Case Law Round-up 2020
(Company Law and Private M&A)

1 COVID-19

Application of the Coronavirus Job Retention Scheme to a company in administration

2020 saw a raft of emergency Government support packages introduced in response to the COVID-19 pandemic (the "**Pandemic**") and unsurprisingly, such new measures often brought with them some uncertainties. In Re Carluccios's Ltd and Re Debenhams Retail Ltd, the Courts considered the application of the Government's Coronavirus Job Retention Scheme (the "**Scheme**") to companies in administration. Both judgments provide useful guidance on the interaction of the Scheme with certain provisions of the Insolvency Act 1986 ("**IA 1986**").

Re Carluccio's Limited [2020] EWHC 886 (CH)

The well-known Italian restaurant chain Carluccio's fell victim to the Covid-19 lockdown restrictions when it closed its branches in early March 2020 and subsequently went into administration on 30 March 2020. The administrators looked to "mothball" the business, retain employees under the Scheme (to avoid making them redundant) and seek a sale. A letter was sent to all employees (the "**Variation Letter**") offering them the chance to be furloughed. Most accepted the furlough offer by the set deadline, but others did not respond.

The administrators were only prepared to keep the employees on if they could be sure that the cost of doing so would be covered by the Scheme and therefore were concerned about how the Scheme would operate in practice in an administration scenario. In particular, greater clarity on how the Scheme would interplay with existing insolvency legislation (namely paragraph 99 of Schedule B1 of the IA 1986, which deals with the costs of "adopting" an employee as part of the administration, so that any wages or salary can be paid out by the administrators in priority to other debts) was sought.

The High Court held that the Scheme was available to administrators, where it could be shown that employees' services could not be used due to the Pandemic, but there was a reasonable likelihood of rehiring workers in the future (i.e. following the sale of the business). Paragraph 99 of the IA 1986 should be interpreted as permitting administrators to give effect to the Scheme and to give priority to furlough payments funded by the Government. However, the High Court confirmed it was only employees who had accepted the furlough offer under the terms of the Variation Letter, that would be adopted as furloughed employees by the administrators. In relation to the non-accepting employees, the Court rejected the administrator's argument that consent could be inferred by their silent conduct. Consequently, without their consent, these employees would not be automatically furloughed, or adopted as part of the administration.

Re Debenhams Retail Ltd [2020] EWCA Civ 600

Debenhams was already in administration when the Pandemic hit, but its troubled financial situation was made even worse when it was forced to close its stores following the lockdown. The administrators sought to take advantage of the Scheme and looked to furlough Debenhams' 15,550 employees. The question once again centred around whether, by furloughing the employees, the administrators would be taken to have adopted their contracts of employment in the administration.

The Court of Appeal in this case upheld the first instance decision of Trower J in the High Court (Re Debenhams Retail Limited (in administration) [2020] EWHC 921 (Ch)) and also considered Snowden J's decision in the Carluccio's case. It confirmed that, on the facts, by paying sums obtained under the furlough scheme, the administrators were taken to have adopted the contracts of employment in the administration. The difference here was that the Court of Appeal felt that the source of authority for payments fell more clearly within paragraph 66 Schedule B1 of the IA 1986, rather than paragraph 99 Schedule B1 of the IA 1986. The latter deals with payments that are made to assist with the achievement of the purpose of administration, whereas the former deals with the order of payments, charges and liabilities at the end of administration.

Corporate Insolvency and Governance Act 2020 ("CIGA 2020")

The CIGA 2020 came into force in June 2020 and introduced a number of temporary measures in response to the Pandemic, as well as new permanent reforms of the UK insolvency regime, including two new restructuring procedures. The case below looks at the interpretation of the new restructuring procedure at

Part 26A of the Companies Act 2006 ("**CA 2006**") introduced by CIGA 2020.

Re Virgin Atlantic Airways Ltd [2020] EWHC 2191 (Ch)

This well-known UK airline business has been severely hit by the Pandemic and the resulting unprecedented decline in passenger numbers. Prior to the crisis, Virgin Atlantic would carry approximately 6 million passengers a year. The company has said it does not expect passenger levels to return to pre-Pandemic levels until 2023. The business consequently faced a severe liquidity crisis and was forced, in short order, to produce a bold restructuring plan (the "**Plan**") that it hopes will shore up the company's finances to see it through the crisis and prevent the business from going into administration.

The Plan was the first of its kind to come before the Courts under the new Part 26A of the CA 2006. At a remote hearing on 2 September 2020, the High Court proceeded to approve the application and the Plan between Virgin Atlantic and four classes of its creditors. Notably, all four classes of creditors had overwhelmingly voted in favour of the Plan. Mr Justice Snowden sanctioned the Plan and held that the Court, when looking at a Part 26A scheme, should largely take the same approach as it would in relation to a Part 26 scheme of arrangement and should consider class composition in broadly the same manner, taking into account:

1. whether the statutory requirements have been complied with, so that every creditor whose rights have been affected by a restructuring plan has had the right to participate in a meeting (unless it can be shown that no members of the creditor's class have a genuine economic interest in the company);
2. whether each class was fairly represented at the meeting and there was no evidence of the majority coercing the minority to the detriment of the class as a whole; and
3. whether the scheme was a fair scheme without any defects, which a creditor could reasonably approve.

