January 2016

2015 Half-year in review M&A legal developments

In this issue...

Authors: Philip Broke, David Crook, Robin Bolivar, Veronica Carson

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.

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

When a contractual provision is a penalty

The Supreme Court has allowed an appeal from a previous Court of Appeal decision on whether the loss of a right to future instalments of the price and a separate discounted price provision in an M&A context amounted to unenforceable penalties under English law. It decided that the relevant clauses were not unenforceable penalties, and articulated a new test based on whether a clause imposes a detriment on the party in breach out of all proportion to any legitimate interest of the innocent party. The Supreme Court also confirmed that the rule against penalties is not limited to clauses which require payment of money on breach but can catch other types of provision imposing a detriment on a party if it breaches the contract, which can commonly arise in transaction documents in an M&A context, for example a forced sale of an asset at an undervalue.

A buyer (B) entered into a sale and purchase agreement (SPA) to increase its existing shareholding in a company by acquiring further shares from the sellers (S). The price was payable by instalments and linked to a profits multiple. There were also put and call options over S's remaining stake. However, if S breached restrictive covenants in the SPA, B was not obliged to pay future instalments and could exercise the options at a much lower price based

Key lessons

- **Replacement of previous tests**: The previous "genuine pre-estimate of loss" and "commercial justification" tests have been replaced.
- **New flexible test**: The new test is whether the clause imposes a detriment on one party out of all proportion to the innocent party's legitimate interests, which helpfully appears to set the bar higher.
- **Wider scope than payment obligations**: Confirmation that the penalty doctrine is not confined to payment triggers on breach but can catch, for example, a forced sale of an asset at an undervalue or non-refundable deposits.
- **Classification as primary or secondary obligations unclear**: The distinction drawn between primary and secondary obligations is not clearcut and it is uncertain how the courts will apply it.
- **Freedom of contract upheld**: The judgment reinforces the court's reluctance to interfere with parties' freedom of contract, which is helpful.

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on the company's net asset value on the date the breach commenced and excluding goodwill. Against this backdrop, S breached the restrictive covenants. The Supreme Court allowed the appeal and decided that the relevant clauses were not unenforceable penalties. In giving its judgment, the Supreme Court clarified and restated the English law rule against penalties. It said that the traditional approach of considering whether the primary purpose of the clause was to deter a breach, focusing for this purpose on whether it was a genuine pre-estimate of loss, was unhelpful. It also did not apply the trend in recent years to focus on whether a clause was commercially justifiable in the circumstances of the transaction. The real question was whether the clause is in fact "penal" by virtue of being disproportionate.

The Supreme Court drew a distinction between a primary performance obligation, which cannot be a penalty, and a related secondary payment obligation on breach of the primary provision, which can. The true test is whether the provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in enforcing the primary clause. The first question is whether any and, if so, what legitimate business interest is served and protected by the clause. The second is whether the provision made for that interest is extravagant, exorbitant or unconscionable. The loss of a right to future instalments of the price was viewed as being, in reality, a price adjustment clause. B had a legitimate interest in the restrictive covenants being complied with to protect the goodwill of the target group. The reduced option price was also a primary obligation for the same legitimate purpose. A joined case involved a car park fine imposed on a motorist who overstayed a two-hour parking limit. The rule against penalties was engaged in this case, as the fine was triggered on breach of a primary obligation. However, applying the same legitimate interest test the fine was found not to be a penalty on the facts. (*Cavendish Square v Talal El Makdessi*; *ParkingEye Limited v Beavis* [2015] UKSC 67)

Clear contractual provisions not undermined by commercial common sense

The Supreme Court confirmed that it will not look to commercial common sense where the wording of a contract is not ambiguous. The Court gave the service charge clause in leases its natural meaning despite the result being an extremely bad bargain for the tenants.

