WHITE & CASE

January 2014

2013 Year in Review- M&A Legal and Market Developments

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 Insight looks at these developments and gives practical guidance on their implications. Summaries feature below, and you can click where indicated to access more detailed analysis.

Contractual Provisions

A number of cases have looked at common contractual provisions on M&A deals, particularly in a Private M&A or Joint Venture context

New Developments in Material Adverse Change Clauses – Implications for M&A Deals

In current economic conditions deal certainty may be a key negotiation issue on M&A transactions. In the first English case on a material adverse change (MAC) termination clause, the High Court has considered such provisions in both Spanish and English law loan agreements between Spanish parties, and given helpful guidance for parties.

The issue was whether a lender (Carey) had been justified in withholding further funds under a loan agreement entered into with a group of companies (GHU) for funding a major hotel and apartment complex in London. Among defaults Carey relied on was a MAC in the financial condition of relevant GHU companies. GHU had represented under the loan agreement that there had been "*no material adverse change in [the] financial condition (consolidated if applicable)*" of those companies since the date of the agreement. This was deemed repeated on subsequent advance dates, just as M&A warranties are commonly repeated at completion. A misrepresentation amounted to an event of default. The Court decided that Carey had established a MAC in relation to one of the GHU companies engaged in its construction business. The judge said you should start by assessing a borrower's financial condition from its financial information at the relevant times. However, there may be compelling evidence to show a sufficient adverse change to trigger a MAC clause even if the financial information might suggest otherwise. This case was an example of that, given that the relevant company had ceased paying bank debts and instigated a wider group restructuring. An adverse change would be material if it significantly affected the borrower's ability to repay principal and interest on the loan, but could be short of insolvency. (*Grupo Hotelero Urvasco S.A. v Carey Value Added S.L. and others* [2013] EWHC 1039 (Comm))

Key lessons

- **Financial condition:** Guidance on how you assess the state of a company's financial condition.
- **External changes:** Express wording is needed to catch external economic or market changes.
- **Knowledge:** The claimant must not be aware of the relevant situation at the date of the SPA or must make it an express MAC trigger.

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ATTORNEY ADVERTISING

Contractual Provisions contd.

Minimising the Risk a Party Circumvents Prohibitions on Share Transfers in a Joint Venture

A recent Court of Appeal decision highlights the care needed in drafting shareholders' agreements (SHAs) to ensure the integrity of provisions aimed at preventing a shareholder from transferring any of its rights in the joint venture company (JVCo) to a third party.

A shareholder (S) in a joint venture entered into a conditional sale and purchase agreement (SPA) to sell his shares to a third party (B), subject to complying with the SHA. S also: (i) executed a power of attorney for one year in favour of B's nominee, giving the attorney wide power to perform acts in relation to the JVCo on his behalf; and (ii) resigned as director and appointed B's nominee instead. As is standard practice, the SHA prohibited any share sale or transfer which failed to comply with pre-emption provisions in the SHA. The Court of Appeal decided that an interest in shares would not pass under a contract subject to a condition until the condition is fulfilled, and that the above prohibition was not breached. It also said that merely achieving control of a shareholding was not enough to trigger the clause, and it noted that in any event the power of attorney was limited to acting in the shareholder's interests. A key factor was that S had used its board nomination rights to transfer voting rights to a third party, in circumstances where the categories of disposal prohibited under the SHA did not preclude this. Parties should ensure that prohibitions on disposals to third parties under SHAs are expressed widely enough to catch any transfer of voting rights in relation to board as well as shareholder decisions, and also agreements to carry out any of the prohibited actions. The Court of Appeal also denied that an express contractual duty of good faith in the SHA had been breached, deciding that this simply required acting honestly in a subjective sense. (*McKillen v Misland* [2013] EWCA Civ 781)

Key lessons

- **Rights on board:** Expressly catch transfer of board voting rights within prohibited disposals.
- **Prohibit SPA:** Extend prohibited disposals to cover entry into an agreement to conduct any of the prohibited activities.

