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2023 Summer review M&A legal and market developments

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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

Refusal to allow derivative action to proceed for challenging climate change risk management strategy

The High Court has refused permission to NGO ClientEarth, a non-profit environmental law organisation, to continue a derivative action against the directors of a public listed company alleging that they were in breach of duty for their climate change risk management strategy.

ClientEarth (E) brought the derivative claim in its capacity as a member holding 27 shares in public listed company S Plc (S), supported by a group of institutional investors. E's main allegations against the directors (D) were that: they had failed to set an appropriate emissions target; S's energy transition strategy did not have a reasonable basis for achieving net zero; and they did not have a plan for complying with a Dutch court order imposing a 45 per cent. emissions reduction obligation by 2030. E alleged that these amounted to breaches of D's statutory duties to promote the success of the company and to exercise reasonable care, skill and diligence. The High Court dismissed E's application on the basis that the evidence did not support that case, and also commented that a person seeking to promote the success of the company would not look to continue the claim. The court further commented on S's argument that E was using the statutory derivative claim procedure to advance its own

Key lessons

- **High bar for permission to continue derivative claim on climate change strategy:** The decision suggests that the court will apply a high bar before giving permission to continue a derivative claim for challenging climate change strategy.
- **Support for good faith commercial decisions:** The court will respect directors' reasonable good faith commercial decisions.
- **Shareholder motive:** The decision raises issues for activist shareholders, where the court commented that the claimant had not adduced enough evidence to counter an inference of collateral motive.

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policy agenda and not bringing the claim in good faith, which is a discretionary statutory factor that it can take into account in deciding whether or not to give permission to continue the claim. The small nature of E's shareholding, as against the overwhelming support for S's energy transition policy at its 2021 and 2022 AGMs, were relevant factors in assessing that. Where the primary purpose of bringing the claim was an ulterior motive, and it would not otherwise have been commenced at all, the claim would not have been brought in good faith. Here, E had not adduced enough evidence to counter an inference of collateral motive. On substantive aspects, the court rejected E's claims that there were six necessary incidents of the statutory duties when considering climate risk for a company such as S, including a duty to make judgments on climate risk based on a reasonable consensus of scientific opinion. This would cut across the basic principle that it is for the directors to determine in good faith how best to promote the success of the company and what weight to give the non-exhaustive statutory factors, such as the impact on the community and the environment. It would be incompatible with the subjective nature of the duty to promote success. On the duty to exercise reasonable care, skill and diligence, the question was simply whether the decisions fell outside the range of reasonable decisions available to D at the time, which they did not. D had also not breached an English law duty in their response to the Dutch court order. This decision was based on written submissions and E was subsequently granted an oral hearing to reconsider the claim, at which the court maintained its original dismissal of the claim. The court should not interfere with the commercial question of the climate change strategy to adopt, and the same principle should apply to the means by which that strategy was implemented. E's case wrongly ignored the fundamental point that the directors had to take account of a range of competing considerations. E indicated that it planned to appeal the decision; Mr Justice Trower has refused leave to appeal at first instance. (*ClientEarth v Shell Plc & Ors* [2023] EWHC 1137 (Ch) and [2023] EWHC 1897 (Ch))

Conversion of preferred shares ineffective as variation of class rights without class consent

The High Court decided that a purported conversion of preferred shares into ordinary shares, under a provision in a company's articles of association that provided for this to happen on an automatic basis on certain trigger events, was invalid for lack of class consent. This was because you had to interpret the share conversion article as subject to the separate article on consents required for variation of class rights.

The preferred shareholders (P) had invested £44 million in aggregate in medical and health technology company C. P were challenging a purported automatic conversion of their preferred shares into ordinary shares. Article 9.2 of the articles stated that the preferred shares would *"automatically convert into Ordinary Shares: (a) upon notice in writing from an Investor Majority…"*. Article 10.1 on variation of class rights stated that class rights could *"only be varied or abrogated… with the consent in writing of the holders of more than 75 per cent. in nominal value of the issued shares of that class."*. The High Court decided that the automatic share conversion was invalid and void because it amounted to a variation or abrogation of the rights attached to the preferred shares without class consent. When construing articles the court can only consider matters that would be available to a third party looking at the constitutional documents available from public sources. These were the documents publicly available on the file maintained by the Registrar of Companies at Companies House. You had to read the articles as a whole. Anyone inspecting the public record would have seen the substantial premium P had paid for the special rights attached to the preferred shares. No reasonable person knowing that would regard article 9.2 as allowing a qualifying majority of ordinary shareholders to abrogate those special rights at will themselves, and P to lose their share rights without consent, by the simple device of the ordinary shareholders converting them. The only way to give business efficacy to the articles as a whole, and to the inter-relationship between the two provisions, was to construe the automatic share conversion article as being subject to the comprehensive protection of the variation of class rights article. This was a rare case where there had been a drafting error. It was not a case of ambiguity where there were two possible interpretations of the share conversion article. There was a clear mistake in failing to express the automatic conversion article as subject to the consent required under the variation

Key lessons

- **Clear and express drafting needed:** The judgment demonstrates the need for clear and express drafting of articles of association and clarity on interaction between related provisions.
- **Avoid conflicting articles:** The court's decision was driven by its interpretation that there were conflicting articles and that this had been a drafting error.
- **Automatic share conversion expressed to occur without consent:** The implication is that an express and clear provision for automatic share conversion without class consent would have been enforceable and, pending the outcome of the appeal, express language to this effect in articles is advisable.