In this case, a landlord let holiday chalets in a leisure park on broadly similar terms for 99 years in a series of leases entered into beginning in the 1970s. The leases contained a service charge clause. The service charge was the yearly sum of £90 in the first year increasing by 10% annually. The landlord interpreted the clause to be a fixed charge with an increase compounded annually. The tenants interpreted the clause to require them to pay a fair proportion of the landlord's actual costs "up to" the fixed sum which increased annually. Otherwise, they argued, the service charge would be absurdly high in the later years of the leases. Lord Neuberger, for the majority, did not let a hard case make bad law. The Supreme Court applied their conventional meaning to the words. The words provided for a compounded increase in the service charge and did not include the phrase "up to." Applying the objective test – what a reasonable person having all the background knowledge available to the parties at the time would have understood the language in the contract to mean – the Court interpreted the contract in line with the landlord's position. During the 1970s inflation was over 10% a year. The leases agreed the allocation of risk. That is, the landlord took the risk that inflation would continue to increase and the tenants took the risk that it would drop (as it has). The majority stated that only if the language is ambiguous should the court look to commercial common sense. Lord Neuberger added that it is not the function of the court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. (*Arnold v Britton* [2015] UKSC 36)

Key lessons

- **Importance of drafting**: Drafters must get the wording right, ensuring it reflects the parties' intentions as well as anticipating and providing for possible future outcomes.
- **Commercial common sense**: Courts will only apply commercial common sense where the meaning of the words is ambiguous.
- **Rectification**: To argue the language used in a contract does not reflect the parties' contractual intention requires a claim for rectification.

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Clarification of law on implied terms

Dismissing a tenant's appeal, the Supreme Court recently refused to imply a term into a lease to require the landlord to return two months' advance rent relating to the period after the tenant had terminated the lease on a break date. In its judgment the Supreme Court clarified the law on when terms may be implied into a contract.

The tenant (T) claimed that it should be repaid two months' advance rent which it had paid to the landlord relating to the period after the break date. T argued that a term should be implied into the lease that advance payments referable to the period after termination should be repaid to it. The Supreme Court dismissed T's appeal and clarified the law on when terms may be implied into a contract. It stated that a higher bar must be met before a term may be implied into a contract than just that it is reasonable to do so. It also added a series of general comments to previous authorities on implied terms. These included that the "business efficacy" test (that implication of a term must be necessary to give business efficacy to the contract) and the "officious bystander" test (in effect that, for a term to be implied, it must be so obvious as to go without saying) are alternative tests to be satisfied, rather than cumulative requirements. It was also suggested that a more helpful way of expressing the business efficacy test was that the contract would need to lack commercial or practical coherence without implying the term. (*Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited and another* [2015] UKSC 72)

Key lessons

- **Useful clarification**: The judgment clarifies when terms may be implied.
- **Reasonableness not enough**: It is insufficient that it is merely reasonable to imply a particular term.
- **Addition of general comments to past authorities**: Helpful guidance that the business efficacy and officious bystander tests are alternatives not cumulative.
- **Reformulation of business efficacy test**: An alternative formulation has been given of the business efficacy test.

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Interpretation of indemnity for consequences of regulatory claims

The Court of Appeal recently considered the scope of an indemnity from a seller (S) under a share SPA for the sale of an insurance broker (T). It decided that the indemnity did not cover a claim from the buyer (B) in relation to mis-selling of insurance policies, because the indemnity only caught losses from a customer's making a claim or registering a complaint with the then Financial Services Authority (FSA), whereas the losses here had arisen from T's self-referring potential mis-selling to the FSA. It did not matter that this made the indemnity uncommercial for B.

