Neutral Citation: [2015] IEHC 126

THE HIGH COURT

COMMERICIAL

[2014] 3558 P]

[2014 No. 47 COM]

BETWEEN

DANBYWISKE AND THE GENERAL PARTNERS OF THE WILSON LIMITED PARTNERSHIP 1

PLAINTIFFS

AND

DONEGAL INVESTMENT GROUP PLC.

DEFENDANT

AND

DONEGAL INVESTMENT GROUP PLC.

COUNTERCLAIM PLAINTIFF

AND

ELST AND MONAGHAN MIDDLEBROOK MUSHROOMS

COUNTERCLAIM DEFENDANTS

JUDGMENT of Mr. Justice Brian J. McGovern delivered on the 16th day of January 2015

1. The plaintiffs seek to enforce an option granted to them by the defendant to purchase 5% of the defendant's shareholding in a company called ESLT ("the Company"). The option is to be found in written Heads of Agreement ("HOA") made on 10th May 2007. The defendant claims that the option is unenforceable.

2. In a counterclaim, the defendant claims that certain sums are due to it in respect of dividends, and claims that in the event of the plaintiffs being entitled to exercise their option, that dividends which ought to have been paid in respect of the option shares must now be paid.

3. The first named plaintiff and the defendant were previously shareholders in a company called Monaghan Middlebrook Mushrooms Ltd. ("Monaghan"). Following a restructuring, the Company became the ultimate parent of Monaghan and the shareholders in Monaghan were granted shares in the Company in proportion to the shares which they had previously held in Monaghan. The rights and obligations of the shareholders in Monaghan were governed by a Share Exchange and Shareholders Agreement ("the SESA") which was made on 1st June 2004.

4. After incorporation of the Company in 2010, the terms of the SESA applied *mutatis mutandis* to the shareholders' rights and obligations in respect of their shareholding in the Company.

5. The SESA came about as a consequence of a merger between Monaghan and Carbury Mushrooms Ltd. ("Carbury"). Carbury had been jointly owned by Donegal and Connacht Gold Co-Operative Society Ltd. ("Connacht Gold"). Following the merger of Carbury with Monaghan, the shareholding in Monaghan was held:

(a) 59.6% by Danbywiske and other associates of Danbywiske;

(b) 23% by Donegal;

(c) 17% by Connacht Gold and

(d) the remaining 0.4% was held in trust by National Irish Bank Nominees Ltd.

6. In 2007, Connacht Gold wanted to exit the business by selling its shares in Monaghan to Donegal. The Articles of Association of Monaghan contained pre-emption rights which would have prevented a direct sale of the Connacht Gold shares to Donegal without giving Danbywiske the opportunity to purchase the majority of those shares (in proportion to the shareholding of Danbywiske and its associates in Monaghan). To overcome the difficulty associated with the pre-emption rights, the parties entered into an agreement which was recorded in writing as 'Heads of Agreement' on 10th May 2007, thereby facilitating the direct sale of the Connacht Gold shares to Donegal. It is that agreement which is the subject matter of this dispute.

Issues

7. The following issues arise on the claim:

(a) Did the HOA constitute a legally binding agreement?

(b) If so, what were the conditions for the exercise of the option?

(c) Were the conditions for the exercise of the option fulfilled?

The issue on the counterclaim is whether or not a dividend, according to clause 11 of the SESA, should have been declared and accrued in respect of the 5% of the Company shareholding and whether that sum should now be paid to the defendant or whether the defendant is entitled to damages on the counterclaim by reason of a breach of the dividend policy.

Did the HOA Constitute a Legally Binding Agreement?

8. The defendant argued that the HOA was never intended to have contractual force and what the 2007 document makes clear is that the option referred to therein would be granted as part of a new shareholders' agreement which would also include other provisions of the HOA. Alternatively, the defendant argued that if the HOA did give rise to contractual rights and obligations that:

> (a) It should be construed so as to give effect to the common intention of the parties, namely, that the option would only be exercised provided a new shareholders' agreement was entered into and that the other measures referred to in the HOA were carried into effect. These provisions must be construed as conditions precedent to the exercise of the option which the plaintiffs have failed to satisfy.
>
> (b) There was a common intention (and the plaintiffs represented) that a new shareholders' agreement would be executed and that the measures in the HOA were to be performed as a package. The defendant claims that in reliance on this representation, it signed the HOA and would not have done so if it knew that the plaintiffs would neither execute a new shareholders' agreement nor give effect to para. 3 of the HOA (which concerned the basis on which directors would be appointed and the appointment of an independent chairman). Accordingly, the defendant argued that the plaintiffs are estopped from enforcing any option contained in the HOA.

