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2024 Summer review M&A legal and market developments

In this issue...

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We set out below a number of interesting English court decisions and market developments which have taken place and their impact on M&A transactions. This review looks at these developments and gives practical guidance on their implications. Summaries feature below, and you can click where indicated to access more detailed analysis.

Contractual provisions

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

Carve-out from limitation clause for fraudulent misrepresentation did not catch fraudulent breach of contract

The High Court decided that a contractual provision limiting liability except in the case of death, personal injury or fraudulent misrepresentation worked successfully to limit damages caused by fraudulent or dishonest breach of contract, although on the facts there had been no dishonesty.

The contract was an arrangement between the claimant pharmaceutical company (C) and the defendant university (D) for D to conduct research on a drug that C had patented, to be led by scientist S. It was alleged that a research paper that D had published contained multiple errors as a result of S's dishonesty. The publisher eventually retracted the paper. Clause 11.1 of the agreement required D to exercise reasonable skill and care in conducting the research. Clause 11.5 stated that any party's liability howsoever arising was limited to £1 million "*except in the case of death, personal injury or fraudulent misrepresentation*". C alleged that D had breached its obligation to exercise reasonable

Key lessons

- **Generic fraud carve-outs to seller limitations on M&A transactions:** From a buyer's perspective, the judgment shows the merits of crafting the fraud carve-out to the seller limitations in the sale and purchase agreement broadly and generically rather than limiting it to, say, fraudulent misrepresentation or otherwise itemising particular types of claims in fraud.
- **Vicarious liability for dishonesty of agents:** The judgment demonstrates that a party may limit vicarious liability for dishonest actions of its agents without express language to this effect.
- **Purported exclusions of fraud for inducing, or in performing, a contract:** The judgment highlights the distinction between a party purporting to exclude fraud for inducing a contract as against exclusion of fraud in performing a contract.

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skill and care. C claimed damages of £95 million for alleged diminution in the value of its patent and the cost of repeating the research. The High Court decided that D had indeed breached its duty to exercise reasonable skill and care, but held that the limitation clause worked to limit liability for damages caused by fraudulent, dishonest breach of contract to £1 million. It awarded C the cost of further research testing up to £1 million for D's breach of clause 11.1. The court gave guidance on purported exclusion or limitation clauses covering fraud. A contracting party cannot exclude liability for its own fraud in inducing a contract. However, it may be able to exclude liability for fraud in performing a contract, the analysis on which depends on construction of the contract and is a matter of risk allocation (although it is more likely to be effective in the case of fraud by an agent or employee than that of the contracting party itself). The court also decided that the clause was not unreasonable under the Unfair Contract Terms Act 1977 (UCTA) for catching fraudulent or dishonest breach of contract. UCTA did not allow a court to strike a clause down for some purposes but not others and the court should be slow to do so anyway for matters the parties were unlikely to have contemplated when they contracted. The court also took into account: the large size of the claim relative to the contract price of £50,000, which would have been far higher if a commercial provider had been used; that such clauses were common in the market; that the agreement had been negotiated on behalf of C by a lawyer; and that both parties had the benefit of clause 11.5. In any event, the court did not find dishonesty by S or any other agent or employee of D. Permission to appeal the decision has been declined. (*Innovate Pharmaceuticals Ltd v University of Portsmouth Higher Education Corp* [2024] EWHC 35 (TCC))

Buy-side W&I insurance policy successfully excluded losses claimed

The Court of Appeal upheld the earlier High Court decision that underwriters had been entitled to decline a claim under a buy-side warranty and indemnity (W&I) insurance policy for losses arising in connection with alleged breach of anti-bribery and corruption warranties. The buyer had failed to demonstrate that an apparent inconsistency between the insured obligations and the policy exclusions was the result of a drafting error.

Buyer B entered into a share sale and purchase agreement (SPA) to acquire target company C. B took out a buy-side W&I insurance policy between signing and completion. The policy was heavily negotiated between the underwriters (U), B and B's advisers. B later went into administration and C into liquidation, allegedly as a result of events entitling B to indemnity from U under the W&I insurance policy. In particular, the SPA contained anti-bribery and corruption warranties as well as warranties on litigation and investigations. A cover spreadsheet appended to the policy listed the anti-bribery and corruption warranties as "covered". However, there was an express exclusion in the policy for "any liability or actual or alleged non-compliance" with anti-bribery and corruption warranties (Anti-Bribery Liability). A provision in the policy document stated that the exclusions took precedence over the cover spreadsheet. B argued that there was a drafting error in the definition of the excluded Anti-Bribery Liability which should be corrected to read "any liability **for** actual or alleged non-compliance…", with the effect that the exclusion would not catch mere allegations. A majority of the Court of Appeal rejected that argument. The Court of Appeal stated that any mistake, if there was one, would need to have been common to both parties. You therefore had to consider the question from U's perspective. The proposed "correction" would have a very significant effect, by bringing within the scope of losses for which U was liable any diminution in share value attributable to allegations that were never proven nor even investigated. The Court of Appeal emphasized that there was a coherent and rational explanation from U's perspective for the way the definition of excluded liability was worded, which pointed against a drafting mistake. There could be a significant impact on share valuation if, say, C's main customer became aware of an allegation of any non-compliance with anti-bribery and corruption laws and immediately ceased trading with C even if no breach was ever established or proved. In any event, the fact that the exclusion clause had been specifically negotiated told against a drafting mistake. Further, in order to correct a drafting mistake by interpretation, not only must the mistake be clear but also the cure. Here, however, it was not clear that any error lay in the drafting of the Anti-bribery Liability rather than the cover spreadsheet. (*Project Angel Bidco (In Administration) v Axis Managing Agency Ltd & Ors* [2024] EWCA Civ 446)

Key lessons

- **Priority of specific exclusions over cover spreadsheet:** This is a rare case on a claim under a W&I insurance policy, and the outcome is perhaps unsurprising given that the policy expressly stated that the policy exclusions took precedence over the cover spreadsheet.
- **Individual negotiation:** It is also significant that the exclusion in question had been specifically negotiated with the buyer's advisers involved.

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Investment bank not entitled to receive commission on public capital raising by Indian bank

The Court of Appeal considered whether the word "private" in the phrase "private placement, offering or other sale of equity instruments" in an engagement letter only qualified "placement" or alternatively qualified "offering or other sale" as well. The Court of Appeal confirmed the existence of a 'natural assumption' that an adjective or determiner at the start of a list qualifies the entirety of it.

In 2019 Indian Bank Y was experiencing severe financial problems and urgently needed additional capital. C was one of several financial services firms engaged to assist it. Under an engagement letter C was engaged to act in connection with a "Financing", as defined, in return for a US$500,000 retainer and 2% of funds raised from the investors listed in a schedule to the letter. "Financing" was defined in the engagement letter as: "*…one or more financing(s) through the* ***private placement, offering or other sale of equity instruments*** *in any form, including, without limitation, preferred or common equity, or instruments convertible into preferred or common equity or other related forms of interests or capital of the Company in one or a series of transactions (a "Financing")*."[1] The issue was whether a further public offering was covered by the definition of Financing. The Court of Appeal read "*private*" as qualifying the entirety of the list, and deemed that a public offering was excluded from the definition. Cantor's argument, that "*private*" was intended to apply only to "*placement*", was rejected.

In reaching its conclusion, the Court of Appeal noted with respect to the ordinary meaning of the words used, that: "*While […] there is no firm grammatical rule to the effect that an adjective or determiner at the start of a list of nouns qualifies them all […] unless something in the content of the list or another adjective or determiner within the list suggests otherwise, the reader will naturally tend to assume that an adjective or determiner at the start of a list qualifies the entirety of it.*" It went on to describe this as a "*natural assumption*".

