Bulletin 155 November 2012

Butterworths Corporate Law Update

BULLETIN EDITOR
Brenda Hannigan
Professor of Corporate Law, University of Southampton

Filing Instructions: Please file at the front of Binder 1.

RECENT DEVELOPMENTS

BIS consultations

Share buy backs: BIS consults on relaxation of CA 2006 provisions

As part of the Government's plans to implement the recommendations of the Nuttall Review of employee ownership, the Department for Business, Innovation and Skills (BIS) is consulting on possible changes to Part 18, Chapter 4 of the CA 2006 governing share buy backs. The Nuttall Review had concluded that the existing procedures are overly burdensome and something of a barrier and disincentive to direct employee ownership. BIS is consulting on the specific matters raised by Nuttall, namely:

- *authorisation* — the proposal is that, rather than requiring an off-market purchase to be approved by a special resolution as now (CA 2006, s 694), an ordinary resolution would suffice.
- *payment* — the proposals are that companies should be able to pay for shares in instalments rather than pay in full on purchase (CA 2006, s 691(2)); and that companies should be given more choice as to how they fund buy backs and should not be limited, as now, to distributable profits, a fresh issue of shares, or out of capital, in the case of private companies (s 692).
- *cancellation* — the proposal is that instead of shares being cancelled once purchased (CA 2006, s 706), all companies (not just listed companies as now) should be able to hold the shares in treasury.

While the Nuttall proposals are with respect to employee ownership, the consultation is not limited in that way and the proposals would allow for the law to be relaxed for all companies regardless of whether the buy back relates to employee shares.

See BIS, *Employee Ownership and Share Buy Backs, Consultation on implementation of Nuttall Review Recommendations* (October 2012) available at http://www.bis.gov.uk/Consultations/employee-ownership-share-buy-backs-implementation-nuttall%20review-recommendation. Comments are sought by 16 November.

BIS consults on employee ownership status

Following on from an earlier call for evidence, BIS has issued a consultation paper on the implementation of employee ownership status – a new class of employment which the Government wishes to promote.

The idea is to give employers and employees greater flexibility in reaching arrangements which suit both parties. Employers would be able to choose to offer this new employment status which is likely to be of most interest to fast-growing companies which might benefit from the flexibility it offers. Employee owners would not have all the rights of an employee, but would have shares in the company for which they work of between £2,000 and £50,000 in value which would be exempt from capital gains tax.

The Government intends to bring forward legislation on the matter in the Growth and Infrastructure Bill currently before Parliament. The associated capital gains tax exemption will be included as part of the Finance Bill 2013. This consultation seeks views on how the Government might implement employee owner status in practical terms, for example, as to the manner in which individuals and businesses might be made fully aware of the implications of taking on this status. Comments are sought by 8 November.

See BIS, *Consultation on implementing employee owner status* (October 2012), available at http://www.bis.gov.uk/assets/biscore/employment-matters/docs/c/12–1215-consultation-on-implementing-employee-owner-status.

Draft regulations on narrative reporting

BIS has issued for consultation draft regulations giving effect to proposals in respect of improvements to narrative reporting (see Update 149).

The key elements of the regulations are:

- A new CA 2006, s 414A which will require directors (other than in a small company) to prepare a strategic report which will replace the current requirement for a business review. This strategic report will be placed at the front of the annual report as a separate matter from the directors' report. The existing safe harbour in CA 2006, s 463 will be extended to cover the strategic report.
- The content of the strategic report (to be set out in new s 414C) will replicate most of the current requirements for the business review in CA 2006, s 417, but for quoted companies, there will be some additional reporting requirements, for example there is an explicit requirement to consider human rights issues when looking at relevant social and community issues; there is also a requirement to disclose the breakdown by gender of directors, managers and employees in the company.

- The unpopular provision currently at CA 2006, ss 417(5)(c) requiring large and medium companies to report on their essential contractual, or other, arrangements in order to identify whether they would be at risk from a failure of these arrangements, is removed. This information will fall in any event into the consideration in the strategic report of the principal risks and uncertainties facing the company.
- Large and medium companies will no longer be required to report on the principal activities of the company (currently CA 2006, s 416(1)(b)).
- Other simplifications which will be welcomed by companies include the removal of requirements for companies to report on any charitable donations above £2000; private companies will be exempted from requirements to disclose certain information on the purchase of their own shares; companies will no longer be required to disclose information on their policy and practice with respect to the payment of creditors.
- The Government has decided against proceeding with an earlier suggestion that each director should be required to sign off the strategic report.

