Neutral Citation Number: Double-click to add NC number

Case No: BL-2023-000135

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
Business List (ChD)

Rolls Building
Fetter Lane
London EC4A 1NL

Date: 30 November 2023

Before :

MASTER PESTER

- -

Between :

(1) DANIEL LEE
(In his personal capacity and as Trustee of the Westerby Private Pension – D M Lee)
(2) WPA TRUSTEES LIMITED
(As Trustee of the Westerby Private Pension – D M Lee)
Claimants

and

(1) GSQUARE CAPITAL II LP
(2) P2U HOLDINGS LIMITED
(3) MARK LIVINGSTONE
(4) GARY DANNATT
(5) PHARMACY 2U LIMITED
Defendants

- -

MATTHEW BRADLEY KC (instructed by **Pinsent Masons LLP**) for the Claimants
JOE SMOUHA KC and BIBEK MUKHERJEE (instructed by **Goodwin Procter (UK) LLP**) for the 1ST and 2ND Defendants

Hearing date: 13 September 2023

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APPROVED JUDGMENT

This judgment was handed down remotely by circulation to the parties or their representatives by email. The date and time for hand-down is deemed to be 4pm on 30 November 2023.

MASTER PESTER:

A. Introduction

1. This is my judgment on an application dated 16 May 2023 ("the Application") by the First and Second Defendants ("GSquare" and "P2U Holdings" respectively) to strike out, alternatively to obtain reverse summary judgment on, certain identified paragraphs in the Particulars of Claim and the Reply. The respondents to the Application are the First and Second Claimants ("Mr Lee" and "the Trustees"). Where I refer to GSquare and P2U Holdings collectively, without distinguishing between them, I will refer to them as "the Applicants". Likewise, where I refer to Mr Lee and the Trustees collectively, I will refer to "the Respondents".

2. The Application requires me to decide two issues:

   (1) Whether a letter, referred to by the parties in their statements of case as the "July 2020 Transfer Notice", is valid ("the Validity Issue"); and

   (2) Whether clause 16.3(d) of the Articles of Association of P2U Holdings ("the Articles") is an unenforceable penalty clause ("the Penalty Issue").

3. In terms of the evidence, I have a witness statement from Oliver Glynn-Jones in support of the Application; a witness statement in response from Mr Lee; and a further witness statement from Mr Glynn-Jones in reply. Mr Lee also submitted a further statement shortly before the hearing, which he had no permission to serve, but which GSquare and P2U Holdings did not object to my reading. The witness evidence relates to the Penalty Issue, and raises matters concerning the extent to which the relevant provisions of Article 16,

which GSquare and P2U Holdings seek to uphold, were exorbitant, unconscionable and serve no legitimate interest.

4. I consider further below the extent to which it is necessary and appropriate to consider this evidence on the Application.

5. I would also add at the outset that, whatever I decide on the Application, these proceedings will continue to trial. Several important issues between the parties will remain live and cannot be resolved on the Application. Mr Lee also claims relief against the Third and Fourth Defendants, and this is again unaffected by whatever I decide.

B. Background

6. I can take the relevant background from the statements of case. Mr Lee founded the Fifth Defendant ("P2U") in 1999. P2U's principal business, or at least a significant part thereof, was acting as an NHS contracted distance-selling pharmacy, managing repeat prescriptions directly for patients at no costs to those patients. Patients would sign up directly with P2U. Thereafter, future prescriptions ordered either via P2U or other patient-facing services would be sent electronically to P2U for dispensing and delivery to the patient.

7. Mr Lee was employed by P2U until March 2018 pursuant to an executive director service agreement. He held shares in P2U both personally and via his pension plan. Mr Lee and the Trustees are the current trustees of Mr Lee's pension plan, a trust in the form of a Self-Invested Personal Pension called "the Westerby Private Pension – D M Lee".

8. As of 2017, the Third and Fourth Defendants ("Mr Livingstone" and "Mr Dannatt") were each directors of P2U, as respectively its CEO and CFO. In September 2017, Mr Livingstone and Mr Dannatt were mandated and authorised by the board of directors of P2U to explore and put in place what is described as an "exit/fundraising process". This led to the eventual sale of all shares in P2U to GSquare/P2U Holdings, as explained below. Mr Livingstone and Mr Dannatt led these negotiations on behalf of P2U's shareholders. Mr Livingstone and Mr Dannatt are separately represented from GSquare, P2U Holdings and P2U. Neither Mr Livingstone nor Mr Dannatt are parties to the Application and, as I have already mentioned, the Application does not touch on the issues between Mr Lee and the Trustees on the one hand and Mr Livingstone and Mr Dannatt on the other.

9. GSquare is a private equity house, specialising in investments in healthcare companies in Europe. In February 2018, GSquare sent a binding offer letter to purchase 100% of P2U's share capital. In very brief summary, the structure of the proposed purchase involved the incorporation of a new company, which would become P2U Holdings, in order to acquire the entirety of the issued shareholding in P2U.

10. On 16 March 2018, GSquare completed its acquisition of P2U's business. The shareholders in P2U (including Mr Lee and the Trustees) sold all their shares in P2U to P2U Holdings by a Share Sale Agreement dated 16 March 2018 ("the SSA"), with the effect that P2U Holdings became the parent company of P2U. Pursuant to the SSA, shares in P2U Holdings were issued to GSquare

and to the existing shareholders, including the Respondents. As well as shares, Mr Lee also received a cash consideration of £895,118.45.

11. On the same date, all the shareholders in P2U Holdings, including the Respondents and GSquare, entered into a shareholders' agreement in respect of P2U Holdings ("the Shareholders' Agreement"). As contemplated by the Shareholders' Agreement, P2U Holdings (known at the time as "GSHPE Bidco Ltd") adopted the new Articles on 29 March 2018.

12. On 29 March 2018, Mr Lee's existing service agreement was novated to P2U Holdings ("the Service Agreement").

13. On 4 June 2019, Mr Lee was given six months' notice of redundancy and placed on garden leave, to expire on 4 December 2019. For the purposes of the Articles, Mr Lee therefore became a "Leaver" on 4 December 2019, which thereby became his Termination Date, as defined under the Articles. This is agreed: see Particulars of Claim, paragraph 50; Defence, paragraph 12.

14. Pursuant to the terms of the Articles, Article 16.1, GSquare was entitled, within 12 months of the Termination Date (that is, by 4 December 2020), to require an employee who was also a Leaver to transfer some or all of his shares, and those of his Permitted Transferee (as defined), to a specified person. By the July 2020 Transfer Notice, on 26 July 2020 GSquare purported to exercise this right, by requiring Mr Lee and the Trustees to transfer their B1 and B2 shares in P2U Holdings to it. Mr Lee and the Trustees did not consent to or effect the transfer. However, again pursuant to the Articles, Article 16.10, there is a mechanism whereby if a shareholder does not execute the

transfer, the defaulting shareholder is deemed to have irrevocably appointed a person nominated by the "Investor Director" (as defined) to be his agent to execute, complete and deliver a transfer of those shares in favour of the proposed purchaser against receipt by P2U Holdings of the consideration due for the shares. P2U Holdings is then to hold the consideration on trust for the relevant shareholders. The shares were transferred by this mechanism on 11 August 2020.