Key lessons

- **Contractual certainty:** The judgment highlights the importance of careful drafting in order to ensure that wording is clear and works to achieve the parties' aims and contractual certainty.
- **Drafting of lists:** When drafting a list, if the intention is to qualify only a part of it, it is sensible to move the adjective or determiner away from the start of the sentence. This can be easily achieved by reordering the list e.g. "*offering, other sale of equity instruments, or private placement.*"

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As is always the case when interpreting contracts under English law, the Court of Appeal's decision did not rest solely on this assumption; it considered several other factors in order to determine the ordinary meaning of the words used in the context of the contract as a whole and the relevant factual and commercial background (excluding prior negotiations). In particular, that the parties' focus had been on non-public fundraising from new sources, specifically C's client list, and there was nothing to indicate that it may have been in their reasonable contemplation that investors introduced by C might invest by a public offering following a major capitalisation. This unique factual and commercial background means that the same words could, therefore, have a different interpretation in another contract. However, the Court of Appeal's support means that the assumption itself is likely to be adopted in future cases. (*Cantor Fitzgerald & Co v Yes Bank Ltd* [2024] EWCA Civ 695)

1 Emphasis added.

Force majeure clause did not require a party to accept non-contractual performance

The Supreme Court decided that, where a shipping contract provided that an event would not amount to force majeure if it could be overcome by the affected party's reasonable endeavours, this did not require a party to accept payment in euros rather than the contractual currency of US dollars.

Shipowners O entered into a contract in 2016 with charterers C for the shipment of goods from Guinea to Ukraine. In April 2018 the US government sanctioned C's parent company. The contract defined a force majeure event as one which prevented loading or unloading goods by reference to different types of event including war, embargo, *restrictions on monetary transfers* or "*any rules or regulations of governments or any acts of interference or acts or directions of governments*". It also provided that an event would not constitute force majeure if it could be overcome by the affected party's reasonable endeavours. O issued a force majeure notice on the basis it could not perform the contract due to the sanctions, as it could not accept payment from C in US dollars. C argued O should accept euros instead. The Supreme Court overturned the Court of Appeal decision and held that the force majeure clause did not require a party to accept payment in a non-contractual currency. The force majeure clause was concerned with steps an affected party should reasonably have taken to enable the contract to be performed, not to secure some different performance. The relevant contractual performance here was payment in US dollars. The question was whether reasonable endeavours by O would have enabled payment in US dollars to be made without delay. The answer was no, because the banking delay for US dollar payments was not overcome by having a non-contractual performance. O had a clear right to insist on payment in US dollars. A party should not be made to give up a valuable right unless the contract clearly identifies expressly or implicitly that they have done so. O's case was straightforward: what could reasonably be done to bring about contractual performance? By contrast, C's case was not anchored to the contract and introduced unwarranted uncertainty, for example, as to what unreasonable detriment might count as a bar to non-contractual performance. Instead, parties needed to know whether or not a force majeure clause could be relied on at the relevant time, not after a retrospective enquiry. The analysis would have been different if the contract had provided C with an alternative of payment in euros. (*RTI Ltd v MUR Shipping BV* [2024] UKSC 18)

Key lessons

- **Force majeure clauses in the context of sanctions:** The judgment is interesting in giving guidance on the scope of force majeure clauses in the context of sanctions. It demonstrates that a reasonable endeavours obligation in respect of an exceptions clause does not require the affected party to give up its contractual right.
- **Drafting of reasonable endeavours obligations:** For parties seeking to apply an endeavours obligation, the case shows the merits of including express wording in the contract itemising steps to be taken. In the absence of such wording here, the judgment shows that the outcome will be that exercise of reasonable endeavours will not be taken to require acceptance of a non-contractual performance.

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Impact of execution by an individual's attorney on validity of legal assignment

In considering whether two loan agreements and a guarantee had been validly assigned, the High Court decided that an assignment signed by the attorney of an assignor who was an individual did not meet the requirement under section 136 of the UK Law of Property Act 1925 (the LPA) that a legal assignment must be in writing under the hand of the assignor.

Dr F extended two loans to D1 under two facility agreements. D2 guaranteed D1's liability to F. After the final repayment dates under both facility agreements had passed without payment being made, F purported to assign all of his rights under the facility agreements and the guarantee to his son C. C executed the assignment under his own signature both "*for and on behalf of [Dr F] by way of a Lasting Power of Attorney*", and also under his own signature on his own behalf. C's lawyers then sent D2 a notice of assignment executed the same way by C and enclosed a statutory demand for sums due under the guarantee. D2 paid a small proportion of what was owing and D1 paid nothing. C applied for summary judgment against them for sums due. Ds 1 and 2 challenged the validity of the assignment on the basis that it did not meet the requirement in section 136 of the LPA to be "*under the hand of the assignor*". The High Court decided that there was no valid legal assignment, but that the transfer took effect as a valid equitable assignment. The court agreed that the assignment executed by C as F's attorney did not meet the requirement under section 136 for a legal assignment to be under the hand of the assignor. The High Court refused to treat the later Powers of Attorney Act 1971 as rewriting the LPA for this purpose. However, an effective equitable assignment had taken place. All that was needed for this to be effective was some transaction that sufficiently manifested an intention by the owner of an identified chose in action, or set of rights over property, to assign it to another. Here, C had clearly shown his intention to assign F's rights under the facility agreements and guarantee. As the equitable assignment was of an existing (rather than a future) chose in action consideration was not needed. As far as the notice of assignment was concerned, this had been valid. No particular words were needed for the notice as long as it was plain and unambiguous. (*Frischmann v Vaxeal Holdings SA & Ors* [2023] EWHC 2698 (Ch))

Key lessons

- **Best practice on assignment by individuals:** The issues in this case arose from the particular language of the LPA (using the expression "under the hand of"), which pre-dates the Powers of Attorney Act 1971 by many years, and the court declining to treat the later Act as rewriting the earlier Act on the issue of method of execution of a legal assignment. In light of this judgment, English law assignments effected by individuals should not be executed under a power of attorney.
- **Assignments by companies:** Although this case related to assignment by an individual, rather than a corporate, it is preferable where possible for companies to execute English law assignments under the rules in section 44 of the Companies Act 2006 rather than by power of attorney (meaning execution by two officers or one director before an attesting witness) to avoid debate.
- **Significance of distinction between legal and equitable assignments):** An equitable assignment may require consideration (such as on assignment of a receivable, being a future chose in action) and will require the assignor to be joined into any post-assignment proceedings against the underlying contractual counterparty). Whilst equitable assignments are common in M&A transactions, legal assignments are preferable when assigning a receivable or on assignments between unconnected parties.

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Notice of warranty claim valid irrespective of basis of calculation of loss

The Court of Appeal has overturned a High Court decision which had found that a buyer's warranty notice was invalid for failing adequately to detail the buyer's calculation of the loss alleged to have been suffered.