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of class rights article. The court could correct that error by reading the conversion article as subject to class consent. This avoided an uncommercial result that you could not contemplate as part of the parties' bargain. The court also commented on the statutory right of the holders of at least 15 per cent. of the issued shares of a class who did not consent to a variation to apply to court for its cancellation, which the court may order if satisfied it would be unfairly prejudicial to the affected class. The court said that this applies equally to a variation of class rights under articles as to one under the statutory default rules, but that unfair prejudice would not be made out where the articles had been followed. The court also commented that unfair prejudice would not have been made out here absent improper purpose or bad faith by the majority. Leave was granted to appeal the decision and the outcome of the appeal hearing is awaited. (*Re DNANudge Limited* [2023] EWHC 437 (Ch))

Court could direct administrators to give consent on behalf of company to UK Companies Act restructuring plan proposed by creditor

The High Court has considered the consents needed for a Companies Act restructuring plan in relation to a company in administration which, unusually, was proposed by a creditor rather than the administrators. The court was clear that company consent was needed and, on the facts, decided that it could direct the administrators to give that consent.

Company C, which provided bespoke payment terminals for charities and fundraisers, was in administration. Its administrators (AD) wanted to rescue C as a going concern. Creditor N was a shareholder in C and provided it with technological support. Although N provided significant funding to C during the administration, C's financial problems persisted. AD applied to court for directions to sell C's business and assets, whilst N opposed that and sought a Companies Act restructuring plan instead. The court allowed N to propose creditors' meetings to vote on the plan. AD left N to draft the plan, apparently on the basis N was better placed to do so. Key terms of the plan were that: rescue funders such as N would get 85 per cent. of new equity; convertible loan note holders (L) would get 14 per cent. of new equity in exchange for their debt; trade creditors would be paid in full within six months of sanction (or once an adjudication process for valuation was complete, if later); and other pre-existing shareholders would be diluted to one per cent. of new equity. All the meetings approved the plan, save for the class of L. AD, as creditors, also voted against the plan but did not actively oppose it at the sanction hearing. The High Court used its cross-class cram-down powers to sanction the scheme and end the administration. It applied case law under predecessor legislation in the context of members' schemes of arrangement that the court would not have jurisdiction to sanction a scheme without company consent. However, it decided that it could direct AD as insolvency officeholder to give that consent on C's behalf and that it was appropriate to do so here. It was relevant that AD were not actively opposing the scheme and were prepared to act on the court's direction. It was also key that it was not a case where an outside creditor was proposing a restructuring plan without referring to the company through its officeholders. The court discounted AD's arguments that an administration sale was preferable because, in contrast to a restructuring plan, all employees' jobs would be preserved under the UK transfer of undertakings regulations. The court pointed out that any such protection would only be for the immediate future and there was no certainty over job protection longer-term. Priority payment to trade creditors in full was justified because their goodwill was essential to C's continued trading and their debts were in any event significantly smaller than L's. Although N would get its trade debt back, it was providing significant funding moving forward, turning its secured administration debt into equity and agreeing revised terms of business with C. Whilst the size of equity that rescue funders would receive was considerably more than L would get, on the relevant alternative of a business and assets sale L would get nothing. (*NGI Systems & Solutions Ltd v The Good Box Co Labs Ltd* [2023] EWHC 274 (Ch))

Key lessons

- **Rare for restructuring plan to be proposed by creditor rather than administrators:** It is rare for the plan to be proposed by a creditor rather than the company, through its officeholders, but the judgment shows that the court may be willing to direct company/officeholders' consent where it considers it appropriate to do so.
- **Approach unlikely to be transferable into a hostile takeovers context:** The approach in this case in directing consent appears unique to the facts and is unlikely to be transferable into a takeovers context were an attempt to be made to effect a hostile takeover by way of scheme of arrangement.

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Director of parent company was also de facto director of subsidiary

The court decided that a director of a parent company was also a "de facto" director of its subsidiary, because he had individually directed the subsidiary's affairs instead of just acting through his position as a director of the parent.

Director D was one of two duly appointed directors of parent company P. P's subsidiary S also had two formally-appointed directors, one of whom was D's co-director of P. Under P's shareholders' agreement (SHA), S's business was to be managed overall by P's board by majority vote and S's directors needed consent from P's board to take decisions outside the agreed business plan. When S went into administration, allegations were made against D of directors' breach of duty in relation to a transfer of assets of S to a company D owned and controlled for no consideration, on the basis D was a "de facto" director of S. This is a person who assumes responsibility as a director despite not having been appointed as such. D argued his actions were taken as part of P's board in overseeing S as envisaged in the SHA. The High Court rejected that and decided that D was a de facto director of S and liable to S for breach of fiduciary duty. You had to look at who ultimately controlled management. A purely negative role of giving or receiving permission for some business activity was not enough. You also had to determine S's corporate governance structure and whether D's acts were directorial in nature. You had to assess what D actually did, irrespective of job title. The test was objective and a person's own belief did not matter. The court was clear here that D had been acting individually and not just giving overall oversight pursuant to the SHA. Here, D had performed functions that could only properly be discharged by a director. He had been the dominant personality who effectively drove decisions and got what he wanted. His role extended to day to day decisions that you could not categorise as those of P's board. Factors were that: he had led S's weekly management meetings in the absence of S's formally-appointed directors; he had led the process of instructing advisers on the administration; he had led discussions with counterparties on a business arrangement; and his co-director of P had played little part in S's affairs. As de facto director of S, D had breached his duty to promote the success of the company. Given S's insolvency, D should have had regard to the interests of its creditors, whereas in contrast his actions had hindered the administrators' ability to conduct the administration for creditors' benefit. D was ordered to pay damages referable to the value of the assets wrongly transferred. (*Aston Risk Management Ltd v Jones* [2023] EWHC 603 (Ch))

Key lessons

- **Guidance on de facto directors:** The judgment gives helpful guidance on the factors a court will take into account in assessing whether a person's conduct in relation to a company amounts to acting as a de facto director.
- **Purely negative role not enough:** The judgment helpfully confirms that just needing to give permission for some business activities is not enough.