15. In September 2020, the Trustees issued a Part 8 claim against GSquare and P2U Holdings seeking rectification of the Register of Members of P2U Holdings, so as to restore the Trustees to that Register as the holder of 9,047 B1 shares in P2U Holdings. The ground of that claim was that Article 16 of the Articles had no application to the Trustees' B1 shares (as opposed to the B2 shares). Those Part 8 proceedings were ultimately not contested, and resulted in an order by consent (i) declaring that the July 2020 Transfer Notice in respect of the Trustees' B1 shares and the actions taken pursuant to that Notice were void, and (ii) ordering the retrospective amendment of the Register of Members of P2U Holdings.

16. The price to be paid for the transferred shares is specified in Article 16.3. The price differs, depending on whether the Transferee is designated as a Good Leaver, a Bad Leaver, an Intermediate Leaver or a Very Bad Leaver. In the July 2020 Transfer Notice, GSquare designated Mr Lee a Very Bad Leaver "… as a result of his involvement with another company called CloudRX Ltd". GSquare's position is that Mr Lee was in breach of various restrictive covenants in the Service Agreement and/or the Shareholders' Agreement. In

consequence, GSquare alleges that the price payable for his transferred shares is just £1. Mr Lee in turn maintains that that price is a gross undervalue of shares which he says, on any view, are worth several million pounds.

17. Mr Lee disputes the allegation that he is or was a Very Bad Leaver. The question whether Mr Lee was, or was not, in breach of the restrictive covenants is a matter to be determined at trial, which in turn will determine whether the designation as a Very Bad Leaver is correct. Mr Lee claims damages for breach of contract as against GSquare, on the basis that the provisions of the Service Agreement and the Shareholders' Agreement on which GSquare relies to contend that Mr Lee was in breach of his duties so as to be a "Very Bad Leaver" have in fact not been breached, and that he is not in fact a "Very Bad Leaver". However, the Respondents' claim is not limited to damages, but also seeks a declaration that the July 2020 Transfer Notice is invalid, with the consequence that the Respondents are entitled to the return of the shares, whether by way of order pursuant to s. 125 of the Companies Act 2006 and/or by way of declaratory and mandatory relief.

18. The claim for invalidity of the July 2020 Transfer Notice is now put on two bases:

(1) The Respondents submit that, properly construed, it is a requirement of Article 16 that the notice requiring the transfer of the shares must not only specify what type of Leaver Mr Lee was (whether Good, Bad, Intermediate or Very Bad,) but must do so "accurately". In the event that this is not done, then the notice is invalid.

(2) The Respondents further argue that Article 16.3(d), the provision by which the price payable for the shares of a Very Bad Leaver is set at £1, is an unenforceable penalty.

19. In addition, the Respondents bring separate claims against Mr Livingstone and Mr Dannatt. These claims are for breach of fiduciary duty, breach of a duty of care in tort and/or in deceit on the basis that (in overview) Mr Livingstone and Mr Dannatt wrongfully bargained away some of the Respondents' rights in relation to their shares in P2U, such that their shares in P2U Holdings could be acquired by GSquare for less than market value, as well as making false representations to induce the Respondents to enter into such an arrangement. It is also said that P2U is vicariously liable for the breaches of duty of Mr Livingstone and Mr Dannatt. Again, however, those are not matters for determination on the Application.

C. Strike out/summary judgment: the legal test

Strike out

20. CPR r. 3.4(2) allows the court to strike out a statement of case which discloses no reasonable grounds for bringing or defending a claim or which is an abuse of process. On an application to strike out, the primary facts are assumed to be true, but the Court should not be deterred from deciding a point of law, if it has all the facts it should "grasp the nettle": per Warby J in *Duchess of Sussex v Associated Newspapers Ltd* [2020] EMLR 21, at [33]. The court should not strike out a claim unless certain it is bound to fail: see per Peter Gibson LJ at [22] in *Richards (t/a Colin Richards & Co) v Hughes* [2004] EWCA Civ 266.

The point made in that case was that the relevant area of law was subject to some uncertainty and developing, and it was highly desirable that the facts should be found so that any further development of the law should be on the basis of actual and not hypothetical facts.

Summary judgment

21. In *Standard Life Assurance Ltd v Building Design Partnership Ltd* [2021] EWCA Civ 1793, at [38], the Court of Appeal said this regarding the overlap between an application for summary judgment and strike out:

> *"[I]n a case of this kind, CPR rr. 3.4(2) and 24.2 should be taken together and a common test applied. If a defendant is entitled to summary judgment because the claimant has no realistic prospect of success, then the statement of case discloses no reasonable grounds for bringing a claim and should be struck out. The court must consider whether the claimant has a "realistic" as opposed to a "fanciful" prospect of success: Swain v Hillman [2001] 1 All ER 91. In essence, the court is determining whether or not the claim is "bound to fail": see Altimo Holdings and Investment Ltd v Kyrgyz Mobil Tel Ltd [2012] 1 WLR 1804, paras 80 and 82. …"*

22. Thus, the tests to be applied in applications to strike out and summary judgment are similar. The court should not grant an application for summary judgment unless the claim has no real prospect of success. Authoritative guidance, which has subsequently been followed on many occasions as well as being approved by the Court of Appeal, as to the meaning of a "real" prospect of success was given in *Easyair Ltd v Opal Telecom Ltd* [2009] EWHC 339 (Ch), at [15], where Lewison J, as he then was, made the following points:

> *"(i) The court must consider whether the claimant (or defendant) has a 'realistic' as opposed to a 'fanciful' prospect of success: Swain v Hillman [2001] 2 All ER 91;*

(ii) "A 'realistic' claim is one that carries some degree of conviction. This means a claim that is more than merely arguable: ED & F Man Liquid Products v Patel [2003] EWCA Civ 472 at [8];

(iii) In reaching its conclusion the court must not conduct a 'mini-trial': Swain v Hillman;

(iv) This does not mean that the court must take at face value and without analysis everything that a claimant [or defendant] says in his statements before the court. In some cases it may be clear that there is no real substance in factual assertions made, particularly if contradicted by contemporaneous documents: ED & F Man Liquid Products v Patel at [10];

(v) However, in reaching its conclusion the court must take into account not only the evidence actually placed before it on the application for summary judgment, but also the evidence that can reasonably be expected to be available at trial: Royal Brompton Hospital NHS Trust v Hammond (No. 5) [2001] EWCA Civ 550;

(vi) Although a case may turn out at trial not to be really complicated, it does not follow that it should be decided without the fuller investigation into the facts at trial than is possible or permissible on summary judgment. Thus the court should hesitate about making a final decision without a trial, even where there is no obvious conflict of fact at the time of the application, where reasonable grounds exist for believing that a fuller investigation into the facts of the case would add to or alter the evidence available to a trial judge and so affect the outcome of the case: Doncaster Pharmaceuticals Group Ltd v Bolton Pharmaceutical Co 100 Ltd [2007] FSR 3;

(vii) On the other hand it is not uncommon for an application under CPR Part 24 to give rise to a short point of law or construction and, if the court is satisfied that it has before it all the evidence necessary for a proper determination of the question and that the parties have had an adequate opportunity to address it in argument, it should grasp the nettle and decide it. The reason is quite simple: if the respondent's case is bad in law, he will in truth have no real prospect of succeeding on his claim or successfully defending the claim against him, as the case may be. Similarly, if the applicant's case is bad in law, the sooner that is determined, the better. If it is possible to show by evidence that although material in the form of documents or oral evidence that would put the documents in another light is not currently before the court, such material is likely to exist and can be expected to be available at trial, it would be wrong to give summary judgment because there would be a real, as opposed to a fanciful, prospect of success. However, it is not enough simply to argue that the case should be allowed to go to trial because something may turn up which would have a bearing on the question of construction: ICI Chemical & Polymers Ltd v TTE Training Ltd [2007] EWCA Civ 725."

