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LLOYDS BANK SHAREHOLDERS NOT MISLED OVER HBOS TAKEOVER

English courts have shown their customary reluctance to re-assess retrospectively commercial decisions in finding that it was not unreasonable for Lloyds Bank's directors to recommend the Bank's takeover of HBOS during the financial crisis. The Bank's circular to shareholders should have mentioned a couple of additional matters, but their omission did not affect the outcome of the shareholders' vote.

Key issues

- Directors have personal responsibility for recommendations to shareholders
- The recommendation must be one that a reasonable director could make
- Directors must provide sufficient information to enable shareholders to decide
- This requires fair and candid disclosure
- A lack of disclosure must cause loss in order to establish liability

The circular sent by Lloyds Bank to its shareholders recommending Lloyds' takeover of HBOS during the depths of the global financial crisis in October 2008 ran to 289 pages. Sir William Norris's judgment in *Sharp v Blank* [2019] EWHC 3078 (Ch) rejecting shareholders' claims against Lloyds' directors over the takeover runs to a near symmetrical 280 pages. The judge accepted that the directors owed shareholders a duty in respect of the contents of the circular, though not for regulatory announcements, but he concluded that, in the circumstances, the recommendation of the merger was reasonable.

The basis of the claim

Lloyds Bank's takeover, or rescue, of HBOS was announced on 18 September 2008, three days after Lehman's collapse undermined the foundations of the financial system. The price originally agreed was subsequently reduced as the crisis deepened, but Lloyds' directors still decided to go ahead with the merger (with the encouragement of the Government, the Bank of England and others, who removed potential anti-trust objections) despite the complex uncertainties of the time. After the takeover, the crisis became even more severe, and HBOS's financial position turned out to be significantly worse than anticipated, weakening the combined group.

Six years on, the claimant shareholders sued certain directors and the Bank, alleging that the directors should not have recommended the takeover to the Bank's shareholders and that the circular doing so did not contain sufficient information about the takeover. Had the takeover not gone ahead, the shareholders contended that their shares in the standalone bank would have been worth more than those in the combined entity, not least because Lloyds could have avoided the dilutive recapitalisation necessitated by HBOS's parlous financial condition.

Directors' duties

Directors in general owe duties to their company, not to shareholders personally. However, in *Sharp v Blank* the shareholders sued a number (but not all) of the directors individually, alleging that they owed the shareholders a

personal duty and that the Bank was vicariously liable for its directors' conduct.

The directors accepted that they owed shareholders a duty of care in respect of the circular soliciting shareholder approval for the takeover because the circular included a statement of personal responsibility for its contents. However, the directors denied that they owed any duty to shareholders in respect of the stock exchange announcements about the takeover or for analysts' calls explaining its rationale. The judge agreed with the directors on this point. The announcements were for regulatory purposes, and made it clear that details and advice would be provided by the subsequent circular. There was insufficient evidence to show that the directors were accepting responsibility for whatever was said on the calls – the calls did not provide advice to individual shareholders. In any event, the shareholders' complaints about the calls followed, according to the judge, "a general pattern of the Claimants seizing upon particular words, isolating them from their context, and then asserting that they were false ".

The recommendation claim

The judge decided that the test to be applied when considering the obligations of the directors in making a recommendation to shareholders is as follows:

> "Could a reasonably competent chairman or executive director of a large bank reasonably reach the view (on the available information and within the timeframe required) that the Acquisition was beneficial to Lloyds and its shareholders? Or would any such director so placed of necessity have reached the view that the Acquisition was not beneficial."

For these purposes, the shareholders are not confined to the shareholders at the time (therefore focusing on the risk of the takeover turning out to be dilutive of existing shareholders) but extend to the continuing body of shareholders over the period contemplated by the circular.

The judge decided that the shareholders had failed to make out their case. He rejected the arguments that it was irrational of the directors to recommend the takeover, that they should have concluded that HBOS had no value, that their due diligence was inadequate, that the directors should have recognised that HBOS's impairments made the takeover destructive of value, or that the funding risks to the combined bank were too high.

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The judge concluded that: "Now that we know what happened we can see that a (possibly) over-capitalised "standalone" Lloyds with a smaller market share and a conservative book *might* have weathered that particular storm better than the Enlarged Group. But… the choice actually made by the individual Defendant directors at the time lay within a range of reasonable choices."

Inadequate disclosure

The judge accepted that directors have an equitable obligation to shareholders to provide "sufficient information", having regard to the interests of the company as a whole, to enable shareholders to make an informed decision about any proposal put to them. This requires directors to set out fairly and candidly matters within their knowledge, but it does not require complete disclosure of everything that went into the decision-making process, nor every single piece of information that might affect shareholder voting.

The judge decided that the shareholders had not made out the bulk of their allegations under this head. He did, however, conclude that the circular to

shareholders should have mentioned that HBOS was in receipt of "emergency liquidity assistance" from the Bank of England (in its role as lender of last resort) and that Lloyds itself had granted HBOS an "extraordinary" repo facility of up to £10bn. The judge considered that any explanation of these matters in the circular would, of necessity, have been delicate. The UKLA would not have "approved any wording in a Circular which ran the risk of destabilising the market to any degree", and mention of the repo facility would merely have indicated that HBOS was "to some degree dependent upon bespoke bilateral arrangements rather than its needs being met by participation in mainstream arrangements".

In order to succeed in their claim for compensation arising from these information failures, the shareholders had to show that, had proper disclosure been made, it would have made a difference to the outcome of the shareholders' vote. Shareholders voted 96% in favour of the takeover. The claimant shareholders contended that, with proper disclosure, the directors would have declined to proceed with the takeover, the takeover would have collapsed or a majority of shareholders would have voted against it.

The judge accepted that proper disclosure might have caused HBOS's share price to decline by 10% to 15%, but he was not persuaded that this would have the led to the collapse of the takeover, nor was he persuaded that it would have changed the directors' view of the merits of the takeover or the shareholders' vote. In short, even with this additional disclosure, the takeover would still have gone ahead. The directors' failure to mention the emergency liquidity facility or the repo was not the cause of the shareholders' losses.

Conclusion

English courts have long been reluctant to second-guess commercial decisions by company directors, recognising that judges lack the relevant business insight and experience to do so. The fragility of human memory and the need to avoid the application of hindsight, especially with regard to the strained financial and economic circumstances of late 2008, also render raking over long-past events - ten years earlier than the trial in this case - a difficult process. The test applied is not, therefore, whether a reasonable director could have reached a different conclusion but essentially whether no reasonable director could have come to the conclusion that the directors came to in the instant case. That is a high hurdle, and one the claimant shareholders in *Sharp v Blank* failed to surmount.

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