Part 26A Restructing Procedure – this new restructuring procedure introduced into the CA 2006 by section 7 and Schedule 9 of CIGA 2020, allows companies in financial difficulties to propose a 'restructuring plan', with greater scope for making it binding on dissenting creditors than was previously possible under a scheme of arrangement. For example, Part 26A includes provision for a potential 'cross-class cram down' of a dissenting class (s.901G).

The Pandemic and its effect on company meetings

The Pandemic and the subsequent restrictions on social contact called into question the meaning of the term 'meeting' in its traditional sense. This useful case considers how the provisions in Schedule 14 of CIGA 2020 (which introduced certain flexibilities regarding the holding of company meetings during the Pandemic) might apply to members' meetings convened by the Court under Part 26 of the CA 2006 (schemes of arrangement).

Schedule 14 CIGA 2020 – introduces temporary flexibility to the holding of company meetings during the Pandemic. For example, meetings can be held without any number of those participating being in the same place and with members voting by electronic means. In particular, Sch.14 paragraph 3(6)(b) removes the rights of company members to attend a meeting in person and to only participate by voting electronically or otherwise.

Re Columbus Energy Resources plc [2020] EWHC 2452(ch)

Columbus Energy Resources plc (the "**Company**"), an AIM quoted oil and gas producer, applied to the Court to sanction a scheme of arrangement under Part 26 of the CA 2006, which (if approved) would allow the takeover of the Company by Bahamas Petroleum Co plc (the "**Scheme**").

An order was made convening a single class meeting and provided that, in light of the lockdown measures, the meeting would take place virtually and voting would be permitted by return of a proxy form. The Scheme was approved by 89.15% by number of scheme shareholders (representing 98.05% by value), but there was an issue as to whether the meeting arrangements had given rise to a "service meeting". The meeting was only attended in person (either physically or electronically) by the minimal number required to form a quorum, all other scheme shareholders were barred. No virtual webinar or other means of listening to the meeting was made available.

Despite this, taking into account the legitimate public health concerns, Trower J held that the application of Schedule 14 CIGA 2020 meant that there had been a valid 'meeting' for the purposes of Part 26 and accordingly sanctioned the Scheme. Although the scheme shareholders had not been permitted to attend in person, the process complied with Schedule 14 and the statutory majority in favour of the Scheme had been achieved. The additional rights given to the directors did not in this case give rise to any concerns about fairness and the class had been fairly represented with overwhelming support from the shareholders for the Scheme.

Walk-away rights: interpretation of a material adverse effect clause

Travelport Ltd v Wex Inc [2020] EWHC 2670 (Comm)

This case centred around the interpretation of a material adverse effect ("**MAE**") clause in a share purchase agreement (the "**SPA**"). The SPA concerned the sale of two business-to-business ("**B2B**") payments companies, which primarily served customers in the travel industry. Following the onset of the Pandemic, which caused a severe downturn in the travel industry, the buyer sought to give notice that a MAE had occurred in the gap period and claimed that it was not obliged to close the transaction.

The MAE clause contained a carve-out for Pandemics, subject to an exception if the relevant event had a 'disproportionate effect on' the target group companies compared to other participants in the industries in which they operated. Whereas the buyer argued that the relevant industry for comparison was the travel payments industry, the sellers held that it was the wider B2B payments industry.

No decision was made as to whether the MAE had been triggered, but the judgment provided guidance on the interpretation of the clause and what would need to be established to rely on the MAE. Applying the ordinary and natural meaning, the Court favoured the wider interpretation and held that 'industries' would capture a wide group of participants in a broad sphere of economic activity for the purposes of the MAE clause. Consequently, to invoke the MAE clause, the buyer would need to show that the Pandemic had a 'disproportionate effect on' the target group compared to others in the wider B2B payments industry, which will likely be more difficult to prove.

This is a rare example of a MAE (or Material Adverse Change, "MAC") clause coming before an English court and while no decision was made on whether or not the MAE was invoked, the judgment illustrates the legal and factual complexities that are likely to arise when seeking to rely on such clauses.

2 Capital maintenance

Payments in relation to share buy-backs

Dickinson v NAL Realisations (Staffordshire) Ltd [2019] EWCA Civ 2146

This case, heard at the end of 2019, serves as a useful reminder of the rules on payments in relation to share buy-backs.

NAL Realisations (the "**Company**") operated an aluminium smelting foundry. It was owned, 50.6% by Mr Dickinson, 39.2% by trustees of a settlement and 10.2% by the trustees of a pension scheme (of which Mr Dickinson and his wife were the only members).

Back in 2010, the Company was facing a host of nuisance claims by local residents and a litigation order was made. The Company sought to buy-back most of its shares pursuant to contracts entered into with Mr Dickinson and the pension scheme. The buy-back contracts provided for the consideration to be nominal value payable in full at completion, which amounted to £2.5 million. However, Mr Dickinson elected for the funds to be kept in the Company and treated as loans. Mr Dickinson entered into a debenture with the Company to that effect.