23. It might be said that there is a tension between paragraphs (vi), which is that although a case may turn out at trial not to be "really complicated", it does not follow that it should be decided without the fuller investigation into the facts which is possible at trial, and (vii), which says that if the court is satisfied that it has before it all the evidence necessary for the proper determination and that the parties have had an adequate opportunity to address it in argument, the court should "grasp the nettle" and decide it. This tension is more apparent than real. On a summary procedure, it is not part of a court's function to decide either conflicts of the evidence on the witness statements or difficult questions of law which call for detailed argument and undue consideration: see *American Cyanamid Co v Ethicon Ltd* [1975] AC 396, at p. 407. On the other hand, where the legal principles are clear and it is not a developing area of law, where neither side is suggesting that further factual evidence will emerge that will or may shed light on the issues between the parties, and there has been a proper opportunity to make full submissions at the summary judgment stage, the court should indeed "grasp the nettle" and decide matters.

24. Finally, where a summary judgment application involves a controversial question of law in a developing area, and there is much to be considered in terms of the relevant authorities, the matter should proceed to a full trial (*Doncaster Pharmaceuticals Group Ltd & ORS v The Bolton Pharmaceutical Company 100 Ltd* [2006] EWCA Civ 661, at [92]; *TFL Management Ltd v Lloyds TSB Bank Plc* [2013] EWCA Civ 1415 at [27]).

D. Relevant Provisions of the Articles

25. The provision of the Articles of central relevance for present purposes is Article 16 – headed ***"Compulsory transfers - Good/Bad Leaver"***. Articles 16.1-16.3 provide as follows:

> ***16.1*** *If an Employee becomes a Leaver, the Investor Majority* [that is, GSquare] *may at any time within 12 months after the Termination Date require such Employee and all of his Permitted Transferees (only to the extent they hold shares in that capacity) to transfer all or some of his shares to any of the following:*
>
> *(a) a Group Company;*
>
> *(b) a person or persons intended to take the relevant Employee's place;*
>
> *(c) any other Employee;*
>
> *(d) an Employee Trust; or*
>
> *(e) any other person(s) approved in writing by the Investor Majority.*
>
> ***16.2*** *The relevant Employee or Leaver and all of his Permitted Transferees will transfer such of the shares that they are directed to transfer free from all Encumbrances and together with all rights attaching to them on the terms set out in this article 16.*
>
> ***16.3*** *The price of the shares to be transferred pursuant to article 16.1 will be:*
>
> *Good Leaver*
>
> *(a) If the Employee is a Good Leaver, the price per share will be the Prescribed Price (the "**Good Leaver Price**");*
>
> *Bad Leaver*

> *(b) If the Employee is a Bad Leaver at any time, the price per share will be the lower of the Cost and the Prescribed Price (the "**Bad Leaver Price**");*
>
> *Intermediate Leaver*
>
> *(c) If the Employee is an Intermediate Leaver at any time, the price per share for the Value Vested Percentage of the shares will be the Good Leaver Price and the price for each remaining share shall be the Bad Leaver Price; and*
>
> *Very Bad Leaver*
>
> *(d) If the Employee is a Very Bad Leaver at any time, the aggregate price for all shares will be £1.*

26. Article 16.4 set out the various vesting dates in a table. It is common ground that Mr Lee's Termination Date was 4 December 2019 (and that he was accordingly a Leaver), and as such, 100% of the Respondents' shares had not vested. This will impact on the calculation of the price to be paid for the Respondents' shares, assuming that Mr Lee can establish that he is an Intermediate, and not a Very Bad, Leaver.

27. As set out in Article 16.5, the 'Prescribed Price' referred to in Article 16.3 was the price per share specified under Article 19.

28. Mr Lee was either a Very Bad Leaver (if he breached the restrictive covenants) or an Intermediate Leaver. The Very Bad Leaver Price was £1 for all shares, and the Intermediate Leaver Price was the Good Leaver Price for the Valued Vested Percentage of the shares and the price for each remaining share was the Bad Leaver Price.

29. Article 16.6 defined a Good Leaver, namely, where an Employee is a Leaver by reason of death, permanent personal incapacity, retirement with the prior

written consent of the majority of directors, or any other circumstances with the prior written consent of the directors.

30. Article 16.7 defined a Bad Leaver as follows:

> ***16.7*** *An Employee will be deemed to be a Bad Leaver if he is a Leaver by reason of:*
>
> *(a) any Group Company being entitled to summarily dismiss the Leaver and then dismissing him for that reason (either with or without notice); or*
>
> *(b) his voluntarily terminating his employment or contract for services (save where a court or tribunal of competent jurisdiction and from which there is no right of appeal or from which the right of appeal has elapsed gives final judgment that such termination was in circumstances which constitute constructive dismissal).”*

31. A “Very Bad Leaver” was defined separately in the Defined Terms section at Article 1.3 as follows:

> “*… a Leaver:*
>
> *(a) whose employment or engagement is terminated for an act or omission constituting fraud; or*
>
> *(b) who has breached any of the restrictive covenants contained either in (i) his service agreement or contract for services, and/or (ii) any shareholders' agreement or similar document in force between some or all of the Shareholders and the Company, and/or (iii) the share sale agreement relating to the whole of the issued share capital of Pharmacy2U Limited dated on or around the Adoption Date."*

32. Article 16.8 stated that a Leaver would be deemed to be an Intermediate Leaver if he was neither a Good Leaver, nor a Bad Leaver, nor a Very Bad Leaver.