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Construction of Claims Notification and Conduct Provisions in Sale and Purchase Agreement

The High Court considered whether any objectivity was required in the test for determining whether a matter was a "Tax Claim" covered by a tax indemnity in a sale and purchase agreement, as well as the effect of a contractual obligation to notify claims and a "business interests" carve-out from an obligation to allow the counterparty to conduct claims.

The case related to the sale and purchase of a 50% interest in a petroleum exploration licence, requiring Ugandan government consent and triggering a substantial capital gains tax charge. The seller (S) disputed the tax charge and issues arose as to the status of funds paid by the buyer (B) into an escrow account. The Ugandan government served agency notices on B requiring it to pay the tax on S's behalf, alleging that the escrow funds amounted to assets of S under Ugandan law. B paid the tax and claimed from S under the tax indemnity in the SPA. The Court decided that the tax demand here pursuant to the notices was within the scope of the indemnity. It was sufficient that B had believed it was valid and that belief was reasonably held. It would be too heavy a burden to impose an objective test on whether that belief was reasonable. The Court also denied that a contractual obligation to notify a third party claim which could give rise to a substantive claim under the tax indemnity within a set time period after becoming aware of it was a condition precedent to S's liability. Further, B's breach of a requirement to take actions required by S to defend the tax claim did not matter, as a carve-out to allow B to protect its own business or financial interests applied. (*Tullow Uganda v Heritage Oil and Gas* [2013] EWHC 1656 (Comm))

Key lessons

- **Express limitations:** Express wording is needed to limit an indemnified party's rights.
- **Different notification requirements:** Distinguish notice requirements on becoming aware of third party claims from prescriptive time bars on notifying claims between the parties.
- **Conduct rights:** Consider the scope of carve-outs from conduct rights.

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Contractual Provisions contd.

Mitigating the Risk of Rescission for Misrepresentation

A High Court decision showed the importance to sellers of careful and express wording to exclude rescission as a remedy for misrepresentation. Although there are some general bars to rescission, such as where the parties can no longer be restored to their positions before the contract, there is case law where rescission has been ordered on a share acquisition some time after completion.

A private equity party formed an acquisition vehicle to acquire the shares in a company (C). Some of C's directors formed a management buyout (MBO) team and also became directors of the buyer. It was alleged that there were breaches of accounts warranties in the SPA which materially overstated turnover. A buyer's knowledge limitation in the SPA said that the buyer could not bring a warranty claim to the extent that it was actually aware of any relevant fact, circumstance or matter constituting a claim. The SPA did not say that the sellers "represented" as well as warranted statements, but equally failed to expressly exclude actions for misrepresentation based on warranties set out in the agreement. The Court decided that the relevant warranty had been breached, but that it had not additionally amounted to a misrepresentation. Further, the buyer's knowledge limitation did not apply, as any knowledge of the MBO team had been acquired in their capacity as directors on the sell-side. From a buyer's point of view, clear and express wording is needed for a warranty to operate additionally as a representation. Negative statements in the entire agreement clause are not enough (such as that no representations have been relied on other than the documented warranties). Conversely, a seller should be careful to expressly exclude remedies for misrepresentation. It is not enough to say in the entire agreement clause that the buyer's only remedy is for breach of the SPA. This is particularly important where a seller is prepared to concede that warranties will amount to representations, but only on the basis that rescission is excluded. The case also highlights the importance of carving out an MBO team from a buyer's knowledge limitation. (*Sycamore Bidco v Breslin* [2012] EWHC 3443)

Key lessons

- **Express rights/exclusions:** Clear and express wording is needed:
  - For a warranty to operate as a representation;
  - To exclude remedies for misrepresentation.
- **Entire agreement clause:** Negative statements in the entire agreement clause are not enough.
- **Role of MBO team:** Carve an MBO team out from a buyer's knowledge limitation.

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Implications of English Law on "Penalties" for Buyouts at Discount to Fair Value

The Court of Appeal has overturned a previous High Court decision on whether a discounted price provision in an M&A context amounted to an unenforceable penalty under English law. A common example is a provision in a shareholders' agreement entitling a continuing shareholder to buy out a defaulting shareholder at a discount to fair market value.