In August 2012, a judge upheld 15 of the 16 nuisance claims against the Company and estimated damages to be worth around £1.2 million. The Company went into liquidation and Mr Dickinson commenced proceedings against the Company, seeking to recover the sums owed to him and his wife following the share buy-backs, which he claimed were secured by the debenture.

The Court of Appeal (agreeing with the High Court) disagreed. It held that the share buy-back was void because the payment requirements pursuant to s.691(2) of the CA 2006 had not been complied with. Payment for shares on a buy-back must be made when the purchase is effected. It is not enough that a contract provides for payment forthwith – payment must in fact be made. However, it is worth noting the obiter comments the Court made, indicating that payment need not necessarily be in money.

S.691(2) of the CA 2006 states that where a limited company purchases its own shares, the shares must be paid for on purchase (i.e. payment must be made on completion of the contract). Further, a purchase by a company of its own shares made in contravention of Part 18 of the CA 2006 will be void (s.658 CA 2006).

Payments to director-shareholders: characterisation of distributions and shares issued at an undervalue

Chalcot Training Ltd v Ralph [2020] EWHC 1054 (Ch)

In this case, the High Court considered whether payments made by the company to two director-shareholders under the terms of a tax avoidance share scheme should be classified as remuneration to employees, or as disguised distributions.

Under the terms of a tax avoidance scheme entered into by Chalcot Training Ltd (the "**Company**"), payments were made to the Company's two director shareholders (Mr Ralph and Ms Stoneman), subject to a requirement that they subscribe for shares ("**E Shares**") in the Company (the "**Share Scheme**"). The payments were ostensibly directors' remuneration and were therefore deductible for corporation tax purposes. Furthermore, the obligation to subscribe for the E Shares meant the payments were also, allegedly, not subject to PAYE income tax, or national insurance contributions ("**NICs**") because they were not classed as taxable earnings.

HMRC challenged the tax treatment of the payments under the Share Scheme in 2016 and demanded that the Company should pay PAYE income tax and NICs, on the basis that the payments to Mr Ralph and Ms

Stoneman were remuneration. Rather than contesting the tax treatment of the payments under the Scheme, the Company instead responded to HMRC by claiming that the transactions under the Scheme were themselves void because they amounted to unlawful distributions as a matter of company law. In a sense, this seems an attempt by the individuals/the Company to claim against themselves, but of course if the Court were to categorise the payments as unlawful distributions rather than remuneration, they would not have been subject to PAYE income tax or NICs.

However, the Court disagreed and held that the payments should be characterised as remuneration for services provided by Ms Stoneman and Mr Ralph (as director-shareholders) to the Company. In reaching this conclusion, the judge provided some useful guidance on the hallmarks for re-characterising remuneration as a distribution, including that (i) the test is not purely objective (e.g. the label attached to the payment is not decisive), and (ii) the subjective states of mind of those deciding upon the transactions is crucial in order to determine the "*true purpose and substance*" of the transaction. Here, the fact that the two directors had entered into multiple documents (including board minutes) indicating that the payments were an award for their services and that the payments had been recorded in the Company's accounts as "*employment expenses*" were seen as determining factors that the payments should be classified as remuneration.

As an aside, it was also noted (obiter) that for the purposes of the prohibition on allotting shares at a discount under s.580 of the CA 2006, it does not matter if shares remain unpaid as to part of their nominal value (i.e. if they are issued partly or nil paid) provided that the shareholder remains liable to a call for the unpaid amount.

3 Shareholder resolutions

Duomatic principle: full knowledge of the facts

> The *Duomatic* principle is not codified under the CA 2006. This common law principle of unanimous decision making got its name from the case *Re Duomatic Ltd [1969] 2 Ch 365*. In that case, the company in question had two classes of shares: ordinary shares that carried a right to vote and non-voting preference shares. The judge, Buckley J, confirmed that where all shareholders, who have a right to attend and vote at a general meeting, come to a unanimous agreement on a matter, which a general meeting of a company can carry into effect, that unanimous agreement is in itself enough to bind the company without passing a resolution. The agreement of the non-voting preference shareholders was not necessary.

> Essentially, the *Duomatic* principle allows for company decisions to be taken informally by unanimous consent, preventing, in certain circumstances, company decisions being invalidated by a failure to observe required procedural formalities. However, certain elements must be established for the principle to apply, including that the shareholders had full knowledge of the relevant matter. There is a long line of case law setting out the limits on the scope of the principle.

Stubbins Marketing Ltd v Stubbins Food Partnerships Ltd [2020] EWHC 1266 (Ch)

Stubbins Marketing Ltd ("**SML**") was originally a family run business incorporated in 1987 to take over a market gardening business. In its heyday during the 1990s, SML became one of the UK's largest suppliers of salad produce from the Iberian peninsula to UK supermarkets. Unfortunately, by 2015 SML's fortunes had taken a downwards turn and the business was under financial pressure. SML and its group of companies looked to refinance and restructure the business. In 2016 the group entered into an asset purchase agreement ("**APA**") under which certain of SML's assets were sold, including the sale of its substantial distribution hub to a new company, Stubbins Food Partnerships Ltd ("**SFP**"), which was owned by four of the five directors of SML.

