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CMS legal update

Quarterly round up key developments under English law

Spring 2015

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Introduction

Across the globe, English law has become the governing law of choice for many cross-border transactions. In the Middle East it is estimated that English law governs two thirds of all M&A transactions and around half of all JV arrangements.

The choice of English law makes sense for a number of reasons. The English legal system, with its freedom of contract and hundreds of years of case law precedent, offers a degree of certainty and predictability that not many other jurisdictions can match. Additionally, international parties who otherwise have no nexus to England often turn to English law as a 'neutral' choice as it is a well-regarded and familiar body of law to govern key contracts, as well as having the added benefit of being written in the widely-used English language.

It is important to keep up with developments under English law. To help you keep up to date, we produce a quarterly update on a range of topics which are relevant to those entering into agreements outside of England. Whilst these updates are not intended to be exhaustive, and are no substitute for taking legal advice, they are intended to help local counsel keep up with key developments which could affect the contracts they enter into.

If you would like further details on any of the matters discussed in this update, please feel free to get in touch.

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No other firm completed more M&A deals than CMS in Europe last year

2014	**1st** in Europe
2013	**1st** in Europe
2012	**3rd** in Europe
2011	**1st** in Europe
2010	**1st** in Europe

(Source: Bloomberg/Thomson Reuters 2010, 2011, 2012, 2013, 2014, by deal count)

Ranked No.1 for M&A in Europe 2014

THOMSON REUTERS

Recent cases on breach of warranty

Deal teams negotiating acquisitions, or considering claims post-acquisition, should be aware of two recent cases relating to breach of warranties in share purchase agreements: *The Hut Group Limited v Nobahar-Cookson and another* and *Augean plc v Hutton and others.*

The most significant points relate to the calculation of damages. Although cases often turn on their particular facts, these decisions highlight a number of principles:

- the method of calculation of loss is likely to differ depending on whether the claimant acquires a majority or minority shareholding
- where quantum of loss is established using a multiple of EBITDA, the court may accept an argument that a 'warranty false' valuation (i.e. the valuation of the target company as it actually is, not as it is warranted to be) requires both a reduction in EBITDA and a reduction in the multiplier of EBITDA applied
- where a liability is partly recovered through a completion accounts process, this may jeopardise the ability to recover additional loss under a warranty claim
- damages for a breach of warranty in respect of one-off items of expense may be assessed on a cost of cure basis, giving a pound for pound adjustment, rather than a more complicated assessment of the loss in value of the shares. This suggests that arguing for an indemnity basis of damages for such items will not always offer any additional protection in practice
- damages are generally assessed at the point of breach of warranty and as a general rule a subsequent recovery of value will be disregarded

The Hut Group also considers other issues, including the process for notification of warranty claims and the effect of fraud. The reader should note that at the time of this publication, Nobahar-Cookson have been granted permission to appeal this judgment.

Background

Both cases relate to the sale and purchase of the entire issued share capital of a company. In Augean this was a waste management business. The purchase price comprised cash paid at completion, a cash retention payable later and an earn-out. One of the claims brought by the buyer related to a breach of the accounts warranties in the sale agreement.

The Hut Group related to the sale and purchase of an online sports nutrition business. The sellers sold the target for cash and also a minority shareholding in the buyer. The buyer brought a claim for breach of warranty relating to the target's management accounts and the sellers counter-claimed for fraudulent breach of the accounting warranties given to them in relation to the minority shareholding.

Calculation of damages

The two cases show that calculation of damages for breach of warranty is likely to vary depending on whether the claimant has acquired a majority or minority shareholding (and the basis on which the parties valued the target). In both cases – where the buyers had acquired 100% of the target company – the correct method for calculating damages was held to be the difference between a multiple of EBITDA calculated as if the warranties were true (a 'warranty true' basis) versus a multiple of EBITDA based on the target as it actually was (a 'warranty false' basis). In both cases, the EBITDA on a 'warranty false' basis was smaller, but the multiplier remained the same. In The Hut Group it was argued that, when calculating the 'warranty false' value, a reduced multiplier should apply (hence enhancing the difference between 'warranty true' and 'warranty false'). The court did not reject this in principle, but disallowed it on the facts, finding that a reasonable buyer and seller would not have revisited the multiple as well as the EBITDA. A reduction in the multiplier was not addressed in Augean.

In *The Hut Group*, the sellers' counterclaim related to their minority (about 12%) shareholding in the buyer. Because of this, the judge decided that the correct measure of damages should be based on a discounted cash flow basis. The judge followed the established contractual principle that damages are generally to be calculated as at the point of breach, but added that damages can be forward-looking and can take into account the claimant's expectations. The fact that, at the time of the sale, the sellers had a clear expectation that the buyer would be involved in an IPO, and that this would result in a windfall increase in the sellers' shareholding in the buyer, was taken into account in calculating the 'warranty true' value. But the fact that the IPO might still happen in the future and the price of the shares might recover was not taken into account in calculating the 'warranty false' value.