33. Article 16.9 dealt with situations where a Leaver became a Subsequent Bad Leaver or a Subsequent Very Bad Leaver, as follows:

> ***16.9*** *If at any time, a Leaver becomes a Subsequent Bad Leaver or Subsequent Very Bad Leaver, without prejudice to any other rights or remedies which any Group Company may have, such Subsequent Bad Leaver or Subsequent Very Bad Leaver shall:*
>
> *(a) not be entitled to retain or receive the Leaver Excess Amount; and/or*
>
> *(b) if required to do so in writing by an Investor Director, immediately repay the amount of the Leaver Excess Amount to the purchaser(s) of the Leaver's shares.*

34. A "Subsequent Bad Leaver" and a "Subsequent Very Bad Leaver" were defined, in the definition section at Article 1.3, as follows:

> ***Subsequent Bad Leaver*** *– an Employee who is a Good Leaver or an Intermediate Leaver at the Termination Date, but in relation to whom there were grounds on which the relevant employer could have summarily dismissed the Employee.*
>
> ***Subsequent Very Bad Leaver*** *– a Leaver who is not a Very Bad Leaver at the Termination Date, but who becomes one at any point following the Termination Date.*

35. The Applicants submit that the need for provision to cater for a change of type of Leaver is obvious, in order to address the situation where the majority owner only discovers the existence of fraud or other grounds which would have justified summary dismissal post termination, or of there being later actual breach of the post-termination restrictive covenants.

36. The 'Leaver Excess Amount' was defined as:

> *"that part of any consideration paid or payable to a Subsequent Bad Leaver or Subsequent Very Bad Leaver in excess of that which would have been paid or payable had they been classified as a Bad Leaver or*

> *a Very Bad Leaver (as applicable) at the date on which the Investor Majority requested a transfer pursuant to article 16.1."*

37. Article 16.10, to which I have already referred, provided as follows:

> ***16.10*** *If any Shareholder does not execute transfer(s) in respect of shares registered in his name in accordance with this article 16, the defaulting Shareholder will be deemed to have irrevocably appointed any person nominated for the purpose by the Investor Director to be his agent to execute, complete and deliver a transfer of those shares in favour of the proposed purchaser against receipt by the Company* [i.e. P2U Holdings] *of the consideration due for the relevant shares. The Company's receipt of the consideration due will be a good discharge to the purchaser, who will not be bound to see its application. The Company will hold the consideration on trust for the relevant Shareholder(s) without obligation to pay interest. Subject to stamping, the directors will without delay register the transfer(s), after which the validity of such proceedings will not be questioned by any person. Each Shareholder will surrender his certificate(s) (or where appropriate provide an indemnity in respect of it in a form satisfactory to the directors), although it will be no impediment to registration of shares under this article that no certificate has been produced. On (but not before) such surrender or provision, the defaulting Shareholder(s) shall be entitled to the consideration for the shares transferred on his behalf, without interest.*

38. Article 19 deals with valuation. The Prescribed Price for the purposes of the Articles was either *(i)* the price per share agreed between the relevant transferor and GSquare as representing the market value of the shares being transferred or *(ii)* in the absence of agreement, the valuation of a valuer as at the Termination Date or the Notice Date (defined as the date on which a notice conferring authority on the directors to transfer shares at the Prescribed Price was given or deemed to be given). The valuation was subject to assumptions set out in Article 19.3 and was required to be completed within 30 days of the appointment of the valuer. The report of the Valuer was to be final and binding on the parties except in the case of fraud or manifest error.

39. Finally, in the definition section in Article 1.3, Transfer Notice is defined as "a notice conferring authority on the directors to transfer shares at the Prescribed Price to such persons as they will determine in their absolution discretion".

E. The Validity Issue

40. The Applicants' position is that Article 16.1 is a comparatively simple clause, to be construed straightforwardly. Article 16.1 requires GSquare to specify in a notice (i) how many shares were to be transferred and (ii) who they were to be transferred to. There is nothing in Article 16.1 which indicates any need or reference to identify the type of Leaver, or indeed the amount of payment. In any event, the July 2020 Transfer Notice as a matter of fact did designate the type of Leaver Mr Lee was, and there is no basis for suggesting that there is a further super-added requirement that the July 2020 Transfer Notice "accurately" identify the type of Leaver.

41. The Respondents' position on this is set out in their Reply, paragraph 9. In summary, they submit that:

(1) Any direction by GSquare (as the "Investor Majority") to compel a transfer of a Leaver's shares under Article 16.1 must "accurately" identify the type of Leaver the Employee is under Article 16.3, in order that the price at which the shares are to be transferred is ascertainable. While Article 16.1 enshrines the right on the part of GSquare to require a transfer of an Employee's share within 12 months of the Employee ceasing their employment, Article 16.2 enshrines the obligation on the part of the relevant Employee/Leaver to effect the share transfer, upon being so

directed by GSquare *"on the terms set out"* in Article 16. Accordingly, on the proper construction of Article 16.2, read as it must be in the full context of the Articles, GSquare's direction to transfer shares as contemplated under Article 16.2 must specify the type of Leaver which the Employee is, from amongst the choices set out under Article 16.3 (whether a Good, Intermediate, Bad or Very Bad Leaver). GSquare's right to compel a transfer of Leaver's shares under Article 16.1 is not separable from the obligation to identify the type of Leaver. It follows, say the Respondents, that if the obligation is not met, any direction to transfer shares is invalid under Article 16.1.

(2) As an alternative, it is submitted that it is a condition precedent to a valid transfer direction under Article 16.1 that it should accurately identify the type of Leaver stated therein.

42. This raises a short point of construction. I was referred to the decision of Popplewell J in *Lukoil Asia Pacific Pte Ltd v Ocean Tankers (Pte) Ltd* [2018] 1 CLC 94, at [8], for a useful recent summary of the relevant principles, none of which were in dispute. In particular, the court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. In doing so, the court must consider the contract as whole.

43. I do not consider the Respondents' contentions on the construction of Article 16.1 to be correct. Nor do I consider the point to be reasonably arguable, such that a decision on the matter should be deferred to trial. My reasons for saying so are as follows:

(1) Nowhere in Article 16.1 is there any express provision that the requirement to transfer shares to GSquare (who is the Investor Majority) should specify the type of Leaver which a departing Employee is. Article 16.1 does not even refer to types of Leaver. The Applicants are correct to say that all that Article 16.1 requires is that the notice to transfer specifies (i) how many shares were to be transferred and (ii) to whom they were to be transferred (from a specified list of five possible transferees, the last one being "any other person(s) approved in writing by the Investor Majority").

(2) Counsel for Mr Lee points to Article 16.2, which sets out the obligation on the part of the Employer/Leaver to effect the share transfer "on the terms set out in this article 16." It is then said that the reference to "the terms set out" must necessarily refer to the categories of Leaver as found in Article 16.3. Article 16.3 refers to the various types of Leaver. However, this is reading too much into the closing words of Article 16.2. Article 16.2 deals with the Employee's obligation, not GSquare's obligation. The obligation on the Employee is to transfer the number of shares to the person specified in the direction from GSquare. The Employee/Leaver does not need to know what type of Leaver he is, in order for him to fulfil his obligation. The obligation to transfer operates perfectly well without reading in any requirement that the direction to transfer refer in terms to the type of Leaver. This does not mean that the closing words in Article 16.2, namely, "… on the terms set out in this article 16", are otiose. The Employee/Leaver must do what he has been directed to do pursuant to Article 16.1.

(3) Which type of Leaver the Employee is certainly matters when calculating the amount to be paid for the shares transferred. The amount to be paid, and the timing of payment, are dealt with by other provisions in the Articles which have nothing to do with the direction to transfer the shares. In any event, the timing of any payment might well take place after the shares had been transferred: see Articles 16.10 and 19.