See BIS, *The Future of Narrative Reporting, A New Structure for Narrative Reporting in the UK* (October 2012), available at http://www.bis.gov.uk/assets/biscore/business-law/docs/f/12–979-future-of-narrative-reporting-new-structure.pdf.

Comments on the draft regulations are required by 15 November.

Recent FRC documents

FRC issues UK Corporate Governance Code 2012 and related guidance

The Financial Reporting Council has published the *UK Corporate Governance Code* (2012) which applies to reporting periods beginning on or after 1 October 2012 – the full text is available at http://www.frc.org.uk/getattachment/a7f0aa3a-57dd-4341-b3e8-ffa99899e154/UK-Corporate-Governance-Code-September-2012.aspx.

There is also an updated version of the important accompanying FRC '*Guidance for Audit Committees*' which is available at http://www.frc.org.uk/getattachment/6ec23196–28ee-406e-8f56–89ab9d1dc06d/Guidance-on-Audit-Committees-September-2012.aspx.

These 2012 documents reflect changes which had been the subject of extensive earlier consultations (see update 152 for the details) which focused on clarification of the role of the board in confirming that the financial reports are fair, balanced and understandable, on the role of audit committees, on the desirability of tendering for the appointment of an external auditor at least every 10 years in the case of FTSE 350 companies and on reporting on the company's boardroom diversity policy (including gender). There is also more detailed comment in the 2012 Code as to what amounts to an acceptable explanation under a 'comply or explain' Code.

The FRC has provided a detailed and valuable feedback statement explaining the changes which is available at http://www.frc.org.uk/getattachment/cb2a31b9-f673–4c52-b02a-75996ab8f202/Feedback-statement-on-UK-Corporate-Governance-Code-and-Guidance-on-Audit-Committees-September-2012.aspx.

FRC issues the Stewardship Code 2012

The FRC has issued an updated version of the Stewardship Code which applies from 1 October 2012. It follows on from an earlier consultation (see Update 152) on clarifying and defining more clearly both the concept of stewardship and the nature of collective engagement as envisaged by the Code.

The Stewardship Code was only introduced in 2010 and then in a form which very closely resembled the then Institutional Shareholders' Committee's influential *Statement of Principles on the Responsibilities of Institutional Investors*. It was always intended that the FRC would look to review and develop it alongside the UK Corporate Governance Code, hence this update. The 2012 Code is available at http://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx.

A useful feedback statement by the FRC explaining the changes made since 2010 is available at http://www.frc.org.uk/getattachment/bfa5e0f5-6250-4336-b9ab-9a384a1b83a5/Feedback-Statement-UK-Stewardship-Code-September-2012.aspx.

FRC issues revised auditing standards

In keeping with the developments above, the FRC has also issued a number of revised International Standards on Auditing (ISAs) (UK and Ireland), of which the most important is ISA 700, '*The Auditor's Report on Financial Statements* (*Revised*)'. The revised standards are effective for audits of financial statements for periods commencing on or after 1 October 2012 and are available at http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2012/September/FRC-issues-revised-auditing-standards-to-enhance-c.aspx.

The FRC notes that the changes in the standards are mainly directed at:

- enhancing auditor communications by requiring the auditor to communicate to the audit committee information that the auditor believes the audit committee will need to understand the significant professional judgments made in the audit;
- extending auditor reporting by requiring the auditor to report, by exception, if the board's statement that the annual report is fair, balanced and understandable is inconsistent with the knowledge acquired by the auditor in the course of performing the audit, or if the

matters disclosed in the report from the audit committee do not appropriately address matters communicated by the auditor to the committee.

FRC debates disclosure framework

The FRC continues its work on the quality of financial reporting with the publication of a discussion paper entitled 'Thinking about disclosures in a broader context, A road map for a disclosure framework' (October 2012).

