been B's. (*Dargamo Holdings Ltd v Avonwick Holdings Ltd* [2021] EWCA Civ 1149)

Fair value on compulsory share transfer under articles

The High Court decided that the correct procedure for determining fair value of transferring shares was that set out in articles of association, not a more evenly-balanced procedure in the related shareholders' agreement (SHA).

Claimants S were former directors of and minority shareholders in financial advisory company C and previously its majority shareholders, as well as directors and employees of another group company. They were removed as directors of both companies and dismissed as employees for alleged misconduct. This amounted to a compulsory share transfer event under the articles, at fair value in accordance with the articles. These required C's directors to instruct an expert to determine fair value, which was defined to have the meaning in the SHA. The majority shareholder controlled the choice of expert. Schedule 2 to the SHA had a separate procedure for determining fair value which was more evenly-balanced. It gave all parties the opportunity to review draft valuation documents and working papers and, if they failed to agree these, to join in inputting into the choice of expert to settle the dispute. When the new majority shareholder alleged the bad leaver price of 25% of fair value applied, S denied the validity of the expert that C's directors had appointed and argued that the procedure in the SHA should have been followed. S based this on: incorporation by reference; the entire agreement clause in the SHA, which required the articles and the SHA to be read together; and the supremacy clause in the SHA, which said it prevailed on a conflict with the articles.

Key lessons

- **Interaction of inter-related documents:** The case shows the need for clear drafting on the interaction between articles and SHA and, more generally, inter-related documents and the need for definitions incorporated by reference to work in the context of the agreement in question.
- **Supremacy clauses:** Parties should not rely on supremacy clauses to resolve a conflict.

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The High Court decided that the fair value procedure in the articles applied, not that in the SHA. The articles had an express procedure for determining fair value and there was no reason to incorporate the quite different procedure from the SHA, which in any event related to put and call options not compulsory transfer notices. The supremacy clause in the SHA was not triggered because there was no conflict. There was also no basis for implying the procedure in Schedule 2 to the SHA into the articles. A term would only be implied into a contract if it was necessary to give business efficacy to the contract in the sense that, without the term, the contract would lack commercial or practical coherence, or was so obvious that it went without saying.[1] That was not the case here. (*Lord & Anor v Maven Wealth Group Ltd & Ors* [2021] EWHC 2544 (Comm))

1 *Marks & Spencer Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd.* [2015] UKSC 72.

Exercise of contractual discretions under LLP agreements

The High Court has applied the duty of rationality[2], that a contractual discretion must not be exercised in a way that is arbitrary, capricious or irrational, to a discretion to make recommendations under a limited liability partnership (LLP) agreement. It also indicated that the wider good faith test in *Re Charterhouse Capital*[3] applied to the ultimate decision by the partners on the basis of the recommendation given.

A former partner in an LLP claimed that discretionary powers to allocate a fund under the LLP agreement had been exercised unfairly in his last two years at the firm, with the effect that he had not been allocated a fair profit share. Under the LLP agreement the allocation of the discretionary fund was to be settled by decision of the partners on recommendations of the senior partner. His recommendation was to be determined in his discretion, taking into account financial performance. The High Court decided that the powers had been validly exercised here. The court applied the duty of rationality to the exercise of the senior partner's discretion in making recommendations. In upholding the exercise of the discretion, the court noted that the senior partner was merely making recommendations. The wider partner group was not obliged to adopt his recommendations and could address any errors. His recommendations primarily just needed to prompt a debate between the partners. The court also stated that a decision of the partners on the senior partner's recommendation had to meet the good faith test in *Re Charterhouse Capital*. The good faith principle in that case and the related line of case law previously has only been applied to the limits on the voting power of majority shareholders to bind a minority by amending articles (most commonly to force a share sale on the exercise of drag-along rights). The Court of Appeal had held there that such power had to be exercised in good faith in the interests of the company. Here, the High Court stated that the same principle applied to a decision of the partners on the senior partner's recommendation, and their decision too should not be outside the range of reasonable decisions that might be made in the circumstances of allocating the discretionary fund. (*Tribe v Elborne Mitchell LLP* [2021] EWHC 1863 (Ch))

Key lessons

- **Duty of rationality:** Confirmation that the duty to exercise a contractual discretion in a way that is not arbitrary, capricious or irrational applies to all types of agreement and, here, even to a discretion to make recommendations.
- **Good faith test in *Re Charterhouse Capital*:** The judgment goes further than previous case law in applying the good faith test in *Re Charterhouse Capital* in a broader context than the power of the majority to bind a minority by amending articles of association.

