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2016 Summer review
M&A legal developments

In this issue…

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We set out below a number of interesting English court decisions 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, applicable particularly in a private M&A and joint venture context

All reasonable endeavours and good faith obligations restricted by other terms of agreement

The Court of Appeal has considered express contractual duties to use all reasonable endeavours and to act in good faith. The question was the extent of a party's obligation to obtain a planning permission. The Court of Appeal decided that the scope of these generic contractual duties was restricted by other specific terms in relation to the planning permission.

BR agreed to sell its football stadium to SA. Completion was conditional on SA obtaining planning permission for a store which allowed unrestricted deliveries round the clock (and on BR getting planning permission for a new stadium). However, the planning permission which SA obtained did have timing restrictions. Under the agreement SA had agreed to use all reasonable endeavours to obtain planning permission as soon as reasonably possible, but only had to appeal if planning counsel advised that this had an at least 60% chance of success. The parties had also each agreed to *"act in good faith in relation to their respective obligations"* under the agreement and to "*assist the other in achieving*" its own planning permission, failing which either could terminate. SA terminated the agreement when planning counsel advised that its chances of success on appeal were less than 60% and refused to allow BR to pursue a further appeal in its own name. The Court of Appeal decided that SA had validly terminated the agreement. The express contractual limitations on when SA had to appeal took precedence over SA's general obligations to use all reasonable endeavours to obtain planning permission and to act in good faith. In any event, the express duty of good faith here applied in relation to a party's own respective obligations. As BR had no contractual obligation to apply for a store planning permission, SA did not have a duty of good faith in relation to an application by BR. SA was entitled to follow the express terms of the agreement, and doing so did not breach the general duty of good faith. (*Bristol Rovers v Sainsbury's* [2016] EWCA Civ 160)

Key lessons

- **General duties subject to specific terms**: The general good faith and endeavours obligations were subject to the specific terms on planning permission.
- **Express wording can help to delineate or restrict general obligations**: Express, specific drafting can help to delineate or restrict such general contractual obligations. Conversely, you need express wording if you intend the general obligations to take precedence.

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Effect of "no variation except in writing" clauses

The Court of Appeal has confirmed, in obiter dicta, that a clause prohibiting variation of a contract except in writing cannot prevent future variation either orally or by conduct if the necessary requirements to create a binding contract are satisfied.

While the Court of Appeal in this case was able to reach its decision without addressing the issue of whether "no variation" clauses are binding, it noted that this was "the only question of general importance" in the case and therefore the Court set out its views on the issue. The issue arose as a defence argument put forth by a buyer who was alleged to be in breach of an exclusive supply agreement. The agreement had a "no variation" clause: "*[The Agreement] can only be amended by a written document which (i) specifically refers to the provisions of this Agreement to be amended and (ii) is signed by both Parties.*" The Court of Appeal gave its view on the "no variation" clause given that full arguments had been made and in light of inconsistent Court of Appeal decisions. Essentially, the issue was that while a "no variation" clause is the result of freedom of contract, allowing variation of a contract despite a "no variation" clause upholds freedom of contract. No variation clauses are standard in many English law contracts. The Court acknowledged the practical utility of "no variation" clauses but could not square enforcing them as binding with the principle of freedom of contract. As a matter of principle, parties' freedom of contract cannot be extinguished by an earlier contract. Their utility is to "raise in an acute form the question of whether the parties who are said to have varied the contract otherwise than in the prescribed manner really intended to do so." (*Globe Motors, Inc v TRW Lucas Varity Electric Steering Limited* [2016] EWCA Civ 396)

Key lessons

- **Utility of "no variation" clauses**: "No variation" clauses raise the bar in terms of assessing an intention to vary a contract other than as set out.
- **Impact of spoken words and actions**: Parties must understand that their spoken words and actions can defeat their written agreement not to vary a contract other than in writing and must govern their conduct accordingly.
- **Best practice**: The case supports the best practice of signing side letters, amending agreements and deeds of variation to reflect clearly the parties' intention.

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Time limit for notifying warranty claims

The Court of Appeal has considered a contractual requirement in a sale and purchase agreement (SPA) to notify a warranty claim within a set period after becoming aware of the matter. It adopted the narrowest possible interpretation.