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Date of actual distribution of interim dividend

The High Court has looked at the actual date of distribution of an interim dividend that was set off against directors' loan account. It decided this was the date the interim dividend had been declared, which meant in practice that there had been sufficient distributable reserves at the time.

The two directors (D) of company C were also its only shareholders. They had received director loans which had been recorded on directors' loan account. In July 2016 they decided to declare a dividend back-dated to 31 July 2015 and use it to reduce their director loans then showing on that account. C's accountant reflected that in C's 2014–2015 accounts which were approved on 29 July 2016, but failed to enter that in C's internal accounting system until April 2017. C had got into financial difficulties after 2015 and went into administration, subsequently converted into a creditors' voluntary liquidation. C did not have sufficient distributable reserves in April 2017 when the entries were made in the internal system but did in July 2016 when the dividend was declared. The High Court decided that a distribution was effected in July 2016 when D had declared the interim dividend. The effect was that the distribution was lawful. D's decision to declare themselves a dividend and pay it immediately into the directors' loan account, thereby reducing it, had amounted to a distribution. That was the

Key lesson

- **Accurate records of date of distribution:** The decision shows the importance of maintaining full and accurate records of the actual date of distribution of a dividend, particularly if satisfied otherwise than in cash.

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substance of what had happened. The 2014–2015 accounts recorded the "distribution" as already having happened. If a dividend was genuinely allocated to directors' loan account and recorded as such in the company's accounts, that was a distribution without further action. The delay in reflecting the dividend in C's internal accounting system did not affect the analysis. That was just a correction to align the internal system with the 2014–2015 accounts. The High Court commented alternatively that an interim dividend recorded in statutory accounts as already paid in itself amounts to a distribution, even if not actually paid or allocated to a directors' loan account. In any event, as sole shareholders D could rely on shareholders' unanimous consent for having authorised the dividend. This meant that you could alternatively view it as a final dividend authorised by members. The duty to take into account creditors' interests in an insolvency or imminent insolvency situation had not been triggered, as C was neither insolvent nor imminently insolvent when the dividend was declared in July 2016. However, the court did find some other breaches of directors' duties. There had been a clear conflict of interest with C, and related beaches of duty, in D's continuing to use the directors' loan account to finance their personal spending through C's bank accounts in financially difficult times and when it was in C's interests to restrain spending. One particular piece of expenditure amounted to a breach of the creditors' interests duty at a time C was actually insolvent. (*Manolete Partners Plc v Rutter* [2022] EWHC 2552))

Substantial property transactions with directors

The High Court decided that a series of conditional agreements entered into collectively between various parties, including a company and one of its directors, amounted to a substantial property transaction between the company and that director which was void for failing to meet the UK Companies Act 2006 requirement for shareholder approval. It did not matter that the agreements were conditional.

C plc had entered into a joint venture with an LLP (R1), run through a joint venture company (JVCo). Due to lack of funds, C failed to meet its funding obligations under the relevant SHA. The parties then entered into an alternative structure, involving a conditional share sale and purchase agreement (SPA) and a conditional option agreement. Under the SPA, C agreed with R1 to acquire shares in JVCo from both R1 and a director of C (D). Under the option agreement, R1 granted C an option to acquire further shares in JVCo. R1 was 70 per cent. owned by another company which D's wife wholly owned. Under section 190 of the Companies Act a company needs shareholder approval to enter into an arrangement under which it acquires or *"is to acquire"* a substantial non-cash asset from a director or a connected person of a director (or under which a director or a connected person of theirs acquires or is to acquire such an asset from the company), unless the arrangement is conditional on that approval. C ran into financial difficulties and applied for summary judgment that it could rescind the arrangement for failure to get shareholder approval as required by section 190. R1 and JVCo argued that section 190 did not apply on the basis that its underlying requirement that the company "is to acquire" a substantial non-cash asset only applied to conditional contracts where there was a high degree of certainty at their date that the acquisition would ultimately happen. The High Court decided that section 190 did indeed apply, irrespective of the conditionality, and granted C summary judgment to rescind the arrangement. The SPA had created a legally binding contract under which C was bound to acquire the shares if a condition on approval of a prospectus was satisfied. You could identify with certainty when the SPA was entered into: the parties, the connected person who would benefit, the subject matter of the sale and the price to be paid. Any other interpretation would produce an arbitrary result. That could not have been Parliament's intention and would open up a "rogue's charter" for easily by-passing scrutiny by inserting one or more conditions into the arrangement. The arguments over conditionality of the option agreement were defeated on the same basis. The court decided that the option agreement clearly granted a contractual right to acquire a "non-cash asset" for the purposes of the Companies Act, which defines this as any property or interest in property. The court rejected that conditionality of the option agreement mattered, noting that the option agreement materially affected R1's proprietary rights over the option shares in any event. Further, for section 190 to apply, the option agreement did not need to individually satisfy the statutory requisite value thresholds. The SPA, option agreement and other related documents were part of one composite arrangement, approved at the same board meeting, executed on the same day and intended to form part of one arrangement. (*MetalNRG plc v BritENERGY Holdings LLP and others* [2022] EWHC 2528 (Ch))

Key lesson

- **Impact of conditionality on acquisition of substantial non-cash assets under the Companies Act:** The judgment gives helpful guidance from the court on the impact of conditionality and entry into collective agreements on the applicability of section 190 and the requirement for shareholder approval.