SML subsequently launched a claim against the directors of SFP, accusing them of breaches of duty by procuring SML entered into the APA, without first passing a resolution approving the transaction under s. 190(1) CA 2006 (substantial property transactions: requirement of members' approval) at a general meeting of SML. The defendant directors of SFP rejected this assertion and alleged that informal unanimous approval had been given by SML's shareholders by virtue of the *Duomatic* principle.

The High Court rejected the defendant directors' argument, holding that although the *Duomatic* principle could in theory apply to the approval of a substantial property transaction, it was not applicable in this case. Here, there had not been full and frank disclosure. Instead, there had been what the judge described as a "*drip-feed of information*" about the terms and circumstances of the transaction, which meant that even though all the shareholders had signed some of the transaction documents, valid consent could not be inferred because they had not been given full knowledge of all the facts.

As an aside, the case also considers whether unanimous consent can be given by an appointed class representative or proxy on behalf of the majority and whether the giving of consent should be re-visited on the release of documents held in escrow – it was implied that in those circumstances, consent would need to be analysed at each stage in order to take into account events subsequent to signing, but prior to completion.

4 Directors' duties

The tumultuous events of the last year and the resulting financial uncertainty faced by many businesses focussed all our minds on the importance of directors' duties during 2020. Directors were often faced with very complex and difficult decisions, particularly where businesses were either heading towards, or already in an insolvency scenario.

Directors' duties to continue during liquidation

Re Systems Building Services Group Ltd (in Liquidation) [2020] EWHC 54 (Ch)

Where a company is insolvent or likely to become insolvent, the duty of a director to act in the best interests of the company is regarded as a duty to act in the interests of its creditors as a whole. In this case, the sole director (who was also the company secretary and sole shareholder) of Systems Building Services Group Ltd (the "**Company**") purchased from the Company (acting by its liquidator) a property, which they knew to be at a substantial undervalue, without regard to the interests of the creditors as a whole.

The Company and its liquidators argued that the director had acted in breach of his duties, by not only breaching s.172(3) of the CA 2006 to act in the interests of the Company's creditors from the time at which the Company became insolvent, but also by breaching his "general duties" more broadly under s.171 to 177 of the CA 2006.

The director rejected this assertion and argued that once a company entered into either administration or liquidation, the "general duties" of a director only survived in respect of any exercise of power by a director acting in accordance with the IA 1986. By this argument, the director was suggesting that their general duties fell away once the Company entered insolvency because they no longer had the requisite authority to act (paragraphs 61 and 64 of Schedule B1 and s.103 of IA 1986 – state that although directors remain in office despite a company entering into administration/liquidation, they are not permitted to make decisions without the consent of the administrator/liquidator).

The High Court rejected the director's argument and confirmed that directors' "general duties" continue to apply even after an administrator or liquidator has been appointed. By procuring an off-market sale of the property, the director had acted entirely out of self-interest without regard to the creditors as a whole and was in breach of his directors' duties under the CA 2006.

When a company is insolvent, shareholders are not the owners of the residual value of the company. The interests of the company in reality are the interests of the existing creditors alone. It is logical therefore that the duty under s.172(1) of the CA 2006 to promote the success of the company for the benefit of its members as a whole has effect subject to any enactment or rule of law requiring directors to consider or act in the interests of creditors of the company (s.172(3) of the CA 2006). One must look to the common law to determine the scope of the duty owed to creditors and the precise circumstances in which it arises. In the fairly recent case of *BTI 2014 LLC v Sequana SA [2019] EWCA Civ 112*, David Richards LJ considered that the trigger was most accurately encapsulated by the formulation that the duty arises when the directors know or should know that the company is or is likely to become insolvent. In this context, 'likely' means probable (i.e. more than 50%, not a 'real likelihood').

A recap of the law on directors' duties and the detail required for an interest to be properly disclosed

Fairford Water Ski Club Ltd v Cohoon [2020] EWHC 290 (Comm)

The club (the "**Club**") sought damages for alleged breaches of duty by three of its directors (the "**Directors**") and against a fourth defendant (a management company owned and run by two of the defendant directors (the "**Management Company**")) for assisting in or benefitting from the breaches.

The Club ran water skiing activities at a lake and the Management Company leased the use of the lake and premises from the Club. The Club paid the Management Company an annual fee for providing management services under the terms of a management agreement (the "**Management Agreement**").

In 2017, the Directors resigned their directorships following allegations of misappropriated funds. Shortly afterwards, the Club commenced proceedings against the Directors and the Management Company alleging that they had misappropriated, or failed to account for, various payments and, in the case of the Directors, had acted in breach of their directors' duties owed under the CA 2006. The alleged breaches were twofold:

1. paying the management fee was a breach of the rule against profiting in s.175 of the CA 2006 and the duty to act for proper purposes in s.171 of the CA 2006; and
2. the directors had failed to declare the 'nature' of their interest in the management agreement as they had not disclosed the amount of the fee payable under such agreement and, as a result, had also failed to comply with the Company's articles of association which required that each director

declare the 'nature and extent' of any interest they had in a transaction or arrangement with the Company.

