Bulletin 158 May 2013

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

Enterprise and Regulatory Reform Act 2013 (ERRA 2013)

Directors' remuneration and other changes

The Enterprise and Regulatory Reform Bill received Royal Assent on 25 April 2013. So far as company law matters are concerned, the Act brings in a new regime governing the content of the directors' remuneration report for quoted companies and giving shareholders of such companies a binding vote on directors' pay policy. The new provisions will apply to financial years beginning on or after the date on which these provisions come into force, which is expected to be 1 October 2013. See Update 153 for the details of the changes on remuneration.

The ERRA 2013 also contains extensive measures on competition law, establishing a new Competition and Markets Authority which brings together the competition functions of the Office of Fair Trading and the Competition Commission. There are measures on employment law, specifically on employment tribunals and providing for greater use of conciliation processes and settlement agreements. There are also measures on modernising the UK's copyright regime to promote innovation in the design industry.

The ERRA 2013 has also been a vehicle for a wide range of repeals and reforms to existing law, and one worthy of note (see ERRA 2013, s 69) is an amendment to the Health and Safety at Work etc. Act 1974, s 47. This reverses the present position on civil liability, with the effect that, unless any exceptions apply, it will only be possible to claim for compensation in relation to breaches of affected health and safety legislation where it can be proved that the duty holder (usually the employer) has been negligent, rather than allowing for strict liability as at present.

It is intended that most provisions of the ERRA 2013 will come into effect in October 2013 or April 2014. A detailed implementation timetable will be published on the BIS website shortly. The full text of the Act can be found at http://www.legislation.gov.uk/ukpga.

Purchase back of own shares

Amending Regulations

The Companies Act 2006 (Amendment of Part 18) Regulations 2013, SI 2013/999, came into force on 30 April 2013 and amend CA 2006, Part 18 (acquisition by limited company of its own shares).

The Regulations implement the amendments to the provisions governing a purchase of a company's own shares, which were discussed in the last Update. Essentially, the changes allow a private company to pay for its shares by instalments where the buy back is for the purposes of or pursuant to an employees' share scheme; allow private companies flexibility to use small amounts of cash without identifying it as distributable profits for the purpose of a purchase back; allow authorisation of off-market purchases by an ordinary resolution; provide for a simplified procedure for a purchase back out of capital for the purposes of or pursuant to an employees' share scheme; and allow all companies limited by shares to hold their own shares in treasury.

Model articles

The Mental Health Discrimination Act 2013

The CA 2006 Model Articles have been amended by the Mental Health Discrimination Act 2013 which removes, with effect from 28 April 2013, a provision in the respective model articles (see SI 2008/3229, Schedules 1 to 3) which provided that a person ceases to be a director as soon as, by reason of that person's mental health, a court makes an order which wholly or partly prevents that person from personally exercising any powers or rights which that person would otherwise have. That is the extent of the legislative change made by the Act, which originated as a Private Members' Bill.

Law Commission review of investors' fiduciary duties

Terms of reference announced

One of the recommendations of the Kay Review of UK Equity Markets (see Update 154) was that the Law Commission should be asked to review the legal concept of fiduciary duty as applied to investment to address uncertainties and misunderstandings on the part of trustees and their advisers. The Department for Business, Innovation and Skills has now announced the terms of reference for this review which in broad terms are to investigate the extent to which, under existing law, fiduciary duties apply to: (a) intermediaries (including investment managers and pension scheme trustees) investing on behalf of others; (b) those providing advice or other services to those undertaking investment activity; and to determine whether fiduciary duties

permit or require such persons to consider factors relevant to long-term investment performance, interests beyond the maximisation of financial return and generally prevailing ethical standards. The Law Commission intends to issue a consultation paper in October 2013.

See https://www.gov.uk/government/news/cable-announces-law-commission-review-of-investors-fiduciary-duties.

