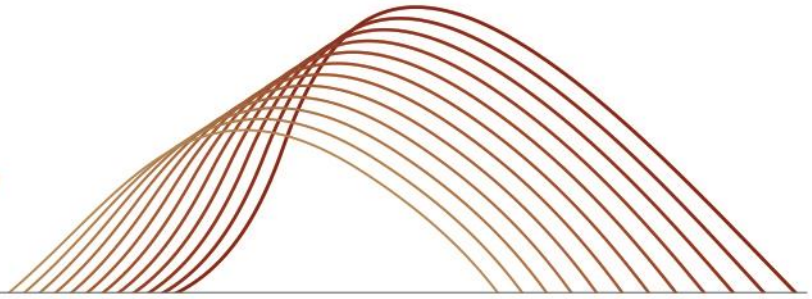
PAUL HASTINGS

STAY CURRENT



November 2018

Follow **@Paul_Hastings**

Avoiding Russian Roulette with Rights of First Offer in Shareholders' Agreements

By Garrett Hayes & Anu Balasubramanian

Overview

In the recently decided case of *United Co Rusal Plc v Crispian Investments Limited (1) and Whiteleave Holdings (2)*, the English courts had to consider the extent of a right of first refusal ("ROFR") contained in an agreement between certain shareholders in a company.

The decision of the court will be of interest to anyone who is negotiating a ROFR under English law or any other provision relating to share transfers (such as drag-along or tag-along provisions or leaver provisions) which are customarily included in joint venture agreements, investment agreements, and co-investment agreements.

Background

A dispute between two Russian oligarchs who were the largest shareholders in PJSC MMC Norilsk Nickel ("NN") was settled through a tri-partite framework agreement entered into between entities (Rusal and Whiteleave) controlled by the two oligarchs in question and an entity (Crispian) controlled by a third oligarch. The framework agreement contained a ROFR in favour of Whiteleave and Rusal which applied if Crispian sold any of its shares in NN.

Crispian entered into a conditional agreement to sell a significant portion of its shareholding to Bonico Holdings Co. Limited ("Bonico"), a subsidiary of Whiteleave. By a notice dated 6 February 2018, Crispian purported to give notice to Rusal and Whiteleave of their ROFR, which included a statement that if a valid acceptance letter was served on Crispian by only one investor, that investor would be required to acquire all of the offered securities.

The dispute largely centered around the ROFR provision in the framework agreement which was translated as:

> If Crispian sells any number of NN shares . . . Crispian shall grant to Wayleave and Rusal the right of first refusal to buy out the shares being so disposed of (pro rata to their shareholdings) . . . on the following terms:
>
> (i) in the event that Rusal and Wayleave exercise their right of first refusal, they shall serve a notice of exercise of the right of first refusal within 10 days of receipt of the relevant notice from Crispian . . . .
>
> . . . the share price . . . shall be equal to the price proposed by a bona-fide third party purchaser . . . .

Key Disagreements

Rusal argued that (i) the right to offer the shares at "the price proposed by a bona-fide third party purchaser" does not extend to offering them at a price proposed by Whiteleave or its affiliates as none of the parties to the framework agreement is a "third party"; (ii) in any event, Bonico was not a bona-fide third party as the price offered to Crispian was not an arm's length commercial price just for the shares in question, but was artificially inflated; and (iii) the ROFR was a single joint right of Whiteleave and Rusal and must be exercised by both of them or not at all.

The defendants disagreed with this interpretation and contended that the reference to "a bona-fide third party" only required the offer to be from a party unrelated to Crispian and did not exclude offers from Whiteleave or Rusal (or one of their respective affiliates).

Principles to Be Applied in Interpreting Shareholders' Agreements and Articles of Association

It is a long-standing principle of English law established in the context of construing pre-emption provisions in articles of association that a shareholder has an inherent right to deal freely with his shares (being personal property) and to transfer them to whomsoever he pleases and, accordingly, this right can only be removed or restricted by clear words with language of sufficient clarity to make it apparent that that was the intention.

The defendants argued that this principle should apply to the framework agreement and that, accordingly, any ambiguity as to the nature and extent of the restriction on Crispian transferring its shares must be resolved in its favour. The court did not agree with this on the basis that a company's articles of association are a contract between all shareholders forming part of the constitution of the company whereas the framework agreement was a subsequent commercial agreement between two or more shareholders (for their own specific purposes) as to how they would deal with their shares and did not affect the intrinsic rights attached to those shares by the articles.

It may be that a shareholders' agreement falls to be interpreted by the same rules as the articles of association if the shareholders' agreement was entered into on establishment of the company or at the time of adoption of the articles between all the shareholders (and with all subsequent allottees or transferees evoking parties to it), but the court did not need to decide this point and questioned whether earlier cases provided authority for this.

Principles to Be Applied in Interpreting English Law Agreements

In interpreting an English law agreement it is necessary to ascertain the objective meaning of the language which the parties have chosen to express their agreement. This is not a literalist exercise focused solely on a parsing of the wording of the particular clause, but consideration should also be given to the contract as a whole and, depending on the nature, formality and quality of the drafting of the contract, give more or less weight to elements of the wider context in reaching a view on the objective meaning.

Where there are rival meanings, weight can be given to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense. This involves an iterative process by which each suggested interpretation is checked against the provisions of the contract and its commercial consequences are investigated. Having read the language in dispute and the relevant parts of the contract that provide its context, it does not matter whether the more detailed analysis commences with the factual background and the implications of rival constructions or a close examination of the relevant language of the contract, so long as the indications given by each are given appropriate balance.