The intention is to promote a debate as to the structure of a disclosure framework that would consider disclosures in the financial report as a whole. At the moment, it is the case that many disclosure requirements are added piecemeal to financial reports with no consistency of approach or regard to the overall quality of corporate reporting. The result is complex financial reporting of decreasing relevance. Adopting a disclosure framework would mean, the FRC suggests, that content could be more targeted to the needs of users; there would be more consistent setting of proportionate disclosure requirements with a greater focus on materiality and on eliminating duplicate and boilerplate information; and the overall result would be that financial reports would be easier to navigate.

The discussion paper looks to consider the issue from the perspective of four questions. What information do users need? Where should disclosures be located? When should a disclosure be provided? How should disclosures be communicated?

The full text of the discussion paper is available at http://www.frc.org.uk/getattachment/4e747c33-cc31–469b-9173-a07a3d8f0076/Thinking-about-disclosures-in-a-broader-context-A-road-map-for-a-disclosure-framework.aspx.

Comments are sought by 31 January 2013.

Premium listing

Proposals for changes to the Listing Rules

Earlier in 2012, the FSA consulted on proposed changes to the Listing Rules, Prospectus Rules and Disclosure and Transparency Rules (see Update 151) and, in that consultation, it indicated that it might return later to address wider issues about the nature of the premium listing standard. It has now followed up that suggestion with a consultation paper looking at enhancing the effectiveness of the Listing Regime – see FSA, Consultation Paper, CP12/25, *Enhancing the effectiveness of the Listing Regime and feedback on CP12/2* (October 2012). The full text of the consultation paper is available at http://www.fsa.gov.uk/static/pubs/cp/cp12–25.pdf.

The consultation paper places any review of the Listing Rules within the objectives of the UKLA which are to provide an appropriate degree of protection for investors in listed securities; to facilitate access to listed markets for a broad range of enterprises; and to maintain the integrity and competitiveness of UK markets for listed securities.

The paper also usefully reminds its audience that the Listing Regime itself focuses on the eligibility of securities for admission to the Official List, rather than subjective qualitative judgements about a company's suitability for listing.

Turning to the specific issue of corporate governance, the paper accepts that there may be a need to address situations where the low number of shares held in public hands means that a single dominant shareholder can exert effective control over an issuer's decision making. In that situation, the paper suggests, there may be a case for incorporating into the Listing Rules some requirements that at present are only part of the 'comply or explain' provisions of the UK Corporate Governance Code.

This wide-ranging paper goes on to suggest a large number of possible changes to the Listing Rules, including:

- implementing the concept of a controlling shareholder (one with a 30% plus holding) and requiring that an agreement be put in place to regulate the relationship between such a shareholder and the listed company – there are then detailed proposals as to the nature of this relationship agreement;
- insisting on a majority of independent directors on the board where a controlling shareholder exists;
- requiring a statement in the annual report setting out how the chairman has ensured the directors have sufficient understanding of the regulatory requirements applicable to a premium listed company and the legal requirements regarding fiduciary duties that apply;
- proposing two new Listing Principles for premium listed companies, one that all of the equity shares in a class that has been admitted to premium listing must carry an equal number of votes on a shareholder vote; and, secondly, where an issuer has more than one class of equity shares admitted to a premium listing, the aggregate voting rights of the shares in each class should be broadly proportionate to the relevant interests of those classes.

Comments are invited by 2 January 2013.

Statutory Instruments

SI 2012/2301 Companies and Limited Liability Partnerships (Accounts and Audit Exemptions and Change of Accounting Framework) Regulations 2012. These regulations apply to financial years ending on or after 1 October 2012.

The regulations were preceded by a consultation paper entitled 'Audit Exemptions and Change of Accounting Framework' (see Update 149).

The main changes are:

- to the thresholds for audit exemption for small companies, allowing SMEs to obtain an exemption if they meet two out of three criteria relating to balance sheet total, turnover and number of employees.

- allowing most subsidiary companies (there are some exclusions, such as a subsidiary that was a quoted company during the financial year) to be exempt from mandatory audit as long as certain conditions are met including, in particular, that the parent company undertaking gives a statutory guarantee of the debts and liabilities to which the subsidiary is subject as at the last day of the financial year in which the subsidiary is seeking an audit exemption. Details of the guarantee must be filed at Companies House, see Form AAO6, available at http://www.companieshouse.gov.uk/forms/generalForms/AA06_statement_of_guarantee_by_a_parent_undertaking_of_a_subsidiary_company.pdf.