EC Insolvency Regulation 1346/2000

UK opts in to the proposal for amendments to the Regulation

The Government has opted in to the proposal for a Regulation amending EC Insolvency Regulation 1346/2000 because it considers the measure will be of general benefit to creditors and businesses, a position unanimously supported by those who responded to an earlier call for evidence on this issue. The Government now intends to participate fully in negotiations on the proposal for the amending Regulation which can be found at http://ec.europa.eu/justice/civil/files/insolvency-regulation_en.pdf.

FRC consultation

Employee share options of private companies

On 24 April 2013, the Financial Reporting Council (FRC) issued an invitation to comment on various issues relating to the use by 'standalone' private companies of employee share option schemes. The invitation for comment follows a preliminary review carried out by the FRC and seeks further information on the results which were received. The consultation closes on 31 July 2013.

The consultation seeks comments on the following areas identified by the preliminary review.

- *The types of employee share option schemes and the number of private companies holding them*. The preliminary review indicated employee share option schemes to be most common among high-growth, technology-focused venture capital backed companies, but uncommon among other 'standalone' private companies.

- *The objective of employee share option schemes*. The preliminary review suggested a primary objective in issuing share options is to give employees a stake in the company so as to incentivise them to work harder and more effectively. Mixed views were reported regarding the usage of share options as an alternative means of employee remuneration.

- *Recognition*. Employee share options are recognised as an expense in the profit and loss account as they are viewed as compensation from employers for employee services received. The majority of responses to the preliminary review favoured a disclosure-only approach to accounting for employee share options in the financial statements of private companies.

- *Measurement basis*. The majority of contributors to the preliminary review considered it to be difficult or very difficult to reliably calculate the fair value of employee share options of a private company.
- *Disclosure suggestions*. Suggestions for improving disclosure included amending the extent to which existing shareholders' proportionate ownership interest in the company may be reduced by the issue of share options.

The invitation to comment can be accessed at http://www.frc.org.uk/getattachment/cd425aa3-37c1-4b3e-b528-9ddf80cd0362/Invitation-to-comment-Share-based-Payment-Empl.aspx.

The Insolvency Service

Government response to Business, Innovation and Skills Committee report

On 25 April 2013, the Government published a detailed response to a report on the Insolvency Service that was published by the House of Commons Business, Innovation and Skills Committee at the end of January 2013. The Government's response is set out under the following headings:

- a new delivery strategy;
- reductions in the workforce;
- reorganisation of office locations;
- the funding model of the Official Receivers' office;
- bankruptcy case administration fees — altering the balance;
- published targets for the Insolvency Service;
- investigation and enforcement resources;
- reform of pre-pack administrations, and penalties for non-compliance;
- continuation of supply to insolvent businesses; and
- remuneration of, and complaints against, insolvency practitioners.

The Government's response can be accessed at www.publications.parliament.uk/pa/cm201213/cmselect/cmbis/1115/111504.htm.

CASES

Company liability for health and safety

Position of injured sole director and shareholder

The Court of Appeal had before it recently the interesting question of whether a sole director and shareholder of a company who was responsible for (and who failed to ensure) the fulfilment of the company's (absolute) obligations as to the maintenance and safety of equipment in a workshop

could successfully sue the company as his employer for breach of that (absolute) obligation which resulted in his sustaining a severe hand injury.

The court noted that it is settled law (known as the *Ginty/Kodak* defence) that, once a claimant establishes a breach of an enactment which makes his employer absolutely liable, and that breach caused the accident, the claimant need do no more, but it is open to the employer to set up a defence that, in fact, it was not in any way at fault but that the claimant employee was alone to blame. The defence applies where the act or omission of the claimant employee himself has the legal result that the defendant employer is in breach of a statutory duty.

The Court of Appeal held that where a director paid no attention whatsoever to health and safety issues and had abrogated his responsibilities as owner and director of the company for them, he would be in breach of his duty as a director under CA 2006, s 174(2)(a). That breach of his duty put the company in breach of the health and safety obligations for which the company was absolutely liable. But the claimant was himself alone to blame for the breach by the company of its absolute duty and the case did therefore fall within the *Ginty/Kodak* defence.