S agreed to indemnify B in respect of "*…all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred,* ***and*** *all fines, compensation or remedial action or payments imposed on or required to be made by [T]* ***following and arising out of claims or complaints registered with*** *[the FSA or other regulators] against [T] [or S]…pertaining to any mis-selling or suspected mis-selling…*" and relating to the period before the completion date. The issue was whether the indemnity was triggered where B incurred losses from T's self-referring potential mis-selling to the FSA. The Court of Appeal decided that the indemnity was limited to loss caused by mis-selling which arose from a customer claim against T (or S) or a complaint registered with the FSA (or other regulators). It did not matter that this made the deal a bad bargain for B. The court could not and would not undo a party's bad bargain[1] and would be unable to tell where a contractual provision had been conceded in negotiation simply in exchange for a concession. The Court of Appeal took into account that B had received conduct of business regulatory warranties in the SPA anyway (so that it had broader rights to recover for mis-selling beyond the indemnity) and that the indemnity was not subject to limitations on claims (with the effect that it was unsurprising that recourse under it was restricted). (*Wood v Sureterm Direct Ltd and Capita Insurance Services Ltd* [2015] EWCA Civ 839)

Key lessons

- **Merits of unambiguous wording**: The judgment is a reminder of both the need for unambiguous drafting and the limits of the application of the business common sense approach to contractual interpretation, even where the language is capable of more than one meaning.
- **Drafting tips**: As a drafting matter, B's position might have been better if the different limbs of the indemnity had been covered in separate sub-paragraphs, some of which expressly required a customer claim or complaint to a regulator and some not.

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1 Following the Supreme Court's guidance in *Rainy Sky v Kookmin* [2011] UKSC 50 and *Arnold v Britton* [2015] UKSC 36 as discussed above in this Review.

Interpretation of MAC termination clause

The High Court has decided that a buyer (B) did not have an arguable case that a material adverse change termination clause in an SPA was triggered by the target (T) making substantial downward revisions to its financial forecasts between signing and completion. However, it was arguable that an actual deterioration in T's pre-completion performance triggered the clause.

B acquired a business division of the seller (S) for £528.8m. The SPA contained a material adverse event (MAE) condition, where MAE was defined as "*…an act or omission or the occurrence of a fact, matter, event or circumstance, affecting [T] giving rise to or which is likely to give rise to a material adverse effect on the business, operations, assets, liabilities, financial condition or results of operations of [T] taken as a whole…*". Following completion B alleged that the MAE clause had been triggered by matters on which S had withheld information, including mid-month and full-month flash results produced between signing and completion. These would have shown drops in sales and operating profit and significant downward revisions to the financial forecasts. The High Court decided that a forecast revision did not fall naturally within the words "*act or omission or the occurrence of a fact, matter, event or circumstance*". S had in any event given separate warranty protection on no MAE in T's financial or trading position. Further, revisions to the forecasts failed to meet the requirement that there must be a causal effect giving rise to an MAE. This construction did not make commercial sense, given that the seller limitations said that S gave no warranty on the accuracy of the forecasts which B had received before signing. It would also generate market uncertainty. However, B had an arguable case that the MAE condition was triggered by the drop in T's *actual* performance between signing and completion. (*Ipsos S.A. v Dentsu Aegis Network Ltd (previously Aegis Group plc)* [2015] EWHC 1726 (Comm))

Key lessons

- **High bar to invoke a MAC clause**: The judgment is in line with previous case law confirming that a high threshold must be reached for a buyer successfully to invoke a MAC clause.
- **Interpretation in the round**: The court has confirmed that a MAC clause will be interpreted in the round, not separately from the other provisions.

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Rescission must be available to award damages for innocent or negligent misrepresentation

The Court of Appeal set out its view that damages in lieu of rescission for innocent or negligent misrepresentation under s. 2(2) of the Misrepresentation Act 1967 can only be awarded if rescission itself is available as a remedy (or had been when the contract was rescinded).