(4) Further, the July 2020 Transfer Notice did specify the type of leaver Mr Leaver was said to be. The July 2020 Transfer Notice states in terms *"Daniel Lee has been designated as a Very Bad Leaver under limb (b) of that definition in the Articles as a result of his involvement in CloudRX Ltd."* Therefore, in order to be able to run an argument on invalidity, the Respondents must succeed on their argument not only that Article 16 requires GSquare to identify the type of Leaver the Employee is, but does so "accurately". It is then said that, in the event of a dispute, where the Court subsequently holds that Mr Lee was wrongly classified, then the requirement to transfer shares would be rendered void. Again, there is nothing in the wording of Article 16 which supports this argument and the consequence appears extreme.

(5) Finally, there is no basis for implying a term requiring GSquare to identify accurately the type of Leaver in a notice directing the transfer of the shares. The typical requirements for implying a term, that is, that it goes without saying and/or is not necessary to give business efficacy to the Articles, do not seem to me to apply.

44. The submission that Article 16 must "accurately" identify the Leaver also leads to commercially absurd results. Article 16.9 expressly addresses the situation where a Leaver's status changes after the Termination Date, by becoming a Subsequent Bad Leaver or a Subsequent Very Bad Leaver. On a straightforward application of the Respondents' submissions, that would mean that where the departing Employee was initially classified as say a "Good Leaver" but (unbeknownst to GSquare) he was in fact a Bad Leaver or a Very Bad Leaver, then the notice to transfer would be invalid. This cannot be what the parties contemplated. Were the position otherwise, the Leaver who successfully concealed his wrongdoing or breach would be able to declare the notice invalid and require the retransfer of his shares.

45. Counsel for Mr Lee sought to meet this point, by submitting that the "Subsequent Bad Leaver" definition *"effectively appears to replicate the common law position, to the effect that a repudiatory breach of the employment contract (which would justify summary dismissal) which is first discovered after termination of the employee's employment contract, can be relied upon by the employer 'ex post facto'".* It is then said this definition affirms the need to ensure accuracy on GSquare's part in specifying the type of Leaver in issue, when issuing a transfer notice, and that *"... this definition* [that is, Subsequent Bad Leaver] *is concerned with ensuring that a Leaver's initial characterisation is not rendered inaccurate, by reason of events post-dating the transfer notice under Art. 16.1"*. I do not follow this argument. If, hypothetically, the Employee were designated an Intermediate Leaver, and (unbeknownst to GSquare) there were grounds to summarily terminate his employment, the initial classification would be wrong. The argument for the

Respondents does not seem to address the point about the absurd commercial results which would follow if one were to accept the initial premise that the transfer notice must "accurately" identify the type of Leaver, on pain of the transfer notice being invalid. If and in so far as the Respondents suggest that the Subsequent Bad Leaver is a permitted "reclassification" under the Articles, then again the use of the word "classification" seems to me to be inconsistent with a legal obligation imposed on GSquare to notify, and notify accurately, what category of Leaver the transferee is.

46. To put matters another way: the provisions dealing with "Subsequent Bad Leaver" are part of the price adjustment mechanism. They do not support the submission that there is any commercial need to read words into Article 16.1 dealing with the initial requirement to transfer.

47. Counsel for Mr Lee had a further argument based on the definition of "Leaver Excess Amount", which refers to the situation where the Leaver has been "classified" as a Bad Leaver or Very Bad Leaver. In this context, I note that the definition of "Leaver Excess Amount" does not use the word "notified" or "specified" or "named", but "classified". The classification of a Leaver as falling into one of the various categories could take place in a variety of ways, such as a by way of an accompanying letter, in an internal company minute or in the Transfer Notice itself. One might even say that the classification is a matter that could be worked out from the price that was offered for the shares. All of these alternatives are plausible. But the use of the word "classified" in the definition of "Leave Excess Amount" undermines, rather than supports, the submissions advanced on behalf of Mr Lee.

48. It was also submitted that it cannot have been the reasonable understanding of the parties that a shareholder could be obliged under Article 16.2 to divest themselves of a shareholding in the company pursuant to a Transfer Notice under Article 16.1 without being given any indication as to the price to be paid, or at a manifestly incorrect price. I do not think this follows. If the price were manifestly incorrect, Mr Lee would undoubtedly be able to bring a claim for damages, but there is no reason to believe that the requirement that the shares be transferred would itself be invalid (provided, of course, that Mr Lee was in fact a Leaver, as to which there is no dispute). Similarly, if he was not given any indication as to the price to be paid for his shares, then he could simply ask for such indication; alternatively, I note that in some circumstances the precise price is a matter to be determined following a valuation process, which suggests that the parties may have to wait to work out what the price will be: see Article 19.

49. In the end, it is a surprising submission that the validity of the transfer notice, a key part of the Investor Majority's rights under the Articles, could be argued to depend on language which is not only not found in Article 16.1 itself, but is nowhere spelled out in Article 16 as a whole. Article 16.1 is drafted in comparatively simple terms. Its construction is clear. There is no reason to defer making a decision on this point to trial. Accordingly, I find for the Applicants on the Validity Issue.

50. I would add that, as Article 16.3 makes plain, what matters is what type of Leaver Mr Lee actually "is". GSquare does not have a free hand to classify Mr Lee as whatever it wants. Mr Lee is perfectly entitled to assert that he was not

a Very Bad Leaver. He maintains that he is in fact an Intermediate Leaver, which would have a very significant impact on the sums to which he is entitled for his shares. That will be a matter for trial in these proceedings.

F. The Penalty Issue

51. The parties' respective submissions can be summarised as follows. GSquare submits that, properly construed, the provisions of Article 16 are primary obligations. GSquare's contractually agreed right to require a transfer of shares arises on the Employee becoming a Leaver. It is not a matter which arises on a breach of contract. The penalty doctrine is therefore not engaged at all.

52. On the other hand, Mr Lee says that Article 16.3 is a penalty clause, because the only circumstances in which GSquare may acquire Mr Lee's shares for a consideration of £1 is on the basis that he is a Very Bad Leaver, which is defined as one *"(a) whose employment or engagement is terminated for an act or omission constituting fraud; or (b) who has breached any of the restrictive covenants contained either in (i) his service agreement or contract for services, and/or (ii) any shareholders' agreement or similar document in force between some or all of the Shareholders and the Company, and/or (iii) the share sale agreement relating to the whole of the issued share capital of Pharmacy2U Limited dated on or around the Adoption Date…"*. Thus, the only circumstances in which the £1 consideration will be payable is where there has been a breach of contract. The penalty doctrine is accordingly engaged, or at the very least that is arguably so. Mr Lee acknowledges that although Article 16.1 itself is "not necessarily" predicated on a breach of

contract, nevertheless he contends that when relied on in tandem with Article 16.3(d), "it is necessarily predicated on a breach of contract": Reply, para. 45.2.

53. Mr Lee's case is that his shareholding in P2U Holdings was very valuable, and was reasonably expected to increase very substantially in value. The shares were worth at least the Subscription Price of £2,006,919.50, and probably considerably more. Pending disclosure and expert valuation evidence, Mr Lee estimates their present value at approximately £8,000,000. On this basis, a forced transfer of his shareholding for £1 is a grotesque undervalue.

