Butterworths Corporate Law Update

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RECENT DEVELOPMENTS

Transparency on Company Ownership

Central registry — BIS review

As reported in the media, the Government indicated during the recent G8 discussions that it intends to improve the transparency of the ownership and control of companies, noting the importance of companies obtaining and holding adequate, accurate and current information on their beneficial ownership. The intention is to amend the Companies Act 2006 to require that accurate information is readily available to the authorities through a central

registry of information on companies' beneficial ownership to be maintained by Companies House. There will be a consultation on whether that information should be publicly accessible. As part of these measures, there will be a review of the supervision and enforcement of trust and company service providers which will include consideration of additional measures to ensure company formation agents conduct effective due diligence including the identification and verification of beneficial owners.

It is intended that the Department for Business, Innovation and Skills (BIS) will conduct a review of corporate transparency, including bearer shares and nominee directors, and will publish a pre-consultation paper before September 2013.

The Government statement goes on to say that these measures will be implemented in various ways, through transposition of the 4th EU Money Laundering Directive and UK Money Laundering Regulations, changes to the Companies Act 2006, as well as through other relevant bilateral and multilateral agreements.

The full text of the statement can be found at https://www.gov.uk/government/news/g8-2013-new-rules-to-bring-unprecedented-transparency-on-company-ownership.

Enterprise and Regulatory Reform Act 2013

Further guidance and an indicative timetable from BIS

As noted in the last Corporate Law Update, the wide-ranging Enterprise and Regulatory Reform Act 2013 obtained Royal Assent on 25 April 2013. The Department for Business, Innovation and Skills has now published various documents concerning this legislation including a brief guide to the Act, a more detailed policy document setting out why the Government is undertaking the measures contained within the Act and explaining what each measure aims to achieve and an indicative timetable outlining when the Act is expected to be brought into force — all these documents are available at https://www.gov.uk/government/publications/enterprise-and-regulatory-reform-act-2013-a-guide.

Quoted companies

Remuneration Reports

As previously discussed in this Update, the intention has been for some time now to require quoted companies to provide a clearer, more accessible, directors' remuneration report, see Update no 153. The necessary regulations replacing the current requirements, substituting a new Schedule for Schedule 8 to SI 2008/410, have been laid before Parliament, see the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208289/bis-13-963-draft-large-and-medium-sized-companies-amendment-regulations-2013.pdf.

The provisions of the 2008 Regulations as they stood immediately before 1 October 2013 continue to apply in respect of a financial year ending before 30 September 2013; the new regulations come into force on 1 October 2013.

Narrative reporting

Strategic report and directors' report

BIS has published in draft form the regulations which will amend the disclosure requirements with respect to annual reports and which will apply to accounting periods ending on or after 30 September 2013. Though in draft form, no further amendments are expected, see The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, available at https://www.gov.uk/government/publications/draft-companies-act-2006-strategic-report-and-directors-report-regulations-2013.

The Regulations will amend the Companies Act 2006, Part 15, to require, inter alia, companies (other than those eligible for the small companies regime for accounts) to prepare a strategic report and the new provisions prescribe the content of that report. There will no longer be a requirement for a business review to be prepared as part of the directors' report (most of that information has been transferred to the strategic report) and the provisions governing summary financial statements are to be repealed.

The Regulations also amend the requirements for the contents of the directors' report, for example, to omit the need for a statement by the company of its principal activities in the course of the year; to limit the obligation to provide information on a company's purchase of its own shares to public companies; and to require quoted companies to make certain disclosures regarding greenhouse gas emissions.

CASES

Piercing the corporate veil

Evasion, concealment, and necessity

The much awaited Supreme Court judgment has been handed down in *Prest* v *Petrodel Resources Ltd* concerning, inter alia, the scope and nature of the jurisdiction to pierce the corporate veil.

At issue was the ability of the court to make orders in favour of a wife requiring companies wholly owned or controlled by the husband to transfer assets held by them to the wife on the basis that this was property to which the husband was 'entitled' for the purposes of the Matrimonial Causes Act 1973, s 24(1)(a).

The wife was appealing to the Supreme Court after the companies had successfully challenged the trial judge's order against them in the Court of Appeal. The Supreme Court has now overruled the Court of Appeal and held in favour of the wife, but on the basis that, properly analysed, the facts showed that the assets were held by the companies on resulting trust for the

husband and therefore they were assets to which he was 'entitled' for the purposes of the MCA 1973, s 24(1)(a).