Buyer B acquired company C from seller S. Under the share SPA, S warranted that a pre-sale reorganisation, which was a condition to the sale, had been conducted before signing. This included assignment by a member of S's group to C of the benefit of an option to require an easement from a third party to lay cables for a new power station. It turned out that the reorganisation had not been implemented correctly and C suffered resulting loss. B claimed against S for breach of warranty. Under the seller limitations in the SPA B had to serve a written notice of claim on S "*…stating in* ***reasonable detail*** *the* ***nature*** *of the* ***claim*** *and the* ***amount claimed*** *(****detailing*** *the Buyer's* ***calculation of the Loss*** *thereby alleged to have been suffered)…*" by a specified date. B gave notice on the last day of the contractual period, stating that: the reorganisation had not been implemented and completed in full; and B remained liable for losses suffered by C in relation to the reorganisation. It also identified future losses likely to arise and yet to crystallise. S argued the notice was invalid because the loss should have been based on the diminution in value of the acquired shares. The High Court had found that the notice of warranty claim was invalid, meaning that a warranty claim was precluded for failure to notify before expiry of the contractual time limit. This was on the basis that B should have explained in the notice that the calculation of loss was the difference between the warranted value and actual value of the shares. Instead, the reference to C's losses for which it was liable was a different basis of loss, whilst future losses were inconsistent with a claim for diminution in share value, which already would have occurred. The Court of Appeal overturned that decision and found B's warranty notice valid. Whilst the basis of loss set out in the notice was unusual, the "nature" of B's claim was straightforward and merely needed a simple statement that S had failed in its contractual obligation to provide the option. On the "amount claimed" B just had to put forward a calculation in good faith and details of how it was arrived at. It did not matter that the claim, as then formulated, was not based on a diminution in value of the shares in C. If S got legal advice that the calculation was unsound, it could obtain an expert valuation to contest it when the claim proceeded, or sought conduct rights to negotiate with the third party for the easement to seek a better deal. The calculation of loss in the notice was not set in stone. The notice had served its purpose of preventing the claim from being time-barred. Notice of claims clauses should not become a "technical minefield" to be navigated divorced from the underlying merits of the claim and courts should not interpret them as imposing requirements which serve no real commercial purpose. (*Drax Smart Generation Holdco Ltd v Scottish Power Retail Holdings Ltd* [2024] EWCA Civ 477)

Key lessons

- **Requirement to detail calculation of loss:** The judgment is helpful in clarifying that a requirement to detail the calculation of loss in the notice does not require the basis of calculation to be "set in stone".
- **Compliance with seller limitations remains mandatory, not permissive:** However, the case still shows the importance of complying with the precise requirements of the seller limitations on content and deadline for serving warranty notices. These are mandatory requirements rather than permissive and failure to comply can result in an otherwise valid claim being time-barred.

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Time limit for commencing proceedings on warranty claim and interaction with earn-out process

The High Court decided that a buyer's warranty claims under a share SPA were not time-barred even though the buyer did not comply with the requirement in the seller limitations to commence proceedings within six months of notifying a claim. This was because the warranty claims were treated as contingent on prior final determination of an earn-out under the SPA.

Buyer B and seller S entered into a share SPA. The purchase price for the shares in target company C was based on an Ebitda multiple and payable party in cash on completion and partly under an earn-out referable to the 12-month period following completion, up to a maximum of £15 million. Under the SPA, B had to commence legal proceedings within six months of notifying S of a claim, except for claims involving contingent or unquantifiable liabilities, when the deadline was six months from the date on which the claim became an actual liability or capable of being quantified. The parties failed to agree the earn-out and the matter was referred to independent accountant A for determination. B also alleged breaches of warranty in relation to: (i) employment costs that were not disclosed or reflected in the warranted financial information files in the data room from which the indicative Ebitda and related purchase price calculation had been based; and (ii) overstatement of gross profit in the management accounts in those files of a subsidiary of C. B commenced proceedings for breach of warranty within six months of the conclusion of A's determination but more than six months after first notifying S of the claims. B argued that: the employment costs claim was contingent on the outcome

Key lessons

- **Significant that the warranty claims were based on facts affecting the earn-out and could not be offset in the earn-out mechanism:** It was significant in this case that the relevant claims were based on facts that affected determination of the earn-out and that there was no provision in the earn-out mechanism to reflect the outcome of a related and preceding warranty claim.
- **Treatment of estimates of claims in warranty notices:** The High Court was clear that, if the parties had intended that an estimate of claim in the warranty notice should be treated as actual and quantifiable for this purpose in the context of the deadline for commencing proceedings, they should have stated that expressly in the SPA.

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of A's determination; and the gross profit claim was also contingent because it was less than the individual de minimis threshold for claims under the SPA and so would only amount to an actual claim if there were enough actual and quantifiable employee costs to reach the aggregate de minimis threshold. S applied for strike out or summary judgment on the basis that B's claim was time-barred. The High Court decided that B's claims were valid and that there was a risk of double recovery if these particular warranty claims were made before A's determination. The court took into account that an undisclosed overhead would affect valuation at both times, being completion and the end of the earn-out period. You could not solve that by giving credit in a later earn-out, as the earn-out mechanism did not provide for adjusting B's offset benefits depending on the outcome of a warranty claim. It was key to this analysis that double counting could only be avoided in the context of a warranty claim which, unlike the earn-out, is a loss calculation where the buyer has to prove the loss it has suffered from a warranty breach. To assess damages for B's loss you had to look at both the actual position and the counterfactual position, but the actual position here could not be known before A's determination. The effect was that the warranty claims in question were contingent or unquantifiable until the earn-out was finalised. This approach not only fitted the actual meaning that a reasonable commercial person would attribute to the SPA, but also was the outcome most consistent with business common sense. However, this would not have been the case in relation to a warranty claim that was not based on facts affecting the earn-out. Permission has been requested to appeal the decision. (*Onecom Group Ltd v Palmer* [2024] EWHC 867 (Comm))

Prohibition on assignment did not prevent transfer by operation of law

The Court of Appeal decided that a prohibition on assignment in a sale contract did not catch a transfer by operation of Japanese insurance law. In order to have prevented a transfer by operation of law it would either have needed to do so expressly or to use a far wider generic prohibition on assignment.

Claimant C was an aircraft manufacturer. It entered into a sale contract with customer M in Japan to supply two aircraft and spares. The sale contract was governed by English law and contained an arbitration agreement. It also contained a prohibition on any party assigning to any third party without the counterparty's prior written consent (article 15). M on-sold the aircraft to the Japanese coast guard (G) under a sub-sale contract on the same day, governed by Japanese law. Some time later, M also entered into an insurance contract (the IC) with defendant insurer D against the risk of incurring liability to G for late delivery. The IC was governed by Japanese law and reproduced in article 35(1) a provision of Japanese law that, where an insurer has paid insurance proceeds, it would be subrogated with regard to any claim of the insured arising from an insured event. It was accepted that, under Japanese law, this involved a transfer of rights. The aircraft were delivered late and M claimed against D under the IC. D paid liquidated damages to G and brought an arbitration against C under the arbitration agreement in C's sale contract with M. A majority of the arbitrators decided that M's claims against C were transferred to D by operation of law and that C's consent was not needed. One arbitrator dissented on the basis that any transfer under the IC was the consequence of M's and D's voluntary decisions to enter into the IC. C challenged the tribunal's jurisdiction and appealed. The High Court had then decided that prohibitions on assignment "*by any party*" did not necessarily exclude transfers occurring by operation of law and that, delineating a distinction between voluntary and involuntary transfers, the transfer of M's claims to D under article 15 was prohibited without C's consent. The Court of Appeal found in D's favour and allowed its appeal. It decided that the prohibition on assignment in the sale contract was neither ambiguous nor unclear: the clause prevented any transfer effected

Key lessons

- **Clear and express drafting:** Clear and express drafting is advisable to delineate expressly the scope of a prohibition on assignment.
- **Guidance on interpretation of prohibition on assignment "by" a party:** The judgment gives clear guidance that a prohibition on assignment "by" a party does not catch an assignment by operation of law.
- **Due diligence reviews:** Depending on the facts, this may be an issue to consider when reviewing the scope of assignment clauses in due diligence reviews.
- **Prohibiting transfer by operation of law:** When drafting restrictions on assignment, to catch transfers by operation of law either express drafting is needed or much wider generic wording than the market standard prohibition on assignment by a party.

