

You Say Hello. I Say Goodbye: The *DnaNudge* Case and Differences of Opinion on Share Conversions and Other Variations of Class Rights

November 6, 2023

Following a recent Court of Appeal decision, investors, portfolio companies and their advisers should be aware that English courts may, on occasion, adopt seemingly strained interpretations of ambiguous or unclear contract terms to give effect to what the court considers to be the outcome most consistent with commercial common sense. Whether such interpretations may constitute overreaching by the courts remains to be seen.

In its decision in *DnaNudge Ltd v Ventura Capital GP Ltd* [2023] EWCA Civ 1142, the Court of Appeal confirmed various points regarding contractual provisions allowing shares of one class to be converted into another, but in doing so approved an interpretation of *DnaNudge*'s articles that appears to depart substantially from the actual drafting.

We highlighted the judgment of the High Court in *Ventura Capital GP Ltd v DnaNudge Ltd* [2023] EWHC 437 (Ch) in a previous [article](#) and indicated that the decision may be appealed. The Court of Appeal decision on that appeal was handed down on Monday, 9 October 2023, affirming the decision of the High Court.

Conversion of shares

At issue before the High Court was a conversion right contained in a set of articles purporting to allow one group of shareholders (who held ordinary shares) to convert by resolution a class of shares held by another group of shareholders (who held preference shares) into a different class of shares and whether that right, although apparently on its face unqualified, was nonetheless subject to a consent right contained elsewhere in the articles. The High Court decided that it was. The High Court decided that converting all of the preference shares in issue into ordinary shares would constitute an abrogation of the rights attached to the preference shares.

The Court of Appeal agreed. The Court of Appeal unanimously upheld the judgment of the High Court that the exercise of a right to convert investors' preference shares into ordinary shares without their consent, purportedly under authority from the articles of association, was, in fact, a breach of the articles of association, and therefore invalid. The Court of Appeal highlighted in its judgment that to interpret the articles as giving the ordinary shareholders the right unilaterally to deprive the holders of preference shares of the particular benefits conferred by their preference shares was irrational and incapable of logical justification.

The Court of Appeal's reasoning also considered that the investors received no consideration for the conversion of their shares, in contrast to a situation in which the holders of preference shares receive their accrued preferential entitlement on a cancellation of those shares. The court confirmed (in accordance with settled English law) that the latter scenario would constitute the performance of the rights attached to the shares in question, whereas the situation in this case constituted an abrogation of those rights.

Points arising from the case – definite drafting will be needed

Both courts agreed that the conversion provision of the articles had to be read subject to the requirement that the consent of the holders of the affected class of shares must be obtained prior to any variation or abrogation of the rights attached to shares of that class. That being so, parties in a similar situation should note that:

1. any conversion of one share into a share of a different class will take effect as a redesignation of the existing shares rather than a cancellation and re-issue of a new share;
2. a “conversion” which has the effect of depriving shares of rights is an abrogation of those rights and will most likely require class consent, either under the Companies Act 2006 or the relevant provision of a company’s articles; and
3. a provision which gives one class of shareholders the right unilaterally to deprive the holders of another class of the benefit of rights attaching to their shares is likely to be challenged if exercised and, depending on the surrounding factual matrix, the courts may uphold that challenge. Therefore, if that is the intention of the parties, that intention should be made very clear and captured in careful drafting.

Judicial intervention

Investment documents often contain provisions allowing conversion of shares or purporting to convert one class of shares into another. Given the prevalence of such clauses, investors and those seeking investment should be aware of the possible risk of a successful challenge to a conversion where it is to take place without the consent of the holders of converted shares.

In addition, parties to investment documents should be aware that the courts may adopt creative interpretations of contracts in the face of ambiguity. This is especially important when drafting bespoke terms. The problem in this case arose from inconsistency between a bespoke article containing a conversion right and a standard form article governing variations of the rights attached to shares. Parties and their advisors must ensure that their boilerplate language is amended in order not to cut across tailored clauses.

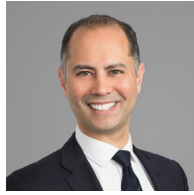
Ambiguity in contracts benefits neither party, and counterparties to investment documents should always strive for certainty in documenting the terms of their transactions and relationships. As was shown in this dispute, the alternative is to have the court determine the correct interpretation of the relevant contract in accordance with its conception of commercial common sense. The outcome of that process is rarely mutually satisfactory.

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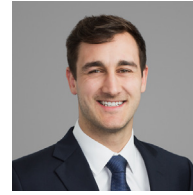
For more information, contact your Katten lawyer or any of the following:



Oliver Williams
+44 (0) 20 7770 5212
oliver.williams@katten.co.uk



Edward A. Tran
+44 (0) 20 7770 5254
edward.tran@katten.co.uk



David Wood
+44 (0) 20 7776 7650
david.wood@katten.co.uk



Omar Malek
+44 (0) 20 7770 5240
omar.malek@katten.co.uk



Alex Potten
+44 (0) 20 7770 5223
alex.potten@katten.co.uk

Katten

katten.com

Paternoster House, 65 St Paul's Churchyard • London EC4M 8AB
+44 (0) 20 7776 7620 tel • +44 (0) 20 7776 7621 fax

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