54. The law on penalty clauses has recently been reviewed by a seven member panel of the Supreme Court in *Cavendish Square Holdings v Makdessi* [2016] AC 1172 (SC). The "true test" for whether a given provision is a penalty clause:

> *"… is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach …":* see at [32], per Lord Neuberger and Lord Sumption.

55. Similarly, Lord Hodge, at [255], held that:

> *"… the correct test for a penalty is whether the sum or remedy stipulated as consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract. Where the test is to be applied to a clause fixing the level of damages to be paid on breach, an extravagant disproportion between the stipulated sum and the highest level of damages that could possibly arise from the breach would amount to a penalty and thus be unenforceable. In other circumstances the contractual provision that applies on breach is measured against the interest of the innocent party which is protected by*

the contract and the court asks whether the remedy is exorbitant or unconscionable."

56. The Respondents' position is that the law on penalty clauses remains subject to uncertainty and further development, notwithstanding the comparatively recent decision of the Supreme Court. It is therefore important to examine closely what that case did and did not decide. In summary, Mr Makdessi had sold part of his advertising and marketing business to Cavendish, for a price of up to US$147million, depending on a calculation of profits, in instalments, with a large amount reflecting goodwill. The sale agreement contained a non-compete clause, breach of which entitled Cavendish to purchase Mr Makdessi's remaining shares for a price which excluded goodwill, which made a very substantial difference to the price paid. Mr Makdessi argued that the clause in question, clause 5.6, was a penalty and consequently unenforceable.[1] He was unsuccessful at first instance before Burton J whose judgment, however, was overturned by the Court of Appeal.

57. The Supreme Court unanimously reversed the Court of Appeal and reinstated Burton J's decision. Whilst there was unanimity that the particular clause was not a penalty, the individual justices took different routes in arriving at that conclusion. The difference in approach is best encapsulated in whether the relevant clause was seen as creating a primary or a secondary obligation. As to this, the joint opinion of Lord Neuberger and Lord Sumption (with whom Lord Carnwath agreed) stated as follows, at [83]:

[1] The opening words of clause 5.6 were as follows: *"Each Seller hereby grants an option to the Purchaser pursuant to which, in the event that such Seller becomes a Defaulting Shareholder, the Purchase may require such Seller to sell to the Purchaser (or its nominee) all (and not some only) of the Shares held by that Seller (the Defaulting Shareholder Shares). The Purchaser (or its nominee) shall buy and such Seller shall sell with full title guarantee the Defaulting Shareholders Shares … …"*

"… More fundamentally, a contractual provision conferring an option to acquire shares, not by way of compensation for a breach of contract but for distinct commercial reasons, belongs as it seems to us among the parties' primary obligations, even if the occasion for its operation is a breach of contract. This may be tested by asking how the penalty rule could be applied to it without making a new contract for the parties. The Court of Appeal simply treated clause 5.6 as unenforceable, and declared that Mr Makdessi was not obliged to sell his shares whether at the specified price or at all. That cannot be right, since the severance of the shareholding connection was in itself entirely legitimate, and indeed commercially sensible. If the option to acquire the retained shares is to stand, the price formula cannot be excised without substituting something else. Yet there is no juridical basis on which a different pricing formula can be imposed. There is no fall-back position at common law, as there is in the case of a damages clause."

58. Lord Hodge, by contrast, whilst acknowledging the "strong argument" that the relevant clause was a primary obligation, ultimately held that the clause in question was a secondary obligation (a view with which Lord Toulson and Lord Clarke agreed). Lord Hodge's decision, at [280]-[281], was as follows:

"There is again a strong argument, which Lord Neuberger PSC and Lord Sumption JSC favour, that clause 5.6 is a primary obligation to which the rule against penalties does not apply. But if all such clauses were treated as primary obligations, there would be considerable scope for abuse. I construe the clause as a secondary obligation, which is designed to deter (a) the sellers from breaching their clause 11.2 obligations and (b) a seller who is an employee from misconduct which damages the interests of the group and leads to summary dismissal (viz the Schedule 12 definition of "defaulting shareholder")."

59. Lord Mance, the seventh member of the Supreme Court panel, indicated that though the relevant clause 5.6 had the effect of "reshaping" the parties' primary relationship (at [183]), it was valid because it was neither exorbitant nor unconscionable (at [185]). When Lord Mance writes of the "reshaping" of the parties' primary relationship, this sounds in substance like the adoption of the approach which found favour with Lord Neuberger and Lord Sumption. On the other hand, the later passage in Lord Mance's speech sounds more as though Lord Mance only concluded that clause 5.6 was valid, and not a

penalty, because it was not exorbitant or unconscionable (the approach of Lord Hodge). Counsel for the Respondents invited me to view Lord Mance's approach as in substance agreeing with Lord Hodge, whose speech should therefore be regarded as setting out the approach of the majority (and therefore with Lord Neuberger and Lord Sumption and Lord Carnwath in the minority). Certainly, the writer of the headnote in the official law report appears to have read Lord Mance as not adopting the ratio which found favour with Lord Neuberger, Lord Sumption and Lord Carnwath, namely, that clause 5.6 was in reality a price adjustment clause which was outside the scope of the penalty rule.

60. It seems to me that it is to overstate the position to write about their being majority and minority opinions in *Cavendish v Makdessi*. Counsel for Mr Lee submitted that the law on penalty clauses was a "developing area of law", and that the issue of whether or not a clause concerned primary or secondary obligations remains "controversial, uncertain and pre-eminently likely to develop further". That is a surprising submission, given that a panel of seven Justices of the Supreme Court have comparatively recently considered the matter. The most that could be said is that, on the construction of the particular clause in issue in that case, Lord Hodge, despite acknowledging the "strong argument" in favour of viewing it as a primary obligation, preferred to construe it as a secondary obligation. One can see why Lord Hodge, and the other Justices of the Supreme Court who agreed with him, adopted that course. The option given to Cavendish to acquire Mr Makdessi's shares was triggered by breach, on Mr Makdessi's becoming a Defaulting Shareholder. Mr

Makdessi was a party in breach of various obligations he owed to the buyer of his business: see at [61] – [63].

61. This can be contrasted with the present position. The trigger for the acquisition of Mr Lee's shares is his becoming a Leaver. In many, if not most cases, the situations where an Employee becomes a Leaver have nothing to do with a breach of contract. It does not arise on a default at all. It seems to me that, on a proper construction, the provisions of Article 16.1 requiring the transfer of shares are primary obligations. Article 16.3 is a price adjustment mechanism. The penalty doctrine is thus not engaged at all. I reach this conclusion for the following reasons.

62. *First*, the trigger under the Articles for the exercise of GSquare's rights to require the transfer of shares is the employee becoming a Leaver. It is not predicated on a breach of contract at all. That means the present case is a clearer example of a primary obligation than clause 5.6 in *Cavendish*. In *Cavendish*, the triggering provision, granting the option to Cavendish to require the transfer of the shares, arose on a breach of contract, and could *only* be triggered by a breach.