The court noted that, as a general rule, the remedy for breach of a director's duty of care was compensation for the harm caused to the company by the director's negligence. Here the damages payable by the director to the company for breach of CA 2006, s 174, would have been the same, which the injured director/claimant would in principle have been able to recover from the company. There was no reason for protecting a director in this situation where he was the only person who had been able to act on behalf of the company. Beatson LJ did say, however, that the position would be different in a case where the director was not in breach of s 174 and, whether a director is in breach of s 174, he noted, was an intensely fact specific question. On the facts here, however, there was a clear breach of s 174 and the director's claim against the company should be dismissed: *Brumeder v Motornet Services and Repairs Ltd* [2013] EWCA Civ 195, [2013] All ER (D) 159 (Mar), CA.

Note: see comment above on the ERRA 2013 which amends the position for the future by reversing the present position on civil liability, with the effect that, unless any exceptions apply, it will only be possible to claim for compensation in relation to breaches of affected health and safety legislation (such as that involved in this case) where it can be proved that the duty holder (usually the employer) has been negligent.

Consent solicitation and payments

Validity under English law

The Court of Appeal has dismissed an appeal from the High Court decision in *Azevedo v Imcopa Importacao, Exportaacao e Industria de Oleos Ltd* [2012] EWHC 1849 (Comm), [2012] All ER (D) 33 (Aug) where Hamblen J had held that payments offered in exchange for votes on a restructuring of bondholders rights – consent solicitation and consent payments – did not constitute bribery and were permissible.

Giving the unanimous verdict of the Court of Appeal, Lloyd LJ concluded that it is not inconsistent with English company law, or with the documents governing the notes in the present case, for the issuer to offer a consent payment to noteholders who vote in favour of a resolution proposed for their consideration as a class, where the payment is available to all members of the class, and provided that the basis of the payment is made clear in the documents relating to the resolution, the meeting and the vote, as was the case here. The payment was available to all noteholders, conditional only on their doing that which was within their power, namely exercising their right to vote in a particular way.

Lloyd LJ noted that it was inappropriate to speak of bribery in this context where all the details of the scheme are fully disclosed to all members of the class. He further stated (at para [69]):

> '… I see nothing wrong in principle with the idea that a company, which has taken the view that a particular course of action is in its best interests and in those of its creditors and shareholders, but which requires favourable votes from one or more classes, should take part in the process which leads to the relevant resolution being put to the necessary vote. It seems to me that it would be extraordinary to suggest that the company cannot take part in the process. Indeed, in practical terms, it must do so. The only issue is whether it is allowed to strengthen its urging and encouragement in favour of a vote by offering an incentive. For my part I find no objection to that in principle under English law, so long as all is open and above board'.

While the judgment is in respect of noteholders in the context of a financial restructuring proposal, its endorsement of consent payments will be important in a range of situations where creditor or member consent is required: *Azevedo v Imcopa Importacao, Exportcao e Industria de Oleos Ltd* [2013] EWCA Civ 364; [2013] All ER (D) 189 (Apr).

Insolvency – winding up

Proof of contingent claims – valuation – setting aside reserve

A company had gone into a members' voluntary liquidation at a time when potential liabilities regarding tax indemnities given by the company on the sale of certain other entities had not been crystallised or quantified. The liquidators indicated that they proposed to make a final distribution to creditors and required them to prove their debts.

The applicants, beneficiaries of the tax indemnities, sought a declaration that the liquidators should be required to retain and ring-fence the maximum value of the contingent claims and that this sum should not become available for distribution until either the contingent claims were crystallised or the date at which the indemnities would lapse occurred (it was a year away).