The SPA said that the sellers (S) would not be liable for any warranty claim unless the buyer (B) served notice of claim on S, specifying in reasonable detail the nature of the claim, as soon as reasonably practicable and in any event *within 20 business days "after becoming aware of the matter"*. B notified a claim against S for breach of management accounts warranties. The question was whether the phrase "aware of the matter" meant that B had to know that it had an actual claim or whether it was enough to know the relevant facts, even if it did not appreciate that they might or did give rise to a claim. The Court of Appeal upheld the High Court decision and decided time did not start to run until B was aware that there was a proper basis for a warranty claim. Applying previous Supreme Court guidance, it emphasized that you had to treat the natural meaning of the language as the best guide to interpretation. However, the wording here was not sufficiently clear to mean that you should not consider alternative interpretations, nor to oust the principle that ambiguous exclusion clauses should be construed narrowly. The purpose behind the clause was just to prevent B from pursuing claims previously kept up its sleeve. To say that the clock started from the moment B was aware of the underlying facts was uncommercial and clearer words would have been needed to achieve that. (*Nobahar Cookson and Ors v The Hut Group* [2016] EWCA Civ 128)

Key lessons

- **Clear drafting**: The case shows the merits of clear and precise drafting in the SPA on the requirements for a valid warranty notice.
- **Causal link**: Buyers should take care to require a causal link in warranty notice requirements, and in buyer's knowledge limitations, between knowledge both of a matter and that it gives rise to a claim.
- **Sellers could be more prescriptive in the drafting**: To impose more restrictive requirements, sellers need to use clear and express wording.

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Warranty notices: satisfying contractual requirements to preserve a valid claim

The High Court decided that a buyer's alleged warranty claims under an SPA were barred because letters served on the sellers did not meet the requirements for valid warranty notices under the seller limitations. The judgment gives useful guidance on drafting warranty notices.

Under the SPA the buyer (B) had acquired two companies and their subsidiaries from sellers (S). The alleged claims related to tax matters. The issue was whether or not B had served valid warranty notices for the purposes of the SPA. The seller limitations schedule contained a highly unusual provision, expressed as a condition precedent to S's liability, which required B to serve a full warranty notice of an actual warranty claim (not just an initial notification) as soon as reasonably practicable after becoming aware of a claim, with reasonable details, the grounds on which it was based and a good faith estimate of the amount of the claim. An entirely separate provision, not expressed as a condition precedent to liability, required B to give notice as soon as reasonably practicable of a possible warranty claim, with reasonable details. The High Court decided that B's claims were barred. It was unclear whether one of the letters was intended to be a notice of actual claims rather than of the existence of possible claims, not least as it did not even refer to the mechanism for notifying actual claims. The letters did not identify which warranties B alleged had been breached, whereas "*grounds on which it is based*" and "*reasonable details*" meant you should identify both the warranties and the claim. Having said that, a "*good faith*" estimate in this context just meant "*honest*", and did not set a higher bar of objective reasonableness. In any event, B had known of at least part of the claims several months before and had breached the requirement to notify as soon as reasonably practicable under the notice of actual claims provision. B has applied for permission to appeal the judgment. (*Teoco v Aircom* [2015] EWHC (Ch))

Key lessons

- **Drafting guidance**: The judgment gives useful guidance on drafting warranty notices and the case is a warning to buyers that their obligations under seller limitations will be strictly construed.
- **Good faith estimates**: On the other hand, the court did interpret a contractual obligation to give a "good faith" estimate liberally.
- **Buyers should not agree to notify actual claims within set periods of becoming aware of them**: It is risky for buyers to agree to notify actual (or even possible) claims within set time periods after becoming aware of them.

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Term sheet legally binding despite not providing for consideration

The High Court determined that, despite not stipulating or providing for consideration, a term sheet was binding based on the wider matrix of arrangements between the parties.

A signed term sheet, drafted by lawyers, was interpreted in the context of the sophisticated business parties' wider relationship to be legally binding despite not providing, on its face, consideration in exchange for one party's rights. The wider relationship was that the term sheet's parties had co-invested in a joint venture company which needed additional financing. Under the term sheet one investor received governance rights and a redemption right in respect of his shares. Separately, he provided financing to the company. Two years after the term sheet was signed he served a notice of redemption on the other investor who challenged it on the basis the term sheet was not binding. The case reiterates that there is no rule that term sheets are not binding. The answer depends on the term sheet and, here, the parties' wider arrangements. The issues in this case were whether the parties intended to enter into a binding agreement and whether there was valid consideration. According to Simler J, the factors that weighed in favour of a binding agreement included (i) the pre-existing contractual relationship of the parties; (ii) the unqualified language of the term sheet; (iii) the term sheet's workability; and (iv) that the term sheet was drafted by lawyers and signed by the parties. Despite the term sheet not providing any reciprocal consideration on its face, the Court determined the rights under it were the commercial quid pro quo of the wider arrangements between the parties. One investor got the right to redeem shares and governance rights under the term sheet in exchange for him providing further funding to the company. As a result, this term sheet was a binding agreement. (*New Media Holding Company LLC v Kuznetsov* [2016] EWHC 360 (QB))