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by a party, but not a transfer effected by operation of law. It denied C's argument that the words "*by any Party*" in article 15 could be read to include the words "caused by any Party". The prohibition on assignment clearly provided that the sale contract should not be assigned or transferred in whole or in part "***by any Party***" to any third party for any reason whatsoever. The correct question simply was whether the transfer was made by M, not whether the transfer was caused by actions taken by M. On contractual interpretation, Sir Geoffrey Vos MR said that the judge at first instance had erred in starting from the position that there were two possible interpretations of article 15 and that one of them was that a transfer by operation of law could be treated as a transfer by M. The objective meaning of the language the parties had used was that article 15 did not invalidate a transfer by operation of law. Permission to appeal the decision has been declined. (*Dassault Aviation SA v Mitsui Sumitomo Insurance Co Ltd* [2024] EWCA Civ 5)

Company law

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

Directors liable for fraudulent trading and breach of duty to promote success

The High Court decided that directors of a company providing short-term bridging loans were liable for fraudulent trading. They had also breached their statutory duty to promote the success of the company, including the creditors' interests duty, and their statutory duty not to approve accounts unless satisfied that these give a true and fair view.

Company C's business was to provide short-term bridging loans secured by legal charges over property. C was a wholly-owned subsidiary of parent company P. C's funds for the loans that it advanced came from an investment fund (IF) whose function was to provide liquidity to C. C went into administration in July 2012, followed by creditors' voluntary liquidation in December 2013, owing around £109.7 million to IF, with an estimated net deficiency of £72.7 million. C's joint liquidators (L) alleged that two of C's directors (D), who were also directors of P, had procured that one set of loans had been entered into by C fraudulently and in breach of their statutory director duties. The allegation was that D had used funds from IF to refinance a number of loans through C to a Mr R that were non-performing loans originally made by P or other group companies on the basis of inflated property valuations, with the aim of allowing these other group companies to discharge sums due to their banks and preserve their own liquidity. L alleged that R's borrowing had been rearranged on extended terms and based on property valuations using excessive loan to value ratios. L argued that there had not been any true commercial purpose benefiting C and that the refinancing had not been in the interests of either C or its creditors. L also alleged that it had been obvious that R's loans were non-performing and that C's accounts for the years ended 2009 and 2010 failed to show due provision for them, which would have identified that C was insolvent, so that C could continue trading. L brought a claim for fraudulent trading. If, in the course of a winding up, it appears that the company's business has been carried on with intent to defraud creditors, or for any fraudulent purpose, the court may order people who were knowingly party to that to contribute to the company's assets. L further alleged breaches of the statutory directors' duty to promote success. Even noting the high threshold to be applied, the High Court decided that D were indeed liable for fraudulent trading. They had known that the refinancing was fraudulent and had acted dishonestly and with intent to defraud C's creditors. They knew that R's loans were in default and premised on property developments that had not completed as expected. They had also breached their statutory directors' duty to promote the company's success, including failing to have regard to the statutory factor of maintaining a reputation for high standards of business conduct. Applying the subjective test, they could not honestly have believed that their actions were in C's or its creditors' interests. They had treated the business of P's group as one undertaking, giving little if any thought to the independent interests of each company. D had further breached the creditors' interests duty, which had been triggered by November 2009. The High Court awarded L equitable compensation for D's breach of duty, to equal the value of the assets knowingly misapplied or misappropriated. (*Bouchier & Anor v Booth & Anor* [2023] EWHC 3195 (Ch))

Key lessons

- **Rare example of successful fraudulent trading claim:** The case is a rare example of a successful claim for fraudulent trading where the high threshold was met.
- **Crucial for directors to treat each member of the group as a separate company:** A salutary reminder that each company in a group is a separate legal entity to which the directors separately and individually owe their statutory director duties, including the duty to promote success.

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Different treatment of sanctioned shareholder did not fracture class on scheme of arrangement

The High Court decided that the fact that a financially sanctioned shareholder was not permitted to vote his shares at a scheme meeting and had different rights on exit under the scheme did not operate as a roadblock to the court's sanctioning of the scheme or require separate meetings of shareholders to be held.

This was an application by Velocys plc to convene a meeting of its shareholders to approve a proposed scheme of arrangement in connection with Velocys's takeover. An 8.3% interest in Velocys was held, indirectly, by DD who had been designated as a UK assets freeze target under The Russian (Sanctions) (EU Exit) Regulations 2019 (the "Regulations"). It was thought that the Regulations prohibited DD from voting and transferring his shares and from receiving payment for his shares pursuant to the Scheme. Velocys therefore proposed that the court give the chair of the meeting a power to disallow any vote purportedly cast by a shareholder if advised that this would be unlawful. This would be without prejudice to the right of the shareholder to assert at the court sanction hearing that their votes should have been accepted. The scheme terms also provided that the shares held by a sanctioned shareholder should not be transferred until the later of: (i) the effective date of the scheme; and (ii) the earlier of the date on which a licence to deal in the shares was obtained from the HM Treasury's Office of Financial Sanctions Implementation ("OFSI") or the date on which the relevant sanctions were removed. The High Court considered that the proposed terms of the convening order struck a fair balance between the imperative to avoid unlawful activity and the need to treat DD fairly and concluded that none of the terms presented a jurisdictional or other roadblock to the scheme. Further the High Court did not consider that the inability of DD to vote his shares at the meeting and the different manner in which his shares were dealt with under the scheme fractured the overall class of shareholders. DD's inability to vote his shares did not arise as a result of his rights as a shareholder, but rather from an external source (the Regulations). Although DD's rights on exit would be different to other scheme shareholders, they were not so different as to make it impossible for all members of that class (in theory) to consult together in common interest. The High Court therefore ordered a single meeting of scheme shareholders as requested by the company. The scheme was subsequently sanctioned by the High Court. (*Re Velocys Plc* [2024] EWHC 28 (Ch))

Key lessons

- **Pragmatic approach:** The judgment highlights the pragmatic approach that the courts will take when considering and approving a scheme of arrangement between a company and its shareholders.
- **Due diligence:** It also highlights the importance of carefully reviewing a company's shareholder **profile** at an early stage to ensure that the proposals do not fall foul of the UK sanctions regime and other regulations.

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Court has jurisdiction to approve extension of long-stop date on scheme of arrangement

The High Court decided that it has jurisdiction to approve the extension of a long-stop date on a scheme of arrangement, provided that the court approval of the extension is sought before the expiry of the original long-stop date.

This was an application by Network International Holdings Plc for an order approving the extension of a long-stop date on a scheme of arrangement (the "Scheme") to effect the company's takeover. The original long-stop date for the scheme to become effective was 9 April 2024 and the company wished to extend this to 9 October 2024 so that outstanding regulatory clearances could be obtained. The High Court held that it did have jurisdiction to grant the approval sought notwithstanding that the CA 2006, Pt 26 did not confer any specific power on the court to do this. The High Court also held that its approval was required and that the offer parties could not simply agree an extension of the

Key lessons

- **Timing:** Parties seeking an extension to a long-stop date on a scheme of arrangement should apply for this before the long-stop date to avoid the scheme lapsing.
- **Process:** Although in this case the High Court was willing for the application to proceed without an application notice being issued, the court's preferred approach is for an application notice to be issued before the court's consent is sought and for this to be served on scheme shareholders.
- **Obiter:** The judge emphasised that his decision had been reached on the facts of the case and without the benefit of argument from both sides. Some caution should therefore be exercised when relying on the judgment on future cases.