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When basis of a claim becomes known to a party

The High Court has considered a clause in a commercial contract excluding liability for claims brought more than one year after "the basis for the claim becomes known" to the party asserting it. It decided that knowledge should be given its ordinary, natural meaning.

English publishing company D applied for a preliminary judgment in proceedings brought against it by C, a Saudi Arabian publishing company. Under an agreement between C and D, C had supplied certain publications to D and granted it an exclusive worldwide licence to publish them. The agreement had been terminated on 1 February 2015. On 13 June 2017 C brought proceedings alleging non-payment of agreed royalty and continued use of its publications after termination. Whilst clause 14.2 of the agreement prevented

Key lessons

- **Analogy on M&A deals:** The guidance on when the basis of a claim becomes known to a party is useful by analogy in the context of seller limitations imposing a requirement on a buyer to notify a claim within a set period of becoming aware of it.
- **Drafting of seller limitations:** The judgment shows the importance of clear drafting of limitations on liability from a seller's perspective to minimise the risk that the court finds ambiguity and intervenes to adopt a buyer-friendly interpretation.

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2 *Braganza v BP Shipping Limited* [2015] UKSC 17.
3 [2015] EWCA Civ 536.

claims "*more than one year after the basis for the claim becomes known to the party desiring to assert it*", C had first sent D a letter with some assertions of breach on 13 October 2015. The High Court decided that certain claims remained valid and were not time-barred. The court stated that generally it treats time bar clauses like exclusion clauses in the sense that, if the clause is ambiguous, it will adopt an interpretation that favours the claimant. Equally, it takes into account that the commercial rationale for the clause is to allow a defendant to investigate a claim soon after the circumstances giving rise to it arose. The court decided that the royalty claim was time-barred save for royalties payable after 13 June 2016. However, C had a real prospect of success in the continued use claim, because it only became aware of it within the year before instituting proceedings. The court stated that the words "becomes known" did not have a statutory meaning here. Knowledge should be given its ordinary, natural meaning. C did not need to have an unwavering conviction in the belief of the truth of the basis of the claim, but had to have a sufficient measure of confidence in the belief which was justified by evidence, experience or reasoning. Just suspecting a claim was not enough. C's letter of 13 October 2015 had only been based on a suspicion and had not amounted to knowledge of a claim. (*Arab Lawyers Network Company Ltd v Thomson Reuters (Professional) UK Ltd* [2021] EWHC 1728 (Comm))

Company law

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

Breaches of directors' duties in context of requisitioned general meeting

In responding to an attempt by a group of shareholders to remove them at a requisitioned general meeting, by allotting shares to defeat the resolutions, four directors (D) of private company C had breached their statutory duties to act within their powers and promote the success of the company, although the case against them failed on causation.

C had significant financial problems and instructed financial adviser F to organise a fundraising. Three individual financial advisers were also instructed to look for further investors. Two other directors on C's board (T), who were also investors, refused to consent to a circular to shareholders on the strategy and fundraising. Together with a third person, T requisitioned a general meeting to remove two of D and appoint one of their own investment vehicle's beneficial owners as director. D then exercised a power under the articles to remove T as directors. T amended their requisition to reappoint themselves. Critically, at this point D issued 75 million shares in C to an entity owned by one of the three individual financial advisers for £3m in cash, with payment deferred for two years. Two days later D also issued a further 2,625,000 shares to F in lieu of its cash retainer which was due when the fundraising concluded. The resolutions were defeated using votes of the new shareholders. A few weeks later D rejected an offer from significant shareholder A of a £700,000 loan facility conditionally on most of the board resigning. Within weeks C went into administration and, later, into liquidation. The liquidators claimed compensation from D for breach of duty. The High Court decided that D had not acted beyond their powers in removing T. They were entitled to be concerned that T's behaviour could impact negatively on the proposed fundraising. However, by contrast, D had acted improperly beyond their statutory powers when allotting the new shares. This follows established authority that directors may not use their power to allot shares for an ulterior motive rather than to raise funds. Evidence indicated that, by the time of the share allotments, the purpose was purely to defeat the resolutions. D had also breached their statutory duty to promote the success of C, which at the time had to be measured against creditors' interests, including by rejecting A's funding and withholding the terms of the £3m subscription from shareholders at the general meeting. Their failure to report their wrongdoing also amounted to a breach of duty and was a "badge of impropriety". However, the claims were dismissed because causation failed as C would have gone into administration anyway. Leave has been requested to appeal the decision. (*TMO Renewables Ltd (in liquidation) v Yeo & Ors* [2021] EWHC 2033 (Ch))