In this case, Salt bought a car that the seller described as "brand new." It was in fact two years old at sale and had been in a collision. The car was best described as a lemon. Only after trying to return the car to the seller and bringing an action for damages based on its quality did Salt learn of the car's history. Over three years from purchase, Salt amended his claim to include misrepresentation. Longmore LJ stated that, on the facts, rescission was available despite the passage of time, Salt's use of the car and its depreciation. Salt's delay was not unreasonable in the circumstances. Nor had his use of the car and its depreciation made restitution impossible. Rescission of the contract is the normal remedy where possible. The unanimous Court of Appeal gave a broad interpretation to when rescission is available which preceded its comments in obiter dicta, which sought to clarify contradictory lower court decisions, that under s. 2(2) of the Misrepresentation Act 1967 "damages in lieu of rescission" requires that rescission be available for a court to award damages. If rescission was not available because the contract had been affirmed, third party rights had intervened, an excessive time had elapsed or restitution had become impossible, then damages could not be awarded in lieu of rescission. (*Salt v Stratstone* [2015] EWCA Civ 745)

Key lessons

- **Preserve the claim for rescission**: Be alive to the fact that affirming a contract, the intervention of third party rights, the excessive passage of time or anything that would make restitution impossible have the effect of making rescission unavailable (and also damages in lieu of rescission unavailable).
- **Consider the correct claim**: Damages can also be awarded for non-innocent (negligent) representations under s. 2(1) of the Misrepresentation Act 1967 unless the misrepresentor proves he had reasonable grounds to believe (and did believe) that the misrepresentation was true.

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Estoppel by convention applied to pre-emption rights

The Court of Appeal recently decided that the principle of estoppel by convention could apply to pre-emption rights over shares and could be based on oversight or forgetfulness over the existence of pre-emption provisions, not just mistake. However, the Court of Appeal doubted that the principle of shareholder unanimous consent could extend to include proxy or representative assents.

The company (C) was set up in 2000. In 2001 D was introduced as an investor and the founders and D signed letters containing pre-emption rights. In 2009 D acquired some shares of other members on a non-pre-emptive basis. In 2011 two founders who had not sold to him purported to sell their shares to a third party, also on a non-pre-emptive basis. After those share transfers were unanimously approved at a board meeting, D located the 2001 pre-emption letters and challenged the sale. The Court of Appeal decided that D was estopped by convention from relying on the pre-emption letters. In any event, even if the pre-emption rights had survived, the directors had already unanimously approved the transfers. There were obvious examples in the parties' behaviour to show that they had gone ahead on a common assumption that there were no pre-emption rights over the shares. To be estopped from invoking the pre-emption rights a party's conduct must "cross the line" enough to show that he had accepted this assumption. That is what had happened here. The transferee also tried to rely on the shareholders' unanimous consent principle as an alternative basis for treating the board meeting to approve the share transfers as binding on C, on the basis approvals were given as shareholders as well as directors. The Court of Appeal commented that it doubted that the unanimous consent principle could apply on the basis of proxy or representative assents where some more distant family members were not present. (*Dixon and another v Blindley Heath Investments Ltd* [2015] EWCA Civ 1023)

Key lessons

- **Clarification of estoppel by convention**: The judgment clarifies the scope of the principle of estoppel by convention and how it may potentially apply in an M&A context.
- **No extension of unanimous consent principle**: The Court of Appeal cast doubt on extending unanimous consent to include proxy or representative assents.
- **Use of definitive documents**: The judgment is a reminder on the benefits of recording pre-emption rights and other key terms in formal definitive documents.

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Meaning of "consummation" of agreement

The Court of Appeal has decided that a contractual obligation under an engagement letter to pay a success fee "if any sale is consummated" within a specified period meant if completion occurred within that period, not just an agreement for sale.

R entered into an engagement letter with A to act as exclusive financial adviser on the sale of an iron ore subsidiary (S). The engagement letter entitled R to a success fee "if any Sale is consummated" within one year of termination of the engagement. Within one year of termination A signed an agreement for the sale of S to a counterparty which had not been introduced by R. Completion took place outside the one-year period. The Court of Appeal decided that R was not entitled to the success fee, because it would only be entitled to the fee if the sale was actually *completed* in the relevant period. The relevant time is when the relevant interest is transferred pursuant to an agreement for sale. "Consummated" is an ordinary word and means "to bring to completion". The Court of Appeal said that it did not matter that the parties had used a word other than the defined term "Completion". This should not lead to a conclusion that consummation meant an event before completion as generally understood. (*African Minerals v Renaissance Capital* [2015] EWCA Civ 448)

Key lessons

- **Express wording advisable**: Express drafting is needed on the exact circumstance in which a success fee is payable.
- **Drafting tip**: It would be clearer to cover agreements for sale whether entered into on a conditional basis or otherwise.