Key lessons

- **Impact of matrix of arrangements**: Whether a term sheet is binding and the presence of consideration may be assessed in light of the wider package of agreements.
- **Value of clarity**: Term sheets should be explicit as to whether parties intend to be bound (e.g. if not, "subject to contract" is helpful).
- **Drafting tip**: Language should be consistent with the parties' intention, either that it is legally binding (e.g. "must" or "shall") or aspirational (e.g. "will be").

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Deleted words may assist the interpretation of an ambiguous contract

The Court of Appeal confirmed that deleted words can be taken into account, with careful consideration, in interpreting an ambiguous contract to show what the parties did not intend.

A debtor applied to set aside his individual voluntary arrangement (IVA) ten years after it was approved on the grounds that a condition precedent in it had not been satisfied. In the agreement the condition precedent itself had been deleted but references to it remained. The clause setting out this condition precedent had been replaced and the IVA had been approved at a creditors' meeting. The Court of Appeal determined that the agreement was ambiguous because of remaining references to the condition precedent. Briggs LJ considered the deleted words to resolve the ambiguity, determining the deletion of the clause setting out the condition precedent indicated that the IVA was not subject to this condition precedent. This decision follows existing case law that the deletion shows what it is the parties agreed that they did not agree where there is ambiguity in the words that remain. Briggs LJ's gloss on this principle was that it is an aid in construction and must be used with care. Reference to deleted words in interpreting a contract is not appropriate where the contract is not ambiguous. However, if the contract is ambiguous, deleted words can assist the interpretation of the contract and the extent to which this may be used must be assessed on a case-by-case basis. (*Narandas-Girdhar v Bradstock* [2016] EWCA Civ 88)

Key lessons

- **Drafting tip**: Nothing beats clear drafting, thorough proofreading and consistency in a contract.
- **Value of well-kept records**: Previous drafts, clear records and a retrievable paper trail may, however, assist to demonstrate what parties turned their minds to and did not agree where a contract is ambiguous.

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Acceptance of repudiatory breach to terminate contract need not follow termination process in contract

The Commercial Court held that, on its construction, the notice and remedy provisions in a contractual termination clause did not apply where a party terminated at common law based on the other party's repudiatory breach.

This case concerned an exclusive supply contract which preserved the remedies available at law and provided the right of termination on breach of any term of the agreement after notice if the breach was not remedied within the set period: *"Either party may terminate this Agreement immediately upon: [(i)] failure of the other party to observe any of the terms herein and to remedy the same where it is capable of being remedied within the period specified in the notice given by the aggrieved party to the party in default, calling for remedy, being a period not less than twenty (20) days[…]."* The termination clause went on to list other contractual bases for termination, not subject to notice and remedy, such as an insolvency event. The issue was whether one party was able to rely on an unhindered common law right to terminate the agreement by reason of a repudiatory breach so as to bypass the notice and remedy provisions in the termination clause. On the drafting, the notice and remedy provisions were interpreted to apply to the specific right to terminate, on failure to observe a term of the contract only, and not to the other express rights to terminate in the wider termination clause which were also set out. Teare J determined further, on the drafting of the agreement, the notice and remedy provisions could not be implied to apply to termination on acceptance of repudiatory breach. While he reviewed the case law, his determination was a matter of construction. (*Vinergy International (PVT) Limited v Richmond Mercantile Limited FZC* [2016] EWHC 525 (Comm))

Key lessons

- **Drafting tip**: If parties want termination, notice and remedy provisions to apply to termination for repudiatory breaches, express drafting should be included.
- **Proceed with caution**: Termination for repudiatory breach without adhering to contractual procedural requirements is possible but whether this is valid will depend on the particular construction of the clause.

