Risky Business.

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Overview

The Commercial Court has recently handed down a judgment which will be of interest to transactional lawyers and litigators alike: Richards -v- Speechly Bircham LLP [2022] EWHC 935. This was a professional negligence claim commenced by Speechly Bircham’s former clients, Mr Richards and Mr Purves, in connection to the sale of their respective equity stakes in a cloud-based communications technology company.

The judgment has wider relevance because it emphasises that it is the role of drafting solicitors to seek clarity in relation to the meaning of important clauses in transaction documents which could be open to interpretation; transactional lawyers should mitigate, through clear drafting, the risk that a provision might operate against their clients’ best interests, or alternatively advise their clients as to such a risk where that is not possible. On the other hand, the case is a timely reminder to litigators that judges can get it wrong and that the risk of a judge reaching the wrong conclusion should be ever clear and present in the advice we give to clients.

Background

The background to the professional negligence claim in Richards was a contractual dispute which arose following the sale of a business in which the selling shareholders’ construction of the relevant provision was rejected by the trial judge, Mrs Justice May. As a consequence, the Claimants were effectively denuded of most of the value of their business. When the Claimants subsequently sued their transactional lawyers, Speechly Bircham, in negligence, one of the firm’s (many) lines of defence was that the judge had got it wrong and the disputed provision did not operate against the Claimants in the way in which she had found.

What is interesting about the decision is that the deputy judge in the subsequent professional negligence action (Jonathan Russen QC) agreed with Speechly Bircham that the first instance decision was wrong, but went on to hold that the firm had nevertheless failed, in breach of duty, to advise the Claimants of the risk that the provision might be found to operate against them.

Under the terms of the relevant transaction documentation, the selling shareholders (the “Claimants”) each acquired a 30% stake and management positions in a newly incorporated company (the ‘NewCo’). This equity was subject to what was termed a Redemption Premium Provision (the ‘RPP’) which was intended to be engaged in the event of a future sale of the shares in NewCo (i.e. a subsequent “exit”, in private equity speak). This essentially provided that the Claimants would be heavily subordinated to the incoming equity and the value of the business would need to grow significantly for the Claimants to benefit from the proceeds of that sale.

In the event, the purchasers dismissed the Claimants at an early stage. This triggered a provision of the articles of NewCo requiring them to be paid the market value of their shares in the event that they were found to be good leavers (which is what the Judge found them to be). The Judge nevertheless held that the RPP was relevant to the valuation of their shares in such a “forced sale” scenario. This meant that the shares were effectively worthless as a consequence of the value of the business not exceeding a hurdle in favour of the new equity.

There was evidence before the Court that the Claimants had repeatedly raised their general concern to Speechly Bircham about the need to protect their equity stakes. HHJ Russen QC held that this should have prompted careful consideration of the relevant equity provisions in the agreement and any risk attached to it, including as to how they might interact with other provisions (in this case, the
articles of association).

As noted above, Speechly Bircham argued that the RPP did not apply where there was a dismissal and that the trial judge had erred in ruling that it did. HHJ Russen QC dismissed this defence ruling that it was reasonable to expect Speechly Bircham to be required to advise their clients as to the risk that the provision could potentially be adversely construed against the Claimants. In so doing it was clear that the judge placed a great deal of weight on the importance of the provision and the potentially significant detrimental effect on Speechly Bircham's clients.

In so holding, the judge noted that whilst what actually happened in this case may have been unthinkable to Speechly Bircham at the time, the consequences for the Claimants of the risk that they could be forced out of the business and paid nothing for their shares were so serious that Speechly Bircham should "have undertaken a cross-check upon the meaning and effect of a provision on which it had drafting input".

This may seem, at first blush, like a harsh incremental step against solicitor defendants in these sorts of claims. However, it could be argued that the Court’s stance simply acknowledges that there is always a degree of risk in contractual interpretation disputes, and serves as a reminder to transactional lawyers that it is their job to mitigate the risk of such disputes arising in relation to key provisions of important agreements (or where that is not possible, to advise their clients of that risk). In so doing it stands as a warning to transactional lawyers that the question is not so much how they consider a particular provision to operate, but what another lawyer (the putative trial judge) might conclude, even in the face of “clear” and “cogent” arguments to the contrary (as they were found to be in this case).

Viewed this way it could be said, in layman's terms, that the duty to consider “bad judge risk” - a topic about which HK partner James Russell has previously written ('Why there should be more solicitor Judges') is creeping into the duty of care of transactional lawyers. This is a point we anticipate considering in more detail in a future article.

The judgment can be found here: [https://www.bailii.org/ew/cases/EWHC/Comm/2022/935.html](https://www.bailii.org/ew/cases/EWHC/Comm/2022/935.html)