The main interest for company lawyers lies in the court's ultimately obiter comments on piercing the corporate veil. The main judgment was given by Lord Sumption and on piercing the veil he concluded, with agreement to some greater or lesser extent from Lord Mance, Lord Neuberger, and Lord Clarke, that:

- There is a limited principle of English law which applies when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control.
- The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality.
- There is another principle, the concealment principle which, Lord Sumption says, does not involve piercing the corporate veil at all. It involves the interposition of a company or perhaps several companies so as to conceal the identity of the real actors and there the court does not disregard the corporate façade but looks behind it to discover the facts which the corporate structure is concealing.

All were agreed, that if it is not necessary to pierce the corporate veil, it is not appropriate to do so. It should only be done if all other more conventional tools have proved of no assistance.

On the facts:

- Whatever the husband's reasons for organising things so that properties were vested in the companies, there was no evidence that he had been seeking to avoid any obligation which was relevant in the instant proceedings. Accordingly, the piercing of the corporate veil could not be justified in the instant case by reference to any general principle of law.
- If there was no justification as a matter of general legal principle for piercing the corporate veil, it was 'impossible to say that a special and wider principle applied in matrimonial proceedings by virtue of MCA 1974, s 24(1)(a)'. As Lord Sumption put it, 'courts exercising family jurisdiction do not occupy a desert island in which general legal concepts were suspended or mean something different' — there is no separate piercing the veil jurisdiction applicable in the Family Division.
- It followed that the only basis on which the companies could be ordered to convey the properties to the wife was that they belonged beneficially to the husband by virtue of the particular circumstances in which the properties came to be vested in them. Only then would they constitute property to which the husband was 'entitled'.

- On the facts, taken cumulatively, it was a fair inference that the main, if not the only, reason for the companies' failure to co-operate in these proceedings was to protect the properties. That suggested that proper disclosure of the facts would reveal them to have been held beneficially by the husband. On the evidence, the husband had, at all relevant times, been the beneficial owner of the properties.
- Whether assets legally vested in a company are beneficially owned by its controller is, Lord Sumption conceded, a highly fact-specific issue. But, he tentatively suggested, that, in the case of the matrimonial home, the facts are 'quite likely to justify the inference that the property was held on trust for a spouse who owned and controlled the company'. He went on: 'where, say, the terms of acquisition and occupation of the matrimonial home are arranged between the husband in his personal capacity and the husband in his capacity as the sole effective agent of the company (or someone else acting at his direction), judges exercising family jurisdiction are entitled to be sceptical about whether the terms of occupation are really what they are said to be, or are simply a sham to conceal the reality of the husband's beneficial ownership'.

A declaration was made that the properties vested in the companies were held on trust for the husband and the relevant part of the original order was restored so far as it required those companies to transfer the properties to the wife: *Prest* v *Petrodel Resources Ltd* [2013] UKSC 34, [2013] All ER (D) 90 (Jun).

Freezing orders — wording of standard CPR form

Whether order can extend to assets of single-shareholder company

In keeping with the *Salomon* theme, Hildyard J was faced recently with the interesting question of whether, for the purposes of a freezing order, assets held by a company with a sole director and shareholder are assets held or controlled in accordance with that director/shareholder's direct or indirect instructions.

The court noted that the relevant wording of the order at issue was in the same form as para 6 of the CPR standard form of freezing order which has been in use in the High Court since 2002 (which is set out in the Annex to CPR PD 25A — Interim Injunctions). Therefore, the point in the case, Hildyard J said, could well affect orders made and to be made in other cases also.

The relevant wording of CPR standard form, para 6, is:

> 'Paragraph 5 [which prevents the respondent from removing his assets from England and Wales, or dealing with, disposing or reducing the value of his assets] applies to all the Respondent's assets whether or not they are in his own name and whether they are solely or jointly owned. For the purpose of this order the Respondent's assets include any asset which he has *the power, directly or indirectly, to dispose of or deal with as if it were his own*. The Respondent is to be regarded as having such

power if a third party *holds or controls the asset in accordance with his direct or indirect instructions*.' (Emphasis added.)

A freezing order had been made in respect of various respondents, one of whom (S) had a company, W Ltd, of which S was the sole director and shareholder. W Ltd settled a debt of $500,000 due to it for a payment of $200,000. The claimants argued that this settlement of the debt amounted to a disposal of an asset of S in breach of the freezing order.