A buyer entered into an SPA to increase its existing shareholding in a company by acquiring further shares. The price was payable by instalments and linked to a profits multiple. There were also put and call options over the sellers' remaining stake. However, if the sellers breached restrictive covenants in the SPA, the buyer was not obliged to pay future instalments and could exercise the options at a much lower price based on the company's net asset value on the date the breach commenced. Against this backdrop, one of the sellers breached the restrictive covenants. Overturning the earlier High Court decision, the Court of Appeal decided that the relevant clauses here were not a genuine pre-estimate of loss and amounted to unenforceable penalties. The Court of Appeal acknowledged the trend in recent cases to focus on whether a clause is commercially justifiable in the circumstances of the transaction when determining whether its primary purpose is to deter a breach. However, it decided that the relevant clauses did not serve some such justifiable commercial or economic function. A key factor was that the consequences occurred on the first, not necessarily material, breach of any one of four different covenants, the effects of which were likely to be wide and of greatly differing degrees of seriousness, many of which were nowhere near the value of what the seller would forfeit or lose. This pushed them into the territory of deterrence. (*Talal El Makdessi v Cavendish Square Holdings BV and another* [2013] EWCA Civ 1539)

Key lessons

- **Treatment of different categories of breach:** Avoid a single compensation term which is triggered on the occurrence of one or more of several potential breaches, some of which are serious and some are not.
- **Conditionality:** If full payment had been *conditional* on compliance with the covenants, the clause might have been valid.
- **Commercial justification:** It remains important to be able to justify the arrangement commercially as a proportionate remedy.
- **Documentation:** Consider documenting the justification in the clause, recitals or negotiation records.

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Contractual Provisions contd.

Confidentiality Obligations – Back-to-back and Procurement Obligations

The Court of Appeal ruled that a confidentiality agreement requiring a receiving party to procure that a third party be bound by similar obligations should enter a back-to-back agreement and it should apply to information provided by both the receiving party and the disclosing party.

The disclosing party (D) and the receiving party (B) entered a confidentiality deed with a clause that D and B "agree to keep – and to procure to be kept – secret, all Confidential Information" and B "will procure that those third parties are bound by similar obligations of non-disclosure […] and they shall be responsible for any unauthorised disclosure, whether by it or any third Party to whom disclosure is made". No back-to-back agreement was entered between B and third party (Ik) but confidential information was disclosed to Ik by both D and B. The Court of Appeal, overruling the High Court, determined the effect of the deed was that, if B proposed to disclose confidential information to Ik, B was required to procure Ik would enter a back-to-back agreement imposing obligations of non-disclosure. The Court also held that B's liability would extend to both the confidential information that it disclosed to Ik as well as the confidential information that D disclosed directly to Ik. (*Dorchester Project Management Limited v BNP Paribas Real Estate Advisory & Property Management UK Limited* [2013] EWCA Civ 176)

Key lessons

- **Back-to-back agreements:** Ensure back-to-back agreements are entered into when the confidentiality agreement requires it.
- **Limit obligations:** Limit any procurement obligations and responsibility provisions to confidential information disclosed by the receiving party.

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Interpretation of "agreement, arrangement or commitment" in relation to an unsigned Agreement

The Court of Appeal reached the surprising conclusion that an unsigned agreement was an "agreement" for the purposes of warranty interpretation in an SPA.

In the context of an SPA warranty, the Court of Appeal concluded that an agreement unsigned at the date of the SPA was an "agreement" and, as a result, there had been a breach of warranty. The warranty stated that the target "is not a party to any agreement, arrangement or commitment which cannot be readily fulfilled or performed by it on time". The target had been selected to enter a framework agreement with the NHS but needed a capital injection to do so. The SPA and related transactions provided the capital injection and the framework agreement was signed shortly after the SPA. Within six months, the target was unable to meet its obligations under the framework agreement and later entered administration. In concluding that the unsigned framework agreement was an "agreement" to which the warranty applied, Rimer LJ stated that construction of the warranty was based on whether a reasonable person with all background knowledge reasonably available to parties at date of the SPA would regard framework agreement as an "agreement", noting that the framework agreement was at the very heart of the deal. Interestingly, the Court also considered the nature of the disclosures made against the warranty. The disclosures against the warranty referred to the framework agreement and the Court noted that this was consistent with the parties having understood the warranty to apply to framework agreement. (*Belfairs Management Limited v Sutherland & Sutherland* [2013] EWCA Civ 185)

Key lessons

- **Bespoke drafting:** Define important terms in warranties and deal explicitly with known issues rather than relying on general language.
- **Disclosure:** Disclosures should be relevant, specific and linked to the warranty against which they are being made.