The Club claimed that the Management Agreement was therefore voidable because the relevant defendant director had not disclosed his interest in the Management Company when the Club entered into the Management Agreement. The Directors sought to rebuff this assertion by relying on another of their directors' duties and claimed that they were acting in the best interests of the Club when they entered into the Management Agreement.

The High Court did not agree. It held that you cannot defend the breach of one directors' duty by reliance upon another. Each of the directors' duties must be complied with in their own right. Even if entering into the Management Agreement was in the best interests of the Club, there was still a duty for the relevant director to disclose fully his interest in the Management Company.

In its consideration of whether or not the duty to disclose an interest had been properly complied with, the judgment provides useful guidance on the level of detail that directors must include when notifying fellow directors of a transaction or arrangement in which they are interested. The judge noted that the standard of disclosure required was "*of the precise nature of the interest*" that the director has, and that directors must show that they have complied "*in letter and spirit*" with the disclosure requirement. This was based on a more general principle that directors, as fiduciaries of a company, are under a duty to make "*full disclosure of all facts material to the transaction*". As a result, it was incumbent on any interested directors to disclose the amount of the management fee allegedly payable by the club. Failing to do so would mean they had not properly declared the nature (or extent) of their interest in the arrangement.

This case is a good reminder that that the duties owed by directors to a company will be strictly interpreted and applied by the Courts and that, where a director has an interest in another business which may give rise to a conflict of interest, they must fully disclose their personal interests. There are no 'hard and fast' perimeters around the extent of detail that should be disclosed, and of course directors should strive for a balance between providing too much information and not enough, but the ramifications of failing to disclose sufficient information can be significant, resulting in personal liability and the potential unwinding of an arrangement.

It is also important to note that a director's interest in a transaction or arrangement can change over time – directors should therefore always be live to any potential conflicts that arise throughout the lifetime of their directorship and disclose their interests (or any change in such interest) as and when they arise.

5 Indemnities

Proper construction of an indemnity

Gwynt y Môr OFTO plc v Gwynt y Môr Offshore Wind Farm Ltd [2020] EWHC 850 Comm)

This case involved a dispute concerning the proper interpretation of an indemnity included in a split exchange and completion sale and purchase agreement relating to an offshore wind farm business (more specifically, the business of owning, maintaining and operating the electrical transmission link between the Gwynt-y-Môr offshore wind farm and the National Grid, which included four subsea export cables).

The SPA was signed on 11 February 2015, and the transaction completed on 17 February 2015. The SPA included an indemnity under which the seller agreed to indemnify the buyer "*if any of the Assets are destroyed or damaged prior to Completion*". On 2 March 2015, one of the cables failed as a result of ongoing corrosion whilst it was submerged under the sea, and another cable failed on 25 September 2015 for similar reasons. On inspection, the cause of the failure was identified as corrosion to the cables dating back months or years and caused by damage to the cables' polyethylene sheath. The buyer covered the cost of repair at a cost of £15 million and tried to bring an indemnity claim under the SPA, alleging that the cables had failed due to damage sustained prior to Completion.

The Commercial Court rejected the indemnity claim, holding that the indemnity was limited to damages that occurred between signing and completion. Both the specific wording of the indemnity clause (the use of "are" in particular, which was considered to be forward-looking from the point of signing) and the broader structure, provisions and commercial sense of the SPA supported the sellers' argument that the indemnity related only to damage occurring between the execution of the SPA and completion. A warranty had been given by the sellers in relation to the period up to signing of the SPA, the indemnity covered the period between signing and completion and a further indemnity had been given in respect of ongoing works from completion.

The case doesn't introduce any new law or rules on interpretation, but is another example of how indemnities are construed "*contra proferentem*" (i.e. against the person seeking to enforce them). It also illustrates how the Courts will look at the natural meaning of the specific wording used as well as the broader structure and commercial sense of the SPA. In deals involving a split exchange and completion, it is important to consider carefully what the parties intend by references to the period "prior to" or "before" completion, particularly where used to delineate a party's contractual responsibilities or liabilities.

6 Restrictive covenants

Triggers for restrictive covenants

Guest Services Worldwide Ltd v Shelmerdine [2020] EWCA Civ 85

Things can get confusing where a person agrees to a restrictive covenant in more than one capacity. In this case an individual, Mr Shelmerdine ("**S**") provided consultancy services to Guest Services Worldwide (the "**Company**") which produced promotional maps. S was also a shareholder in the Company and had entered into a shareholders' agreement (the "**Shareholders' Agreement**") pursuant to which he agreed to a 12-month post-termination restrictive covenant which operated to prevent "employee shareholders" from engaging in business that would be in competition with the Company. More specifically:

"5.1 No Employee Shareholder shall during the times specified below, carry on or be employed, engaged or interested in any business which would be in competition with any part of the Business, including any developments in the Business after the date of this agreement. The times during which the restrictions apply are:

(a) any time when the party in question is a shareholder; and

(b) for a period of 12 months after the party in question ceases to be a Shareholder…"

S subsequently ended his employment with the Company, but remained a shareholder. S argued that, at that point, he was no longer an "employee shareholder" and therefore no longer bound by the covenant in the Shareholders' Agreement. Interestingly, the court at first instance found in his favour (taking a very literal interpretation of the clause) but the Court of Appeal overturned the decision, holding that it made no commercial sense for the restrictions to fall away immediately when S terminated his employment, but still remained a shareholder. The case is a reminder to be very careful when drafting restrictive covenants, to make sure that the triggers are clearly drafted with no inadvertent ambiguities.