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Company law

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

Directors must act with a proper purpose when disenfranchising shareholders for inaccurate responses to s. 793 notices

The Supreme Court held that the board's power to restrict voting rights of shareholders, based on its reasonable belief that their responses to requests for information on their interests in the company's shares were inaccurate, must depend on the purpose for which the power was exercised being a proper one. A proper purpose is to obtain the information requested, while obstructing a corporate raid is an improper purpose.

The Supreme Court determined that board's exercise of the power to issue restriction notices, here conferred by the company's articles, must be for the purpose for which it was conferred (a proper purpose) as set out in s. 171(b) of the Companies Act 2006. The board suspected an arrangement between two shareholders and a raid by them. The suspicions were reasonable based on the facts. To ascertain information about the shareholders' arrangements, the board requested information under provisions in the company's articles similar to s. 793 of the Companies Act 2006. The responses did not reveal the arrangements that the board reasonably believed to exist. Under the articles, the board could issue restriction notices to prevent shareholders from voting at a general meeting where it had reasonable cause to believe their responses were false or materially inaccurate. The board issued restriction notices, preventing the shareholders from voting at the upcoming general meeting. The Court found that disenfranchising shareholders was ancillary to the power to obtain information (the proper purpose). Protecting the company and shareholders against the non-provision of information was the proper purpose, manipulating the outcome of a general meeting, as was determined to be the purpose here, was an improper purpose. The Supreme Court unanimously agreed, on the facts and arguments here, that the shareholders were improperly disenfranchised.
(*Eclairs Group Limited v JKX Oil & Gas Plc* [2015] UKSC 71)

Key lessons

- **Proper purpose**: Restriction notices are properly issued to halt voting until the shareholder provides missing information. Obtaining information is the purpose for which a board can issue them and they are not an additional weapon to defend against a takeover.
- **PSC Register**: The upcoming legislative changes requiring companies to maintain a Register of Persons with Significant Control contain similar provisions in respect of issuing restriction notices. It follows that restriction notices under those new provisions should also be issued for a proper purpose.

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Double (or multiple) derivative claims governed by common law

The High Court outlined that the common law continues to provide for double (or multiple) derivative claims. Where a claim is brought by a shareholder of a parent company for a cause of action of its subsidiary, the common law applies unaffected by statutory procedure. Statute provides only for derivative claims where the claimant is a shareholder of the company with a cause of action.

The Companies Act 2006 (ss. 260-4) sets out the procedure for single derivative claims (i.e. by a shareholder in respect of a cause of action vested in the company seeking relief for that company). The statutory procedure includes a wider range of circumstances in which a single derivative action may be brought than was the case under the common law. The High Court confirmed that the common law continues to provide for double (or multiple) derivative claims which are therefore

Key lessons

- **No gap**: While the Companies Act 2006 provides for single derivative claims, the common law ensures there is no gap in the law.
- **Narrower scope**: Double (or multiple) derivative claims have a narrower scope than single derivative claims under ss. 260-4 as the requirements at common law and under statute are not aligned.
- **Corporate groups**: Corporate groups should be aware that their ultimate minority shareholders can bring an action by way of a double (or multiple) derivative claim under the common law on an albeit narrower basis than a derivative claim can be made under statute.