Price adjustment mechanisms and subsequent claims

In Augean the amount and type of waste stock on site at the target gave rise to a number of allegations of breach of warranty. The disclosure letter included a statement that the cost of treating waste stock had not been included in the accounts and that it was estimated to be £25,000. The completion accounts subsequently included a provision for waste stock of just under £75,000. The buyer confirmed that the completion statement was agreed without amendment and gave a statement that 'at today's date there are no known matters which we believe give rise to a claim under the Warranties'. The actual cost of treating the waste stock was higher than had been estimated in either the disclosure letter or the completion accounts, so the buyer brought a claim for breach of the accounts warranty. The judge found that, at the point the completion accounts were agreed, the buyer clearly did not think that there was a material difference between the estimate given for waste stock in the disclosure letter and the provision in the completion accounts, and that this weighed evidentially against the buyer in its attempt to maintain a claim for breach of the accounts warranty. This suggests that a buyer should take great care to reserve its rights when agreeing completion accounts if it is expecting to bring a warranty claim in the future that relates to the relevant item.

Damages for one-off items

In both cases, where breach of warranty was proven, the judge calculated damages in respect of one-off items on a 'cost-of-cure' basis – i.e. a pound-for-pound recovery – even though the claim was for breach of warranty rather than an indemnity claim. This illustrates that, in practice, all is not necessarily lost as far as the buyer is concerned if the share purchase agreement does not provide expressly for recovery for breach of warranty on an indemnity basis, since the same pound-for-pound calculation might be applied by the court, provided it is reasonable and proportionate to do so.

Notification of warranty claims

In *The Hut Group*, the sale agreement provided that warranty claims must be notified within 20 days of the party 'becoming aware of the matter'. When did awareness occur? The judge said that, to make commercial sense of the agreement, time started to run only once the buyer had enough information to realise that there was a proper basis for putting a claim forward – in this case, that point was not reached until the buyer had had initial advice from forensic accountants. Nevertheless, the case highlights the risk to the buyer of specifying such a short period for notification, as it can be difficult to review and consider a potential claim within that period.

The sellers tried to argue that the notice of claim did not meet the requirement in the sale agreement to specify the nature of the claim in reasonable detail and the amount claimed. The judge considered the notice to contain all that was practicable at that early stage by way of quantification, and commented that not much was required by way of description. Much depends on the wording of the agreement, however – in other cases, would-be claimants have been barred from bringing warranty claims because they have not meticulously complied with notification provisions.

Damages for fraud

In *The Hut Group* the sale agreement contained a financial cap on the buyer's liability to the sellers but (as is standard) provided that the cap would not apply in cases of fraud. The sellers argued that the accounts warranties relating to the buyer were untrue and were based on fraud. It was accepted by both sides that the buyer's financial controller had manipulated the buyer's accounts, but the buyer argued that the financial controller's fraud was not attributable to the buyer: he was not senior enough.

But the judge decided that, although the financial controller was not a director, he was involved in the deal and had personally provided information relating to the accounts warranties. The fact that he was not 'front facing' was irrelevant. His fraud was the buyer's fraud and the cap did not apply.

Agreements often provide that the awareness of the parties is to be fixed by reference to the knowledge of named individuals – for example, where warranties are qualified as being given 'so far as the seller is aware' or the buyer affirms that it is not aware of any grounds for a future warranty claim. The case is a salutary reminder that provisions like this will not necessarily have any bearing on whether fraud can be attributed to a party (and it is doubtful whether the parties could effectively pre-ordain whose awareness is to count where fraud is in issue).

Comment

These cases are helpful as reminders of the basic principles which underpin damages for breach of warranties, and offer some useful pointers for the negotiation of M&A transactions and the avoidance of pitfalls.

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Locked in by confidentiality

A recent case in the High Court illustrates the incidental effect confidentiality obligations can have in reinforcing lock-in and deadlock provisions, such as restrictions on the right to transfer shares. If a shareholder in a joint venture company, for example, is thinking of selling its stake to an outsider, the shareholder is likely to concentrate first on the transfer provisions in the company's articles of association or the relevant shareholders' agreement, looking for ways to get round the often elaborate prohibitions on its right to deal with the shares. But any serious buyer is likely at an early stage to want information about the company going well beyond what can be read on the public file at Companies House. How can the shareholder safely disclose information to the buyer, especially if the shareholder has expressly agreed to keep the information confidential?

A robustly commercial approach can be tempting: if the information goes no further than the buyer, what harm is there? But in *Richmond Pharmacology Ltd v Chester Overseas Ltd* the court decided that a confidentiality obligation meant exactly what it said, and refused to read into it an implied licence to pass information to an outsider as long as the outsider treated the information as confidential.

The case

The case concerned a pharmaceutical research company owned by its three founders and by an outside investor, which held 44% of the share capital. There was a shareholders' agreement that allowed the investor to disclose confidential information to its professional advisers and bankers (as long as they kept it confidential), but otherwise required the investor to treat all commercially sensitive information about the company's affairs as strictly confidential unless the board agreed to its disclosure. An initial lock-in period had expired, and shareholders were free to transfer their shares provided they first offered them at the same price to the other shareholders.

The investor decided it was time for exit. Hopes of a sale to the founders in an MBO came to nothing, and the investor engaged advisers to search for prospective buyers and disclosed information to the advisers for that purpose. Care was taken to ensure that any prospective buyer received confidential information only after the buyer had entered into a non-disclosure agreement.