Hildyard J concluded that:

- It is clear beyond argument that the assets of W Ltd are not in law the assets of the shareholder, nor is the company by virtue of the shareholding, the agent of the shareholder.
- The question is whether by virtue of his sole ownership and control of W Ltd, S has, or is to be treated as having, the power, directly or indirectly, to dispose of or deal with the debt as if it were his own and that question depends on whether, for the purposes of the freezing order, the company 'holds or controls the asset in accordance with S's direct or indirect instructions'.
- Applying settled principles of company law, Hildyard J said that the answer to the question is 'No'. The standard form of freezing order does not ordinarily and without more extend to restrain dealings in the assets of a body corporate wholly owned and controlled by a respondent.
- Hildyard J noted that this outcome 'may dilute the efficacy of the standard CPR form of freezing order, and surprise and unsettle not a few; but to my mind there is no escape from it'.
- In signing the settlement agreement regarding the debt, S was not, as a matter of law, instructing W Ltd directly or indirectly, he was acting in right and on behalf of the company, he was the means by which the company, as an artificial creation, acted.
- Accordingly, the application to have S committed for contempt on the basis that the settlement of the debt by W Ltd constituted a dealing with or disposal of S's assets failed.

Having disposed of the case, Hildyard J went on to make some interesting observations about the effect of his ruling on standard form freezing orders. Essentially, he indicated that a variation of the standard form might be appropriate in some cases (and he was minded to make such a variation in this case) where there is a wholly owned and controlled body corporate, non-trading, which is being used in effect 'as a convenient wallet or pocket'.

Exceptional circumstances would have to be demonstrated for such a variation to be made, however, such as would support a piercing of the corporate veil and in many cases, he noted, restraint on any transactions diminishing the value of the shares held by the respondent may well suffice. He also noted

that 'judicial reticence in deploying the doctrine of lifting the veil is mandated', a point reinforced now by the Supreme Court ruling in *Prest v Petrodel Resources Ltd*, discussed above, which was given after the judgment in this case: *Group Seven Ltd v Allied Investment Corporation Ltd* [2013] EWHC 1509, [2013] All ER (D) 64 (Jun), Ch.

Postscript: in an unreported case, *Lakatamia Shipping Co Ltd v Nobu Su*, on the same day, 6 June 2013, Burton J appears to have reached a contrary view to that of Hildyard J in *Group Seven Ltd* above, holding that assets of companies controlled by a sole director and shareholder did fall within the terms of the freezing order.

Triggering default

Test for balance sheet insolvency — Supreme Court

The Supreme Court has dismissed an appeal from the decision of the Court of Appeal in the *Eurosail* case (noted in Update 146).

- The case revolved around the interpretation of the 'balance sheet test' laid down in IA 1986, s 123(2) which provides that 'A company is … deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities'.
- The case is of particular significance because, in many financial transactions, the balance sheet insolvency test set out in IA 1986, s 123(2) is specified as an event of default. Hence the importance of the decision, not just in the statutory context of winding up petitions, but in the commercial context of contractual definitions of acts of default.
- The case concerned a bondholder dispute arising out of the collapse of Lehman Bros — it suffices to note that the issuer company was able to meet its current debts, but a subordinate class of noteholders was trying to establish that the company was balance sheet insolvent so as to trigger enforcement provisions which would operate to their advantage.
- The Court of Appeal decision, [2011] 3 All ER 470, attracted a lot of comment, in particular because of Lord Neuberger MR's view that the balance sheet test can only be relied on by a future or contingent creditor of a company which has reached 'the end of the road'. The concern was that this test (which Lord Neuberger conceded was 'imprecise, judgement-based and fact-specific') set the threshold so high that it might be difficult ever to invoke it and trigger enforcement options.

In the Supreme Court, Lord Walker gave the main judgment and he noted that a 'cash flow' test is concerned with debts falling due from time to time in the reasonably near future, as well as debts currently due. What is the reasonably near future, for this purpose, will depend on all the circumstances, but especially on the nature of the company's business. But beyond the reasonably near future, he said, any attempt to apply a cash flow test becomes

completely speculative, and a comparison of present assets with present and future liabilities (discounted for contingencies and deferment) becomes the only sensible test. However, as he acknowledged, that is still very far from an exact test, and the burden of proof has to be on the party which asserts balance sheet insolvency.