  The subsidiary's shareholders must also unanimously agree to the exemption from audit and a written notice to that effect must be delivered to the registrar of companies.
- allowing dormant subsidiaries not to prepare and file annual accounts, provided they are subject to a similar guarantee, which they must file using the same form AA06 above.

The regulations also make it easier for companies which had prepared their accounts under International Financial Reporting Standards (IFRS) to move to UK Generally Accepted Accounting Principles (UK GAAP) and take advantage of reduced disclosures.

CASES

Salomon triumphant

Family Law v Company Law in the Court of Appeal

In a very interesting 2–1 decision, the Court of Appeal has considered the application of *Salomon v Salomon & Co Ltd* [1897] AC 22 and the jurisdiction to pierce the corporate veil in the context of divorce proceedings.

At issue is the ability of the court to make orders in favour of a wife against property held by companies wholly owned or controlled by the husband on the basis that it is property to which he is entitled for the purposes of the Matrimonial Causes Act 1973, s 24(1)(a). The factual background was an appeal by companies against which an order had been made, an appeal upheld by the majority in the Court of Appeal.

As noted in Update 154, the Court of Appeal in *VTB Capital plc v Nutritek* [2012] EWCA Civ 808 has recently looked at the consequences of veil piercing in the commercial context of companies being used to avoid pre-existing contractual obligations. The theme in that decision, now under appeal to the Supreme Court, was that there is in domestic law a very limited veil piercing jurisdiction (affirming a line of authorities to that effect) and consequently orders made following veil piercing (the point at issue in VTB) should be equally limited.

Now, in the different context of the family courts, the Court of Appeal has delivered an equally interesting judgment with the minority judge (Thorpe LJ) strongly supporting the view that assets held by companies wholly controlled or owned by the husband are assets to which he is entitled and in respect of which orders can be made in favour of the wife. He would have dismissed the appeal. He noted that were the family division judges to be constrained by narrow company law principles then they would be unable to make orders fair to applicant wives. Essentially his position was that, whatever the strict company law position on piercing the corporate veil, the family law issue is whether in reality the husband is entitled to the assets.

Rimer LJ gives a lengthy powerful judgment resolutely demolishing the trial judge's approach (and implicitly therefore the approach of Thorpe LJ) which Rimer LJ summarised as 'power equals property'. The trial judge had accepted that there were no grounds for piercing the corporate veil and simply equated the shareholder's control of the companies with an entitlement to the property of the companies.

Rimer LJ variously dismisses the trial judge's findings as wrong, heretical, astonishing, having absurd consequences and noted that they were the result of a judicial attempt to shoehorn into the MCA 1973, s 24(1)(a), assets which manifestly do not fit there. He then proceeded to demolish various family law authorities, notably dicta in *Nicholas v Nicholas* [1984] FLR 285, CA, which appear to support piercing the corporate veil in the interests of justice, something which is at odds with company law decisions stretching from the House of Lords in *Salomon* and in *Woolfson v Strathclyde RC* [1978] SC (HL) 90 to the Court of Appeal in well-known company law authorities, *Adams v Cape plc* [1990] BCLC 479 and *Ord v Belhaven Pubs Ltd* [1998] 2 BCLC 447, decisions recently affirmed in *VTB Capital v Nutritek*.

Rimer LJ concluded that the separate corporate identity of a company is a fact of legal life which all courts are required to recognise and respect, whatever jurisdiction they are exercising. It is not open to a court, he said, simply because it regards it as just and convenient, to disregard such separate identify and to appropriate the assets of a company in satisfaction either of the monetary claims of its corporator's creditor or of the monetary ancillary relief claims of its corporator's spouse. A one-man company, he said, does not metamorphose into the one-man simply because the person with a wish to abstract its assets is his wife. He went on 'Just as there is no rational ground for regarding the family courts as exempt from *Salomon*, so there is no rational ground for regarding them as exempt from the need to be satisfied as to the conditions affirmed in *VTB* before piercing the corporate veil'. The dicta in *Nicholas* should no longer be regarded as of any authority, he said.