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Contractual Provisions contd.

One-way Jurisdiction Clauses – Validity Confirmed under English law

The Commercial Court upheld the validity of asymmetrical jurisdiction clauses while such clauses are invalid in other jurisdictions, such as France, Russia and Bulgaria.

The Commercial Court confirmed that one-way (or asymmetrical) jurisdiction clauses are valid under English law. The decision allays any concerns in English law arising from the decision in *Ms X v Banque Privée Edmond de Rothschild* (French Supreme Court, First Civil Chamber, 26 September 2012, No 11-26.022), invalidating a one-way jurisdiction clause between a French national and a Luxembourg bank. Here, the lender brought proceedings in England after the borrower defaulted under a loan agreement which provided that English courts had exclusive jurisdiction to settle any dispute arising out the agreement and that English courts were the most appropriate and convenient forum, stating the clause was for the benefit of the lender only and that the lender was not prevented for taking proceedings in another jurisdiction. The Court concluded that while the lender had the right to sue in any court which would regard itself as of competent jurisdiction, the borrower was obliged to sue the lender in England (i.e. lender agreed to be sued in England). As a result, the clause was not entirely one-sided because the lender was subject to exclusive jurisdiction of English courts when being sued. While such clauses are valid under English law, there are jurisdictions in which they are unenforceable including France, Russia and Bulgaria. (*Mauritius Commercial Bank Ltd v Hestia Holdings Ltd & Anor* [2013] EWHC 1328 (Comm))

Key lessons

- **Consider your deal:** Consider the parties and the deal in determining whether a one-way jurisdiction clause is appropriate and enforceable.
- **EU law:** This decision does not resolve the question of whether one-way jurisdiction clauses are enforceable as a matter of EU law.

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Listed Companies

Two FCA final notices have highlighted important lessons for listed companies

Adequate Systems and Controls and Timely Announcements

The FCA highlighted the importance of internal systems and controls to ensure compliance with disclosure obligations in conjunction with timely and adequate announcements.

The FSA (now FCA) fined Lamprell plc £2.4 million for its breach of Listing Principle 2, the Disclosure and Transparency Rules and the Model Code. Lamprell had failings in its systems and controls that meant it did not give the market important information regarding its financial performance in a timely manner. Additionally, the information that Lamprell provided to the market omitted things that were likely to affect its import. Following an acquisition in 2011 in which Lamprell doubled its size, the UKLA had warned Lamprell it was concerned about its systems and controls for dealing with inside information. Lamprell failed to inform the market of its deteriorating position and also gave clearance to persons discharging managerial responsibilities (PDMRs) to deal during a prohibited period. The FSA determined Lamprell's fine using a new methodology (a formula based on the company's market capitalisation) which yields significantly higher penalties. (*FSA Final Notice 2013: Lamprell plc* dated 15 March 2013)

Key lessons

- **Systems and controls:** Systems and controls must keep pace with operational development. If the FCA issues a warning about a company's systems and controls, the company must take action and allocate resources to address the issue.
- **Holding announcements:** Potential material changes to expected financial performance require a prompt holding announcement even if the company determines it must make further enquiries and confirmations regarding the information.

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Failure to Deal with the FCA in an Open and Co-operative Manner

Final Notice demonstrates the need to contact the FCA at an early stage in a potential significant transaction and deal openly and co-operatively with the FCA.