Key lessons

- **Directors' statutory duty to act within their powers:** The judgment is a reminder that directors must not exercise their powers, including the power to allot shares, for a collateral purpose, the test for which is objectively determined.
- **Directors' statutory duty to promote success:** Whilst the test for directors' separate duty to promote the success of the company is subjective, it is no answer to an allegation of breach of the duty to act within their powers that a director says they were acting to promote the success of the company.

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Allotment of shares by public companies for non-cash consideration

The High Court decided that shares in a public company had been improperly allotted where there was a non-cash consideration without an independent valuation and report as required under section 593 of the UK Companies Act 2006 (CA 2006).

Claimant company C was incorporated as a holding company to raise funds to develop a fibre optic telecommunications network in Malaysia. Defendant S was an investor in the Malaysian operating company (M) and one of the subscribers to C's memorandum. S was allotted 840 million shares in C and the alleged consideration purportedly was a transfer by S of shares in M to C. Even setting aside that the CA 2006 requires shares allotted to a subscriber to a public company's memorandum to be paid up in cash, the focus of the judgment was on the apparent breach of section 593 as there had been no independent valuation of S's shares in M that were the purported consideration. The key question was whether the purported share exchange amounted to an "arrangement" for the purpose of the statutory exception to the requirement for an independent valuation which applies to an arrangement where the whole or part of the consideration for the share allotment is the transfer of all or some of the shares (or the shares of a particular class) in another company. For the exception to apply the "arrangement" in question must be open to all holders of the shares (or the shares of that particular class) in the transferor. The High Court decided that there was no "arrangement" here for the purposes of the relevant exception. Whilst an arrangement did not require a contractually binding agreement, it did require a certain bare minimum of coherence. It had to embrace both the share allotment by the public company and the transfer of shares by the allottee. You had to be able to say what the arrangement consisted of, at least in relation to key aspects. Here, the share exchange agreement failed to identify: how many shares in C were to be held by each shareholder (the schedule was blank); what the existing shareholdings were in M and what shares in M were to be transferred to C; how many of the pre-existing shares in M were held as nominee, nor what the ultimate beneficial ownership of C would be; nor critically, whether or not the preference shareholders in M were entitled to receive shares in C. The effect was that allottee S was liable to pay C a sum equal to the entire nominal value of the allotted shares (which had not been issued at a premium). The High Court also declined to grant relief, which it has a discretion to grant where it is just and equitable to do so. Leave has been requested to appeal the decision. (*Zavarco UK PLC v Sidhu* [2021] EWHC 1526 (Ch))

Key lessons

- **Meaning of "arrangement" for purposes of exception to requirement for independent valuation:** The judgment gives helpful guidance on the meaning of an arrangement for the purposes of the relevant exception to the requirement for an independent valuation and report on a share allotment by a public company for a non-cash consideration. This is useful in the context of consideration structures on both public takeovers and Private M&A transactions.
- **Severity of the rules:** The judgment highlights the severity of these requirements and the penalty for breach, which also amounts to a criminal offence by the company and defaulting officers. A breach of the section may also have implications for director duties and risk that the company is undercapitalised.
- **Documenting an "arrangement":** It is crucial to document clearly and precisely any arrangement being relied on for the purposes of the above exception.