7 Execution of deeds and documents

Pre-executed signature pages

Bioconstruct GmbH v Winspear and another [2020] EWHC 7 (QB)

It is a common scenario on transactions; a deed has already been executed, but the parties subsequently agree changes to the document. In such circumstances, should the deed be re-executed, or can the pre-signed signature pages be affixed to the updated version with the express authority of the signatories?

In the *Bioconstruct* case earlier this year, the High Court rejected a deed that was executed in this way. The claimant Bioconstruct GmbH brought a claim against two co-defendants, under an alleged deed of guarantee, to recover unpaid sums which had been loaned to Biopower Group Ltd (Group) to support the construction of a biogas energy plant. The High Court dismissed the claim and found that the defendants had not validly executed the alleged deed. The affixing of pre-signed signature pages taken from a materially different version of the agreement did not constitute valid execution. It was also held that, as a matter of law, the co-defendants could not be estopped by convention from denying the validity of the deed.

The decision followed the obiter comments of Underhill J in the *Mercury Tax* case that a deed must be executed as a discrete physical entity at the moment of signing and reinforces the premise that execution of a deed will only be valid if the finalised version is circulated in a "Mercury" compliant manner to all parties before signature.

> *R (on the application of Mercury Tax Group and another) v HMRC [2008] EWHC 2721*: Underhill J commented obiter that section 1(2) of the Law of Property (Miscellaneous Provisions) Act 1989 had the effect that, in the case of a deed,"…the signature and attestation must form part of the same physical document". This comment raised some concern among lawyers regarding virtual signings and the use of pre-signed signature pages and in response to those concerns, a Joint Working Party of the Law Society Company Law Committee and The City of London Law Society Company Law Committee and Financial Law Committee developed a practice note which included a non-exhaustive range of Mercury-compliant options available to parties to facilitate the execution of deeds and other documents without the physical presence of all signatories.

This is a useful reminder of the need, particularly in the current climate where we face further obstacles on signings, to double check that all necessary execution formalities have been met. The statutory requirements for execution are not simply a formal or technical requirement, but a fundamental legal requirement. Failure to comply with such requirements can be fatal to enforceability, as the Courts will not allow a party to invoke an estoppel to try and enforce a legal obligation in circumstances where a document is, on its face, invalid.

8 Notice provisions

Notice provision pitfalls (time limits)

Towergate Financial (Group) Ltd & Ors v Hopkinson & Ors [2020] EWHC 984

This case is a cautionary tale of what can go wrong where there is any ambiguity in a notice provision. In 2008, the claimants purchased a financial advisory business (the "**Target**") from the defendants under the terms of a share purchase agreement (the "**SPA**") which contained various indemnities.

In 2014, the FCA launched an investigation into the Target, which focussed on the advice given before the completion of the SPA. Following the FCAs investigation, in July 2015, the claimants gave notice to the defendants of potential claims under certain indemnities in the SPA. The relevant notice provision in the SPA stated that notice of any claim under the indemnities had to be given "*as soon as possible and in any event on or before the seventh anniversary of the SPA*". The defendants argued that, although notice had been given just before the seventh anniversary of the SPA, notice had not been given "*as soon as possible*" and was therefore invalid. The claimants disputed this claim, arguing that for the notice to be valid, it was only necessary to satisfy one element, not both.

The Court disagreed and held for the defendants, stating that the notice provision imposed two separate requirements. Whilst the claim was made before the seventh anniversary of the agreement, the claimants had not notified the defendants as soon as possible after becoming aware of the indemnifiable loss and consequently the notice had not been validly served in accordance with the SPA. As a result, a potential indemnity claim in excess of £50 million was precluded.

This formulation is often used to express time limits in contracts, perhaps on the false assumption (on the part of the notifying party) that the inclusion of a longstop date provides more leeway. However, the case usefully highlights that this is not necessarily the case and that each element of a time limit clause should be considered carefully and adhered to. It is a stark reminder of the need to draft notice provisions carefully and to follow them to the letter when attempting to bring a claim – in this particular case, failure to do so resulted in a costly error for the claimant.

High Court considers what constitutes a valid notice of a claim

Dodika Ltd v United Luck Group Holdings Ltd [2020] EWHC 2101

The decision in this case provides a further reminder of the importance (i) to the seller, under a sale and purchase agreement ("**SPA**"), of drafting robust notice of claim provisions, and (ii) to the buyer (if attempting to bring a claim against the seller) of ensuring that any notice of claim complies fully with the notification requirements as set out in the SPA and includes sufficient detail of the facts, events and circumstances giving rise to it.

In this case, certain warrantors brought an application for a summary judgment, seeking the release of certain escrow monies, on the basis that the buyer had not validly given notice of their claim under the tax covenant. The notification clause in the SPA stated that any claim under the tax covenant would be enforceable if the buyer gave written notice to the warrantors stating in reasonable detail: (a) the matter which gives rise to such claim; (b) the nature of the claim; and (c) (so far as reasonably practical) the amount to be claimed.