The FSA (now FCA) fined Prudential plc £14 million for its failure to inform the UKLA of the proposed reverse takeover of AIA. The failure resulted in a significant risk the UKLA would make the wrong regulatory decision. The FSA fined Prudential a further £16 million in a related action and also censured its CEO. Prudential did not deal with the FSA in an open and co-operative manner in breach of Listing Principle 6. Prudential alleged it believed a leak by the FSA was possible and was a serious threat to the deal. It repeatedly delayed informing the UKLA of the proposed transaction, despite its sponsor's repeated advice, alleging it did not believe the transaction was certain enough to merit disclosure to the UKLA. Prudential's conduct forced the UKLA to make far-reaching decisions on complex issues in a compressed time. As a result, the UKLA has consulted on three related Technical Notes intended to clarify the obligation under Listing Principle 6 to contact the FCA at an early stage when contemplating a significant transaction, to remind issuers of the importance of early engagement with the FCA in reverse takeovers and to explain the sponsor's obligation to deal with FCA in an open and co-operative manner. (*FSA Final Notice 2013: Prudential plc* dated 27 March 2013)

Key lessons

- **Sponsor's advice:** An issuer should not ignore a sponsor's advice because it is not explicit that the issuer will be in breach of regulatory obligations if it is not followed.
- **Principles alone:** The FCA is prepared to take disciplinary action on the basis of a breach of the Listing Principles alone.

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Company Law

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

Inaccurate Responses to s. 793 Notice and Power in Articles to Issue Restriction Notices

The High Court concluded 793 notices are a broad information gathering tool and that in considering the accuracy of responses the board can consider the information available in the round. However, the board cannot use restriction notices to hinder a suspected takeover but only to facilitate obtaining more accurate information.

In this highly publicised case, the High Court concluded that (i) the scope of 793 notices properly included questions getting to other interests in the addressee's shares; (ii) the directors had reasonable cause to believe 793 responses were materially inaccurate on the basis of conflicting information and known circumstances; and, (iii) notices imposing restrictions on shares under a company's articles (similar to the statutory provisions in the Companies Act 2006) can be issued for purpose of suspending rights until 793 responses provide accurate information but not for another purpose (e.g. to hinder a perceived raid on the company). Here, JKX suspected an arrangement between two beneficial shareholders and a raid by them. To ascertain information about these shareholders' arrangements, JKX sent a number of 793 notices which included questions on whether the addressee was a party to any agreement or arrangement relating to the exercise of JKX share voting rights. Mann J agreed with the board that none of the 793 responses revealed the arrangements which the board reasonably believed, based on the "mosaic" of circumstances, to exist and enough were inaccurate to justify restriction notices. JKX's articles of association stated that if it had reasonable cause to believe 793 responses were materially inaccurate, JKX could issue notices imposing restrictions on shares. However, the Court concluded the board's purpose in issuing restriction notices was not to get missing information (the proper purpose) but to prevent shareholders from voting at the upcoming annual general meeting (an improper purpose) to assist in fending off a takeover attempt and therefore the restriction notices were not valid. The general statement in board minutes that the board had issued restriction notices to promote success of company did not assist. (*Eclairs Group Limited and Glengary Overseas Limited v JKX Oil & Gas Plc* [2013] EWHC 2631 (Ch))

Key lessons

- **Assessment of inaccuracy:** The board can consider information in the round to form a reasonable belief that the information provided is not materially accurate.
- **Proper purpose:** The restriction notices cannot be used as an additional weapon to defend against a takeover.

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Accidental Failure to Give Notice on a Scheme and Class Composition

The High Court held that the inadvertent failure by registrars to use the record date set by the company did not invalidate meetings in light of level of support for the scheme and information otherwise available. It also held that depositary interests in the Bermudian newco issued to uncertificated shareholders in the scheme did not form a separate class.

The company instructed its registrar as to the record date but the registrar based the scheme documents mailing list on a shareholder list dated five days earlier than the set date. Due to a placing by the company, there were 50 additional shareholders added to the register by the record date. The company's articles of association contained a standard article on the accidental omission of notice which applied as there had been a genuine attempt by the company to serve its shareholders with the effect that the failure to give notice alone did not invalidate the court meeting. It was therefore for the High Court to determine whether to exercise its discretion to approve the scheme at the sanction hearing despite the omission. In concluding the registrar's accidental failure did not prejudice the omitted shareholders, Henderson J took into account:

Key lessons

- **Dealing with registrars:** Ensure registrars (and printers etc.) are clear on what is in their witness statement, highlighting the important information in covering emails and following up on points of process.
- **Class mechanics:** Practical arrangements and structuring will not create a separate class unless the effect is a substantive difference in position.