In due course the founders discovered what was going on and the company took proceedings for breach of contract, arguing that the sale process had caused substantial loss of business for the company. The company also alleged that, to boost interest, the investor had misleadingly given buyers the impression that it could deliver the whole company, and that this in itself was in breach of the confidentiality obligations and had caused the company loss.

The decision

The investor argued that the shareholders' agreement was being read out of context and that, on a proper commercial interpretation, the investor had been within its rights. Although the clause listed exceptions, such as disclosure to advisers and bankers, the investor said the list was not intended to be exhaustive. Nobody would be willing to buy a minority shareholding in a company of this kind without substantial amounts of detailed information about the company's affairs, much of which would inevitably be confidential. The investor said its right to sell its shares (albeit subject to pre-emption) would be entirely illusory unless it could provide such information to a third party. The obligation was to 'treat (the information) as strictly confidential', and that, according to the investor, was not the same as a bar on divulging or communicating the information to any other person. It must follow that the contractual obligation to keep information confidential could be complied with by ensuring that the third party agreed to keep the information confidential.

But the judge said that, on the contrary, the ordinary and natural meaning of an obligation to treat information as confidential was that it could not be disclosed to anyone else unless expressly permitted. This interpretation was by no means contrary to business common sense. The need to approach the board for permission to disclose to third parties was reasonable in the circumstances. One should not jump to the conclusion that the board would behave arbitrarily, especially as the shareholders' agreement contained deadlock provisions leading to winding-up as the ultimate recourse. The commercial reality was that it was always going to be virtually impossible for a person in the investor's position to sell its shares without getting the prospective buyers to engage directly with the founders.

The judge also decided representations – even though they were untrue – that all the shares in the company were for sale were in breach of the obligation not to disclose commercially sensitive information to outsiders.

Comment

Although the investor was found to be in breach of the confidentiality obligations, the company was unable to prove that it had suffered any loss as a result. Nevertheless, if the circumstances had been different, the investor might have had to pay substantial damages.

The case stands in the way of those who argue that it is implicit that there will be no breach of confidentiality as long as there is a chain of undertakings between the owner of the information and the ultimate recipient. Non-disclosure agreements are often quite specific about the categories of third party to whom disclosure is permitted, such as advisers, other group companies involved in the transaction, and employees on a need-to-know basis. Most owners would be far from happy to think that their information could be disclosed with impunity to a third party whose only contractual duty was to the discloser, not the owner. The judgment is therefore welcome, as it promotes certainty.

The case is also a useful reminder to minority investors in private companies of the real practical difficulties of achieving an exit. In the absence of express agreement, it cannot be assumed that the company or the other investors will co-operate in facilitating a sale – especially where potential buyers are likely to be competitors. Confidentiality provisions can stop the process in its tracks.

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Joint Ventures – a time to reflect

Joint ventures are a preferred route to market for international businesses to expand into new territories, sectors and developing markets. Sharing risk and having a local partner to 'open doors' are key drivers behind this. However, a recent case heard in the English Court of Appeal concerning a Middle Eastern joint venture has produced a surprising result which could impact on many transactions across the region. Perhaps now is a good time to reflect on joint venture arrangements to make sure you don't get caught out.

Picture this. You are a director of a business looking to expand. You agree to buy a 60% stake in a target business (the **Target**) from its owner, a well-known businessman (the Seller), who retains a 40% interest in the Target. You secure his continued involvement with the Target by making him a non-executive director.

You agree to pay the purchase price in three instalments – the first on completion, and the remainder staggered over a number of years.

The Seller enjoys personal relationships with the clients of the Target, and also has interests in other competing businesses. The Seller gives the standard non-compete restrictive covenants and agrees that he will forfeit any unpaid parts of the purchase price if he breaches them. He also grants you a call option to purchase his shareholding at a discount to market value if he breaches his covenants (the **Call Option**). All of this is negotiated by international law firms on behalf of you and the Seller, and included in the purchase and joint venture agreement which documents the whole transaction (the **JVA**).

The transaction completes and you pay the Seller the first portion of the purchase price. You are now the proud owner of 60% of the Target business - so far so good.

After completion, you discover that the Seller has been diverting customers and employees away from the Target to his competing businesses. This is exactly what you had feared could happen and could potentially wipe off millions of dollars from the value of the Target, and therefore also the value of your 60% shareholding.

Fortunately, all is not lost. You have not paid the full purchase price yet and you still have that Call Option, so you can still salvage some value from this mess. The Seller disagrees and demands that you pay the full purchase price, despite his deliberate breaches of contract and despite what the JVA says. The Seller also refuses to honour the Call Option. You find yourself in court.

The Verdict?

On these facts, most people would regard the Seller as being in the wrong – he has deliberately acted in bad faith, breached the JVA and caused significant loss to the Target and the purchaser. The purchaser and Target are innocent here and should be granted some relief, surely?

If you agree with that (as most surely do), it will surprise you to learn that in a recent case based on these facts, the English Court of Appeal found in favour of the Seller, ordering the purchaser to pay the remaining parts of the purchase price in full, and preventing the purchaser from exercising the Call Option.

