Private Equity: When is a Leaver "Transfer Notice" deemed to be served by an Employee who is also a Director?

In its recent judgment in *Syspal Capital Ltd v Truman & Anor [2024] EWHC 1561 (Ch)* the English High Court of Justice found that the correct interpretation of a "leaver" provision in a company's articles of association resulted in an employee shareholder (the leaver) being deemed to have served a "Transfer Notice" for the compulsory transfer of his shares upon his retirement from his position as a director of the company, rather than upon his earlier dismissal as an employee of another entity within the same group. As a result, the leaver was entitled to receive the higher "Fair Value" for the sale of his shares, rather than the lower "Market Value".

The case demonstrates that when drafting leaver provisions in private equity ("**PE**") transactions, it is important that the parties are clear as to when the compulsory transfer mechanism is triggered in circumstances where a leaver may hold multiple positions as an employee, consultant or director in different companies within the same group.

Background

The *Syspal* case concerned the articles of association of the second defendant, Syspal Holdings Limited ("**SHL**"), the holding company of Syspal Limited ("**SL**"), an engineering company specialising in the design and fabrication of stainless steel and aluminium products. The first defendant, Mr Truman, owned 24% of the shares in SHL. The remaining 76% shareholding in SHL was held by the claimant, Syspal Capital Limited ("**SCL**"), which, in turn, was controlled by Mr Roberjot, who was also a director of SHL.

Mr Truman had been an employee of SL since 1980 and had also been a director of such company. He was dismissed as an employee of SL on 10 October 2022 and was subsequently removed as one of its directors on 3 November 2022. Mr Truman had also been a director of SHL until he resigned on 24 May 2023, his 65th birthday, leaving Mr Robjerot as the sole director of SHL.

The Articles

The articles of association of SHL provided that if any "*Employee Member*" ceased "*to be employed as an employee, director or consultant of a Group Company (and does not continue in that capacity in relation to any Group Company)*" then a transfer notice would be deemed to be served on the date of such cessation and the Employee Member would be required to offer his shares for sale to the other shareholder(s) of the company (which, in this case, was the claimant, SCL). Mr Truman was an "*Employee Member*" under SHL's articles and "*Group Company*" under the articles included both SL and SHL.

The articles further provided that the price an Employee Member was entitled to receive for the sale of his shares would be the "*Market Value*" of the shares, unless the transfer notice was deemed to be served as a result of the Employee Member's "*death, permanent incapacity or retirement at 65 years of age*", in which case it would be the "*Fair Value*" of the shares. The key difference between the two valuations was that "*Market Value*" included a discount for minority shareholdings (such as Mr Truman's 24% shareholding), whereas "*Fair Value*" did not include such a discount.

The Dispute

The difference between the "*Fair Value*" and "*Market Value*" of Mr Truman's shares in this case was very significant. A dispute therefore arose between the parties as to whether Mr Truman was deemed to have served a transfer notice upon his resignation from his position as a director of SHL on his 65th birthday on 24 May 2023 (in which case he would have been entitled to receive "*Fair Value*" for his shares) or upon his earlier dismissal as an employee of SL on 10 October 2022 (in which case he would only have been entitled to receive "Market Value" for the shares).

"In that capacity..."

The arguments submitted by each of the parties revolved around the meaning of the words "*in that capacity*" in the compulsory transfer provisions.

SCL argued that the words "*in that capacity*" referred to the capacity in which an Employee Member ceased to be employed, so that when Mr Truman ceased to be employed as an employee of SL on 10 October 2022, as he was not an employee of any other Group Company, he had been deemed to serve a Transfer Notice on that date.

Mr Truman argued that the words "*in that capacity*" referred to any of the three different ways in which an Employee Member might be engaged to work for a Group Company, i.e. as an employee, director or consultant of a Group Company. In other words, while Mr Truman had ceased to be employed as an employee of SL on 10 October 2022, he had continued to be a director of SHL until 24 May 2023 and, therefore, had been deemed to serve a Transfer Notice on that date, being the date of his retirement at the age of 65.

Decision

The court found in favour of Mr Truman.

Mr Justice Roth noted that the wording of the article was "*not entirely clear*" but ultimately agreed with the interpretation put forward by Mr Truman. He said that the word "*employed*" was not used in its strict sense of being an employee under a contract of employment but also included being engaged to serve as a director or consultant. Accordingly, the reference to not continuing "*in that capacity*" referred to the capacity of an employee, a consultant or a director. Therefore, notwithstanding that Mr Truman ceased to be employed as an employee, because he continued to be a director of SHL, there was no deemed Transfer Notice until his resignation as a director on 24 May 2023. The judge held that this interpretation was "*the more natural reading of the wording*" and "*accords with commercial common sense*".

The court found that the purpose of the compulsory transfer provision was that if one of the shareholders stopped contributing to the day-to-day running of the business, the other shareholders should be given the opportunity of buying that shareholder's shares. The judge noted, however, that it is not uncommon for a senior employee to retire from full-time employment but continue to serve the business as a consultant or director. To require an individual in such circumstances to sell all his shares, and to do so at the lower of the two valuations, would not make "*commercial good sense*", the judge said.

The judge further noted that if dismissing an employee of a Group Company could be deemed to serve a Transfer Notice, even though he remained as a director, this would create the potential for the employing company to dismiss him "*for no good reason*" in order to trigger a forced sale of his shares at the lower price. This could not, according to the judge, have been the parties' intention when adopting the articles.

Accordingly, the court found that a Transfer Notice was deemed to have been served by Mr Truman on his retirement from the position of director of SHL on 24 May 2023, being the date of his 65th birthday. The sale price for Mr Truman's shares was, therefore, the "*Fair Value*" of the shares.

Commentary

Although the English High Court of Justice's decision in *Syspal* is not binding in Ireland, it is likely to be of persuasive authority.

When drafting leaver provisions, it is important that the parties are clear as to when the compulsory transfer mechanism is triggered in circumstances where an employee may also be a director of the company or another company within the same group. This will ultimately depend on the wording in the relevant provisions in the company's constitution and therefore it is important that such provisions are clearly drafted in a way that reflects the parties' intentions.

PE sponsors will likely not want an employee who has been dismissed to continue to remain as a director of a group company, especially if this would entitle the individual to continue to hold on to their shares in that group company or another group company. To prevent such a scenario occurring, sponsors should ensure that the service agreement for such an employee contains a clause providing for his or her resignation as a director immediately upon the termination of his or her employment.

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