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available in a narrower range of circumstances. In this case, a shareholder of the parent sought to bring a double derivative claim for wrongs to its subsidiaries. The allegations related to (1) a series of cash gifts or interest-free loans from the subsidiaries to a company of a director of the subsidiaries; and, (2) the transfer of property from a subsidiary to the same director. There were neither approvals nor disclosures. Morgan J assessed whether the common law test for bringing a derivative claim had been met. At common law, under the rule in *Foss v Harbottle* the right to sue a director for breach of duty owed to a company vests in the company and cannot be pursued by a shareholder. However, where the wrongdoers are in control of the company and their actions amount to fraud, there is an exception allowing a shareholder to bring an action (fraud on the minority). This may be satisfied if there is actual fraud or a breach of a fiduciary duty with a prima facie case of benefit to the wrongdoer. With regard to the cash payments, the Court determined that the subsidiaries had a prima facie case that was within the exception. The director was the beneficiary of dishonesty which he knew about (dishonest breach of fiduciary duty). However, in relation to the property transfer there was no evidence of transfer at undervalue, so there was no prima facie case of dishonesty. (*Bhullar v Bhullar* [2015] EWHC 1943 (Ch))

Repudiatory breach does not apply to multi-party LLP agreements

The High Court decided that the doctrine of repudiatory breach was implicitly excluded from multi-party limited liability partnership (LLP) agreements which fall within the Limited Liability Partnerships Act 2000. This applies statutory default rules to members' relationship in the absence of an express LLP agreement between them or where any such agreement is silent on a matter, including on equal distribution of profits.

F had been a member of the LLP, a fund management business. The LLP agreement expressly excluded the statutory default rules and had bespoke provisions on allocation of capital and income and expulsion of members. In particular, F contributed nominal capital and was entitled to a fixed profit share of £125,000 a year. The LLP served notice of compulsory retirement on F in breach of the express provisions of the agreement. F alleged that this was a repudiatory breach, triggering the statutory default rules on allocation of profits, under which profits would be distributed equally. The High Court decided that once an LLP agreement has been made it will continue to bind the LLP and the members until either it is terminated by common agreement or varied under a procedure which the parties have previously signed up to. An injured party cannot treat the agreement as repudiated, although he can claim damages for his actual loss. Here, though, it was hard to identify how he had suffered any loss beyond non-payment of his fixed allocation for two years. F could bring an unfair prejudice petition, but his interest in the LLP did not have any continuing value above his fixed allocation of profits. (*Flanagan v Liontrust Investment Partners LLP* [2015] EWHC 2171 (Ch))

Key lessons

- **Repudiatory breach not for instigating default rules**: A party to an LLP agreement cannot deliberately instigate the statutory default rules where he would have greater rights under them than under the express multi-party LLP agreement.
- **Analysis for bilateral LLPs left open**: The court left open whether, by contrast, a repudiatory breach can be invoked in the separate context of a bilateral LLP agreement.

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Listed companies

A number of FCA actions have examined issues crucial to listed companies

Public censure for misleading statements in RIS

The FCA publicly censured the Co-operative Bank plc for false and misleading statements about its capital position in its financial statements in breach of Listing Rule 1.3.3R, concluding the bank did not take reasonable care to ensure the information was not misleading, false, deceptive or without omissions.

Listing Rule 1.3.3R requires an issuer take reasonable care to ensure information notified to an RIS is not misleading, false or deceptive and does not omit anything likely to affect the import of the information. In March 2013, the bank published its 2012 financial statements via an RIS announcement which indicated that: (i) it could maintain adequate capitalisation at all times (even under the most severe stress scenarios); and, (ii) it had a sufficient capital buffer to absorb capital shocks and to cover its regulatory minimum requirements. However, from January 2013 the bank was aware it did not have sufficient capital to absorb capital shocks or to ensure sufficient surplus capital was available to cover its regulatory minimum requirements. Indeed, it was in communication with FSA on the steps necessary to improve its capital position. The FCA concluded the bank did not have a "reasonable basis" for stating it had adequate capital in the most severe stress scenarios. These statements had been removed elsewhere due to concerns about their accuracy. In the view of the FCA, the bank fell "significantly below the standards expected of listed companies in the UK." The FCA concluded that a "substantial financial penalty" (£120 million) would have been appropriate but for the bank's financial position and turnaround plan. Instead of a financial penalty, the FCA applied its discretion to publicly censure the bank as provided in s. 91(3) FSMA. (FCA Final Notice: The Co-operative Bank plc dated 10 August 2015)