The case in question was Talek El Makdessi v Cavendish Square Holdings BV (2013) EWCA Civ 1539. In broad terms, Makdessi was the seller and Cavendish the purchaser, and the decision turned on two particular points of English law which are not always fully appreciated by parties to joint venture contracts. The points in question were the principles around 'reflective loss', and the unenforceability of penalty clauses. The reader should note that the Supreme Court has granted permission to Cavendish to appeal the decision, the results of which are currently unknown.

Reflective Loss

Reflective loss refers to the diminution in value of a shareholder's shares, which reflect losses directly suffered by a company.

By way of illustration, let us take the example of a shareholder which owns 100% of a company. If that company suffers a $10million loss due to actions of a third party, the shareholder's loss is the $10million reduction in the value of its shares. Similarly, if the shareholder only owned 60% of the company, its losses would amount to $6million.

Under the doctrine of reflective loss, if the company has a right to bring a claim against the wrongdoer, the company's claim displaces that of the shareholder. The loss suffered by the shareholder is the reduction in value of his shares and is said merely to reflect the company's loss, because his position would be restored if the company recovered in respect of its own loss. The logic here is to avoid the shareholder and company competing against each other to recover essentially the same loss from the same wrongdoer. The fundamental point to bear in mind here is that, if the company does not (or cannot) make its claim, the shareholder is still left without any remedy.

Although the restrictive covenants which Makdessi breached were given only to Cavendish in the JVA, Makdessi's behaviour was also a breach of his fiduciary duties as a director of the Target. The same wrongful acts breached both the JVA and Makdessi's fiduciary duties at the same time. However, due to the principles of reflective loss, the Target had a primary right of action in respect of the wrongdoing, and Cavendish was barred from bringing its claim for breach of the JVA. Consequently, the recoverable losses suffered by Cavendish were $0, as it had no right of action.

Penalty Clauses

Penalty clauses are unenforceable under English law.

Makdessi claimed that forfeiture of the remaining parts of the purchase price upon breach of his restrictive covenants amounted to a penalty clause. He also claimed that enforcing the Call Option (which would have forced Makdessi to sell his shareholding at a significant discount to market price) was a penalty clause, too.

What constitutes a penalty clause has been debated in the courts for many years, and in this case the Court of Appeal reviewed the history of this area of law in some detail. This article does not propose to review that history; it is enough to say that, although no new concepts were introduced in the case, the position taken by the Court of Appeal has established a new two-stage approach to determining whether the provisions amount to penalty clauses:

— the court should first ask whether the remedy claimed is based on a genuine pre-estimate of the losses suffered as a result of the breach: in other words, was the primary purpose of the provisions to compensate the victim for its recoverable losses? A provision based on a genuine pre-estimate of loss could not be a penalty; and

— if the court finds that a provision is not a based on a genuine pre-estimate of loss, it then asks if there is some other commercial justification for upholding the provision.

Genuine Pre-Estimate of Loss:

The Court of Appeal considered whether the consequences for Makdessi as a result his breach of contract were 'extravagant or unreasonable' when compared with the likely losses suffered by Cavendish: were Makdessi's potential losses in the same range as those recoverable losses which Cavendish might suffer?

Crucially, in this context, the Court noted that Cavendish's recoverable losses were $0 due to the reflective loss point. In comparison, Makdessi stood to lose approximately $44million from forfeiture of the unpaid portion of the purchase price, and many more millions of dollars as a result of the Call Option being exercised at a significant discount, instead of at market price.

The Court also noted that the effect of forfeiture and the Call Option were not proportionate to the extent of the breach of restrictive covenant. Any breach of restrictive covenant, whether it was trifling (such as an unsuccessful attempt to recruit one of the Target's employees) or significant, would have the same financial consequences for Makdessi.

The Court therefore held that, when comparing the two losses - $0 against way in excess of $44million - the consequences of breach for Makdessi were extravagant and unreasonable compared with Cavendish's recoverable losses. Therefore, the primary purpose of the consequences of breach was not to compensate Cavendish for its losses. Was there nevertheless some other commercial justification for the provisions?

Commercial justification

If the court finds that there is a good commercial justification for the provisions it can be persuaded that the primary purpose was not a deterrent to breach, so that the clauses might not be penalty clauses after all.

The Court again noted that there was no proportionality between the extent of the breach by Makdessi and the financial consequences he would bear. In that context, the Court found that the provisions were firmly in the territory of a deterrent. The Court found there was no commercial justification for them, and concluded that both provisions were penalties.

Conclusions

Parties to a joint venture contract should consider carefully whether the joint venture company should be a party to the JVA, as giving contractual rights to the company could have the unexpected consequence of defeating shareholder claims due to the reflective loss principles. There are certainly pros and cons to the joint venture company being party to a JVA – for example, the shareholders may want direct contractual undertakings from the joint venture company which sit best in the JVA – and each joint venture will have its own features. Careful drafting of the JVA can reduce the chances of the reflective loss principle applying even if the joint venture company is a party to the JVA, but it is not possible for the company simply to contract out of reflective loss.