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long-stop date and leaving it to the sanction hearing for any Scheme shareholder to raise an objection. The High Court expressly disagreed with the decision in *Re Emis Group Plc [*2023] EWHC 1543(Ch) in which the judge had suggested that it should be possible to seek a retrospective extension to the long-stop date after the original long-stop date had expired. If the long-stop date was not extended before 9 April 2024, the Scheme would not be capable of becoming effective and in that event the company would need to restart the scheme process. An application notice should have been issued when the company sought the extension from the court, but this could be 'cured' by the company undertaking to issue the required application notice. Normally this should be served on the scheme shareholders, but in the present case the High Court agreed that the company could instead publicise the court order approving the extension on its website and via an appropriate news feed. The order granting the extension would include a recital making clear that scheme shareholders were not precluded from objecting to the extension of the long-stop date at the court sanction hearing. The High Court therefore ordered that the long-stop date be extended to 9 October 2024. (*Re Network International Holdings Plc* [2024] EWHC 1545 (Ch))

Enhanced premium payable to convertible loan noteholders did not fracture class on scheme of arrangement

The High Court decided that a scheme of arrangement to effect a takeover was not impaired by the fact that the company had failed to disclose adequate details regarding the directors' interests in certain convertible loan notes. The High Court also held that the directors' holding of such CLNs and the enhanced premium payable to the noteholders on the company's change of control, did not fracture the class and require a separate class meeting to be held.

This was an adjourned sanction hearing to approve a scheme of arrangement (the "Scheme") proposed by The Lakes Distillery Company plc ("Lakes") to effect its takeover by Nyetimber Wines and Spirits Group Ltd ("Nyetimber"). The court had adjourned the original sanction hearing after raising concerns about the adequacy of disclosures in the explanatory statement relating to the directors' interests in convertible loan notes ("CLNs") issued by Lakes, which were due to be repaid in full with a 100% premium as a result of the takeover.

On the facts, the High Court concluded that the arrangements for repayment of the CLNs at a premium were not part of, or collateral to, the Scheme. The CLN terms were consistent with Lakes' previous loan arrangements and had been entered into by the company to give it breathing space to secure new equity investment and not in anticipation of a premium on a takeover. The rights of the shareholders holding CLNs were not so dissimilar from the other shareholders as to make it impossible for them to consult together with a view to their common interest. There was no fracturing of the class of shareholders.

Key lessons

- **Adequate disclosure:** Although in this case the High Court was willing to sanction the Scheme, the court emphasised that any material deficiency in disclosure would usually result in sanction being refused, at least pending a further meeting after full and proper further disclosure. The court also highlighted that disclosure should not be formulaic, but rather specific to, and fair and reasonable in, the context of the particular scheme.
- **Class issues:** The case highlights the importance of determining at an early stage whether there are any arrangements with shareholders that might be treated as part of or collateral to the scheme. Where this is the case, separate meetings of shareholders should be convened.

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On the issue of inadequate disclosure in the explanatory statement, the High Court noted that this would often be grounds for the court to withhold its sanction of the Scheme. However, in this case the High Court agreed to sanction the Scheme having considered the strong support for the Scheme at the class meeting and Lakes' uncertain financial position. (*Re Lakes Distillery Company Plc* [2024] EWHC 1535 (Ch))

Amendment of articles of association by conduct and failure to notify refusal to register share transfer

The High Court decided that articles of association had been amended by conduct on appointment of directors to allow appointment on written notice from registered shareholders, and also confirmed that, where a company fails to notify a refusal to register a share transfer within two months of the transfer being lodged with it, the right to refuse to register is lost.

Company C managed and maintained a courtyard of four office units and held the freehold interest in the inner courtyard. Claimants L1 and L2 (together, L) jointly owned the freehold interest in Units 3 and 4. C's articles envisaged that each unit owner would hold one share in C. Further, C had been run informally on the basis that each unit owner had the right to appoint a director. L were duly registered as joint holders of two shares. Defendants D1 and corporate D2 (together, D) were the freehold owners of Units 1 and 2 respectively, although their names had not been entered on the register of members. All of L1, L2, D1 and an officer of D2 claimed to be directors of C. Under article 19 of C's articles of association, all C's powers which were not required by law or the articles to be exercised by C in general meeting were to be exercised by the directors. When relations between L and D broke down, D disputed L's right to be entered on the register of members in respect of Unit 3, which had been the second of their unit purchases, and also disputed L2's appointment as director following L's purchase of Unit 3. The High Court decided that the articles had been amended by conduct on the basis of informal shareholders' unanimous consent. The starting point was that the articles, which were silent on appointment of directors, conferred the power to appoint directors on the board by virtue of the effect of generic article 19. In practice though for many years successive directors had been appointed by written notice to C from appointing members without any formal shareholders' or board resolutions. The High Court decided

Key lessons

- **Amendment of articles by conduct:** This is another example, in a line of case law, of the court finding informal amendment of articles of association by conduct applying shareholders' unanimous consent. Strictly speaking the amendments would not have operated against a third party without registration at Companies House.
- **Right to refuse to register a share transfer:** A rare case on the operation and scope of a company's right to refuse to register a share transfer under the Companies Act 2006.

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the effect was that C's members had agreed by conduct to amend the articles to allow this, and that this amendment had been made permanently rather than just on a one-off basis. On the facts, L2 had been appointed director on this basis. However, the court held that the articles had only been amended to allow unit owners who were registered members of C to appoint directors this way, noting that the principle of shareholder's unanimous consent generally only applies to registered shareholders. There was no evidence here to support a wider amendment to the articles. On the dispute over L's share ownership in relation to Unit 3, the court emphasized that any exercise of the directors' discretion under the articles to refuse to register a transfer had to be in accordance with their statutory duties and was lost if notice of refusal was not given by C's directors within the two-month time limit under the Companies Act 2006. There had been no proper purpose to refuse to register the transfer here, notice of refusal had been out of time anyway and L's names should therefore go on C's register of members in respect of Unit 3. (*Re Bramber Road Management Ltd, Clarke & Anor v Lakha & Anor* [2024] EWHC 51 (Ch))

Unanimous consent needed to include beneficial owner

The High Court decided that a director who, together with his wife, was registered legal shareholder in a company, was in breach of duty that could not be ratified applying shareholders' unanimous consent without the consent of the beneficial owner of 50% of the shares in the company.

Defendant director D and Mr H entered into an oral joint venture agreement in which their two families were to hold equal interests in the joint venture company (C). Shares in C were held by D and his wife, on the understanding that 50% of the shareholding was held on trust for Mrs H. It was alleged that D was in breach of duty for arranging for C to grant him a lease of its main asset, office premises, with security of tenure and with an extended term in place of a previous unexpired lease in his favour with no security of tenure. D took this step after his relationship with Mr H broke down. Mrs H brought a derivative claim alleging that D had breached his statutory duties to act within his powers and to promote the success of the company, and that the new lease was void. The High Court found in Mrs H's favour that the new lease was indeed void. The court held that D had known that he was procuring a material advantage for himself at C's expense given that relations with Mr H had irretrievably broken down and rushing to take "a bird in the hand". The proper purpose for which C's power to grant leases was delegated to directors was for the benefit of members or obtaining a rental stream for C without unnecessarily burdening it with a tenant with security of tenure. By contrast, D had exercised the power to safeguard his own position before becoming tenant of a deadlocked company. He had consequently breached his statutory director duty to act for a proper purpose by failing to exercise his powers for the purposes for which they were conferred. The High Court commented that he had also breached the director duty to promote the success of the company. There was no evidence that D actually considered whether entering into the new lease was in C's best interests. This meant that the standard subjective test fell away and the court instead applied an objective test of whether an intelligent and honest person in D's position would have considered it so, which had not been met. The High Court denied that entry into the new lease had been approved by shareholders' unanimous consent. There was no evidence that D or his wife had positively considered and ratified the decision, and on the facts of this case Mrs H's consent as beneficial owner of 50% of the shares should have been obtained. (*Chohan v Ved & Ors* [2024] EWHC 739 (Ch))

Key lessons

- **Duty to act for a proper purpose:** An example of a judgment on directors' duty to act for a proper purpose.
- **Consent from beneficial owner for unanimous consent:** Whilst generally shareholders' unanimous consent requires consent from registered shareholders, this is an example of the court, on specific facts involving a director's breach of duty, requiring consent of the beneficial owner of 50% of the shares for unanimous consent to apply. The court did not consider whether the principle of shareholders' unanimous consent can apply where a director is in breach of duty to act for a proper purpose.