Key lessons

- **Verification**: The decision and potential penalty highlights the importance of verification (and consistency) in any RIS announcement to ensure compliance with the requirements in LR 1.3.3R.
- **Impact of public censures**: Even without a financial penalty, the FCA's public censure resulted in a significant amount of negative commentary in both the financial and mainstream press.
- **Distressed companies**: The FCA demonstrates it will use its discretion not to impose a penalty, instead issuing public censure, when the impact of a financial penalty could adversely impact a turnaround plan.

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Related party transaction policies must be implemented effectively

The FCA fined Asia Resource Minerals plc (formerly Bumi plc) £4.6 million for Listing Rule breaches from the company's failure to implement effectively its related party transaction policy and deal with possible related party transactions appropriately.

After listing in 2011, the issuer became aware of allegations of potential irregularities in its Indonesian operations. It conducted an internal review and reported to its financial advisers a list of numerous possible related party transactions (RPTs). Having analysed the transactions, its financial advisers determined that three were RPTs. While the issuer had a RPT policy, conducted RPT training and set up a conflicts committee, the FCA determined that there was insufficient follow through. With the result there was not an effective system to ascertain and assess possible RPTs. In the FCA's view (i) the RPT policy was inadequately implemented; (ii) required related party lists were incomplete and not updated; (iii) training was not adequately attended and not repeated; and, (iv) the conflicts

Key lessons

- **Policies must be implemented**: It is insufficient for an issuer to have well-drafted policies that are not implemented effectively.
- **Training must be effective**: Training must be delivered (and repeated) for senior management and employees.
- **Increased diligence and vigilance**: An issuer's policies and procedures must work throughout the group and take into account any increased risk resulting from the group's structure, industry and geography.
- **Issuers have limited scope to assess RPTs**: While an issuer may be able to assess transactions that are clearly not RPTs, an issuer must seek sponsor guidance if a transaction may be a RPT.

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committee was ineffectual. In the findings of the FCA, the issuer ought to have operated in light of the increased risk of undetected RPTs because: (i) directors of its Indonesian subsidiary were unfamiliar with the Listing Rules; (ii) there were a significant number of potentially connected parties and inter-related directors in the industry; and, (iii) there were concerns about RPTs before listing. These increased risks ought to have made the issuer vigilant but instead its measures were inadequate and delayed. As a result, the issuer breached (i) Listing Principle 2 (now Listing Principle 1) requiring the issuer take reasonable steps to establish and maintain adequate procedures, systems and controls to comply with its obligations; (ii) Listing Rules 11.1.10R and 11.1.11R setting out the requirements for smaller RPTs and aggregation; and, (iii) Listing Rule 8.2.3R requiring sponsor guidance on transactions that may be RPTs. The substantial fine was a percentage based on the value of the three RPTs (£8 million). (FCA Final Notice: Asia Resource Minerals plc (formerly Bumi plc) dated 12 June 2015)

High court imposes penalties and final injunctions for market abuse

In this FCA action for market abuse, the High Court imposed penalties and final injunctions in relation to both traders engaged in layering and the company (Da Vinci) with whom they partnered. This was the first action by the FCA in the High Court for market abuse penalties and injunctions rather than the FCA proceeding by way of enforcement action for penalties.