Court Decision

As the framework was a detailed and complex contract between sophisticated parties (advised by leading law firms), the court felt the most appropriate starting point in interpreting the contract would be to closely examine the wording used to create and define the rights in question.

Overall, on the basis of its review of the text of the agreement the court provisionally concluded that it was clear that the ROFR is a single right granted to both parties and to be exercised by both or neither of them. The judge noted that it would have been straightforward to provide that the right was granted to Whiteleave and/or Rusal (a formulation used elsewhere in the contract), but the parties did not do so. The court was of the view that any differences in wording between various clauses must be taken to be deliberate and intended to create a clear distinction.

If the ROFR was indeed granted jointly to Whiteleave and Rusal, then, as a matter of logic or common sense, neither of them (nor their affiliates) could be considered a third party for these purposes. Even if the ROFR was granted severally, the court was of the view that the natural and ordinary meaning of the words "a third party" connote an outside person unconnected with the transaction in question which would obviously exclude the very parties to the grant and probably all parties to the contract in which it is contained.

The court considered how different interpretations of the clause interacted with other provisions of the agreement—if a particular interpretation resulted in other provisions becoming redundant, this would suggest that that interpretation was not the preferred interpretation of the clause.

An analysis of the wording of the relevant clause and consideration of its commercial context led the Court to the same conclusion as to the proper interpretation of that clause, namely that (i) neither Whiteleave nor Rusal (directly or through an affiliate) are permitted to be the third party purchaser which triggers the ROFR; and (ii) the ROFR is a right which must be exercised by both Whiteleave and Rusal if it is to be exercised at all.

In addition, the court found that Bonico's offer was an inflated price as a result of other proposed arrangements between the defendants. Therefore, even if the court had found that Bonico was a third party for the purposes of the framework agreement, the offer was not on arm's length terms and therefore was not an offer from a bona-fide third party.

Practice Points

It is not clear if the defendants knew that their approach was a try on or whether they genuinely believed that the wording of the contract did not reflect the parties' intentions. In either case, the parties could have been saved significant time and cost had the ROFR provisions been clear and unambiguous with less scope of misinterpretation (deliberate or otherwise).

Clearly, a balance is required between engineering transfer-related provisions to the nth degree and the commercial reality of the negotiations. However, given that rights of first refusal, rights of first offer, drag-along rights, mandatory transfer provisions and other similar provisions regulating share ownership and transfer are often exercised in contentious circumstances, it is not unreasonable to anticipate the potential for dispute when a party seeks to rely on these provisions.

Any provisions restricting the transfer of shares in articles of association need to be absolutely clear as any ambiguity as to the nature and extent of the restriction is likely to be resolved in favour of the holder of the shares. The same rule might also apply in relation to restrictions on transfer contained in shareholders' agreements if the shareholders' agreement is entered into between all of the shareholders. Key points to consider include:

- Who is the right granted to? Is it granted jointly or jointly and severally?
- What constitutes a "third party" for the purposes of any underlying transaction triggering the right? For example, can the selling party have any interest in, or relationship with, the third party?
- Must the price offered by the third party be in cash (and, if so, in any particular currency)? Can non-cash consideration be offered? If so, how does this impact on the ROFR?
- Could there be factors which might have an impact on the price which a third party is willing to pay for the shares, and should this be specifically factored in in determining whether this price is bona fide / on arm's length terms? For example, could there be material customers, suppliers or competitors willing to pay more for the shares which could result in the ROFR process becoming distorted? If so, the parties should consider how this can be addressed in the agreement.
- How is the right in question to be triggered? In the current case, each of the parties to the framework agreement had a different view on whether the ROFR would be triggered by a conditional sale of the shares by the proposing transferor, an offer from a proposed transferee or simply a decision taken by the proposing transferor to sell his shares.

The framework agreement was largely drafted in Russian but, for the purposes of the proceedings, the parties agreed a definitive English translation, obviating the need to call expert witnesses to provide their view on the English-language translation of the framework agreement. From the agreed translation, the drafting of the relevant provisions of the framework agreement is clearly inelegant. Parties should consider the desirability of drafting an English law agreement in a language other than English as, even if an agreed translation can subsequently be produced, it may contain nuances or potential differences in interpretation which are not apparent to lawyers not entirely fluent in written English.

The dispute arose between the major shareholders of the world's largest producer of nickel and palladium, incorporated in Russia. The claimant was incorporated in Jersey and the defendants were incorporated in Cyprus. The relevant contract was written in Russian but was expressed to be governed by English law and specified that the courts of England and Wales should have jurisdiction over disputes. After a dispute in relation to the ROFR procedure crystallised on 7 February 2018, an application for injunctive relief was issued at the High Court in London. That application was dealt with on 16 February 2018 by way of undertakings and the matter was re-listed for hearing on 8 March 2018. On that date, the High Court accepted revised undertakings and made various orders, including for an expedited trial. The trial took place over various dates in May and judgment was given on 27 June 2018. A detailed written judgment setting out the reasons for the decision was published on 14 September 2018. This demonstrates the ability of the English courts to deal promptly with urgent issues when the circumstances require. It also highlights one of the benefits of specifying English law and submitting to the jurisdiction of the English courts, even where the underlying transaction or the parties have little or no connection to England.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:

Anu Balasubramanian
44.020.3023.5151
anubalasubramanian@paulhastings.com

Garrett Hayes
44.020.3023.5153
garretthayes@paulhastings.com

Roger Barron
44.020.3023.5150
rogerbarron@paulhastings.com

Matthew Poxon
44.020.3023.5171
matthewpoxon@paulhastings.com