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Property and Litigation & Dispute Resolution Briefing Note: Landlord and Tenant principles on the issue of withholding consent applied in a commercial context

Relevant to

Parties to commercial agreements; landlords and tenants.

Summary

In the case of *Porton Capital Technology Funds & Ors v 3M UK Holdings Ltd & Anor* [2011] EWHC 2895 the High Court held that the Claimants were entitled to consider their own relevant interests first when considering the Defendants' application for consent under an agreement. The Claimants did not need to consider those of the Defendant unless there was a manifestly disproportionate outcome.

Facts

On 14 February 2007 the Defendants agreed to buy the entire shareholding of Acolyte Biomedica Ltd ("Acolyte") under a Share Purchase Agreement ("the Agreement"); a contract between a purchaser and a vendor where the vendor sells a stated number of shares at a stated price.

Acolyte had developed BacLite MRSA, a device used for the purpose of detecting MRSA. As part of the purchase consideration for Acolyte, the Defendants agreed to make to the Claimants an earn-out payment by reference to the 2009 sales of BacLite MRSA. Earn-outs are used in situations where it is difficult to place value on businesses upfront and to ensure that businesses are not overpaid for or undersold.

Under the Agreement the Defendants were not entitled to cease operating the business without the consent of the Claimants, such consent not to be unreasonably withheld. In 2008, the Defendants wrote to the Claimants requesting their consent to discontinue BacLite MRSA based on poor clinical performance and a lack of commercial viability. In response, some of the Claimants indicated that they would not provide consent unless they received

the maximum payment under the earn-out provisions in the Agreement for sales of BacLite MRSA in 2009. The Defendants did not agree to the Claimants' conditions and consent for termination was therefore not obtained. At the end of 2008 the Defendants ceased production of BacLite MRSA, and as a result made no sales in 2009.

The Claimants commenced proceedings in the High Court for damages for breach of the Agreement. The key question in the proceedings was whether the Claimants had acted unreasonably in withholding consent to the termination of the BacLite MRSA. The Claimants relied upon the principles developed in the context of landlord and tenant cases. The requirement for consent not to be unreasonably withheld is frequently used in leases in relation to matters such as assignment, change of use and alterations by a tenant.

The High Court's Decision

The High Court held that it was not unreasonable for the Claimants to withhold consent to the Defendants for the termination of BacLite MRSA, and applied the principles set out in *International Drilling Fluids Ltd v Louisville Investments (Uxbridge) Ltd* [1986] 1 Ch 513, a leading authority on consent in landlord and tenant cases. The High Court held that:

1. The burden was upon the Defendants to show that the Claimants' refusal to give consent to the cessation of the Acolyte business was unreasonable;
2. It was not necessary for the Claimants to show that their refusal of consent was right or justified, simply that it was reasonable in the circumstances;
3. In determining what was reasonable, the Claimants were entitled to have regard to their own interests in earning as large an earn-out payment as possible; and
4. The Claimants were not required to balance their own interests with those of the Defendants or to have any regard as to the costs that the Defendants might be incurring in connection with the ongoing business of Acolyte.

The High Court considered that, in these circumstances, ceasing the production of BacLite MRSA would have had a detrimental effect on the purchase price paid for Acolyte, and therefore it was not unreasonable for the Claimants' to withhold consent. The Court awarded the Claimants' damages in the amount of US\$1,299,808.

Prior to this case there had been little guidance as to what constitutes unreasonably withholding consent in the context of commercial agreements. *Porton* provides a useful starting point on the principles, developed in landlord and tenant cases, that can be applied in commercial contexts when determining whether or not a party to a commercial agreement has acted reasonably in refusing consent to the other party, where the agreement requires that such consent should not be unreasonably withheld.

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This note does not constitute legal advice but is intended as general guidance only. It is based on the law in force in February 2012. If you would like further information please contact Julian Johnstone at j.johnstone@druces.com or on 020 7216 5502.