9. The defendant also argued that if the HOA gave rise to contractual obligations, the plaintiff failed to exercise any such option within the option period. Although a letter was written on 11th December 2013 by the plaintiff purporting to exercise its option enclosing a Share Transfer Form, the plaintiff failed to tender the option price within the option period and that period expired on 1st January 2014. Accordingly, the option was not exercised within the time period and has lapsed.

10. For its part, the plaintiffs argue that they did exercise their option within the time period and that they called on the defendant to complete the Share Transfer Form and they were not obliged to pay over the money until that form was completed. But they had done all that they were required to do within the prescribed period.

11. The plaintiffs also argued that there were only two preconditions to the exercise of the option and that both those conditions were satisfied.

12. The HOA has many indicia of an agreement. Its very title 'Heads of Agreement' indicates a consensus, and in the first paragraph it states "*In connection with the proposed purchase of the investment held in Monaghan Middlebrook Mushrooms Ltd. by Connacht Gold by Donegal Creameries plc., the following agreement has been reached by Danbywiske and Donegal Creameries plc*." [Emphasis added]. Clause 5 of the document states what is to happen "*on completion of this agreement . . .*" and in para. 6 there is a definition of "*profit before tax, for the purposes of this agreement . . .*"

13. It is worth noting that in the defence and counterclaim, the defendant did not plead in terms that the HOA did not constitute a legally binding agreement, but rather, sought to plead that the terms of the agreement which would permit the plaintiffs to exercise the option had not been complied with.

14. The HOA was not drafted by lawyers but did reflect what was agreed between the parties and was signed by a representative of the parties. The agreement is not one which requires being in writing for it to be binding. Undoubtedly, further steps were to be taken on foot of the HOA and as a consequence of it, but I have no doubt, on the evidence, that negotiations had taken place to find a mechanism to effect a direct sale of Connacht Gold shares to the defendant, notwithstanding the pre-emption rights in the Articles of Association of Monaghan, and that the HOA facilitated that direct sale of the Connacht Gold shares to the defendant. That is the stated purpose of the HOA in the first paragraph of the document. The parties had made a bargain and agreed that further steps should be taken, all of which are set out in the document. All of the provisions provided for in the HOA have been implemented with the exception of the transfer of Gateforth Assets referred to in clause 5, and the transfer of the option shares as provided for in clause 6. The fact that some of these terms were to be effected by the execution of other formal documents does not mean that the HOA was not, of itself, a binding contract. It is not recorded anywhere in the HOA that it is necessary to record the terms in a further formal contract.

15. The Court was referred to the case of *Rossiter & Ors. v. Miller* [1874-80] All ER Rep. 465, where the House of Lords confirmed that a contract has been concluded if the parties have reached agreement on all of the essential terms. Simply because the parties envisage recording those terms in a subsequent formal document does not render the concluded agreement or bargain unenforceable. This decision was adopted in the High Court by Kenny J. in *Law & Ors. v. Robert Roberts & Co.* [1964] I.R. 292. This judgment was upheld on appeal.

16. The Novation Agreement of 18th August 2010 makes a number of references to the obligations contained in, and the binding nature of, both the SESA and the Heads of Terms. In fact, the Heads of Terms are attached at Schedule 1 to the Novation Agreement. The document is couched in terms which clearly indicate that the parties understood that the HOA was a binding agreement. The Novation Agreement was signed by two directors on behalf of Donegal as well as all the other parties to the Novation Agreement.

17. Mr. Ronald Wilson, in the course of his evidence, was quite clear that the HOA was a binding agreement. I found Mr. Ian Ireland's evidence to be somewhat evasive on the issue, although he did state that the HOA had to be honoured in full. That was in the context of his assertion that the terms were not in fact honoured by the plaintiffs in a way which would entitle them to exercise the option to purchase shares.

18. Another indication that the HOA did constitute a binding agreement is to be found in the financial statements of Donegal for each year since 31st December 2007, where it is recorded that:

> *"During 2007, the Group granted an option over an additional 5% of Monaghan to the majority shareholder and a member of key management and personnel of Monaghan, exercisable if the Company achieves certain performance criteria during the 5-year period to 31st December 2011."*

The financial statements of the defendant made provision for the exercise of this option.

19. In short, the wording of the HOA itself, the circumstances under which it was made, and the documents I have referred to above, all point to a binding agreement. Therefore, on the first legal issue, I hold that the HOA constituted a legally binding agreement.

What were the Conditions for the Exercise of the Option?