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Unfair prejudice on breach of duty under SHA to work in good faith towards an exit

The High Court decided that a shareholder's unfair prejudice petition was made out where a company had breached a contractual requirement in a shareholders' agreement (SHA) to work in good faith towards an exit by a specified date.

Under the SHA company C and its investors were under a contractual obligation to work in good faith towards an exit by 31 December 2019, to give good faith consideration to any opportunities for an exit before that date and, failing that, to engage an investment bank to "cause" an exit after that date on such terms as the board of directors consented to, such consent not to be unreasonably withheld. "Exit" was defined to include a sale of all or substantially all of C's share capital or business or assets. No exit was achieved by the deadline. When defendant director and indirect investor D instructed financial adviser F to work on the sale process there was no explicit instruction to work towards the contractual deadline in the engagement. C had still not been sold four years after the deadline. Petitioner P brought an unfair prejudice petition. The High Court decided there had been unfair prejudice, because P had been unable to sell its shares in the way provided for in the SHA. The court made a conditional order for the purchase of P's shares, subject to a trial on quantum and noting that the prejudice here was the value of the hypothetical best offer that C would have received which would have been acceptable to selling shareholders. D had argued that there was an implied directors' duties override to the contractual obligation to effect an exit by the deadline, on the basis that the board believed that the timeframe would not maximise value for shareholders. The court rejected this. It emphasized that it was unsupportable to suggest that it was a breach of directors' duties to do a deal today rather than wait for a better deal tomorrow. Case law on "fiduciary outs" where directors receive simultaneous competing bids in the course of a public takeover were irrelevant in this context. The court also rejected D's claims that a potential offer involving some shareholders becoming equity investors, and which had not been considered by the board, was not an opportunity for an

Key lessons

- **Unfair prejudice where contractually agreed process not followed:** It was key to the outcome in this case that unfair prejudice was made out where the agreed contractual mechanism was not followed and the petitioning shareholder could not sell its shares in the way envisaged in the SHA as a result. This shows the importance of following a contractually agreed process and the risk that a minority shareholder may otherwise succeed in an allegation of unfair prejudice.
- **"Fiduciary outs":** The judgment contains interesting guidance on the scope of implied directors' duties overrides at law.

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exit because it did not amount to a sale of all or substantially all of the shares in C. Whilst simply replacing one shareholder with another would not amount to a sale of "substantially all" of C's shares where rolling over shareholders were both in a majority of the equity-holders in the acquisition vehicle and in the same economic position as before the transaction, that was not true where the acquisition vehicle's capital structure was completely different to C's. If C had performed its contractual obligation to consider all offers it would have had at least one or two conditional offers by the contractual deadline. If it had instructed F properly, it might have had more. There was an implied term that an exit must take place as soon as reasonably practicable and within a reasonable time after the contractual deadline. Permission has been granted to appeal the decision. (*Saxon Woods Investments Ltd v Costa & Ors* [2024] EWHC 387 (Ch))

No unfair prejudice to the extent exit mechanism in SHA was followed

The High Court decided that an unfair prejudice petition had not been made out over the management of a company and the instigation of an exit procedure under the SHA in relation to a minority shareholder's shares, although it did uphold the petition on the issue of share valuation.

Company C was a waste management business. W was director and registered holder of 14.3% of the issued shares, where the remainder was held by two brothers (B). On 23 September 2015 HMRC started investigating B regarding a suspected fraud involving non-payment of landfill tax (albeit, this was eventually dropped in 2019). W then sent B an email on 26 September 2015 that he had decided to leave C at the end of November. W ceased working for C and to be paid salary as an employee after that date. Accountant A valued W's shares, applying a 75% discount for the minority stake but used out of date figures from 2014 in his valuation. The SHA in relation to C covered certain sale eventualities, including a shareholder's wish to effect a voluntary "sale". It provided that a selling shareholder would "make a written offer" to sell their shares to the other shareholders proportionately to their existing shareholdings "at the relevant time" at a price to be determined by an appointed accountant. W brought a petition alleging unfair prejudice, including: alleged historic dilution of his shares; failure to declare dividends; excessive and uncommercial related party transactions by B; and A's use of outdated figures in valuing his shares. The High Court decided that W's email informing B that he had decided to leave amounted to a voluntary sale event obliging W to offer to sell his shares under the exit clause in the SHA using the prescribed mechanism. W had failed to make out unfair prejudice either over past conduct of C or the instigation of the exit mechanism. This was because W had an available contractual exit route that he had triggered which could reflect matters of prejudice in valuing his shares.

Key lessons

- **No unfair prejudice where contractually agreed process followed:** The judgment shows that it will be hard for a minority shareholder to make out an unfair prejudice petition over the application of contractual provisions where the provisions have been implemented in accordance with the contract terms.
- **Clear exit route available to minority shareholder:** It was key to the finding of no unfair prejudice that there was a clearly defined exit route available to the minority shareholder in this case, including a contractual requirement on the company to purchase an exiting shareholder's shares if the other shareholders failed to exercise their right to do so and no sale was negotiated with a third party.

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W's interests as a shareholder had crystallised on 26 September 2015 with the effect that any breaches of directors' duties after that date were neither prejudicial nor unfair. However, A's share valuation was not binding because he had departed from his instructions to value as at 30 September 2015 by using outdated figures from December 2014. The court treated A's valuation as "affairs of the company" that amounted to unfair prejudice, taking into account that, under the SHA, C had to acquire an exiting shareholder's shares if the other shareholders did not elect to do so and no third party sale was negotiated. The effect was that A's conduct over the valuation could be characterised as conduct of the company's affairs and was at least in part carried out for C's benefit. W's shares should be valued at the correct date and applying a minority discount. (*Wells v Hornshaw & Anor* [2024] EWHC 330 (Ch))

Alleged breach of directors' statutory duties on conflicts of interest not suitable for summary judgment

Overturning the earlier High Court decision, the Court of Appeal held that a derivative claim based on alleged breaches of directors' duties to avoid situational conflicts and to declare transactional conflicts did not lend itself to summary judgment.