In this action the traders who were involved in layering resulting in the market abuse actions against Swift Trade resurfaced engaging in the same conduct. "Layering" is the practice of placing orders of one side of an electronic order book that are too extreme to be filled with the objective of moving the market in one direction and then acting in the opposite direction to make a profit and then cancelling the original unfilled orders. In 2010 the traders resumed operations and partnered with Da Vinci. After a few months, both their Direct Market Access (DMA) provider and BATS reported suspicious trades to the FSA. While Da Vinci was represented at trial, the traders and their company did not appear. The case raised a number of novel points. In response to Da Vinci's objection to the FCA proceeding in the High Court, Snowden J determined that the FCA can elect between pursuing penalty via a final notice (s. 123) or via the court (s. 129) under FSMA. Da Vinci also objected to the court action on the basis that s. 123(2) provides a defence not set out in s. 129. In the Court's view, given that a penalty under s. 129 is imposed only if the court "considers it appropriate" and the basic elements in s. 129 are similar to s. 123, it follows that the same considerations relevant to the FCA are relevant to the court. The Court concluded it was "doubtless" that the traders knew what they were doing and Da Vinci did not do all it reasonably could to prevent the market abuse. The FCA's detailed framework is not imposed on courts in calculating the penalty amount but there was no prejudice in this. Da Vinci was fined £1.5 million and the traders and their company £1.11 million and £5 million respectively. Additionally, the Court granted final injunctions against the traders and, for the first time, a firm (Da Vinci). Da Vinci has applied for permission to appeal the judgment. (*FCA v Da Vinci* [2015] EWHC 2401 (Ch))

Key lessons

- **Enforcement toolkit**: The FCA has shown it is willing to use its full (and expanding) enforcement toolkit.
- **Interpretation**: The High Court applied pragmatic interpretation of s. 129 of FSMA in relation to the s. 123(2) defence which is not set out in that section.
- **Penalty framework is not a cap**: While the framework applies to the FCA on an enforcement action, neither the Upper Tribunal nor the courts need follow it.

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Good faith

Issues related to implying a duty of good faith have arisen again in an interesting decision

No right to repudiate contract for anticipatory breach, penalties and good faith

The High Court has decided that a contracting party faced with a repudiatory breach of contract was not entitled to elect to keep the contract in force where its only basis for doing so was to claim daily liquidated damages indefinitely in a scenario where the court found that it was not suffering ongoing financial loss. The judgment also raises issues on unenforceable penalties, scope of the duty to mitigate loss and implied duties of good faith.

A carrier (claimant, C) contracted with a seller (defendant, D) to supply containers of D's cotton to a consignee in Bangladesh (buyer, B). Under the bills of lading D had to return C's containers within 14 days of discharge from the ship, failing which a daily tariff (demurrage) would apply. A dispute followed between B and D and customs authorities would not allow the containers to be unpacked without a court order. C claimed daily demurrage. The High Court decided that C did not have a legitimate interest in keeping the contract in force, since the only basis for doing so was to claim unlimited demurrage in a scenario where the court found that it was suffering no ongoing financial loss. This was a rare example of a case where the aggrieved party had no choice but to accept the repudiation, terminate the contract and claim its actual loss. The court treated the demurrage clause as a liquidated damages clause and confirmed that there was no duty on a claimant to mitigate its loss when claiming liquidated damages. However, it commented that where such a clause conferred an unfettered right to ignore a repudiatory breach and claim damages indefinitely, it could potentially amount to an unenforceable penalty. The court suggested that an unreasonable decision to keep a contract alive against the other party's will may breach an implied duty of good faith. It did not matter that the right to terminate here arose by operation of law. An appeal hearing is awaited in relation to the judgment. (*MSC Mediterranean Shipping Company S.A. v Cottonex Anstalt* [2015] EWHC 28 (Comm))

Key lessons

- **Legitimate interest needed in keeping contract in force**: An innocent party must accept a repudiatory breach and terminate the contract if it has no legitimate interest in keeping the contract in force.
- **Limits on implication of duty of good faith**: The comments implying a duty of good faith appear to have been focused on an unreasonable decision not to terminate a contract and claim actual loss suffered.

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White & Case LLP
5 Old Broad Street
London EC2N 1DW
United Kingdom
T +44 20 7532 1000

whitecase.com

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