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Company Law contd.

(i) of the total number of shares issued in the placing, 61% voted for the scheme at the court meeting; (ii) details of the scheme were made know to placees (albeit not via the scheme documents); and, (iii) overwhelming majorities (in number and by value) were obtained at the court meeting. On the issue of class composition, the Court determined that the shareholders formed a single class despite the issue of depositary interests (DIs) in the Bermuda newco to existing holders of uncertificated shares. This was done so that interests could be held in CREST to overcome the fact that Euroclear UK is not able to settle shares issued by non-UK companies. Given the DIs were not less valuable than the new certificated shares and the holders were free to switch to certificated shares at any time, the Court determined the arrangement was mechanical. It did not create a difference in interest with certificated shares so as to form a separate class. (*Re Randall & Quilter Investment Holdings Plc* [2013] EWHC 4357 (Comp))

Duties of Shadow Director of Company in Financial Difficulty

The High Court ruled a shadow director normally owes fiduciary duties to a company where he provides instructions on which the directors are accustomed to act, taking a more expansive approach to the duties of shadow directors than an earlier High Court decision.

The High Court determined the sole director of a company was the "legman" of a shadow director on the basis the shadow director made substantive decisions, engaged with advisers and brought industry experience to the role which the sole director did not have. A shadow director is someone on whose advice or instruction the board is accustomed to act (excepting retained professional advisers) no matter whether he is formally a director. Here, following a re-organisation, the company had large rental obligations and no income. Despite this, the sole director authorised a dividend removing one third of the company's cash, the company entered an expensive consultancy agreement and the company provided various loans on unattractive terms. The net effect of these transactions was to take more than £10 million out of the company. Previously, *Ultraframe (UK) Ltd v Fielding & Ors* [2005] EWHC 1638 (Ch) held the indirect influence of a shadow director will not usually be enough to impose fiduciaries duties on the basis a shadow director has not assumed responsibility for the company. Here, the Court held shadow directors commonly owe fiduciary duties to the company they influence. Newey J's reasoning was that if the shadow director is accustomed to giving directions or instructions to a company's board that he intends to be acted on, it is fair to say the shadow director assumes responsibility for the company and should therefore act in good faith in the company's interests. While generally the interests of a company would be identified with its members, this company was so financially fragile they had shifted to the interests of its creditors. Both the shadow director and sole director had breached their fiduciary duties and the Court concluded the decisions were motivated by a desire to remove money from the company before, and regardless of, any future failure of the company. (*Vivendi SA and Centenary Holdings Ltd v Murray Richards and Stephen Bloch* [2013] EWHC 3006 (Ch))

Key lessons

- **Potential shadow directors:** Consultants, as well as shareholders (and their directors) in joint ventures and private equity investors should be alive to the true nature of their role, guarding against becoming unintentional fiduciaries.
- **Creditors' interests:** Particular diligence should be applied in a situation where a company's interests may have shifted from its shareholders to its creditors.

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Fiduciary Duties

A number of cases have looked at contractual duties of good faith or wider issues on fiduciary duties

Developments in the Doctrine of Good Faith in Performance of Long-Term Contracts

The High Court has implied good faith obligations into a distributorship agreement and made broader comments about parties' duties under long-term "relational" contracts. Despite this decision, which was based on the particular circumstances of the case, it remains the position that there is no overriding duty to act in good faith under English law.