It is also possible to restructure how penalty provisions might operate to ensure they remain enforceable. For example, the Court in Makdessi noted that, if the deferred payment terms had been drafted as conditions – i.e. payment of the deferred purchase price was conditional on Makdessi being fully compliant with his restrictive covenants at the time of payment – they would not have been penalty clauses. Generally, an obligation to pay or to transfer property that arises from a choice by the relevant party rather than a breach of contract by him will not be a penalty.

English law has arguably become the 'go to' law for international businesses in relation to key corporate contracts across the Middle East, and there is good reason for this. However, the parties need to take advice, as technical points like reflective loss can have a real, tangible impact on contracting parties using English law.

The important point to remember here is that these issues are not confined to joint ventures, but are equally relevant in many other contexts, such as shareholder agreements, private equity and M&A transactions. As Makdessi shows, sometimes they arise where you might not expect.

For example, liquidated damages provisions in English law-governed construction contracts may stipulate that the contractor shall pay the client a pre-defined sum based on the number of days or weeks behind schedule a project may be. If this is 'extravagant and unreasonable' compared with the client's actual losses, might it be a penalty clause?

Ask yourself again - is this a genuine pre-estimate of my loss? Or is it really intended to scare the other party from even contemplating being in breach?

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Completion accounts - a cautionary tale

A recent case has demonstrated how important it is to ensure that there is no misunderstanding between the parties about the basis on which a set of completion accounts are prepared and how they will be used in determining the final purchase price. The case is also an unusual example of the court applying the rules of contractual interpretation to arrive at the real meaning of the contract, but then using a different process to decide that, despite its real meaning, the contract does not reflect the common intentions of the parties and should be rectified to reflect those intentions.

The focus (whether it be working capital, net assets or another metric) varies from transaction to transaction, but the concept is that the parties agree at signing what they expect the financial position of the target to be at completion and then after completion use the completion accounts mechanism to establish retrospectively what the actual position was. The completion accounts are normally prepared on behalf of the buyer within an agreed period after completion and, once finalised, may cause an adjustment of the purchase price – whether by a repayment of part of the purchase price by the seller to the buyer or a top-up payment by the buyer to the seller.

The basis on which completion accounts are prepared is normally mapped out in detail between the buyer and seller and set out in the share purchase agreement. There will be detailed processes to resolve any disputes on the numbers, with ultimate recourse to independent accountants.

The recent case of *Mihail Tartsinis v Navona Management Co* demonstrates how important it is to ensure that there is no misunderstanding between the parties about the basis on which the completion accounts are prepared and how they will be used in determining the final purchase price. The case is also an unusual example of the court applying the rules of contractual interpretation to arrive at the real meaning of the contract, but then using a different process to decide that, despite its real meaning, the contract does not reflect the common intentions of the parties and should be rectified to reflect those intentions.

The facts

The target company's subsidiary owned a fleet of ships, which had been accounted for in the historical accounts at net book value (i.e. acquisition cost less accumulated depreciation). Given the deteriorating market conditions which existed at that time, the net book valuation was calculated to be US$14.1 million higher than the approximate market value of the fleet at the time of completion – the fleet's value had plummeted.

The SPA included a purchase price adjustment mechanism that (amongst other things) required the buyer to prepare a set of completion accounts in accordance with International Financial Reporting Standards (**IFRS**), from which the net asset value of the target company (which included the value of the fleet) was to be determined. A correctly drafted set of completion accounts under IFRS would not have valued the fleet at net book value; rather, under International Accounting Standard (**IAS**) 16 and/or IAS 36, the value of the fleet would have been substantially lower. The buyer, however, produced completion accounts that incorrectly valued the fleet at net book value. On this basis, the buyer was obliged to pay a substantially higher purchase price to the seller than it had intended, and was certainly paying more than the market value for the component attributable to the fleet. Realising its error, the buyer refused to pay the additional sums claimed by the seller on the post-completion price-adjustment.

The court understandably decided that the buyer had no right to challenge completion accounts which it had itself prepared. The buyer was therefore left to argue that, on a true interpretation of the SPA, it was not obliged to pay. The buyer claimed that the parties had in fact agreed, throughout their negotiations leading to signing the SPA, a particular value for the fleet based on market valuations: US$96.5 million, not the US$110.6 million in the completion accounts.
The buyer contended that the completion accounts should be used to revalue all elements of the net asset value of the target group **except for** the pre-agreed value of the fleet, which was simply not to be subject to post-completion adjustment. The buyer said that this was so obvious and so critical a part of the bargain that it did not need to be stated in the SPA and, in effect, went without saying.

As an alternative, the buyer requested the court to rectify the clear mistake in the contract in relation to the fleet's value, to state that the value of the fleet was to be fixed at US$96.5 million and that it was not subject to adjustment.

The result

The first issue was the true meaning of the SPA. The courts have developed rules as to the approach that must be taken when there is a dispute as to what a contract means. Very broadly, it is a matter of ascertaining the meaning the document would convey to a reasonable person who had all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract. That does not mean, however, that in deciding the meaning the court can take account of what the parties said to each other, for example, in the run-up to signing, or what either party thought the agreement meant. It is not the court's function when interpreting an agreement to seek to improve upon it, or put right any inadequacies of meaning.