Two minority shareholders and former directors (M) together holding 49% of company C alleged that director D1 and his co-director and partner D2 had breached their statutory duties to avoid unauthorised situational conflicts of interest and to declare transactional conflicts. The allegations against D related to wrongfully transferring land owned by C, with the benefit of planning permission, to company S, which was wholly-owned by D, and diverting the opportunity to develop it. D argued that: C could not afford to develop the land; M would not contribute the necessary capital; and that it had been agreed that another of C's companies would do so, and that M had not objected at any point to the sale. On this basis D alleged that any conflicts had been authorised applying the principle of shareholders' unanimous consent or declared and were known anyway. The High Court had granted summary judgment against D1. The Court of Appeal allowed D1's appeal, deciding that the case against D1 did not lend itself to summary judgment. The Court of Appeal held that it was reasonably arguable that, if M had refused to pursue the project through C and agreed that D could run it though another company, that was sufficient shareholder authorisation and declaration of the transactional conflict. In particular, it was reasonably arguable that, in those circumstances, D1 would not have needed to explain to M how the acquisition would take place nor which of his corporate vehicles he would use. The Court of Appeal took into account that the parties had run C very informally. When considering the statutory directors' duty to declare transactional conflicts, you had to consider the alleged agreement in the context of what all parties must have known that the project would involve. Here, it was arguable that M should have appreciated that C would need to sell the land to D (or one of their companies) once M had agreed that D could pursue the project outside C. The Court of Appeal also commented that the same issues on the statutory directors' duty to avoid a conflict of interest arose with regard to D2's relationship with company S. It made no difference that D2 was only a director and, unlike D1, was not also a shareholder in S. Cross-directorships alone were sufficient to trigger the statutory rules on conflicts of interest, and a director did not also need a shareholding in another company before the rules against conflicts came into play. (*Humphrey & Anor v Bennett & Anor* [2023] EWCA Civ 1433)

Key lesson

- **Record any authorisations and agreements reached:** The judgment shows the importance of directors recording carefully any authorisations and agreements reached over the handling of business opportunities and wider potential conflicts of interest.

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Listed companies

The following decisions are of particular interest to listed companies.

Permission refused to challenge FCA's decision to approve a prospectus

The High Court has refused permission to apply for judicial review of the Financial Conduct Authority's (FCA) decision to approve a prospectus prepared by an issuer (I) in the oil and gas sector for the admission of its shares to trading on the Main Market of the LSE.

I published an FCA-approved prospectus on 9 November 2022. C (a non-governmental organisation) alleged that the FCA's decision to approve I's prospectus under section 87A(1) of the Financial Services and Markets Act 2000 (FSMA 2000) was unlawful because: (i) the prospectus failed to adequately disclose or describe (in breach of Article 16 of the UK Prospectus Regulation): (a) I's assessment of the materiality of its climate-related financial risks; and (b) the specificity of the climate-related risks associated with I's securities; and (ii) the FCA's conclusion that I's prospectus contained the information required by Article 6(1) of the UK Prospectus Regulation was rationally unsustainable.

The High Court refused permission for C to apply for judicial review of the FCA's decision to approve I's prospectus. C's grounds of challenge were unarguable and had no realistic prospect of success. The FCA's decision to approve I's prospectus could only be challenged on public law grounds, i.e., that it had misdirected itself on the meaning of the law it had to apply, or failed to take relevant considerations into account, or made an irrational decision. Article 16(1) required the disclosure of material risk factors but not the issuer's assessment of risk and materiality. Article 16(1) also provided that the risk factors be limited to specific risks and must be adequately described, but did not require the issuer to disclose its assessment of risk and specificity. I's prospectus addressed risks arising out of climate change factors, associated regulatory measures and changes in consumer use. The FCA considered that the risk factors were adequately described. C had failed to demonstrate any arguable error of law in FCA's approach or its conclusions. The Court would not substitute its view or that of C for the considered judgment of the FCA. The prospectus identified the Paris Agreement as a material risk for the business. The FCA was satisfied that the prospectus complied with Article 6. The Court held that C did not come close to demonstrating that the FCA acted irrationally, which is a high hurdle to overcome. (*R (on the application of ClientEarth) v Financial Conduct Authority* [2023] EWHC 3301 (Admin))

Key lessons

- **Limited scope to challenge prospectus approval:** This decision makes clear that the FCA's decision to approve a prospectus under section 87A of FSMA 2000 can only be challenged on limited grounds. While unsurprising, this provides a measure of certainty to the issuer, its advisers and the FCA.
- **Importance of risk disclosures:** In this case, adequate disclosure in the prospectus helped the FCA to defend its approval decision. This underlines the importance of carefully drafting and verifying risk factors and related disclosures. A prospectus must properly reflect the risks as well as any attractions of investing in the issuer's securities.

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FCA censures issuer for false or misleading announcements and financial reports

The Financial Conduct Authority (FCA) has censured a premium listed company (N) in relation to false or misleading information regarding N's debt position and related matters contained in N's announcements and annual and half-yearly financial reports.

On 17 December 2019, an activist short seller (M) published a report making various allegations impugning the accuracy of N's financial reporting. N's share price fell by 32% that day. On 18 and 19 December 2019, N issued announcements essentially denying M's allegations. On 23 December 2019, N announced that it would commence an independent third-party review to review the allegations. On 26 February 2020, N announced that the review was ongoing but (among other things): (i) it had identified and was examining certain supply chain financing arrangements guaranteed by N which had not been disclosed to, or approved by, N's board and were not reflected in N's financial statements; (ii) potential discrepancies and inconsistencies had been identified in N's bank statements and ledger entries which were being investigated; and (iii) the board had removed N's CEO with immediate effect. The listing of N's shares was suspended on 27 February 2020. By then N's share price had fallen by nearly 64% since 17 December 2019. Administrators were appointed to N on 9 April 2020.

Key lessons

- **Knowledge at a senior level:** The FCA's findings that there was knowledge at a sufficiently senior level within N, and that incorrect information was provided to N's auditors, emphasise some of the challenges that issuers may face in consistently implementing procedures, systems and controls. This also highlights the benefits of robust procedures for internal audit and whistleblowing.
- **FCA focus on misleading information:** This is another example of FCA civil enforcement action against an issuer for market abuse by disseminating false or misleading information. This has become an important enforcement tool for the FCA. Since 2017 the FCA has also used it against Carillion plc, Carillion's CEO and Group Finance Director, Redcentric plc, Tesco plc, and the CEO and CFO of Worldspreads Group plc.

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N committed the offence of market manipulation under Articles 12(1)(c) and 15 of the Market Abuse Regulation (EU) 596/2014 by disseminating information that gave false or misleading signals as to the value of N's shares in circumstances where it knew that this information was false or misleading. The FCA censured N. It would have imposed a substantial financial penalty if N was not in administration. N had operated with two parallel sets of partial financial records. These included spreadsheets that categorised debts into "non-showing" (which were not disclosed in N's financial statements) and "showing" (which were disclosed). The false or misleading information released by N included: (i) N's preliminary results announcement on 7 March 2019 and half-yearly results announcement on 22 August 2019 which understated the group's total debt by about two thirds; (ii) N's results announcements and annual report failed to declare certain related party transactions, namely supply chain finance facilities (for which N was guarantor) used to pay suppliers which were related parties; (iii) N's incorrect statement in its announcement on 18 December 2019 that its disclosures were reviewed by its independent disclosure committee; and (iv) certain statements and implications in N's announcement on 19 December 2019. The FCA was satisfied that there was knowledge at a sufficiently senior level that this information was false or misleading for that knowledge to constitute the knowledge of N. (*FCA final notice to NMC Health Plc (in Administration)* – 30 August 2023 (published 17 November 2023))

Takeover Panel orders directors to pay compensation for concealing controlling interest (MWB Group Holdings plc)

The Takeover Panel (Panel) has for the first time used its powers under the Companies Act 2006 (CA 2006) and the Takeover Code (Code) to require payment of compensation for breaches of the Code.

The Takeover Appeal Board (TAB) has dismissed an appeal by Richard Balfour-Lynn, a former director of MWB Group Holdings plc (MWB), against a ruling of the Panel's Hearings Committee (Committee) that he and two other former directors should pay compensation to former MWB shareholders for breaches of Rule 9 of the Code.

The Committee found that the former directors, with the assistance of other parties, had acted in concert to acquire additional MWB Shares, which increased the concert party's aggregate percentage shareholding above the relevant thresholds in Rule 9 of the Code. The concert party had concealed the extent of its controlling interest from the other MWB directors and from the market generally, including through a series of sham transactions involving offshore entities. The former directors and other parties had also breached Section 9(a) to the Introduction to the Code by failing to take reasonable care not to provide incorrect, incomplete or misleading information to the Panel.