In the Court's opinion, limb (a) referred to the factual basis of the claim, meaning that notification should provide "*sufficient*" or "*reasonable*" detail of the circumstances on which the buyer was relying. Here, the notice of claim fell short because there was no indication of the facts, events or circumstances, it simply alluded to a tax investigation. Without further details, the Court held that notice had not been validly given, upheld the warrantor's claim for summary judgment and ordered the escrow monies be released to the sellers. Again, this is a stark reminder of the severity of the consequences where notice provisions are not strictly complied with.

9 Completion accounts

Construction of a completion accounts clause

Damoco (Bermuda) Ltd v Atlanta Bidco Ltd [2020] EWHC 501 (Comm)

This case centred around the construction of a completion accounts clause in a sale and purchase agreement (the "**SPA**"). Pursuant to the SPA, the claimants in this case (the "**Sellers**") agreed to sell their shares in a company to the defendant, Atlanta Bidco Ltd ("**Bidco**"). The consideration for the sale consisted in part of deferred consideration that was calculated in accordance with a completion accounts mechanism set out in Schedule 11 of the SPA.

Schedule 11 in the SPA stated that Bidco had to deliver to the Sellers deferred consideration accounts within 30 days of the auditors signing-off on Bidco's audited financial statements (which covered the deferred consideration period) and in any event no later than 30 June 2019. The audited accounts were delayed. On 5 August 2019, Bidco sent the Sellers draft deferred consideration accounts, but made it clear that the deferred consideration was not payable until after the auditors had signed-off on its accounts. The Sellers ignored this, demanded that the deferred consideration of €20 million was immediately payable and subsequently made a claim to that effect.

The Sellers' application was refused and the Court sided with Bidco, holding that the deferred consideration would only become payable once the audited accounts were ready to be signed-off by the auditors. The fact that the long-stop date of 30 June 2019 had passed was disregarded. The Court considered that Schedule 11 was constructed in a manner that meant the auditors were seen as having a crucial role to play in the preparation and determination of Bidco's financial statements, for the purposes of calculating the deferred consideration and protecting both parties by providing independent oversight of Bidco's accounts.

This is yet another case on interpretation, but it also serves as a reminder that the use of audited accounts as completion accounts can take control over the timing and preparation of such accounts out of the hands of the parties and delay the payment of any deferred consideration.

10 Meaning of "fair value"

Interpretation of "fair value" (in the context of a compulsory share acquisition)

Shanda Games Ltd v Maso Capital Investments Ltd & Ors (Cayman Islands) [2020] UKPC 2

In this case, certain minority shareholders of Maso Capital Investments Ltd (the "**Company**") appealed against a decision relating to the fair valuation of their shares following a merger.

The minority shareholders had been opposed to the Company's merger and under Cayman Islands Company Law, dissenting shareholders are entitled to a payment of "fair value" for their shares if the merger goes ahead. There is no such equivalent provision in the CA 2006 and as such the Privy Council was asked here to interpret the meaning of "fair value" as it relates to the compulsory purchase of shares under the Cayman Islands company law. The crux of the question was whether a minority shareholder should receive payment on a pro rata basis, or whether a minority discount should be applied.

The minority shareholders' appeals were dismissed. In reaching their decision, the Privy Council identified a general principle of share valuation – unless there is evidence to the contrary, the shareholder is only entitled to be paid for the shares with which he is parting. By this the Privy Council confirmed that the minority shareholders shares should be valued prima facie as a minority shareholding and not on a pro rata basis and the minority discount could not be ignored.

While this applies to a valuation under a Cayman Islands statutory instrument, the case is a useful reminder to take care when drafting valuation mechanisms to make sure that there is no ambiguity on how they are to be applied (e.g. by including worked examples), unless you are deliberately seeking to avoid such clarity.

11 Leaver provisions

Compulsory transfer of leaver shares

Ajayi v Ebury Partners Ltd [2020] EWHC 166 (Comm)

This case looks at proceedings relating to the grant of share options and an alleged breach of Ebury Partners Ltd's (the "**Company**") articles of association (the "**Articles**").

The Claimant, Ms Ajayi, had worked for Ebury Partners Ltd (the "**Company**") between 2013 and 2016 and had entered into an option agreement to acquire shares in the Company via the Company's EMI share option scheme. Ms Ajayi went on to exercise her EMI options and was issued with a share certificate for 3,000 shares in the Company in November 2015. Between 2015 and 2017 the value of the Company's shares rose significantly, but the relationship between Ms Ajayi and the Company had deteriorated. In 2016 her consultancy engagement with the Company terminated – Ms Ajayi went on to issue proceedings against the Company.

As part of her claim, Ms Ajayi alleged that the Company had acted in breach of the leaver compulsory transfer provisions in the Company's articles of association (the "**Articles**") by failing to take the steps necessary under the Articles following a deemed transfer notice, including failure to follow the valuation methodology as set out in the Articles – thus depriving her of the chance to sell her shares at their increased market value. The Company argued that the share valuation provisions in the Articles only applied to "Good Leavers" whereas Ms Ajayi was a "Bad Leaver".