The Court of Appeal, dismissing an appeal, refused the application. A liquidator is not obliged to set aside a reserve fund to meet contingent claims in full. Contingent claims of creditors fall to be satisfied through the

valuation of their claims under Insolvency Rules 1986, r 4.86. There might be cases where a contingent debt was so imminent that the liquidator could sensibly wait for the event to occur rather than spending time in a valuation of the chances of the claim ultimately materialising, but otherwise a liquidator was entitled to go ahead and value a contingent claim as the rules envisaged. Once any appeal against valuation was disposed of, the liquidator was free to distribute the assets on the basis of the debts admitted to proof.

As to the issue of valuation, there was no legal duty on a liquidator to assume a worst-case scenario in favour of the contingent creditor. To do so would produce a valuation which, by definition, was unfair to the company and its other creditors and members. Any valuation of a contingent liability had to be based on a genuine and fair assessment of the chances of the liability occurring. The very concept of valuing a contingency implied the need to make an assessment of how likely were the chances of the event occurring.

In the instant case, the liquidators had made a realistic estimate of the likelihood of the tax liabilities arising and they were not required to simply wait and see. Accordingly, there had been no error by the liquidators in their approach to the valuation of the applicants' contingent claims and the application for a declaration for the creation of a reserve was refused: *Ricoh Europe Holdings BV v Spratt, Re Danka Business Systems plc* [2013] EWCA Civ 92, [2013] All ER (D) 217 (Feb).

Insolvency

'Assistance' to Jersey court

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 recoup a £6m loan to the company which was now in serious financial difficulty. 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.

As part of an arrangement for the sale of the company's properties, it was considered that the company should be placed in some insolvency procedure, but no form of Jersey insolvency procedure 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 it by appointing administrators to the Jersey company, something which is relatively common practice.

However, the High Court in this instance, declined to make the appointments. The court noted that IA 1986, s 426(4) presupposed a request and three elements: (i) a UK court exercising insolvency jurisdiction; (ii) a foreign court exercising a similar jurisdiction; and (iii) assistance of the latter by the former.

The problem in the instant case was that it was not possible to see how the Jersey court was assisted. The English court was not empowered to act merely because a foreign court invited it to do so. The foreign court had to be

an insolvency court, as the Jersey court was, and the English court had to be invited to 'assist' it. That required that the foreign court be assisted in its functions as an insolvency court. That in turn presupposed that the foreign court was doing something, or perhaps planning to do something, which the English court could, and was invited to assist.

In the instant case, there was no Jersey insolvency proceeding on foot, and no apparent intention on the part of anyone to start one. The English court was not, on analysis, being asked to assist the Jersey court in any endeavour. The application for the appointment of administrators was refused: *HSBC Bank v Tambrook Jersey Ltd* [2013] EWHC 866 (Ch), [2013] All ER (D) 116 (Apr).

Business sale agreement

Vendors' position as non-executive directors post-sale

Under the terms of sale of an estate agency business, a clause provided that until all of the purchase money was paid, the vendors 'shall remain as directors of the company in a non-executive capacity unless otherwise agreed and/or requested by the purchaser'.

At issue was whether, under this clause, a request by the purchaser terminated the position of the vendors as non-executive directors or whether a request merely terminated the obligation of the vendors to remain as directors without detracting from their option to remain, if they wished.

The Court of Appeal was critical of the drafting of this clause (and other aspects of the drafting of the sale agreement) with Mummery LJ noting that 'and/or' in this case made no sense and could only mean 'or'.

Given the imperfect drafting, all three judges were conscious that they had to construe the agreement the parties had entered into and not construct another legal agreement that eliminated the problems with the actual agreement. With a certain measure of reluctance, therefore, they allowed an appeal and ruled that the wording must mean that, on a request from the purchasers, the vendors were removed from office, a conclusion consistent with the structure and language of the clause.

Finally, it is worth noting Mummery LJ's comments that 'the use of the expression "and/or" in any legal document is in any case open to … fundamental objections of inaccuracy, obscurity, uncertainty, or even as being just plain meaningless' (citing Sir Robert Megarry on the point). See *Bonham-Carter v Situ Ventures Ltd* [2013] EWCA Civ 47, [2013] All ER (D) 110 (Feb).