The normal remedy for a breach of Rule 9 is to require a mandatory offer to be made. However, MWB had gone into administration in 2012 and had subsequently been liquidated and removed from the Register of Companies. It was considered impractical to restore MWB to the register and the Committee instead used its powers under CA 2006, s 954(1) and Section 10(c) to the Introduction to the Code to require the former directors to pay compensation to shareholders on the register at 12 January 2010 in an amount equivalent to what they would have received under a mandatory offer, with credit being given for the proceeds of sale of any shares sold after 12 January 2010. The Committee also ruled that the three former directors and seven other individuals involved in the deception should be made the subject of 'cold-shoulder' statements for periods of between one and five years. Under the UK Market Abuse Regulation, if a person is made the subject of a 'cold-shoulder' ruling, FCA-regulated firms should not act, or continue to act, for such persons in connection with a transaction to which the Code applies (including share dealing and other transactions subject to Rule 8 of the Code) for the duration of the 'cold-shouldering' sanction.

Another former MWB director was also made the subject of a public statement of censure under Section 11(b)(ii) of the Introduction to the Code for not consulting the Panel when he was in doubt as to whether a proposed course of action was in accordance with the Code.

Key lesson

The decision is a good illustration of the wide range of powers available to the Panel for breaches of the Code. Before the Panel's powers were put on a statutory footing, its main methods for enforcing the Code were private and public censuring and, in extreme cases, a 'cold shoulder' ruling. However, in 2017 we saw the Panel pursue a shareholder in the courts to require a mandatory offer to be made for Rangers Football Club and now we have seen the Panel order compensatory relief for the first time using powers conferred by the CA 2006 and the Code. The decision also highlights the importance of consulting the Panel where there is any doubt as to whether a course of action is permitted under the Code and being open and transparent when dealing with the regulator.

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None of the parties appealed against the Committee's 'cold-shoulder' sanction, but Mr Balfour-Lynn appealed against the compensation ruling. In dismissing the appeal, the TAB commented that a breach of Rule 9 was analogous to a breach of statutory duty and that the object of Rule 9 (and other Rules) was fairness to shareholders by providing for their ability to make informed decisions about their shares in the target company. The TAB highlighted the following as being relevant in determining the appropriate amount of compensation:

- the former directors were under a continuing obligation until the date of MWB's administration to disclose the extent of the concert party's shareholding. This arose as a result of the obligation in Section 9 of the Introduction to the Code to correct incorrect or misleading information provided to the Panel, and the obligation under General Principle 4 not to permit the creation (or continued existence) of a false market in MWB's shares
- the principal purpose of the Code was to ensure that shareholders were treated fairly and given appropriate information
- Section 10 of the Introduction to the Code gave the Panel power to order payment of compensation in an amount equivalent to what the relevant shareholder would have received at the time of the offer if the relevant rule had been complied with.

Against this background, the TAB rejected Mr Balfour-Lynn's arguments that the Committee wrongly applied the compensatory principle. (TAB Statement 2024/1, Panel Statement 2024/16 and Panel Statement 2024/17)

Good Faith

Two recent cases have looked again at contractual duties of good faith, fiduciary duties and the relationship between contracting parties.

No relational agreement between competitors giving rise to duty of good faith

The High Court decided that an agreement between a mobile network phone operator and a supplier of consumer connections to mobile networks was not a relational agreement giving rise to an implied duty on the operator to act in good faith.

The agreement was between mobile phone network operator N and a supplier of consumer connections to mobile networks, claimant C. It had a three-year term and could be renewed. One year before the expiry of the agreement, N wrote to C stating that it would not renew the agreement at the end of the term. Three days later C went into administration. C's administrators argued that N had intended to trigger C's administration so that N could terminate early and cease to be obliged to make further contractual payments. The High Court denied that there was a relational agreement triggering an implied duty of good faith. The court also rejected that an express term of the agreement requiring N to act in good faith and refrain from acts designed to reduce or avoid revenue payments under the agreement extended to a general duty of good faith. It was a detailed professionally drafted agreement. The parties could have drafted an express general duty of good faith if they had wanted to. Further, if there were such a provision, it was inconceivable that it would not have imposed a corresponding obligation on C. Some features of the agreement, viewed alone, might have suggested a relational agreement. These included: that it had a moderately long term; that it required extensive collaboration in order to perform; and that it was an exclusive arrangement. However, the parties were competitors, as N was trying to expand into direct retail connections, which told the other way. In any event, there had been no lack of good faith on the facts. N was entitled to prioritise its own interests and concerns. Reasonable and honest people would not regard N's letter as commercially unacceptable. Permission has been granted to appeal the decision. (*Phones 4U Ltd (In Administration) v EE Ltd & Ors* [2023] EWHC 2826 (Ch))

Key lessons

- **Approach of the courts on relational agreements:** This is another in a line of case law highlighting that the court will not lightly find a relational agreement giving rise to an implied duty of good faith.
- **Agreements between competitor parties:** The judgment shows that a relational agreement is less likely to arise between competitor parties.

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Breach of contract and fiduciary duty for exploiting new business opportunity

The High Court decided that a party was in breach of contract, fiduciary duty and duty of confidence for wrongfully exploiting the counterparty's business opportunity which had been disclosed to it during merger negotiations.

Both claimant C and defendant D provided motor insurance services. C was a warranty and after-sales products provider and D was an insurance provider for the motor industry. In the course of merger negotiations between them, C informed D of a business opportunity from a Korean car manufacturer that needed a new warranty provider. C wanted to use D to place the opportunity for C and was willing to use D to source underwriting for C in respect of it. C argued that it was agreed with D that this would remain C's opportunity, and that D was only to benefit to the extent that their merger completed. Within six months C and D fell out. D proceeded to exploit the business opportunity entirely for itself, and earned revenue from it, without paying C anything. The High Court found in favour of C. Many of the parties' dealings here had been unwritten and the lack of a direct written record was not surprising. In any event, the available written documents were consistent with C's case. C viewed the business opportunity here as potentially of substantial value and would not have handed it over for D to use as it liked for its own account, effectively as a gift. In the very least it would have been implied that the opportunity would remain C's. D had also breached a fiduciary relationship with C. Whilst fiduciary relationships do not usually arise from general commercial dealings (as parties are free to act in their own interests), one had arisen here. This was because the effect of the oral agreement here was that D was not at liberty to prioritise its own interests. An even stronger argument of a fiduciary relationship arose here than in say the category of joint ventures, where no one party necessarily itself controls the assets which are to be exploited for the benefit of both. By contrast here, even though practical control of the business opportunity had been passed to D, it was to be exploited for the benefit of C. It made no difference in this case that the parties were competitors generally. They were not treated as competitors in relation to this business opportunity. The fiduciary duty here was to act in C's best interests and not to profit personally at C's expense. D had also breached a duty of confidence in relation to the business opportunity. Details of the business opportunity were confidential irrespective of whether they had been shared with others in the warranty market. Whilst there had been no express confidentiality arrangement between the parties, given the context D could not have thought that it could use the information unrestricted. (*Motoring Organisation Ltd v Spectrum Insurance Services Ltd* [2024] EWHC 261 (Comm))

Key lessons

- **Misuse of business opportunities:** The outcome in this case shows that misuse of a business opportunity can found a claim for breach of an undocumented agreement.
- **Fiduciary duties in commercial arrangements:** The case also demonstrates that fiduciary duties may arise in a general commercial relationship involving particular degrees of trust and confidence.

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