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Headcount test on scheme of arrangement where single registered shareholder

The High Court considered the voting arrangements for a proposed court meeting to consider a scheme of arrangement of company C where there had only been one registered member, but two directors had recently each transferred their shares from that sole registered shareholder. This meant that by the time of the court meeting there would be three registered shareholders and a majority could be obtained.

The shares in C were traded on Nasdaq in the form of American depositary receipts (ADRs). The issue was how to approach the headcount test for approving the scheme, which must be approved by a majority in number of shareholders voting on the scheme, as well as 75% by value. Where a shareholder is nominee and the underlying beneficial owners are likely to give different voting instructions, the court has in the past adopted a range of approaches on how to apply the headcount test. Notably, on a creditors' scheme the court had treated a nominee that splits its vote as having voted once for and once against the scheme[4]. However, there can be concerns that this may result in more votes than the number of members, that the votes cancel each other out and that it does not respect the weight of votes cast. The preference here was to convert some of the dematerialised interests into certificated shares to enlarge the constituency of votes for the purposes of the headcount test, to complement that approach. The High Court granted the order convening the court meeting of scheme shareholders to consider and approve the scheme on this basis. It noted that the conversion right was available to all ADR-holders across the board. This was not a manipulative share split but a pragmatic solution. At the sanction hearing the court could review whether the additional certificated shares had had a disproportionate effect on the outcome of the meeting. (*Re Cardtronics PLC* [2021] EWHC 1617 (Ch))

Key lessons

- **Headcount test for approving scheme of arrangement:** This is another judgment giving useful guidance on how to apply the headcount test for approving a scheme of arrangement where there is a single registered shareholder and holders of beneficial interests might give different voting instructions.

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Application of directors' duty to avoid conflicts of interest to former directors

The High Court decided that a director's conduct after resigning can give rise to a breach of their statutory duty to avoid a conflict of interest, even where there was no relevant conduct during their directorship and their resignation was not instigated by an intention to exploit a business opportunity of the company.

The case involved allegations of breach of duty and breach of confidence by company C against investor and former chief executive officer S, on the basis he was a "de facto" director. C manufactured and sold remote tracking devices. Separate company T developed the software which C used in the devices. Under a licence agreement, T granted C rights to use the software. S had agreed to become a director of C but had never been formally appointed. S left C when their relationship broke down and acquired shares in T, also becoming T's sole director. He subsequently terminated the licence agreement with C and pursued claims against C for

Key lessons

- **Scope of statutory duty to avoid a conflict of interest:** The judgment gives useful guidance on the scope of the statutory directors' duty to avoid a conflict of interest and highlights that it is wider than under the previous common law rules. Prior to the CA 2006 it was believed that a director's resignation needed to be instigated by an intention to exploit a business opportunity of which they became aware during their directorship for there to be a breach of duty.
- **Behaviour of past directors:** Directors need to exercise care after resigning over the risk of using opportunities of which they may have become aware while a director.

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4 *Re Equitable Life Assurance (No.1)* [2002] BCC 319.

sums allegedly unpaid. The High Court decided that S had been a de facto director, as he had been held out as a director and had assumed the status and function of a director. This meant that the statutory director duties applied. Although it was accepted that S had not resigned from C to exploit the intellectual property rights, he had come to know of C's rights under the licence agreement while a director of C. The court considered section 170(2)(a) of the CA 2006, which states that a former director continues to be subject to the statutory duty to avoid a conflict of interest "*as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director*". The court decided that this implied the resignation need not have been prompted or influenced by an intention to exploit a business opportunity. Given the very specific ambit of the extended duty, this interpretation did not threaten the delicate balance between protecting the fiduciary relationship and avoiding a regime which acts as a restraint on trade. The section fell to be interpreted under existing principles of case law in deciding whether a breach had occurred and, if so, the consequences. By acquiring shares in T and then terminating the licence agreement S had put himself in a position where his personal interests conflicted with those of C as regards exploiting C's rights under the agreement, of which he had become aware while a director. That was a breach of his continuing statutory duty, as well as a breach of confidence. (*Burnell v Trans-Tag Ltd* [2021] EWHC 1457 (Ch))

Listed companies

The following European decisions are of particular interest to listed companies

High-level summary information on a website can constitute a public offer of bonds

The EFTA Court has provided guidance on the meaning of an "offer of securities to the public" under the EU Prospectus Regulation, and the prospectus exemption for offers to fewer than 150 persons.