The definition of a "Bad Leaver" under the Articles included a provision relating to the termination of a consultancy agreement by a consultant on or before the third anniversary of the commencement date of the consultancy. It was this limb of the definition that the Company was relying on. However, the Court disagreed with the Company's analysis and held that on the facts Ms Ajayi was a "Good Leaver". Ms Ajayi had not taken any action to terminate her engagement with the Company, her consultancy arrangement had simply expired by the effluxion of time – that in itself was not sufficient for her to be labelled as a "Bad Leaver" and penalised.

Accordingly, the Company had acted in breach of the Articles by not following the prescribed procedure for a Good Leaver and, in particular, by not instructing an independent expert to value Ms Ajayi's shares. However, the Court went on to find that because the value of Ms Ajayi's shares had increased in the interim, she had not suffered any loss as a result of the Company's breach of its Articles. This part of her claim was consequently rejected by the Court.

There is no new law here, but the case is a good reminder (i) to be especially careful when drafting good and bad leaver definitions, and (ii) where you encounter drafting that uses a deemed transfer notice mechanic (which may on its face seem a more efficient method of dealing with leaver shares) to think carefully about whether that will work in practice. The safer option, from the perspective of the company is to allow the company a right to serve a transfer notice on the Leaver, thus retaining control over the leaver process. It is also advisable from the company's perspective to include the ability to revoke a sale notice – this can be helpful when there are issues relating to the fair price calculation.

High Court analyses the contractual duty of good faith in a shareholders' agreement in the context of a leaver scenario

Unwin v Bond [2020] EWHC 1768 (Comm)

The Claimant, Mr Unwin, was employed by Hensall Mechanical Services Ltd (the "**Company**") which provided mechanical and electrical services. The defendant, Mr Bond, was initially the sole shareholder in the Company's parent company ("**Holdco**") and the sole director of the Company and Holdco. In 2011, Mr Unwin purchased 20% of Mr Bond's shareholding in the Company and became a fellow director of the Company and Holdco. Upon acquiring shares in the Company, Mr Unwin entered into a shareholders' agreement with Mr Bond (the "**Shareholders' Agreement**").

The relationship between Mr Bond and Mr Unwin deteriorated and in September 2016 Mr Bond summoned Mr Unwin to a meeting where he terminated Mr Unwin's employment on alleged grounds of poor performance. Mr Unwin's dismissal triggered the "Bad Leaver" provisions in the Company's articles of association, requiring Mr Unwin to offer his shares to Mr Bond at issue price.

Mr Unwin disputed his dismissal, claiming that it was not to do with his conduct, but instead that Mr Bond had dismissed him as a means of acquiring his shares at less than their market value. He further alleged that Mr Unwin's motivations meant that he had not acted in good faith in accordance with his duty under a good faith provision in the shareholders' agreement.

While the Court found that Mr Bond did not act dishonestly, or with the ulterior motive of seeking to acquire Mr Unwin's shares at an artificially low price, he was found to be in breach of his duty of good faith when he terminated Mr Unwin's employment. Mr Unwin was not given advance notice that his employment might be terminated, there was no investigation into the performance issues, no opportunity for Mr Unwin to respond to the complaints against him and no remedial action was considered. This case is an important reminder of the difficulties that arise when seeking to apply good faith clauses in shareholders' agreements, due to the myriad of different and sometimes conflicting duties that can be caught under this provision.

12 SPA/tax gross-up provisions

High Court considers the meaning of 'subject to taxation'

AXA SA v Genworth Finance International Holdings LLC

This case relates to the payment of amounts under an indemnity in a share purchase agreement, whereby the buyer, AXA SA, agreed to acquire two insurance businesses from Genworth Finance International Holdings LLC ("**Genworth**"). The insurance businesses in question had historically provided payment protection insurance (PPI) and found themselves liable to meet compensation for mis-selling. The SPA included an indemnity to cover AXA against 90% of the costs of compensation for an agreed period.

AXA brought a claim under the indemnity and in determining the precise amount Genworth was required to pay AXA, the Court had to consider the interpretation and effect of a tax gross-up provision. Specifically, the Court considered the meaning of the phrase "subject to Taxation in the hands of the receiving party" in the context of the gross-up provisions. The question for the Court was whether it meant:

(i) "*within the scope of a tax and not exempt*", which would mean that the sums payable under the relevant clause needed to be grossed-up at the date of their payment; or

(ii) "*actually taxed in the hands of the receiving party*", which meant the clause operated by reference to tax on the payment in question, which the receiving party was under an obligation to pay.

Applying the principles of contractual construction, the Court held that the ordinary and natural meaning of the words was "*actually taxed in the hands of the receiving party*". The clause operated by reference to tax, which the receiving party was under an enforceable obligation to pay, such tax having been assessed by the relevant revenue authority and determined as being due. The case confirms that the construction of terms in an SPA will depend on the objective meaning of the words used, alongside the commercial purpose of the clause. It highlights the importance of using clear language, particularly where the intention of the parties is to depart from the ordinary commercial expectations.

FOR FURTHER INFORMATION, PLEASE CONTACT

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