On the facts, there were three imponderable factors affecting the issuer company — currency movements, interest rates and the UK economy and housing market — and the final redemption date for all the notes issued by the company was not until 2045. The movements of currencies and interest rates in the meantime, if not entirely speculative, were incapable of prediction with any confidence. The court could not be satisfied, therefore, that there would eventually be a deficiency.

- The Supreme Court expressly rejected the approach favoured by Lord Neuberger in the Court of Appeal. Lord Walker noted that, in the Court of Appeal, Toulson LJ had agreed with Lord Neuberger but had expressed himself in a more guarded way.
- Toulson LJ had agreed that Professor Sir Roy Goode's reference (which Lord Neuberger had relied on particularly) to a company having 'reached the point of no return because of an incurable deficiency in its assets' illuminated the purpose of IA 1986, s 123(2) but did not purport to be a paraphrase of it. Toulson LJ had continued:

  > 'Essentially, section 123(2) requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowance for its prospective and contingent liabilities, it cannot reasonably be expected to be able to meet those liabilities. If so, it will be deemed insolvent although it is currently able to pay its debts as they fall due. The more distant the liabilities, the harder this will be to establish.'

- Lord Walker went on 'I agree with what Toulson LJ said here, and with great respect to Lord Neuberger MR, I consider that "the point of no return" should not pass into common usage as a paraphrase of the effect of s 123(2)'. Lord Mance, Lord Sumption and Lord Carnwath agreed with Lord Walker.

The court of first instance and the Court of Appeal had been correct on the issues and the decision of Court of Appeal was affirmed – it would have reached the same conclusion without reference to any 'point of no return' test. The company was not balance sheet insolvent so as to have triggered the enforcement provisions and the appeal was dismissed: *BNY Corporate Trustee Services Ltd and others v Eurosail-UK 2007–3BL Plc* [2013] UKSC 28, [2013] All ER (D) 107 (May).

Administration order for Jersey company

Assisting an overseas jurisdiction

The controversial judgment in the *Tambrook* case, [2013] EWHC 866, has been overruled by the Court of Appeal in an expedited appeal.

- The case concerned the scope of IA 1986, s 426(4) which provides, so far as material: '(4) The courts having jurisdiction in relation to insolvency law in any part of the United Kingdom shall assist the courts having the corresponding jurisdiction in any other part of the United Kingdom or any relevant country or territory'. The Channel Islands are a 'relevant country or territory'.

A bank wished to appoint administrators to a Jersey-registered company as part of a scheme agreed with the company's sole director to assist the bank in recouping a £6m loan to the company which was 'hopelessly insolvent'. The company's main business activity was in England and the company's main asset, certain properties, were in England, but its centre of main interests was in Jersey.

It was agreed by all concerned that the most advantageous way forward was to place the company in administration, but Jersey does not provide for administration and no other form of Jersey insolvency procedure, such as the désastre procedure (akin to liquidation), was considered appropriate. The bank therefore obtained an order from the Royal Court of Jersey asking the High Court pursuant to IA 1986, s 426, to assist the Jersey court by appointing administrators to the Jersey company.

- Mann J declined to make the appointment, finding that the section required the UK court to assist a foreign court exercising insolvency jurisdiction, but as there were no Jersey insolvency proceedings on foot, and no apparent intention on the part of anyone to start any, the English court was not being asked to assist the Jersey court in any endeavour. Mann J acknowledged that there were five prior decisions where, on like facts, administration orders had been made pursuant to a request from the Royal Court of Jersey.

The Court of Appeal allowed an appeal by the bank.

- IA 1986, section 426(4) is not, by its actual wording, applicable to courts 'exercising' jurisdiction in relation to insolvency law; it is applicable to courts 'having' jurisdiction, or the corresponding jurisdiction, in insolvency law. Under established authorities, s 426(4) is to be given a broad interpretation and, broadly read, the words of the subsection were amply sufficient to enable the English court to 'assist' the Royal Court in the way requested.

Davis LJ, with whom McFarlane and Longmore LJJ agreed, said that the approach of Mann J would seem to require the maintenance of separate formal insolvency processes in the requesting state, even where such process was not desired, would serve no purpose and would run up needless costs. Further, it was demonstrable that the Royal Court had been engaged in an insolvency endeavour. It had heard detailed evidence and had carefully considered the matter and its request to the High Court had contained a request that any administration order should give creditors having priority under the Jersey désastre procedure the like priority in the English administration. All of this was the very stuff of insolvency, Davis LJ said.