Disqualification for unfitness

Whether a de facto or shadow director

In a disqualification case involving an alleged director of a company which ran an unlawful land bank business and which had collapsed owing £70m, the court had the opportunity to consider the criteria to be applied in deciding whether someone is a de facto or shadow director.

A de facto director has to presume to act as if he were a director. He has to be or have been in point of fact part of the corporate governing structure and has to participate in directing the affairs of the company in relation to the acts or conduct complained of. He has to be either the sole person directing the affairs of the company or a substantial or predominant influence and force in so doing as regards the matters of which complaint is made. Influence is not otherwise likely to be sufficient. The indicia is whether the person concerned has undertaken acts or functions such as to suggest that his remit to act in relation to the management of the company is the same as if he were a de jure director.

Hildyard J noted that it was settled law that the differences between de facto directors and shadow directors might have been overstated in previous authority. It was clear that (i) the same sort of evidential indicia were likely to be relevant to establishing both shadow and de facto directorship, and (ii) a person might act as both, the one in fact shading into the other. Even so, it might still be necessary to distinguish between the two categories in determining the extent of their culpability.

As to the appropriate label for the individual in this case, the court thought both were appropriate, since his involvement and influence were consistent, but the manner of its exercise was changeable. He was directly involved in financial decisions, including with respect to loans and dividends, and in those areas (at least) properly characterised as having acted as a *de facto* director (albeit that he was not held out as such). In other areas of the company's activities, he was the person capable of and, where he chose, in fact ultimately exercising, real and probably decisive influence in the management of the company in the relevant period, albeit from afar, and to some extent in and from the shadows. In other words, Hildyard J said, this is a case where the defendant's influence was sometimes express and direct, sometimes indirect or implicit; but it was pervasive. It demonstrated his involvement as a de facto or shadow director, and he was therefore a director for the purposes of the Company Directors Disqualification Act 1986, s 6.

As to disqualification for unfitness under s 6, the defendant's conduct, both in respect of the individual allegations (that he had used the company as a personal bank involving unsecured loans to him and improper dividend payments) and in the round (the unlawful business), constituted a sufficient departure from the standards to be expected of him to make him unfit to be concerned in the management of a company. The appropriate period of disqualification was 12 years: *Re UKLI Ltd, Secretary of State for Business, Innovation and Skills v Chohan* [2013] EWHC 680 (Ch), [2013] All ER (D) 253 (Mar).

Insolvency

Letter of comfort by parent company

The High Court considered the nature of letters of support by a parent company in a recent case where a sub-contractor of a subsidiary company

tried, following the insolvency of the subsidiary, to claim that the parent company's letters gave rise to obligations in law which were binding on the parent company.

On the facts, the court held that the letters of support had not subjected the parent company to any enforceable obligation. Instead, the letters had been intended to do no more than provide the directors of the subsidiary with evidence from which they could properly conclude, as they evidently had, that it had been proper for the subsidiary's accounts to be prepared on a going concern basis, and no more.

That this was the position was evident from, inter alia, the fact that the letters were addressed deliberately to the board of directors and not to the company; that they were provided in the course of the preparation of the company's year end financial statements; that the letters did not even purport to be a contract with the company and that there was no indication in the letters of what the consideration was (if any) passing from the company in return for the financial support. It would be extravagant, the court said, to read brief letters as a contractual undertaking to discharge what were huge liabilities on the part of the company. It was improbable that the parent company would have undertaken so extensive and open-ended an obligation in so summary a manner: *Re Simon Carves Ltd, Carillon Construction Ltd v Hussain* [2013] EWHC 685 (Ch), [2013] All ER (D) 304 (Mar).

Company agents

Actual and apparent authority

Company B was hired by A to carry out some building work for him. C was the manager of B, but he was not a director or shareholder. C was also the godson of A. The total cost of the building work was expected to be around £200,000 and A made payments on account as the work progressed. At C's request, A paid about £155,000 to C's wife and to a company run by C. Company B subsequently sought payment from A for the work done, claiming it had not been paid.