The judge pointed out that, if in fact the parties had intended the fleet valuation not to be adjusted, they had been perfectly capable of explicitly stating this in the SPA, but they had not done so. As a matter of interpretation of the SPA, the value attributable to the fleet was indeed subject to adjustment. That was what the SPA meant and no evidence of pre-contractual negotiations fixing the fleet element of the price as non-adjustable was admissible.

On rectification of the contract, however, the position was quite different. The judge was able to take account of the substantial evidence that there was pre-contractual agreement about the value of the fleet and was convinced. The court came to the buyer's rescue and ordered that the contract was to be rectified by introducing a few brief words fixing the value for the fleet and removing that element from the completion accounts mechanism. The seller's claim was therefore substantially dismissed.

Practical points

The case illustrates a number of points that should be borne in mind during an M&A transaction:

— Those tasked with financial due diligence for the buyer should be instructed to analyse the basis on which target company's historical accounts have been prepared, the basis on which they should have been prepared, and the basis on which the parties agree the completion accounts should be prepared, and highlight any key discrepancies to the deal team. Otherwise, there is a risk that like will not be compared with like.

— Care should be taken when agreeing the terms of any purchase price adjustment mechanism to ensure that any input from the financial due diligence team is duly accounted for in the drafting of the SPA and the completion accounts mechanism. In particular, if any specific item is to be treated differently to the rest, this must be clearly stated.

— It is very important that the accountants preparing the first set of completion accounts carefully take into account the relevant provisions of the SPA.

— It is vital for the party preparing the first draft of the completion accounts to ensure they are correctly prepared in accordance with the SPA. It will usually be extremely difficult to challenge one's own draft completion accounts.

Rectification – approach with care but always consider its application

Although claims for rectification are not easily won, it is often worthwhile including a pleading in the alternative where it is believed a contract contains a mistake within the drafting. For rectification, a compelling case must be presented, which typically requires presenting the court with substantial evidence of a common intention that the document mistakenly failed to express. This, by necessity, means that a much broader range of evidence is admissible when pleading for rectification, compared with what the court will consider when it interprets a contract. In particular, evidence of what was said in pre-contractual negotiations is admissible, and indeed is generally essential, to prove the existence of the missing common intention. Evidence of the parties' subjective aims and intentions is also admissible, as is evidence of their subsequent conduct insofar as it sheds light on their relevant intentions.

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Disqualification of Directors due to actions abroad

As a result of changes to the UK legislation on company director disqualifications, it will now be possible for the Secretary of State for Business (in practice, via the Insolvency Service) to seek an order from the UK courts, in respect of a person who has been convicted outside the UK of an offence relating to the running of an overseas company, disqualifying them from acting as a director of a UK company for a period of up to 15 years. In addition, where a disqualification order is sought against any person on the grounds that their conduct as a director of a UK company that has become insolvent makes them unfit to be a director of a UK company in the future, in deciding whether to make such an order, and for how long it should last, the court or Secretary of State must take into account any breach of fiduciary duty, and any material breach of local law or regulation relating to directors, that the person has committed while acting as a director of an overseas company.

The changes are set out in amendments to the UK Company Directors Disqualification Act 1986 (CDDA) which have been introduced by the Small Business, Enterprise and Employment Act 2015. The 2015 Act received Royal Assent on 26 March 2015, but the changes to the CDDA will take effect from a date to be specified by the Government: this is expected to be at some time within the next year. The 2015 Act includes various amendments to company legislation that were consulted on last year.

Amended CDDA

Under a new Section 5A of the CDDA, the Secretary of State can apply to court for a disqualification against a person who 'has been convicted of a relevant foreign offence'. A relevant foreign offence is defined as being 'an offence committed outside Great Britain:

- in connection with –
  - the promotion, formation, management, liquidation or striking off of a company (or any similar procedure);
  - the receivership of a company's property (or any similar procedure); or
  - ia person being and administrative received of a company (or holding a similar procedure); and
- which corresponds to an indictable offence under the law of England and Wales or (as the case may be) an indictable offence under the law of Scotland'

The maximum duration of disqualification is unchanged at 15 years. The power to disqualify under section 5A is likely to be used only in relation to persons that have committed serious company-related offences overseas, such as a large-scale fraud on investors.

Under a new section 12C of the CDDA, where a court or the Secretary of State has to decide whether a person should be disqualified on the grounds that they are unfit to be concerned in the management of a company and, if so, for how long, the court or Secretary of State must have regard to certain matters set out in a replacement Schedule 1 to the CDDA. Such matters include:

- 'any misfeasance or breach of any fiduciary duty by the direct in relation to a company or overseas company';
- 'any material breach of any legislative or other obligation of the director which applies as a result of being a director of a company or overseas company'.

In other words, if a director has breached his fiduciary duty in relation to any overseas company, or has committed a material breach of any law or regulation that applies to an overseas company of which he is a director (e.g. in relation to wrongful trading, or the payment of dividends), this will be taken into account in the decision as to whether he should be disqualified from acting as a director of a UK company and, if so, for how long.

In addition, the period within which the Secretary of State can apply to court for a disqualification order against an unfit director of an insolvent company has been increased from 2 years to 3 years.

During its consultation last year the Government made it clear (and based on feedback received) that it was mindful of the "potentially significant divergence of UK and worldwide systems", and that therefore the role of the court will be crucial. Given the breadth and nature of the matters which the court will have to take into account under the new rules, there will certainly be cases in which the court's discretion will be critical.