Patten LJ agreed and fully endorsed the approach of Rimer LJ and specifically emphasised that the provisions of the MCA 1973, s 24(1)(a) do not give the court power to disapply the established principles of legal and beneficial ownership or of company law. He went on to say that the dicta relied on from *Nicholas* 'have led judges of the Family Division to adopt and develop an approach to company owned assets in ancillary relief applications which amounts almost to a separate system of legal rules unaffected by the relevant principles of English property and company law. That must now cease.'

Surely, one for the Supreme Court.

Prest v Prest [2012] EWCA Civ 1395, [2012] All ER (D) 293 (Oct).

Approving service contracts – duties of remuneration committee

Authority of executive directors to instruct company solicitors

In a wide ranging judgment, Proudman J considered issues as to the role of the remuneration committee and, especially, of the chair of that committee in approving executive service contracts and the extent in this instance to which the relevant executives had authority to instruct the company's solicitors to draw up those contracts.

The case arose from a renegotiation of service contracts for two executive directors of an airport company (the only executive directors) which resulted in their securing large bonuses (about £8m between them) on the refinancing of the company and the removal of a restrictive covenant preventing one for them from working for another airport.

Claims against the directors had been settled (one had resigned, the other had died) and the company was now suing its solicitors for breach of a duty of care on the basis that the solicitors should have ensured that they had established directly the wishes of the remuneration committee and its chair, advising them as to the terms of the contracts, rather than as was the case drafting the contracts directly with the two executive directors who stood to gain from them.

The court found that the chair of the remuneration committee had caused the two executives to instruct the solicitors, she had held them out as authorised (they had actual authority) to give instructions to prepare the draft contracts. That necessarily meant that they had apparent authority to give instructions on the contents of the contracts. It was not a case where the executive directors had sought to clothe themselves with authority merely by reason of their position in the company.

The solicitors were not put on notice as to anything which would negate that apparent authority for the unchallenged evidence was that it was common place for directors to deal with solicitors in the drafting of their contracts.

Once apparent authority had been established, there was no duty of care to advise the chair of the remuneration committee as to the meaning and effect of changes to the contracts since provision of advice to the agents themselves would have discharged the duty. The chair of the remuneration committee had consciously left all matters of detail regarding the new contracts to the two executives. But the solicitors had not in fact left the final approval of the contracts to the executive directors. The drafts had been sent to the chair of the remuneration committee for approval and signature, but she did not read them other than cursorily before signing them.

It was not the function of the solicitors to advise the company as to the merits or wisdom of the contracts. Most importantly, there was no conflict of interest between a director and his company when there had been full disclosure to the company, in the instant case to the remuneration committee. There was nothing secretive about what was being proposed; on the contrary, the draft contracts were to be (and were) provided to the remuneration committee for approval.

The evidence was damning that the chair of the remuneration committee did not bother with minutiae, did not bother to read attachments to emails, did not think in terms of the actual figures for the bonuses and had 'a special distaste for documents produced by lawyers'. The court noted that, while she acted honestly, it was 'hard to accept that she acted … reasonably and appropriately, having regard to her terms of engagement and responsibilities. … An important part of [her role as chair of the remuneration committee] was to ensure that new contractual provisions affecting executive directors were subject to independent scrutiny by the … committee'.

Other members of the remuneration committee likewise did not read documents carefully or ask relevant questions or they remained silent for their own reasons. The court noted that, if the remuneration committee had picked up on the terms of the new contracts, they would not have been executed and that the members of the committee had both the opportunity and the ability to do so.

The court therefore concluded that the real reason the company suffered loss was because its non-executive directors failed to carry out their obligations to the company. The claim against the solicitors was dismissed: *Newcastle International Airport Ltd v Eversheds LLP* [2012] EWHC 2648, [2012] All ER (D) 20 (Oct).

Administration

Date of conversion from administration to liquidation

Previously, as noted in Update 152, the High Court has considered the time at which a notice converting an administration into a liquidation takes effect. The requirement under IA 1986, Sch B1, para 83(4), is for the registrar to register the conversion notice 'on receipt' but it was accepted in practice that it can take about three working days (longer if public holidays intervene) for the notice to be registered. If conversion only happens on registration, and the administrator's term of office comes to an end before the conversion takes effect, there is a potential gap between the two processes. Briggs J overcame that difficulty by ruling that a notice converting an administration to a liquidation took effect on receipt of the notice by the registrar of companies, an interpretation which he thought was in line with the Parliamentary intention of a seamless move from one regime to another.