Y, a company incorporated in Singapore, had entered into a distributorship agreement with X, an English company, on the basis of assurances that X had a licence in relation to the subject products. It subsequently emerged that the licence had only been obtained at the time they had entered into the distributorship agreement and, for one product, later. Y terminated the agreement due to alleged repudiatory breaches by X. The Court decided that X had acted in bad faith and Y was entitled to terminate. It accepted that English law would not imply a general duty of good faith on parties to all commercial contracts. Key factors in the outcome were, first, that the agreement was extremely brief, increasing the likelihood that the Court would imply terms and, second, the presence of dishonesty. Against that backdrop, particular points of interest were, that: the Court implied a duty of good faith based on the presumed intention of the parties and the relevant background against which the contract was made; and a suggestion that long-term "relational" contracts, such as joint venture agreements, franchise agreements and long-term distributorship agreements may require a particularly high degree of communication, co-operation and predictable performance based on mutual trust and confidence. It is open to parties to consider excluding an implied duty of good faith in an entire agreement clause. (*Yam Seng Pte Limited v International Trade Corporation Limited* [2013] EWHC 111)

Key lessons

- **Good faith:** A duty of good faith was implied based on the parties' presumed intention and relevant background.
- **Relational arrangements:** Long-term "relational" contracts may require a particularly high degree of co-operation based on mutual trust and confidence.
- **Exclusions:** The implied duty may be expressly excluded or varied.

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Joint Ventures – Interaction between Shareholders' Agreement and Articles

A recent Court of Appeal decision highlights the need to ensure proper interaction between a shareholders' agreement and the related articles of association.

Two director-shareholders in a company agreed in an SHA to vote to appoint and continue reappointing a particular individual as director (D). The SHA did not expressly prevent them and other directors from removing D. Other relevant provisions were: a further assurance clause which obliged them to give effect to the SHA and a provision in the articles allowing a director to be removed by notice from two or more other directors. D was dismissed by notice under the articles. The Court of Appeal decided that the SHA, including the further assurance clause, did not prevent this. The case highlights the importance of ensuring that an SHA and related articles of association interact properly and do not contain contradictory provisions. The Court of Appeal also pointed out that, whilst shareholders in a UK company can vote in their own interests, directors must abide by statutory duties, and it would be hard to imply a term made by parties in one capacity which fetters exercise of their powers in another. The Court of Appeal also took into account the position of independent directors and future directors who do not know the SHA. In deciding whether or not to take up office, they were entitled to assume that the director removal-provisions in the public articles of association were self-standing. (*Dear and Griffith v Jackson* [2013] EWCA Civ 89)

Key lessons

- **Interaction of SHA and articles:** Ensure that an SHA and related articles of association properly interact and do not conflict.
- **Restrictions:** It works better to impose any restrictions on a nominating shareholder's director-removal rights at shareholder rather than board level.
- **Independent directors:** Take into account the position of independent directors who can only access the public articles, not the SHA.

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Fiduciary Duties contd.

Fiduciary Duties of Parties to a Contractual Joint Venture

The Court of Appeal decided on particular facts that fiduciary duties were owed both between parties to a contractual joint venture and also by a director of one party direct to the other party.

W and R entered into a joint venture agreement (JVA) relating to a land development project. B was director and 80% owner of W, and had initiated the project. R provided the project finance to buy a key site. B was only party to the JVA to guarantee liabilities of W which did not arise. Disputes arose in relation to R's share of net profits and the priority these were given in a subsequent side agreement. The Court of Appeal noted that W owned all the relevant assets under the JVA, B entirely controlled how W exploited them and the high degree of trust R placed on B to run the joint venture for the benefit of all parties. It decided that both W and B owed R a fiduciary duty of good faith in their conduct of the venture and not to do anything as regards the handling of the joint venture revenues which favoured W and B to R's detriment. It took into account R's position without any nominee director on W's board nor any shares in W and that B received management fees for a time which were deductible from net profits. The effect was that W was not permitted to make payments out of joint venture revenues before R's net profit share had been paid, other than proper payment of development expenses or expenses to which R had agreed. The burden of proof was on the fiduciary to justify the payment, not the beneficiary. The case is a reminder on the duties that can arise outside the express terms of a JVA, although the Court of Appeal emphasised that it will depend on the facts whether a particular relationship gives rise to fiduciary obligations. (*Ross River v Waveley Commercial* [2013] EWCA Civ 910)

Key lessons

- **Duties outside JVA terms:** Reminder on the fiduciary duties that can arise outside a JVA's express terms.
- **Deal-specific analysis:** It will be case-sensitive whether a particular relationship carries fiduciary obligations.

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