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Contractual provisions

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

Breach of warranty as to no MAC in target's prospects since last accounts date

A buyer has succeeded on a claim for breach of a warranty in an SPA as to no material adverse change (MAC) in the target company's prospects since the last accounts date. However, there was no breach of the warranties as to no MAC in the target's turnover since that date nor on the accuracy of the target's financial and other records.

Buyer B entered into a share SPA with sellers S to buy all the issued shares in IT consultancy C. One warranty in the SPA said that, since the last accounts date, there had been no MAC in C's "*turnover, financial position or prospects*" and another confirmed the accuracy of all C's *"financial and other records"* and that they had been properly prepared and maintained. B alleged breaches of both warranties on the basis that the turnover and prospects of four projects were not properly reflected in forecasts and sales pipelines, including that the records warranty was breached for material inaccuracies in those forecasts and pipelines. The High Court decided that the "no MAC" warranty had been breached in respect of prospects, but not turnover. You could not set an abstract definition of "prospects", and you had to interpret the term in the context of this deal. It was clear here that B had considered C's prospects in terms of expected level of ebitda. You had to determine a baseline figure for C's expected profits and the "actual" figure as at the date of the SPA and assess whether the difference was so great that it was material. The baseline is the level which reasonable buyers and sellers would have agreed to be the most likely estimate of the factor concerned over the period concerned. In this case the difference was material, taking into account that C's earnings for the year to date were much lower than forecast and the four projects were not progressing as envisaged in the pipelines. The test for materiality was an objective one of whether a reasonable person who had entered into the deal with B's aims would have looked to pull out or renegotiate had it known of the change. The analysis depended on a particular company's business model and, whilst short-term blips generally were not enough, for some businesses even a short effect could be material. This was an issue here. C had set its cost base in the expectation of winning the contracts in the sales pipelines and even a short delay in winning a large contact would quickly cause significant losses. However, there had been no breach of the warranty as to no MAC in turnover. The court agreed that a change in turnover was not material if revenues were only delayed a few weeks. Further, "turnover" was purely backward-looking, and prospective developments were only covered by the part of the warranty on prospects. Again, there was also no breach of the records warranty. "Financial and other records" were the records of everyday transactions which form the bedrock of a company's accounting and management systems, but not every document created in running its operations. Again, the term implied a retrospective aspect and so did not apply to documents on forecasts or prospects or intended future transactions. The effect was that the relevant forecasts and sales pipelines were not "records" for the purposes of the warranty. In any event, there was no evidence that such documents did not accurately record S's belief on the likely course of the financial year. (*Decision Inc Holdings Proprietary Ltd & Another v Garbett & Another* [2023] EWHC 588 (Ch))

Key lessons

- **Rare finding of a MAC in English court:** The judgment is significant as a rare example of the English court finding a material adverse change had occurred, albeit in the context of a warranty as to no MAC rather than a contractual termination right.
- **Test of materiality:** The decision gives useful guidance on the test of materiality to apply in assessing whether or not a post-accounts date warranty as to no MAC in prospects has been breached.
- **Records warranties:** The judgment contains interesting discussion of the scope of company records warranties.

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Failure of buyer's claim against insurers for breach of warranty as to no MAC in trading position since last accounts date

The High Court decided that there had been no breach of warranty in an SPA as to no MAC in the target company's trading position since the last accounts date, nor breach of a separate warranty as to no price reductions in that period creating a specified reduction in turnover or otherwise likely to materially affect profitability.

Buyer B was a food manufacturing group. It acquired the target company C Limited, which was a specialist manufacturer of gluten free products. B took out a buy-side warranty and indemnity insurance policy in relation to breach of warranties it received from sellers S under the SPA. One warranty in the SPA said that there had been no MAC since the last accounts date *"in the trading position of any of the Group Companies or their financial position, prospects or turnover and no Group Company has had its business, profitability or prospects adversely affected by the loss of any customer representing more than 20% of the total sales of the Group Companies…"*. Another warranty said that, also since the last accounts date, no group company had offered ongoing price reductions or discounts on sales of goods that would result in an aggregate reduction in turnover of more than £100,000 or otherwise be reasonably expected to materially affect its profitability. The dispute related to recipe changes and price reductions that C's group had agreed with a key customer before the sale. B claimed against the insurers under the policy for breach of both the "no MAC" and the "no price reductions" warranties. The SPA had been concluded on 31 August 2018, with a last accounts date of 31 December 2017. The High Court found that the relevant price reductions had been agreed by June 2017. The court decided that neither warranty had been breached. First, there had been no MAC caused by the recipe changes. The court interpreted the "no MAC" warranty as having two components: (i) a warranty as to no MAC in the trading position or turnover of C's group; and (ii) a separate warranty as to no loss of a customer representing more than 20 per cent. of its total sales. It was the first component that was relevant here. The court decided that a MAC since the accounts date must exceed 10 per cent. of total group sales for the warranty to be breached, which it took to be a sufficiently significant or substantial change over the relevant period of nine months. That had not happened here. In any event, recipe changes were part of the ordinary course of a bakery's business and so fell outside the scope of the "no MAC" warranty anyway. As for the price reductions warranty, the court agreed with the insurers that only price reductions offered or agreed to be offered after the last accounts date were prohibited, irrespective of whether a reduction offered or agreed before then was only implemented after that date. In any event, a buyer's knowledge limitation in the SPA applied and the court was satisfied that a relevant individual who fell within the definition of B's knowledge in the SPA had actual knowledge of the relevant facts at the date of the SPA. (*Finsbury Food Group PLC v Axis Corporate Capital UK Limited and Others* [2023] EWHC 1559 (Comm))

Key lessons

- **Clear and express drafting needed:** The judgment shows the importance of clear and express drafting on the definition of a MAC and the scope of a "no MAC" warranty.
- **Further guidance on the construction of a MAC provision:** The judgment is interesting as another example of the court considering the scope of a "no MAC" warranty and the meaning of a MAC.