A Liechtenstein company (A) was the issuer of certain bonds (Bonds). The offer of Bonds was promoted on a website which included certain high level summary information. F was the competent authority for Liechtenstein under the EU Prospectus Regulation. Under the EU Prospectus Regulation, securities could only be offered to the public after publication of a prospectus. This did not apply to an offer addressed to fewer than 150 persons per Member State, other than qualified investors (Article 1(4)(b) of the EU Prospectus Regulation). On 3 June 2020, F decided that the information on the Bonds disclosed on the first website constituted an "offer of securities to the public", and prohibited this in the absence of a prospectus. A appealed. The Board of Appeal of F referred certain questions to the EFTA Court.

The EFTA Court stated that an "offer of securities to the public" is broadly defined. It requires a minimum amount of information relating to the offer terms and the securities offered. What is "sufficient information" must be assessed on a case-by-case basis. In circumstances such as these, the EFTA Court considered that there was a public offer. Promotional messages for the Bonds were published on the internet in a manner freely accessible to anyone. The messages presented information on the minimum

Key lessons

- **Relevance in the UK:** While this decision relates to the EU Prospectus Regulation, the equivalent wording in the UK Prospectus Regulation is substantially identical. Accordingly, we expect the UK courts will have regard to this decision when interpreting it.
- **Clearly identify addressees and use website blockers:** This decision demonstrates the importance of making very clear to whom any information relating to a UK offer of securities is addressed (e.g. qualified investors only), and using website "blocker" pages to restrict inappropriate access by others. This is usual market practice on significant ECM transactions by UK listed companies.
- **Take care when relying on the "149 persons" exemption:** Where an issuer seeks to rely on the UK prospectus exemption for offers to fewer than 150 persons (other than qualified investors), the safest course is to only disclose the offer to prospective investors on request. Any offer-related information disclosed to others (including on a website) should – in aggregate – fall well short of the minimum required to constitute a public offer.
- **Keep good records:** Good records should be kept of what offer-related information is disclosed and to whom.

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investment, the possible range of interest, the minimum term of investment, frequency of interest payments, and relevant fees. It may be relevant that a communication includes certain clearly visible indications stating that further information may be obtained elsewhere, and the full bond terms are not accessible online or otherwise generally available. However, if a communication already presents sufficient information, then these additional features will not stop it being a public offer. In order to rely on the exception in Article 1(4)(b), an offer must actually be addressed to fewer than 150 persons per EEA State, other than qualified investors. An offer published and promoted on the internet in a manner freely accessible to anyone must be considered as being addressed to an unlimited number of persons. The "149 persons" limit cannot be circumvented by disseminating the offer in an EEA state through various media. (*ADCADA Immobilien AG PCC in Konkurs v Financial Market Authority (Finanzmarktaufsicht)*, European Free Trade Association (EFTA) Court, Case E-10/20, 18 June 2021)

Institutional investors may claim damages for an inaccurate prospectus for a public offer of shares

The ECJ has confirmed that qualified investors may claim damages for an inaccurate prospectus for a public offer of securities, and that national law may allow or require courts to take account of an investor's awareness of the issuer's economic situation.

In 2011, an issuer (B) offered shares to the public for the purposes of an initial listing. There were separate tranches for retail and qualified investors (as defined in Article 2(1)(e) of the former Prospectus Directive). At the start of the bookbuilding period, B registered a prospectus with the Spanish regulator (CNMV). This was required because a tranche of the offer was addressed to retail investors. A qualified investor (U) subscribed for shares. Following a revision of B's annual financial statements, the shares lost almost all their value and were suspended from trading. In proceedings brought by retail investors, the Spanish Supreme Court held that B's prospectus contained serious inaccuracies. U brought proceedings against B. The Spanish Supreme Court referred certain questions to the ECJ.