63. *Second*, Article 16 envisages that the price to be paid for the shares to be acquired by GSquare varies, depending on a number of factors, including what type of Leaver the departing employee is. Of course, one of those factors is whether the Leaver is in breach of the Service Agreement or the Shareholders' Agreement itself. In my view, this does not detract from the fact that the underlying trigger for the transfer of shares is the employee becoming a Leaver – and not any breach of restrictive covenants.

64. I accept that the Court must be astute to detect disguised penalties, and the penalty doctrine extends to deposits, forfeiture clauses and provisions that provide for a party in breach to transfer property at less than its full value. But Article 16.3 is rightly viewed as a price adjustment mechanism for the shares transferred. What the submissions of the Respondents appear to me to overlook, is that what one might describe as the compulsory deprivation of the Respondents' shares was contractually agreed to arise in circumstances which do not itself depend on a breach of contract.

65. *Third*, Article 16.3(d) has to be construed in light of the fact that the Articles apply to all shareholders, and not just Mr Lee. Whether a clause is penal is a matter of construction to be judged as at the time of making the contract, and not as at the time of breach: *Cavendish v Makdessi*, at [9], [28], [142], [221], [243]. Therefore, the repeated references to Mr Lee's specific position or the specific breaches he is said to have committed are, properly speaking, irrelevant.

66. *Fourth*, one can test the matter by asking what would be the result, were Article 16.3(d) held to be a penalty clause. In the claim form, Mr Lee sought a declaration that Article 16.3(d) is "an unlawful penalty clause and for further declaratory relief to the effect that the … purported transfer of the B2 Shares was invalid, wrong and a nullity …". That is to understate the reality of what Mr Lee is seeking. What Mr Lee is actually contending for is the striking down of Article 16 as a whole, including in particular Article 16.1, the option given to GSquare to acquire his shares. Mr Lee is not simply challenging the price at which his shares are to be acquired, but the obligation to transfer the

shares in the first place. This is made clear in Mr Lee's Reply, paragraph 43. In oral submission, Counsel for Mr Lee accepted that the consequence of the acceptance of his submission that Article 16.3(d) operated as a disguised penalty would be that, even if Mr Lee were a Very Bad Leaver, he could retain his shares.

67. That would involve a wholesale re-writing of the bargain between the parties. It would require the Court not only to strike down Article 16.3(d), but Article 16.1 as well. The price formula in Article 16.3 cannot be excised without substituting something else. The Respondents have not suggested what the alternative pricing mechanism could be. In any event, no suggested alternative pricing mechanism could be lawfully imposed by the Court on the parties. This would involve making a new contract for the parties, which the Court cannot do.

68. In their Claim Form and Particulars of Claim, the Respondents restricted their claim for relief to a declaration that Article 16.3(d) was "an unlawful penalty". However, as I have explained above, the relief sought by Mr Lee and the Trustees must necessarily be wider. The Respondents are really seeking to strike down not only Article 16.3(d) but Article 16.1 as a whole. In his closing remarks, Counsel for the Respondents indicated that he would indeed wish in due course to amend the Claim Form and the Particulars of Claim so that the declaration sought expressly provided that Article 16.1, when relied upon in tandem with Article 16.3(d), operated as an unenforceable penalty. It does not seem to me that there would be any prospect of granting such an amendment. First, there is no principle that a contractual provision can be declared

unenforceable to the extent necessary. Second, the logic of the Respondents' position would be that that GSquare could compel the transfer of a Good Leaver's, or Intermediate Leaver's, shares, but could not compel the transfer of a Very Bad Leaver's shares. That would be a commercially absurd conclusion to reach. Third, and in any event, for the reasons set out above, I hold that Article 16.3(d) is not an unenforceable penalty clause.

69. *Fifth*, the authorities to which I was taken postdating *Cavendish* also support this conclusion. Importantly, these authorities do not seem to me to support the Respondents' submission that the law on penalty clauses post-*Cavendish* remains unsettled and open to further development.

70. The first authority to which I was taken, *Richards v IP Solutions Group Ltd* [2016] EWHC 1835 (QB), may be of only limited utility, because the Judge in that case (May J), indicated that her comments concerning the penalty doctrine were obiter. Counsel for the Applicants before me indicated that they were not relying on it. However, I note that in that case, in contrast to the clause in *Cavendish* (but similarly to the present case), the clause involved the payment of just £1 for the leaver's shares. It was submitted that such a negligible amount necessarily fell foul of the penalty rule, if it were engaged.

71. May J indicated that the issue was "an interesting and complex one" which clearly called "for fuller argument over more time than was available at this trial": at [83]. She then went on to hold, albeit tentatively, that the arrangement for leavers as provided for under the articles of association in that case appeared to her to be "more akin to a primary obligation agreed between parties for distinct commercial reasons to do with a shareholder leaving the

Company" and that on that basis "the price of £1 payable for the aggregate shareholding of a person who is a 'Bad Leaver' is simply the agreed price on transfer": see at [85].

72. The next decision is *Signia Wealth Limited v Vector Trustees Limited* [2018] EWHC 1040 (Ch), a decision of Marcus Smith J. That case, like the present, involved consideration of the articles of association of a company, the operative provisions of which provided that the purchaser of a business could require a shareholder to transfer her shares, in certain circumstances. The price to be paid for those shares depended on whether the transferor was classified as a "Good Leaver", an "Incapacitated Leaver" or "Bad Leaver", as well as the type of shares held and the length of time since the Leaver's Employment Start Date.

73. Marcus Smith J concluded, following a trial, and not a summary judgment application, that the penalty doctrine did not apply, and that even if it did, he did not consider the Leaver provisions in the Articles to be a penalty: at [653]. The key points made were as follows:

(1) Although a court should be astute to detect disguised penalties, it was recognised that the penalty doctrine is an interference with freedom of contract: see *Cavendish* at [33]. The court should be careful when applying the doctrine, in a commercial case, where the contract has been negotiated without suggestion of oppression.

(2) The compulsory transfer process in the articles set out a detailed and extensive code for the compulsory transfer of a shareholder's shares. None

of the Transfer Events triggering the process had anything to do with the shareholder's breach of contract.

(3) It was true that the valuation process, whereby a value was attributed to the Leaver's shares, was affected by a variety of factors, including whether the Leaver is a Good or a Bad Leaver. One of the factors determining whether a Leaver is Good or Bad is whether the Leaver was in breach of his or her contract of employment. But Marcus Smith J held that this fact did not mean that the Leaver provisions, still less the compulsory transfer process, amounted to a penalty payable on breach. It was said that this would be a mischaracterisation of the nature of the provisions which were triggered by events other than a breach of contract.

74. Marcus Smith J's reasoning is directly applicable to the case before me. Mr Lee has not suggested that there was any oppression exercised by GSquare in the negotiations which culminated in the acquisition of P2U. His complaint is directed at Mr Livingstone and Mr Dannatt, who were negotiating the sale of P2U's business to GSquare, and who are said did not properly take into account Mr Lee's interests. That is a separate claim.