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Warranty claim under SPA precluded for invalid notice of claim

A warranty claim has been precluded because the buyer's warranty notice failed to meet the requirement of the SPA to give reasonable detail of its calculation of the amount claimed, with the effect that the claim was time-barred. However, a related indemnity claim did stand.

Buyer B acquired company C from seller S for £702 million. It was a condition to completion that a pre-sale reorganisation first take place. S warranted in the share SPA that this had happened by signing and indemnified B from any losses from failing to complete the reorganisation in full before then. As it turned out this had not happened. C suffered loss because it lacked an easement it needed for laying cables to

Key lessons

- **Crucial for buyer to comply with requirements of seller limitations in the SPA for notices of claims:** The decision demonstrates the importance that a buyer complies with the exact requirements of the seller limitations on content and deadline for serving warranty notices.
- **Mandatory, not permissive:** These contractual obligations are mandatory not permissive, and the strict requirements must be followed in order to preserve a claim.

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run a new power station as part of its business. Under the SPA, B was obliged to serve a written notice of claim on S *"…stating in reasonable detail the nature of the claim and the amount claimed* ***(detailing the Buyer's calculation of the Loss thereby alleged to have been suffered)"****…*" by a specified date. B gave notice on the last day of the period for notifying claims, stating that B was liable for losses C had suffered from failure to implement the reorganisation and also identifying future losses likely to arise but not yet crystallised. Under amended particulars of claim B's claim was for the diminution in value of the shares it had acquired. The High Court decided that the notice of warranty claim was invalid. Where a buyer was contractually required to detail the calculation of its loss, and its claim was based on the diminution in value of the acquired shares, the notice of claim should have identified that. The purpose of a notice of claim was to allow the recipient to make enquiries, gather or preserve evidence and assess the merits of the claim. You had to construe the notice objectively. A reasonable recipient would have understood from the wording that B was claiming for loss that C had suffered in the first place for which B was liable, not loss suffered by B direct. This suggested that B had indemnified C for the losses rather than suffering losses direct itself. The reference to losses likely to arise in the future was also inconsistent with a claim for diminution in value of the acquired shares, which was alleged already to have been suffered. It made no difference that diminution in value of the shares was a standard measure for quantifying damages. That did not mean a reader was bound to assume B was formulating a claim on that basis, particularly where the notice was inconsistent with that. However, a related indemnity claim stood, because the requirement in the SPA to serve a demand for an ascertained sum on an indemnity claim was not limited in time. A lower requirement in the SPA to serve notice of indemnity claim by a specified date giving just reasonable detail of the nature of the claim and the amount claimed had been met. (*Drax Smart Generation Holdco Limited v Scottish Power Retail Holdings Limited* [2023] EWHC 412 (Comm))

Impact of "no dealings" clause on purported informal novation

The Court of Appeal decided that a contractual prohibition on dealings without the other party's prior written consent did not prevent a novation by conduct. The continuing party was at liberty to waive the need to give prior consent and to consent instead after the dealing had happened.

The question was whether a new party (N) was liable to pay commission in the form of investment management fees due to the introducer under an introduction agreement. At the date of the original agreement N had lacked the necessary regulatory approvals to conduct business in its own right. The relevant clause said: *"neither party shall assign, transfer, mortgage, charge, subcontract, or deal in any other manner with any of its rights and obligations under this agreement without the prior written consent of the other party."* N argued that no novation had occurred because that would have amounted to a dealing without the introducer's prior consent. The Court of Appeal decided that on the facts here an effective novation had occurred, although it acknowledged that it was arguable that a prohibition on dealings without consent could in principle catch an informal novation. Here, a novation could occur because the "no dealings" clause did not affect the new party's ability to take on the original party's liabilities, which had happened here by conduct. The court accepted that provisions similar to "no dealings" clauses had been held to prevent transfer of rights when not complied with. By contrast, a breach of a provision requiring prior consent to novate could be waived by the other contracting party in the form of retrospective consent after the dealing. The court took into account that: the parties had anticipated that management services would be provided under N's own business authorisation once obtained; the outgoing and incoming parties were closely connected, meaning that there was not a new commercial counterparty involved; the parties understood the change as a name-changing exercise; and the income stream under the agreement had transferred to the new party and it was commercially unrealistic for anyone to proceed on the basis the outgoing party would have a continuing role, which they had not done. The Court

Key lessons

- **Criteria for novation by conduct met:** The outcome in this case is understandable given the criteria for novation by conduct had been met. The Court of Appeal emphasized that the judge at first instance had been entitled on the evidence to find a novation by conduct and an appellate court would not lightly interfere with that.
- **Effect of "no dealings" clause:** It is interesting nonetheless that the Court of Appeal stated that it is arguable in principle that a "no dealings" clause may catch an informal novation.

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of Appeal also rejected that the "no oral variations" clause in the introduction agreement prohibited novation. A novation involved termination of a contract and its substitution with a new contract, not a variation. In any event an estoppel by convention applied, because there had been an understanding as to a novation that had "crossed the line", the introducer had relied on that and it would be unconscionable for N to deny this. (*Musst Holdings Ltd v Astra Asset Management UK Ltd* [2023] EWCA Civ 128)

Formalities for valid attestation of English law deed executed by multiple individuals

The High Court decided that a deed of guarantee had been validly executed by three individuals where one witness had purportedly attested for all three of them beneath their signatures with the words "and witnessed, by".