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Penalties analysis where sums payable on a stated event

The Court of Appeal has confirmed that a payment may not contravene the rule against penalties where it is triggered on the happening of an entirely separate event from a contractual breach of duty owed by the party claiming relief to the party seeking to enforce the clause and there is no inherent contractual breach by the party claiming relief which drives the trigger event.

Finance arrangements were entered into in relation to a property acquisition. These included an upside fee agreement between a lender (L) and borrower (B). In consideration of L procuring financing, a large fee was payable if certain payment events occurred, including repayment of a junior loan in the structure. There followed a breach of a separate personal loan agreement between L and two investors in B. This entitled L to accelerate the junior loan and this, in turn, constituted a payment event under the upside fee agreement. The Court of Appeal decided that the upside fee did not fall foul of the rule against penalties, as it was remuneration payable to L for providing part of the finance necessary to complete the property purchase. It became payable on a specified date when breach occurred of a separate agreement between different parties. This had nothing to do with damages for breach of contract, as it was payable on the happening of a stated event. (*Edgeworth Capital v Ramblas Investments* [2016] EWCA Civ 412)

Key lessons

- **Payment clauses triggered on the happening of a specified event**: Where the payment trigger is a specified event occurring rather than a breach of a contractual provision, the rule against penalties may not apply.

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Company law

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

Interpretation of articles of association containing pre-emption rights

A recent High Court decision is a reminder that articles of association are a statutory contract and the usual rules of construction apply. The Court made interesting comments on interpretation of a share valuation provision, the information on which experts should base their valuation and the meaning of "any person" in the context of a permitted transferee of shares.

The defendants (D) each had minority shareholdings of 10% and 11% in the claimant companies (C). D wanted to sell their shares and served transfer notices. These triggered pre-emption provisions in C's articles of association which required expert accountants to determine a "prescribed price per share". The High Court decided this meant fixing a price per share on a pro rata basis (meaning no discount or uplift for the size of the holding). This will usually be the case where articles require valuation of individual shares, particularly where at the time of the valuation the expert does not know the significance that the holding might have in the hands of the transferee (for example, by creating a majority holding). By contrast, a valuation requirement as a "block" usually requires applying an uplift if the shares carry control or a discount if they represent a minority holding. The High Court also said that the valuations should not just be based on publicly available information, but also such further available information as the accountants might request. The article did not limit relevant information to what was publicly available and there was no basis for implying a term to that effect. The articles also allowed D to sell to "any person" if the pre-emption rights were not taken up. The Court decided that the plain and natural meaning of the words "any person" was to apply to any potential transferee, irrespective of whether they were a natural person or a legal person. To interpret the words as referring only to natural persons would impose a significant restriction on a seller's freedom to transfer his shares, which the Court should be slow to attribute. An appeal hearing is awaited in relation to the judgment. (*Cosmetic Warriors Ltd and another v Gerrie* [2015] EWHC 3718 (Ch))

Key lessons

- **Clear drafting of pre-emption provisions**: The case shows the importance of setting out clearly the required basis of valuation under pre-emption or other share transfer provisions in articles of association or shareholders' agreements.
- **Articles of association**: The judgment is a reminder that the usual rules of construction apply when interpreting articles of association.

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Whether director had been properly appointed and articles of association informally amended

The High Court recently decided that an individual had been properly appointed as a director of a company, even though he did not meet a membership qualification in the articles of association, because the articles had been amended by informal agreement. However, under separate provisions in the articles he had only held office until the next annual general meeting.

X was the sole shareholder in the company (C) and Y was the sole director. The issue was whether Y had been properly appointed director of C at an earlier time when there were two shareholders. This affected whether Y was capable of appealing, on C's behalf, a petition by X to wind up C on grounds of insolvency. C's articles of association imposed a shareholding qualification for being a director and said that any board appointee had to vacate office at C's next following annual general meeting (AGM), where an AGM was required every year. They also stated that the minimum number of directors was one and, unless otherwise determined by the board, the quorum at directors' meetings was two. The High Court decided that the articles of association had been amended by informal agreement to remove the membership qualification and that Y had been validly appointed. However,

Key lessons

- **Informal unanimous consent**: Informal agreement to amend a company's articles of association can be inferred from members' conduct.
- **Clear and precise drafting**: Clear and precise drafting is advisable in articles of association, to ensure the workability of inter-related provisions and that the actual language does not conflict.