75. I also note that the Bad Leaver provisions in *Signia* nevertheless resulted in the Bad Leaver receiving a very considerable price for her shares. I accept that this is a point of distinction with the present case, given that (assuming that Mr Lee is properly designated a Very Bad Leaver) he stands to receive only £1. However there is no reason why the amount received should matter, if the correct starting point is that the provision is not a penalty clause at all.

76. Marcus Smith J also considered the case on the alternative basis, if the penalty doctrine could in principle apply to the clause before him, before holding that he could see nothing in the detriments imposed which was out of proportion to the legitimate interests of all the parties to the Articles. However, the fact that Marcus Smith J also approached the matter on an alternative basis does not cause me to doubt that Article 16 in the present case, properly construed, is anything other than a primary obligation.

77. Finally, I was referred to a decision of the Court of Inner Session, *Gray v Baird Group (Holdings) Limited* [2016] CSIH 68. The Court of Inner Session was, again, concerned with whether provisions within a company's articles of association were unenforceable as constituting an unlawful penalty. The majority (Lord Brodie and Lord Malcolm) held that it was enforceable, although their reasoning differed. Lord Brodie took the view that the clause in question operated as a secondary obligation, and therefore was at least potentially a penalty clause, but held that the majority shareholder had legitimate interests to protect, and the means adopted to protect them were not exorbitant or unconscionable: at [112]. Lord Malcolm approached the issue by asking, if one were to assume that the bad leaver provision was an unenforceable penalty, what happened then, and answered his question by saying it would involve re-writing the parties' contract and pointing out that the court could not decide what the appropriate formula should be: at [125]. On that basis, Lord Malcolm rejected the submission that it was an unenforceable penalty, expressly by reference to the reasoning in *Cavendish v Makdessi*.

78. Lord Menzies dissented. I have a number of difficulties with the dissent. The first point to note is that his comments on the penalty issue were obiter: see at [79]. Secondly, it is a dissenting judgment, so it would not be binding, even for Scottish courts. Thirdly, Lord Menzies, in his references to *Cavendish v Makdessi* and his reasons for distinguishing *Cavendish*, appears to have had regard to the Supreme Court's analysis of a different clause, namely clause 5.1, and not clause 5.6, which was the analogous provision in *Cavendish* to the one Lord Menzies was considering: see at [81] – [82]. Finally, Lord Menzies in his judgment avoided grappling with the point that to hold the relevant clause to be a penalty would involve the court making a new bargain for the parties.

79. The decision of the Court of Inner Session is not binding on me. The Respondents submit that there is a "dissonance" between the analysis in *Signia* and that of the majority in *Gray*. It seems to me that Lord Malcolm's approach is entirely consistent with the approach adopted by Marcus Smith J in *Signia*, and that Lord Brodie essentially preferred to approach the matter by reference to Lord Hodge's analysis of the position in *Cavendish v Makdessi*. To the extent that there is a "dissonance" in the approach of the various judgments, I prefer the reasoning of Marcus Smith J, which is binding on me.

80. I should follow the decision in *Signia*, unless I conclude that the Respondents have some reasonable prospect of showing that the position may turn out to be different at trial. In this context, I remind myself that this is an application for summary judgment. All that the Respondents need do is establish that they have a reasonable argument which should go to trial that Article 16.3(d) may

be a disguised penalty clause. However, what I am considering is essentially a point of construction. I have carefully considered whether there are any reasons why a trial judge might be in a better position to decide the matter than me. The Respondents have not suggested that there might be material produced following disclosure which would tend to affect the background matrix of facts so as to lead to a different conclusion on construction. I consider it unlikely that the trial judge will have more time to consider submissions on this point. The parties have already spent nearly a full day on their respective submissions on this point, and the Respondents' skeleton argument was a full 47 pages, with copious citation of authorities.

81. In the circumstances, I do not see that there are any reasons not to grasp the nettle and decide the point at this juncture. I conclude, therefore, that Article 16.1 is a primary obligation, and so the penalty clause doctrine is not engaged at all.

82. The Applicants advanced an alternative basis for their summary judgment application. It was submitted that, even if Article 16.3(d) were to be properly characterised as a secondary obligation, the detriment imposed on the Respondents as a consequence of Mr Lee's alleged breach was not unconscionable, exorbitant, extravagant or out of all proportion to the Applicants' legitimate interests.

83. I do not think that that question can be decided on an application for summary judgment. If I were persuaded that Article 16.3(3) might be characterised as a secondary application, then I would need to determine, in the words of Lord Hodge, whether the Very Bad Leaver provisions was an exorbitant or

unconscionable undervaluation when measured against GSquare's legitimate interest in protecting its investment from Mr Lee acting against the company's interests. The Applicants have filed evidence, in the form of a witness statement from their solicitor, which seeks to establish that Mr Lee was "in fact central" to P2U as at the date the agreement was entered into, on 29 March 2018. His evidence sets out a number of factors, including the fact that, at the time of the acquisition of P2U by P2U Holdings, Mr Lee was Chief Pharmaceutical Officer (or "CPO") of P2U, a role which is described by GSquare as "of huge importance to P2U's business success". The evidence then goes on to set the nature of the Applicants' commercially important and legitimate interests, before concluding that the provisions of Article 16(3)(d) were neither exorbitant nor unconscionable nor out of all proportion to the legitimate interests of the Applicants.

84. Mr Lee, in his witness statement in response, disputes this characterisation. Mr Lee describes his role and activities as CPO, and explains why he says the CPO role was in fact a reduction of or demotion from his previous role in the P2U business. On Mr Lee's telling, he was entirely unimportant to the goodwill of the P2U business, and importantly was seen as such by GSquare at the time of the acquisition.

85. Attempting to decide whether or not the detriment imposed on the Respondents as consequence of Mr Lee's alleged breach was unconscionable, exorbitant, extravagant or out of all proportion to the Applicants' legitimate interests is not something which can be determined on a summary judgment application. It is properly a matter for trial. Among other things, the

Applicants rely, at least in part, on what Mr Glynn-Jones was told by the Third and Fourth Defendants (Mr Livingstone and Mr Dannatt). Mr Lee would be entitled to challenge those accounts at trial.

86. The Applicants sought to sidestep that issue by submitting that the relative importance of Mr Lee to the P2U business is irrelevant. All that matters, they say, is whether GSquare and P2U Holdings had sufficiently legitimate interests to protect. GSquare and P2U Holdings rightly point out that the Articles are not applicable only to Mr Lee, but to all shareholders. That is true, but considering whether Article 16.3(d) is or is not "unconscionable or extravagant" inevitably requires examination the role of those various shareholders. I do not agree that the issue is limited, or can be decided on a summary judgment application. In effect, it requires getting into a mini-trial on the documents.

87. As it is, the issue does not arise, as I have held that Article 16.3 is not a penalty clause, because it is not a secondary obligation at all.

G. Conclusion

88. Accordingly, for the reasons set out above, I have concluded that the service of the July 2020 Transfer Notice was valid, and that Article 16.3(d) is not a penalty clause. I will hear from Counsel at a date to be fixed as to what consequential orders follow from my judgment.