20. The HOA provides at clause 6:

> *"The share option provisions set out in the Shareholders Agreement will be replaced by the following:*
>
> > *Within a 2-year timeframe, commencing on 1 January 2012 and ending on 1 January 2014, Danbywiske will have the option to purchase 5% of the share capital of the company from Donegal Creameries plc. for €350,000 provided both the following criteria have been met:*
> > > *Profit before Tax has averaged €6,000,000 per annum for the 5-year period commencing on 1 January 2007.*
>
> *All sums due to Donegal Creameries plc. to repay the Carbury Fixed Amount, including the interest arising on the outstanding balance from 1 January 2008 have been discharged in full."*

The terms of the SESA were amended in that respect. While there were other terms applicable if the Carbury Fixed Amount was paid by either 31 May 2010 or 31 May 2011 these are not relevant on the facts which have been established. It is clear that the Option is subject to two conditions, namely, that the profit before tax for a 5-year period commencing on 1st January 2007 averaged €6m per annum, and that the Carbury Fixed Amount (a sum defined in the SESA) be paid in full. There is no dispute that both conditions have been met. In the case of the Carbury Fixed Amount, it was repaid in September 2013.

21. By letter dated 11th December 2013, the plaintiff exercised the Option and called on the defendant to execute and return a Share Transfer Form in respect of the Option shares. As the Novation Agreement had provided for the transfer of the Option from Danbywiske to the Wilson Partnership, the Partnership also notified the defendant at that time that in the event that Donegal objected to Danbywiske exercising the option, that the Partnership was doing so in the alternative.

22. The defendant claimed that the plaintiffs have failed to comply with their obligations under the Option agreement on the basis that the Option was subject to further conditions which have not been met.

23. The first of these further conditions is that the parties would enter into a new shareholders' agreement which would replace the SESA.

24. In the HOA, there is no mention of a new shareholders' agreement. Specifically, there is no condition expressed therein that the option can only be exercised once the parties have entered into such an agreement. The Court was referred to a number of well-known decisions on the interpretation of contracts including *Reardon-Smith Line Ltd. v. Hansen-Tangem* [1976] 1 WLR 989, *Investors Compensation Scheme v. West Bromwich Building Society* [1998] 1 W.L.R. 896, *UMP Kymmele Corporation v. BWG Ltd*. (Unreported, High Court, Laffoy J. 11th June 1999) and *Ryanair Ltd. v. An Bord Pleanála* [2008] IEHC 1. The jurisprudence is clear. To ascertain the parties' intentions, the Court does not enquire into the parties' subjective states of mind, but makes an objective judgment based on the meaning of the document as conveyed to a reasonable person having 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 making of the contract. The Court adopts an objective rather than a subjective approach and thus the courts will not admit evidence of prior negotiations where it is interpreting a written document.

25. There was no evidence before the Court of any representation having been made by the plaintiffs to the effect that the terms of the HOA were dependent upon a new shareholders' agreement being entered into by the parties. Mr. Ireland gave evidence that such a representation was to be implied but I cannot accept that that is so. There is nothing to be found in any correspondence or exchange of emails on the subject prior to the conclusion of the HOA.

26. Neither the clear terms of the HOA itself nor the surrounding evidence supports the defendant's contention that the conclusion of a new shareholders' agreement was a precondition to the exercise of the Option, and accordingly I reject that argument.

27. The defendant raised a further argument based on the Novation Agreement, Recital C of which provides as follows:

> *"The parties have implemented most of the terms of the Heads of Agreement attached at Schedule 1 to this Amendment and Novation Agreement (the 'Heads of Terms') and intend to complete the implementation of the said Heads of Terms (save that the Option set out in Clause 6 of the Heads of Terms shall be granted to WLP1 rather than the Monaghan Shareholder) by entering into a revised shareholders agreement within six weeks from the date hereof."*

28. The plaintiffs argued that this objection is unsustainable for two reasons. In the first place, the subsequent behaviour of parties to an agreement is not relevant in interpreting the meaning of the agreement. Secondly, Recitals do not form part of the binding terms of the Novation Agreement, or indeed any other agreement. Finally, the plaintiffs argued that, even if it was appropriate to look to the Recitals in the Novation Agreement as a means of interpreting the HOA, nothing in the Recital in question alters the meaning and effect of the Option or renders its exercise conditional on any new event or obligation not expressly stated in the 2007 agreement. I accept the plaintiffs' contention on that point. In construing the terms of a contract, the intention of the parties must be gathered from the language of the contract and the circumstances in existence at the time it was made and not subsequent events. See *Union Insurance Society of Canton Ltd. v. George Wills & Co.* [1916] 1 A.C. 281. The law does not allow a contract to have one meaning when it is signed and another meaning at a later date by reason of subsequent events. That would lead to confusion and uncertainty. See *James Miller & Partners Ltd. v. Whitworth Street Estates (Manchester) Ltd.* [1970] A.C. 583.