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he had only held office until the date on which the next AGM should have taken place, whether or not it was actually held. The effect was that he was not able to cause C to oppose X's petition to wind it up. The Court confirmed that articles of association are a species of contract and can be amended by agreement, which may be reached informally. That agreement can be inferred from conduct. Here, both the shareholders at the relevant time had allowed Y to be appointed director whilst knowing of the membership requirement. The obvious inference was that the articles had been amended to allow this. The Court also decided that Y had validly been appointed on this basis at the relevant board meeting. A board determination that one director was a quorum was unnecessary where there was only one director. In any event, a sole director implicitly determines, whenever he or she decides to transact business, that the quorum is one for the purpose of taking that decision. (*The Sherlock Holmes International Society Limited v Aidiniantz* [2016] EWHC 1076 (Ch))

English court sanctioned restructuring scheme despite minimal connection to jurisdiction

The High Court sanctioned the restructuring of a foreign-based group of companies by way of an English scheme of arrangement under the Companies Act 2006. On the facts, the Court observed that this scheme was an example of "good forum shopping."

The scheme of arrangement was part of a debt-for-equity restructuring as well as the taking on of new debt obligations. The group's business was overseas, as was its stock exchange listing, with financing principally from two sets of notes. Two years earlier it had commenced restructuring negotiations due to financial difficulties. Options in other jurisdictions would have involved insolvency proceedings which, in turn, would put the group's licences, required for its business, at risk. The English scheme of arrangement, however, avoided this business risk. It also avoided issues with unanimous consent. The scheme's objective was to preserve value and prevent larger losses to creditors. Newey J considered the issue of the group's relatively recent acquisition of the English company which had been acquired with a view to using the Court's scheme jurisdiction, setting out the group's links to the jurisdiction. These included that 22% by value of scheme creditors were domiciled in England and 97% of noteholders by value submitted to the jurisdiction of the English court. At the sanction hearing Newey J determined the scheme to be an example of "good forum shopping" on the basis that (i) the scheme aimed to achieve the best possible outcome for creditors and (ii) the arrangement was likely to be effective in the other relevant jurisdictions. So on the facts of this case, the Court sanctioned the scheme despite minimal links to the jurisdiction. (*Re Codere Finance (UK) Limited* [2015] EWHC 3778 (Ch))

Key lessons

- **A unique solution**: Schemes of arrangement offer unique and flexible solutions unavailable in other jurisdictions.
- **Differing views**: This pragmatic approach to forum shopping recognises the benefits to creditors of the scheme in this case but differing views have been expressed by the judiciary on this issue.

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Parent's duty of care in relation to pollution caused by subsidiary

The High Court decided that there was an arguable issue to be tried over whether a UK parent company (P) had owed and breached a duty of care to individuals in Zambia in respect of alleged pollution and environmental damage caused by a copper mine in Zambia operated by its Zambian subsidiary (S). It reviewed the principles emerging from past case law on the circumstances in which a parent company may assume responsibility for a subsidiary's activities.

The claimants (C) brought proceedings against P and S in England, on the basis of P's domicile, alleging that they had suffered personal injury and damage to property as a result of pollution and environmental damage caused by the mine owned and operated by S. They argued that P had breached a duty of care to them, on the basis of control which it had exercised over S's activities. Although the case raised a number of complex issues of jurisdictional competence, on which the High Court decided on the facts that the English courts did have jurisdiction in this case, it also raised wider issues over the extent of a parent's potential liability for the operations of its subsidiary. On this aspect, the High Court decided that it was arguable that there was an issue to be tried between the parties. S had argued that P was simply a holding company with few staff and no mining expertise, whilst it was S which was licensed to, and operated, the mine. It also denied that P had any superior knowledge to S, particularly given that P was not an operating company. However, the High Court stated that it would not embark on a mini-trial of these issues, and that the existence or otherwise of a duty of care should be a straightforward matter to resolve at trial. It did, though, say that C could face difficulties in making out the case here, noting that previous case law had arisen in the contrasting scenario of an asbestosis-related claim in an employee context. Application has been made for permission to appeal the judgment. (*Dominic Liswaniso Lungowe & Others v (1) Vedanta Resources Plc (2) Konkola Copper Mines Plc* [2016] EWHC 975)

Key lessons

- **Mere existence of subsidiary will not shield parent**: Parent companies cannot assume that they will not be liable for their subsidiaries' actions just because they exist as subsidiaries with separate legal personality.
- **Centralised group functions**: Relevant decisions should be the responsibility of a subsidiary's management or board, not that of the parent company, even if some matters need sign-off at parent company level.

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