Three individuals (D) were trying to renege on their guarantee of a loan from lender L, alleging that the guarantee was invalidly executed as a deed. On the facts, this would have made the guarantee out of time. D argued that the single attestation clause beneath their signatures had wrongly failed to specify that witness W had: observed them sign the deed; nor witnessed all three of their signatures; nor signed herself in their presence. The High Court decided that they had validly executed the deed. The relevant provisions in the Law of Property (Miscellaneous Provisions) Act 1989, governing execution of deeds by individuals, simply state that an instrument is validly executed as a deed by an individual if they sign in the presence of a witness who attests the signature. Whilst the statute requires the witness to be present to watch a primary signatory execute, there is no need to use particular words in the attestation clause. The attestation clause did not need to say expressly that W had witnessed all of the signatures nor specify that she had signed in their presence, nor did you need separate attestation clauses. You could perfectly well interpret W's own signature as attesting all three of the signatures. Without any evidence to the contrary, the words "and witnessed by" presupposed that D had executed in W's presence, which was the key requirement, not for the witness to sign in the primary signatories' presence. Even if the court was wrong and simultaneous attestation was needed, it would be sufficient where, as here, the witness had signed on the same day that the primary signatories executed the deed. In any event, D would have been estopped from challenging the validity of the deed of guarantee anyway. Signing and delivering it was an unambiguous representation that the guarantee was valid, which L had relied on. It would be unconscionable for them to challenge the guarantee's validity on the basis of their own execution when they had encouraged the belief that it was valid. (*Euro Securities & Finance Ltd v Barrett* [2023] EWHC 51 (Ch))

Key lessons

- **Challenges to validity of execution to renege on obligations:** The judgment shows that the court will be reluctant to allow a party that has taken the benefit of a deed to renege on their obligations by challenging the validity of its execution.
- **More prescriptive approach under Companies Act 2006:** By contrast to the outcome in this case on attestation of individuals' signatures, where companies are primary signatories, under section 44(6) of the Companies Act 2006 a document signed by a person on behalf of more than one company is not duly signed unless they sign separately in each capacity.

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No binding email contract where key terms still to be agreed

The High Court decided that there had been no binding email contract over a success fee for corporate finance work because key contractual terms had not yet been agreed and the parties had not intended to be bound before that happened.

Corporate finance firm F worked on the potential sale of A's insurance division. No engagement letter was entered into and the deal did not go ahead. However, there had been

Key lessons

- **Criteria for binding contract:** The question was whether or not the parties intended to be bound immediately and before finalising outstanding terms, not the amount of work conducted.
- **Effect of email correspondence:** Clear and express language is advisable in email correspondence to identify whether or not the parties intend to be bound.

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detailed negotiations on the terms of engagement and significant work was carried out. The discussions envisaged a project fee for work conducted and a significant success fee if the deal completed. F had wanted to extend the triggers for the success fee to include the scenario where a deal that A's board considered acceptable was turned down by its shareholders or the sale of the insurance division aborted as a result of a public takeover of A. F had set out proposed fee details in an email exchange, including the success fee. Ultimately there was a public takeover of A some time after the potential sale of the insurance division fell through. The court had to decide whether there had been a binding contract over the success fee and, if so, whether the success fee had been triggered. The High Court decided that there had been no binding contract. The email exchange in question only covered fees and not other outstanding key terms. One example was what the exact triggers would be for payment of the success fee. Another was whether or not a material indemnity was capped. The court decided that the parties did not intend to be bound before entering into a contract containing all key terms. In effect the commercial and legal negotiations here had been split. The court believed that both parties had intended the legal and commercial aspects to be agreed before an engagement letter would be signed and that they would not be bound just because the commercial negotiations were complete. You had to distinguish the situation where the parties agree that fees will be paid without trying to first reach a contract before work starts (where you can imply an agreement to pay reasonable fees) from the different scenario where parties try to agree a contract under which fees will be paid but fail to do so (where you cannot imply a contract). The latter was what had happened here. The court also looked at the draft proposed "public takeover trigger" for the success fee. It said that "aborted" did not mean "rendered impossible" or "terminated". It required the potential sale of the insurance division to be ongoing at the time of the public offer, so that the effect of the public offer would be to bring a possible business sale to an end. That had not happened here, as the potential business sale was already "ancient history" at the time of the public offer. However, A had to pay for the work that F had performed, as it would otherwise be unjustly enriched, although this did not include the success fee. (*Fenchurch Advisory Partners LLP v AA Limited* [2023] EWHC 108 (Comm))

Listed companies

The following decisions are of particular interest to listed companies

FCA fines issuers for misleading prospectuses, circular and announcements

The Financial Conduct Authority (FCA) has fined a premium listed company (B) and its standard listed subsidiary (BB) for misleading prospectuses, announcements and a circular which omitted certain fees payable to investors in two capital raisings. B also failed to act with integrity towards holders and potential holders of its shares.