The Court of Appeal has overruled that finding. The natural meaning of IA 1986, Sch B1, para 83(4), the court held, was that a conversion notice does not take effect until it is actually registered. It was envisaged that between receipt and registration, there would be some delay as the registrar in performance of his or her public duties would perform some element of checking the information given to improve the accuracy of the register. Thus, an interpretation that allowed that checking to take place before conversion occurred is to be preferred.

The problem of a gap between the two processes is resolved by para 83(6) which provides that, 'on registration, the appointment of an administrator in respect of the company shall cease to have effect'. Accordingly, an administrator's term of office is, by implication from the words of para 83(6), in general extended by the filing of a conversion notice from the date on which the term of office would otherwise have expired by effluxion of time until the conversion comes into effect on registration of the conversion notice: *Re Globespan Airways Ltd, Cartwright v Registrar of Companies* [2012] EWCA 1159, [2012] All ER (D) 144 (Aug).

Dissolution and restoration to the register

Validation of existing claim

A claimant had issued personal injury proceedings against a defendant company when it was discovered that the company been struck off the register of companies and dissolved, pursuant to CA 1985, s 652. The claimant successfully applied under CA 2006, s 1029 to have the company restored to the register, but the defendant argued that the proceedings remained a nullity – they had been when they were issued and the order restoring the defendant to the register did not validate the proceedings retrospectively.

It was ruled at first instance that the changes in the law on restoration made by the CA 2006 did not alter the position as previously established under the CA 1985 that a restoration order has the effect of retrospectively validating an action purportedly commenced against a company during the period of its dissolution. The defendant appealed.

The Court of Appeal dismissed the appeal. Prior to the CA 2006, there had been two different procedures in place for restoration, now there is a single composite procedure set out in CA 2006, s 1029. The effect of a restoration order is set out in s 1032(1) which provides that 'the general effect of an order by the court for restoration to the register is that the company is deemed to have continued in existence as if it had not been dissolved or struck off the register' (which was the consequence under only one of the previous two procedures, the procedure under CA 1985, s 653). The fact that in all material respects Parliament had chosen to use precisely the same language in CA 2006, s 1032(1) as had previously appeared in CA 1985, s 653 and its predecessors could not have been fortuitous. Parliament had plainly been seeking to carry forward, albeit with a wider application, the principle which had, in a narrower context (i.e. limited to restorations under CA 1985, s 653), been repeatedly used in successive Companies Acts. Given Parliament's deliberate use of a well established and much construed form of words, there was every reason for asserting that the previous jurisprudence was highly relevant and should be applied to CA 2006, s 1032(1). The effect remained therefore that a restoration order retrospectively validates an action purportedly commenced by or against a company during the period of its dissolution.

Accordingly, the judge had been right to allow the claimant's appeal and find that the order restoring the defendant company had validated the claimant's proceedings: *Peaktone Ltd v Joddrell* [2012] EWCA Civ 1035, [2012] All ER (D) 287 (Jul).

Correspondence about this bulletin may be sent to Stephen Barc, Technical Editor/Writer, Commercial & Property Law Team, LexisNexis, Halsbury House, 35 Chancery Lane, London WC2A 1EL (tel: +44 (0)20 7400 4674, email: stephen.barc@lexisnexis.co.uk). If you have any queries about the electronic version of this publication please contact the BOS and Folio helpline on tel: +44 (0)845 3050 500 (8:30am–6:30pm Monday to Friday) or for 24 hour assistance with content, functionality or technical issues please contact the Content Support Helpdesk tel: +44 (0)800 007777; email: contentsupport@lexisnexis.co.uk

Published by LexisNexis (www.lexisnexis.co.uk)

Printed in Great Britain by Hobbs the Printers Ltd, Totton, Hampshire

FSC
www.fsc.org
MIX
Paper from responsible sources
FSC® C020438

ISBN 978-1-4057-6597-8

9 781405 765978