The ECJ held that Articles 6 and 3(2)(a) of the Prospectus Directive meant that, if an offer of shares to the public was addressed to both retail and qualified investors, an action for damages on the grounds of the information given in the prospectus may be brought by both qualified and retail investors. Where an offer is addressed to both qualified and retail investors, all investors have the prospectus at their disposal. Article 6 lays down, without exception, a principle of civil liability in the event of an incorrect prospectus. Where a prospectus has been published, it must be possible to bring an action for damages on the grounds of the information in it, irrespective of the type of investor injured. Article 6(2) did not preclude national law from allowing or even requiring the court to take account of the fact that a qualified investor was, or ought to have been, aware of the economic situation of the issuer, on the basis of its relations with that issuer and otherwise than through the prospectus. However, the national court must verify that those provisions are no less favourable than those governing similar actions under national law and do not, in practice, make it impossible or excessively difficult to bring that action. (*Bankia SA v Unión Mutua Asistencial de Seguros (UMAS)*, European Court of Justice, Case C-910/19, EU:C:2021:433)

Key lessons

- **Relevance in the UK:** This decision relates to the repealed Prospectus Directive, and the equivalent successor wording was removed from the UK Prospectus Regulation on 31 December 2020. Nevertheless, it can be assumed that UK law regarding prospectus liability complied with these requirements while they were in force. Accordingly, we expect that UK courts will have regard to this decision when interpreting s.90 (Compensation for statements in listing particulars or prospectus) and Schedule 10 of the Financial Services and Markets Act 2000 (FSMA 2000).
- **Qualified investors may claim damages for an inaccurate prospectus for a public offer:** Section 90 of FSMA 2000 does not distinguish between claims made by retail and qualified investors. Nevertheless, qualified investors will find it helpful that the ECJ has confirmed that they may bring an action for damages in the circumstances of this case.
- **Courts may be allowed or required to take account of investors' awareness:** Issuers and their directors will find it helpful that the ECJ has confirmed that the Prospectus Directive did not preclude national law from allowing or requiring courts to take account of a qualified investor's awareness of the issuer's economic situation. Relevantly, paragraph 6 of Schedule 10 FSMA 2000 provides a defence to a s.90 claim where a person acquires securities with knowledge of a particular matter (e.g. that a statement in a prospectus was false or misleading).

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Good faith

A recent case has looked again at contractual duties of good faith and the relationship between contracting parties

Breach of contractual duty of good faith by exclusion from management

The High Court decided that exclusion of two minority founder shareholder-directors from management of a private company both amounted to breach of a contractual good faith provision in the SHA and unfairly prejudicial conduct. The other directors who had facilitated this had also breached their statutory duties under the CA 2006.

S and F were the founders and former CEO and chairman respectively of company C. Under the SHA each shareholder undertook at all times to act in good faith in all dealings with the other shareholders and with C. It also provided across the SHA and articles that: the quorum at board meetings was three, which had to comprise S, F and one investor director appointed by the majority shareholders (M); board resolutions were to be decided by majority vote provided that S and F formed part of that majority; and the board could not resolve to remove S or F as directors. The High Court decided that M's conduct in removing them from management had amounted to unfair prejudice. C's constitution had been set deliberately to maintain an appropriate balance of power between the shareholder majority and minority. The good faith obligation was a balancing provision on the otherwise untrammelled rights of M to exercise their majority voting power as they chose. M had to act with fidelity and respect the constitution. They had failed to act openly and fairly and to take into account the minority interests as well as their own. Given the constitutional settlement, it made no sense to allow M an unrestricted right to drive a coach and horses through it via their majority voting power. M's nominated directors had breached their statutory duty to act within their powers by undermining the constitution. They had also breached their statutory duty to promote the success of the company, because one of the statutory factors to which they were obliged to have regard in exercising that duty was the need to act fairly as between members of the company, which they had failed to do. Leave has been granted to appeal the decision. (*Re Compound Photonics Group Ltd (Faulkner & Ors v Vollin Holdings Ltd & Ors)* [2021] EWHC 787 (Ch))

Key lessons

- **Guidance on contractual duties of good faith:** The judgment highlights that a justifiable result (removal of a director in a legally effective manner) achieved in a procedurally non-compliant way risks amounting to a breach of an express contractual duty of good faith and, in turn, prompting a successful petition for unfair prejudice.
- **Statutory director duties:** It identifies the statutory director duties which may be breached in this context.

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