On 25 June 2008, B announced a £4.5 billion capital raising. Two investors (Q and C) agreed to invest up to about £2.3 billion. The prospectus disclosed that B would pay them commissions totalling about £34.5 million. The same day, B and Q entered into a 3-year advisory services agreement under which B agreed to pay £42 million. B's announcement and prospectus briefly referred to this June agreement, but did not disclose the fees paid under it. On 31 October 2008, B announced a further £7.3 billion capital raising. Q and C agreed to invest up to £2.3 billion. The same day, B and Q entered into a 5-year advisory services agreement under which B agreed to pay £280 million to extend and vary the June agreement. B's circular and prospectus and

Key lessons

- **FCA focus on misleading information:** This is another example of FCA civil enforcement action against an issuer and its executives for failing to take reasonable care to ensure that announcements are not misleading.
- **Circulars and prospectuses under scrutiny:** This is the FCA's first public enforcement action for a circular breaching its rules, and only its second for a prospectus breaching its rules. This may be because they typically undergo robust verification – but that process is not foolproof.
- **Limits of the verification process:** No doubt the launch announcements, prospectuses and circular were carefully verified. However, they only included about 3 lines (repeated) on the advisory services agreements. Identifying misleading omissions can be challenging. It is especially difficult when key executives do not share the full facts with the Board and advisers.

BB's prospectuses disclosed that Q and C would receive commissions and an arrangement fee totalling £128 million. They did not disclose the October agreement nor the fees to be paid under it.

The FCA fined B £40 million and BB £10 million. It considered that they should have disclosed the fees under each services agreement and their connection to Q's and C's participation in the relevant capital raising. B and BB breached LR 1.3.3R by failing to take reasonable care to ensure that their announcements and prospectuses were not misleading. B's circular breached LR 13.3.1R(3), as it did not contain all information necessary to allow shareholders to make a properly informed voting decision. B's and BB's breaches in October were committed recklessly. A senior manager acted recklessly and the FCA attributed their state of mind to B and BB. As a result, B breached its obligation to act with integrity towards holders and potential holders of its listed equity shares (LR 7.2.1R, LP 3; now LR 7.2.1AR, PLP 2). B received legal advice that it did not need to disclose any further information regarding the agreements, provided the value it could expect to receive fully justified the fees.

- **Issuers should keep good records:** Good records should be kept of material decisions and the reasons for them. The FCA considered that the lack of documented records, especially of advice sought and given by external lawyers, and assessments of the value of the advisory services, supported its conclusion that B and BB failed to take reasonable care.

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However, B did not consider LR 1.3.3R nor seek specific legal advice on it. The FCA also considered that B's external lawyers were not informed of certain key facts. B's Board and Finance Committee were not aware of the connection between the June agreement and the June capital raising, nor of the £280 million fee under the October agreement. B and BB have referred their FCA decision notices to the Upper Tribunal. (*FCA decision notices to Barclays plc and Barclays Bank plc* – 23 September 2022)

FCA fines issuer, CEO and CFO for misleading trading update

The FCA has fined a premium listed bank (M), its former Chief Executive Officer (D) and its former Chief Financial Officer (A) in relation to a misleading trading update announced by M.

D and A (Executives) were M's only executive directors from April to October 2018. By 11 September 2018, M was aware that the correct risk weighting for its commercial loans secured on immovable property (CLIP loans) was 100% not the 50% M was using. On 5 October 2018, external lawyers advised that M was not required to make a proactive announcement about its miscalculation of the risk weighting. On 16 October 2018, a consultant was formally engaged to review M's policies, procedures and controls in relation to the calculation of RWA and ascertain the extent of the adjustment required. On 24 October 2018, M's Q3 results announcement said that "risk weighted assets at 30 September 2018 were £7,398m". This was partly based on a 50% risk weighting for CLIP loans. On 23 January 2019, M announced that RWA at 31 December 2018 were expected to be about £8.9 billion. This included adjustments of around £900 million due to risk weighting errors, with about £563 million of this attributable to M's risk weighting error for CLIP loans. M's share price dropped by 39% that day.

The FCA fined M £10,002,300 for breaching LR 1.3.3R by failing to take reasonable care to ensure that its Q3 trading update was not misleading. The FCA fined D (CEO) £223,100 and A (CFO) £134,600 for being knowingly concerned in M's breach (under section 91(2) of the Financial Services and Markets Act 2000 (FSMA 2000)). They had central roles in reviewing, finalising and approving the

Key lessons

- **FCA focus on misleading information:** This is another example of FCA civil enforcement action against an issuer and its executives for failing to take reasonable care to ensure that announcements are not misleading.
- **Executive directors under scrutiny:** This is the third time since 2019 that the FCA has fined a company's executive directors for being knowingly concerned in a breach of the UK listing regime.
- **Confidential discussions with other regulators:** The PRA made it clear to M that it expected their discussions to be kept confidential, and had criticised M for releasing information in September 2018. However, other regulators' requirements do not provide an exception to the UK listing regime.
- **New executives beware:** It was not a defence that A was relatively new to his role as CFO of a listed company. The FCA said it would have expected A (being relatively new) to be particularly careful to ensure that M complied with its regulatory obligations regarding the Q3 trading update.

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Q3 trading update and were on M's Disclosure Committee. M should not have published a RWA figure that it knew was materially inaccurate without qualification or explanation. M's Q3 trading update failed to explain that the RWA figure was based on an incorrect risk weighting for CLIP loans, M had recognised it needed to correct this error, it was carrying out a review, and the size of the correction would be substantial. M and the Executives failed to consider whether these matters ought to have been included in the Q3 trading update, or seek legal advice on this issue. M unreasonably assumed that it did not need to say anything publicly while its review was ongoing and that it was appropriate to include the inaccurate RWA figure in its announcement. The FCA considered M's and the Executives' breaches to be a very serious matter (despite being negligent rather than deliberate or reckless). The Executives have referred their FCA decision notices to the Upper Tribunal. M did not refer its FCA final notice. (*FCA final notice to Metro Bank PLC – 8 December 2022 and FCA decision notices to Craig Donaldson and David Arden* – 10 November 2022)

FCA cancels issuer's listing for persistent failures over 18 months

The FCA has cancelled the listing of standard listed shares in an issuer (U) for persistent failures relating to its issue and allocation of shares, publication of financial information, systems and controls, and inadequate responses to the FCA.