The issue was whether the payments made by A to C were to be treated as payments made to Company B in respect of the building work, on the basis that, while C had no actual authority to receive payments, he had apparent authority to do so.

The court concluded that there was no apparent authority. A had made the payments to C because of his personal relationship with C, he had not been induced to do so by any representation by Company B of C's authority. There had been a representation by Company B that C had authority to deal with financial matters, by making him manager, but on the evidence A did not rely on that representation.

It would not be within the usual authority of a manager to ask a customer to pay a third party, but if properly explained, it might be, as where a payment directly to a third party might expedite the delivery of materials or such like, but A had sought no explanation. An unexplained request for money owed to

a company to be paid to the wife of the company manager and to an unconnected business carried on by the manager were plainly outside the usual authority of someone in the manager's position and therefore not within his apparent authority.

The payments by A did not discharge any liability he had for the work carried out by Company B save to the extent, if any, that the payments were passed on by C: *Acute Property Developments Ltd v Andrew Apostolou* [2013] EWHC 200 (Ch), [2013] All ER (D) 231 (Feb).

Access to the register of members

Proper and improper purposes

For the first time, it seems, the courts have had an opportunity to consider the new provisions in the CA 2006, ss 116 and 117, governing access to the register of members. These provisions allow a company, faced with an application to inspect the register of members, to apply to the court for an order that access be refused on the basis that it is being sought for an improper purpose.

The application in this case was made by a shareholder in respect of two companies which were under the control of two families – the shareholder was a member of one of the families. The shareholder sought access in order that he might write to the shareholders of each company to outline his concerns about past conduct of the directors (a matter which he had been pursuing intermittently for a decade or so), about proposed changes to the articles governing share valuation and to invite shareholders to join a group to obtain expert advice on matters arising in the future.

Registrar Baister concluded that the way in which the CA 2006 provisions are framed justify the proposition that the burden is on the company to justify why access should be refused and the power to direct non-compliance with a request for access should be exercised sparingly and with circumspection.

However, a defendant who wants his concerns to be taken seriously ought to provide some material to enable the company and the court to form some view about the seriousness and/or bona fides of the concerns giving rise to the request for access to the register.

The words 'proper purpose' should be given their ordinary, natural meaning. The statute gives the court an unfettered discretion to decide what is a proper or improper purpose, but in the exercise of that discretion, the court must balance the right of members and the public to access information in order to identify and communicate with shareholders against the need to protect shareholders from those who seek to use information for improper purposes, for example simply to harangue shareholders.

A proper purpose ought generally, in the case of a member, to relate to the member's interests in that capacity and to the exercise of shareholder rights. Where access to the register is sought for a mixture of proper and improper purposes, a proper purpose is not necessarily tainted by being coupled to an improper purpose.

On the facts, the allegations regarding the conduct of the directors were more than 12 years old (the companies had sought to address them but not to the applicant's satisfaction) and there was an issue of delay (there had been long intervals of silence from the applicant) and the court had grounds for believing that he was part of a private family dispute with which the shareholders should not be troubled. The part of the request relating to the past conduct of the boards was for an improper purpose as was the request with respect to matters arising in the future which the court thought could be a cloak for mischief.

Access for the purpose of considering the share valuation provisions in the articles was a proper purpose, however, but in the circumstances direct access by the applicant would not be allowed. Instead a letter would be sent to the shareholders drafted by the applicant's solicitors and approved by the companies' solicitors or the court with responses forwarded via the companies to the applicant or his solicitors and with the shareholders' personal details omitted unless they expressly consented to their inclusion: *Re Burry & Knight Ltd*, 13 February 2013, Ch D, Registrar Baister.

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

© Reed Elsevier (UK) Ltd 2013
Published by LexisNexis (www.lexisnexis.co.uk)

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

ISBN 978-1-4057-7441-3