These amendments are important in today's globalised corporate environment, where executives are increasingly required to sit on the boards of subsidiaries in different countries. The new rules make it all the more important for executives to ensure that they understand and comply with local rules on directors' duties, company and insolvency law.

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The Internet of things: a data protection challenge?

The European Union’s influential Article 29 Working Party (‘**WP29**’) has recently adopted an opinion (the ‘**Opinion**’) on the Internet of Things (‘**IoT**’). The IoT describes the increasing interconnection of devices, including TVs, cars and refrigerators, and the associated rise in the flow of data between those machines.

The Opinion focuses on: (i) wearable computing (for example watches and glasses); (ii) quantified self (objects which record information about an individual’s habits and lifestyles, such as sleep trackers and devices that measure weight, pulse etc.); and (iii) home automation (domotics).

The WP29 projects that IoT is on the threshold of integration into our daily lives, whilst warning that this growth opportunity should not be to the detriment of privacy and security. Businesses should enable users to remain in control of the sharing of their personal data throughout the product lifecycle. The Opinion highlights key data protection obligations and sets out practical recommendations for businesses. Although the opinion relates to matters within the European Union, it is expected to bear influence in other jurisdictions which may be considering data protection implication on the IoT.

Legal basis for processing personal data in the IoT environment

The Opinion confirms that the Data Protection Directive 95/46/EC (the ‘**Directive**’) is fully applicable to IoT in establishing the legal basis for processing personal data.

Fair processing

With regard to transparency, data controllers may choose to provide the information required for fair processing (including the data controller’s identity) in innovative ways, for instance, using location through privacy-preserving proximity testing via a centralised server to inform users located close to the sensor.

User consent

The WP29 confirmed that if businesses are to rely on individuals’ consent as the legal basis for processing personal data in the IoT environment, they must ensure that consent is ‘*fully informed, freely given and specific*’. They also warned that *‘classical mechanisms used to obtain individuals consent may be difficult to apply in the IoT environment’* as they may produce ‘‘low-quality’ consent’ that does not conform to EU privacy rules.

The WP29 suggested that manufacturers should decentralise control over data processing in the IoT environment, in order to help consumers understand what data their device collects, and cut down on the transfer of personal data to device manufacturers. The Opinion also recommends that data controllers offer an option to disable the ‘connected’ feature of the IoT device and allow it to work as an unconnected item.

The Opinion emphasises that businesses which store personal information or have access to data on IoT devices must gain individuals' consent to store or access the data. Such consent is not necessary if the storage or access is '*strictly necessary*' to provide a service individuals have '*explicitly requested*'. However, quantified self-applications (which relate to the well-being of an individual) may process sensitive personal data (e.g. relating to the individual's health) which requires the individual's explicit consent.

At the same time, consumers must be given '*accessible, visible and efficient*' tools to revoke their consent and object to the data processing relating to them; there must be no '*technical or organisational constraints or hindrances*' imposed on them. In line with the 'right to portability' (which may be included in the new General Data Protection Regulation being introduced by the EU), the Opinion recommends that personal data processed by a device should be stored in a standard format to allow data portability.

'Legitimate interests'

EU data protection rules permit the processing of personal data if it is in the stakeholders' 'legitimate interests', except where this would be detrimental to the interests or fundamental rights of the user (including the right to privacy when processing personal data). However, the Opinion indicates that economic and legitimate interests are unlikely to be a suitable basis for processing personal data generated in relation to the IoT without user consent. This is suggested on the basis of the privacy implications when processing personal data in the IoT environment.

Using data for specified purposes

The WP29 reminds businesses that personal data can only be used for '*specified, explicit and legitimate purposes*'. If businesses intend to use data for other purposes, they should ensure that the data is used for purposes that are compatible with the original purposes and that consumers are notified about those purposes before the processing takes place. The WP29 warned that businesses which hoped to find a retrospective use for the processing could be breaching EU data protection laws.

In addition, businesses should apply the 'data minimisation' principle when collecting personal data. This means that only personal data which is '*strictly necessary for the specific purpose previously determined*' should be collected. Therefore, data that is unnecessary for this purpose should not be collected and stored '*just in case*' or because '*it might be useful later*'.

Some Risks of IoT

The IoT raises several security challenges, namely, the risk that the IoT may '*turn an everyday object into a potential privacy and information security target*'. Connecting to less secure devices would potentially increase new methods of attack. The WP29 encourages businesses to have an adequate data breach notification policy in order to minimise software vulnerability issues. Also of concern is the fact that the processing of data in the IoT may relate to individuals who are neither subscribers nor actual users of the IoT. For instance, smart glasses are likely to collect data from other data subjects as well as from the owner of the device. The Opinion confirms that the application of EU data protection rules does not depend on the ownership of a device/terminal, but rather on the processing of the personal data itself, whoever the individual concerned may be.

Given the large amount of data processed automatically in the IoT environment, an additional risk is that of re-identification following the anonymisation of data. For example, wearable devices kept close to the data subject can result in the collection of a range of other identifiers which could generate a digital fingerprint. Such data can later be combined with other data issued from other systems such as CCTV or internet logs. The WP29 has published a separate Opinion on Anonymisation Techniques which includes guidance on how to minimise this risk.