29. There is nothing ambiguous about the Option clause in the HOA that would permit the courts to interpret it by reference to Recitals in the Novation Agreement or any other document.

30. Having considered the Option clause in the HOA, I am satisfied that it was subject to the two conditions referred to in para. 21 above and the exercise of the Option within a two-year timeframe between 1st January 2012 and 1st January 2014. The Option was not subject to any further conditions.

Were the Conditions for the Exercise of the Option Fulfilled?

31. As I stated at para. 20 above, there is no dispute that profit before tax for a five-year period commencing on 1st January 2007 averaged €6m per annum and the Carbury fixed amount has been repaid since September 2013. Accordingly, the conditions for the exercise of the Option have been fulfilled. The HOA required that the Option be exercised by 1st January 2014. By letter dated 11th December 2013, the plaintiffs' solicitors wrote to the defendant stating:

> *". . . our client hereby formally notifies you that it wishes to exercise the Option and calls on you to duly execute and return the enclosed Share Transfer Form to this office within seven days from the date hereof. Upon receipt of the*

completed Share Transfer Form, our client confirms that it will pay you the sum of €350,000 as per the terms of the Agreement."

32. The defendant complained that the plaintiffs did not pay over the sum of €350,000 by 1st January 2014, and that the time for doing so has passed so as to render the Option unenforceable. I do not agree. It is clear that within the time allowed, the plaintiff informed the defendant that it wished to exercise the Option and called on the defendant to return the enclosed Share Transfer Form within seven days. If there was a delay in completing the necessary formalities surrounding the Option, it was on account of the defendant's failure to return the Share Transfer Form. I accept the evidence given on behalf of the plaintiff that the sum of €350,000 would have been paid over within the time limit, had the defendant done so. I hold that the Option was exercised within the time limit set out in the HOA.

Counterclaim

33. An important distinction exists between the parties listed in the claim and in the counterclaim. The initial defendant (plaintiff in the counterclaim) is Donegal Investment Group PLC., and the counterclaim defendants are ELST and Monaghan Middlebrook Mushrooms ("Monaghan"), neither of whom is named as a party to the claim.

34. The plaintiff in the counterclaim claims that the sum of €807,000 is due to it in respect of dividends which should have been declared or, if they were not declared, should have accrued.

35. It was a matter for the Board to recommend to shareholders whether a dividend be paid. Clause 11.1.2 of the SESA states:

". . . the Board shall recommend that the shareholders shall exercise their voting rights in the Company to procure that an amount be declared by the Company as a dividend . . ."

There was no evidence that Donegal-appointed directors had ever suggested the declaration of a dividend to the Board. Furthermore, it had been agreed between the plaintiff and the defendant to forego dividends to help the growth of the Company. While the defendant sought to suggest that the plaintiffs were in control of the Board and that the issue of declaring a dividend was their responsibility, there was no evidence that the question of declaring a dividend was ever discussed or voted upon at Board meetings.

36. Clause 11.3 of the SESA provides that no dividends would be paid unless the Carbury fixed amount was discharged in full. This did not occur until September 2013, and therefore no dividends could have been declared prior to that date.

37. Mr. Wilson, in his replying witness statement dated 28th November 2014, stated that on 4th November 2011, a facility agreement was entered into between the second named counterclaim defendant and the Bank of Ireland which specifies the circumstances in which a dividend can be paid by Monaghan. This arises where the payment of a dividend by Monaghan of a maximum aggregate amount in any financial year equal to 20% of PAT for that financial year is (i) made when no default is continuing or would occur immediately after the making of the payment and (ii) Adjusted Leverage is less than 2:1. The Adjusted Leverage as of 28th November 2014 was 3:1 and consequently neither of the counterclaim defendants could declare a dividend without being in breach of the facility agreement. Mr. Wilson adopted his statement as his evidence and repeated that evidence to the Court when he stated that:

"I don't envisage any circumstances where these dividends will be either declared or accrued because there are clauses in the banking facility letters that don't allow us to declare dividends until we have a debt equity ratio of less than 2:1." (A. 525 11th December 2014)

This evidence was not challenged.

38. The burden of proving the counterclaim lies on the defendant. The defendant has failed to establish that a dividend should have been declared and that it is entitled to the sum claimed or any sum. I accept the evidence of Mr. Wilson that in the circumstances which obtained, no dividend was payable.

Conclusions.

39. For the reasons set out above, I hold that the plaintiffs are entitled to specific performance of the Option to purchase the shares contained in the Heads of Agreement of 10th May 2007. The defendant has failed to prove its counterclaim and it follows that it must be dismissed.