In the circumstances, there had been no good reason to refuse to acknowledge the role of the Royal Court as an exercise of insolvency jurisdiction simply because formal proceedings for an (unwanted) désastre order had not been issued or contemplated. Mann J's approach had been unduly and unnecessarily restrictive. Accordingly, an administration order would be made.

For the avoidance of doubt, the Court of Appeal also noted that the administration orders made in the previous five cases on request from the Royal Court of Jersey were orders which the High Court had jurisdiction to make: *HSBC Bank plc v Tambrook Jersey Ltd* [2013] EWCA Civ 576, [2013] All ER (D) 247 (May).

Insolvency Regulation EC 1346/2000

Definition of 'establishment' for the purposes of secondary proceedings

The Court of Appeal has considered the meaning of 'an establishment' for the purposes of the Insolvency Regulation (EC) 1346/2000, art 2(h). The case involved an appeal from the decision of the High Court that the relevant company did have an establishment in the UK and therefore secondary winding up proceedings could be opened in the UK though the company's centre of main interests was in Greece (see Update 153). Article 2(h) defines 'establishment' as designating 'any place of operations where the debtor carries out a non-transitory economic activity with human means and goods'.

A pension fund trustee petitioned for the winding up of the Greek airline company, Olympia, in the UK on July 20, 2010 which depended on the company having an establishment in the UK on that date, which the company denied. The trustee wanted to have the company wound up in the UK in order that the UK employees would benefit from the Pension Protection Fund.

The company was incorporated in Greece and had gone into liquidation there in 2009. The company had offices at Heathrow and Manchester with a staff of 27, but those offices had closed by May 2010, with a skeleton staff of two or three people continuing to work out of London premises doing some administrative matters.

The particular point of contention was whether the Insolvency Regulation's definition of 'establishment' required some economic activity which was external and market-facing, rather than the desultory internal running down of a business. The Chancellor of the High Court, Sir Andrew Morritt, did not accept that to be 'economic', there had to be some external market activity.

Allowing the appeal by the company, Sir Bernard Rix, with whom Sir Stephen Sedley and Moore-Bick LJ agreed, noted that:

- the Virgos-Schmit Report on the Convention on Insolvency Proceedings from which the Insolvency Regulation is derived is regarded by the courts as authoritative commentary on the Regulation. The Report

observed that 'place of operations' means a place from which economic activities are exercised on the market (i.e. externally), whether the said activities are commercial, industrial or professional and the Court of Appeal accepted that that requirement of external activity is 'likely to be correct'. It was also consistent with the jurisprudence on this issue and the court noted that, 'in the case of a definition which is part of an international code, which requires an autonomous meaning, and which has been applied internationally in a certain direction, in line with an authoritative (even if not binding) report, it would need something special to make it necessary to strike out in a different direction'. The court could find nothing in the language to necessitate such a new departure'.

- What is being looked for is a location where there was still, at the critical date, a business operation (a 'place of operations' performing 'economic activity') such as would justify secondary proceedings in a state outside the state of the centre of main interests. If such an establishment could be provided by the desultory winding-up of any business with a former 'place of operations' as long as some 'human means' activity was involved and as long as some assets survived, perhaps no more that the worthless detritus of a defunct operation, then there would hardly ever be secondary proceedings which did not come within the definition. That was plainly not intended to be the case.
- The definition is clearly intended, the court said, to lay down a rule that the mere presence of an office or branch, a 'place' at which the debtor is located, is not sufficient. It has to be a place 'of operations': human and physical resources have to be involved in those operations; and there has to be 'economic activity' involving those resources. Thus, a dormant branch, or one which has not yet started operating, or one which has fallen into economic inactivity, will not suffice. Moreover, the need for external activity is supported, even if only inferentially, by the requirement stressed in *Interedil SRL v Palimento Interedil SRL* (2011) Case C-396/09, ECJ, for something which can be ascertained by third parties.

On the facts, the definition of 'establishment' as required by the Regulation had not been fulfilled. By the relevant date, the date the winding up petition was presented in England, the respondent company had already been in liquidation in Greece for some ten months, had ceased all commercial operations for almost as long and the remaining staff had been dismissed and paid off.

There was no jurisdiction to commence secondary proceedings in England with the result, regretfully the court said, that the beneficiaries of the pension scheme were denied the protection of the Pension Protection Fund: *Re Olympic Airlines SA* [2013] EWCA Civ 643, [2013] All ER (D) 39 (Jun).

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