Certain applications require data subjects to install third-party applications which enable them to access their data. Installing these applications often involves providing the application developer with an access to the data through the API (application programming interface). Such applications are traditionally installed on an opt-in basis. However in practice, the user's consent is often not specific and sufficiently informed as third-party application developers do no display sufficient information for the user's consent.

WP29 recommendations to all stakeholders

The WP29 made recommendations applicable to all business stakeholders in the IoT environment, including: (i) performing Privacy Impact Assessments ('**PIAs**') before any new applications are launched in the IoT; (ii) deleting raw data as soon as the data required for processing is extracted; (iii) users must be able to exercise their rights and be 'in control' of the data; and (iv) the methods for providing information and requesting consent should be as user friendly as possible.

The Opinion also sets out specific recommendations to device manufacturers, application developers, social platforms, IoT device owners, standardisation bodies and data platforms.

Conclusions

Given the fast pace of technological innovations in the IoT environment, it is clear that businesses need to engage with consumers about how they intend to store and process their data. Businesses must find a way to be transparent about their data processing intentions, at the same time as empowering consumers to remain in control of their personal data.

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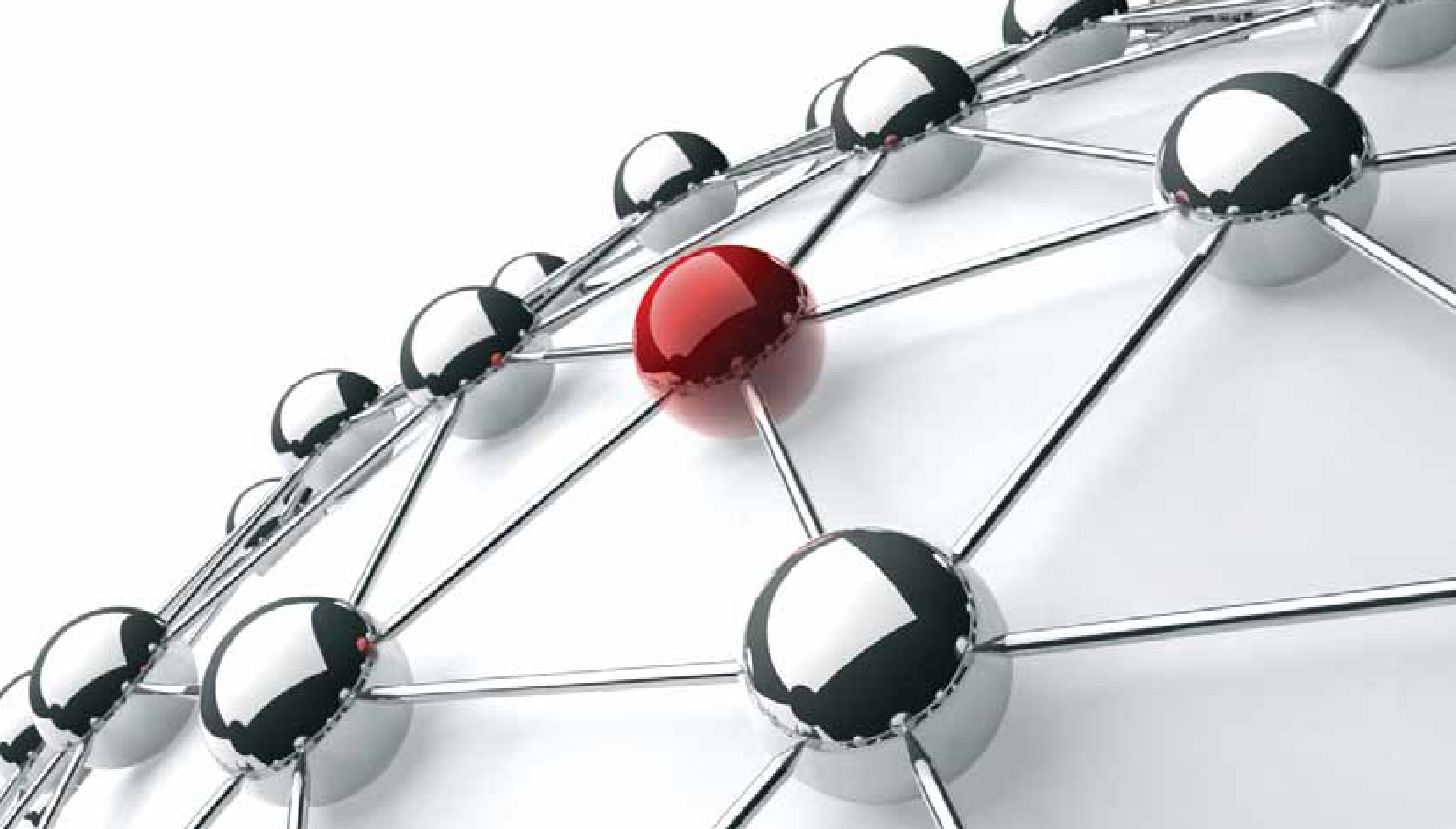

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