U published a listing prospectus on 27 June 2020 and a supplementary prospectus on 26 February 2021. Its accountants did not consent to the financial statements contained in either. U's shares were listed on 4 March 2021. The FCA suspended them from 10 March until 25 May 2021 (after U had published audited historical financial information). The FCA then learned that: (a) certain shareholders were unable to deal in their shares; and (b) it was unclear whether U's major shareholdings had been accurately disclosed and whether U complied with the free float requirement. The FCA again suspended U's shares on 3 June 2021. U's annual and half-yearly financial reports (due by 31 August and 31 December 2021 respectively) remained outstanding on 4 July 2022. On 13 September 2021, a non-executive director wrote to the FCA stating that on 23 August 2021, U had received a letter alleging fraud in the sale of U's shares and identifying a consultant to U as a person of interest. The non-executive director had resigned. In October 2021, the consultant was charged in South Africa on suspicion of fraud. The consultant had been held out as U's advisor and representative.

On 4 July 2022, the FCA cancelled the listing of U's shares. Special circumstances precluded normal regular dealings in U's shares (as required by section 77 of FSMA 2000 and LR 5.2.1R) because: (a) the supply of shares was fundamentally uncertain. U was unable to adequately explain when and how shares were issued and allocated at admission. U was also in an ongoing dispute as to the existence of certain shares; (b) U's financial position was fundamentally uncertain. U had needed to correct its prospectus and supplementary prospectus. U had also failed to publish its annual and half-yearly financial reports; (c) the FCA saw no realistic prospect of U resolving either issue in the foreseeable future. U had been provided with a reasonable time period to address them and its responses to the FCA had been consistently late, incomplete and/or inadequate; and (d) U's shares had been suspended for over 12 months. It was not possible for there to be a fair and orderly market in U's shares. This was likely to persist for the foreseeable future. U has referred the FCA's first supervisory notice to the Upper Tribunal. (*FCA first supervisory notice to Umuthi Healthcare Solutions plc* – 4 July 2022)

Key lessons

- **An extreme case:** A well-managed, well-resourced and well-advised issuer should not experience anything like the persistent issues which affected U. Nevertheless the FCA gave U ample opportunity to address the problems. Delisting is a powerful sanction and should only be used as a last resort, as it was here.
- **Persistent failures of procedures and controls:** U's multiple problems led the FCA to question whether its procedures, systems and controls were adequate (as required by LR 7.2.1R, LP 1). When issues arise, the FCA will often want to explore this issue. It will want to see well-documented procedures which are followed in practice.
- **Timely and candid responses to the FCA:** Issuers should provide timely and candid responses to the FCA. Failure to do may breach their duty to deal with the FCA in an open and co-operative manner (under LR 7.2.1R, LP 2). It may also raise further questions about the adequacy of their systems and controls.

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Good Faith

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

Power to expel LLP member and duty of utmost good faith

The High Court decided that a member of an LLP had been validly expelled for serious and persistent breaches of the LLP agreement and that a decision to expel could be made by a majority of members excluding the member in default. However, the express duty of utmost good faith in the LLP agreement had not been breached by the other member of the LLP in the lead-up to the expulsion.

An LLP (L) had been set up to exploit software owned by individual W. L's members were individual D and a company of which W was sole director (T). D ran a training and mentoring company which had a licence to use the software. Under both the licence and the LLP agreement (LLPA) D was contractually obliged to put a copyright notice on all educational material relating to the software. Under the LLPA: D had to advertise the software in seminars and webexes; T was to run L day to day; L could expel a member for "any serious or persistent breach" of the LLPA; and T and D had to *"show the utmost good faith to the LLP and the other Members"*. T and L accused D of serious and persistent breaches of the LLPA justifying expulsion, as well as infringing copyright and reverse passing off. The High Court decided that D was in serious breach of the advertising obligations in the LLPA, which went to the heart of the joint business, and had been validly expelled. The court discussed what a serious breach means. This is a material breach which is more than trivial but need not be repudiatory. It means a breach that is substantial. It must be a serious matter rather than a matter of little consequence. For persistent breaches, as well as repetition, you needed some gravity, meaning that they should be non-trivial. The power to expel under the LLPA was vested in "the LLP". You had to read that as meaning L acting by the non-defaulting member. The court rejected that you needed a meeting for all the members to participate in a good faith decision. The LLPA could have included expulsion as a matter requiring unanimity but did not. Instead, it expressly provided for expulsion by L. Clearly expulsion did not form part of the day to day running of L by T. However, it would make complete nonsense if a member could only be expelled if they chose to consent to it. Further T had not beached the express duty of utmost good faith in the LLPA in the prelude to the expulsion. This duty required certain minimum standards of fairness before someone was expelled and did not necessarily require dishonesty for breach. However, there had been no breach here. T had genuine concerns over a drop in sales potentially connected to D's breach of his advertising obligations and had not acted for an ulterior motive. (*THJ Systems and Another v Sheridan and Another* [2023] EWHC 927 (Ch))

Key lessons

- **Serious and persistent breach analysis:** The judgment gives interesting guidance on serious and persistent breach of contract as well as express contractual duties of good faith in a partnership context, which were applied by analogy on the contractual wording in this case.
- **Expulsion rights in the case of an LLP:** It shows the merits of clear and express drafting on which members are entitled to vote on expulsion.

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