Butterworths Corporate Law Update

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RECENT DEVELOPMENTS

BIS Guidance on Share Buy Back changes

Purchases out of capital

As noted in Corporate Update 158, the Government made amendments to the rules governing share buy backs with effect from 30 April 2013. The amendments were effected by the Companies Act 2006 (Amendment of Part 18) Regulations 2013, SI 2013/999.

The Regulations were primarily deregulatory and focused on private companies with a particular concern to reduce the burdens with respect to purchases in connection with an employees' share scheme.

Since the Regulations came into force, BIS says that it has received feedback with respect to certain issues which may need amending in the Regulations and therefore the Government proposes to consult on further minor changes to:

- clarify the operation of the de minimis exception whereby private companies may buy back small amounts of shares out of share capital, with cash, if there is authorisation to do so in the articles (CA 2006, s 692(1)(b)); and
- simplify further the reduced requirements which since April 2013 apply to a purchase back out of capital for the purpose of or pursuant to an employees' share scheme (CA 2006, s 720A).

Pending further changes, BIS has published a Guide to the 2013 Regulations which explains the Government's intentions and view of how the Regulations should be interpreted: see BIS, *Employee Ownership & Share Buy Backs, A Simple Guide to the Companies Act 2006* (*Amendment of Part 18*) *Regulations 2013* (November 2013), BIS/13/1277. The full text of the Guidance is available at www.gov.uk/government/publications/employee-ownership-and-share-buy-backs-guide-to-companies-act-regulations.

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Risk Management, Internal Control and Going Concern

FRC consults

The Financial Reporting Council (FRC) has issued a Consultation Paper addressing a variety of matters relating to risk management, internal control, and going concern issues.

The paper arises from a need to implement the recommendations of the Sharman Inquiry (see Update 153), to update the FRC's own guidance on internal control (commonly known as the Turnbull Guidance, last issued in 2005) and to make associated revisions to the UK Corporate Governance Code which will be reissued in 2014.

The FRC considers that the key conclusions of the Sharman Inquiry and work by the FRC on risk include that boards must determine the desired risk culture within the company, and must incorporate risk management and internal control within the company's normal management and governance processes, rather than treat it as a separate compliance exercise. They must make a robust assessment of the principal risks to the company's business model and agree on how those risks will be managed and mitigated, on an ongoing basis.

Those board processes should then inform a number of different disclosures in the annual report: the description of the principal risks and uncertainties facing the company in the strategic report; the disclosures in the financial statements on the going concern basis of accounting and material uncertainties thereto; and the report required by the UK Corporate Governance Code on the review of the risk management and internal control systems.

To assist boards in considering risk identification and management, including making an assessment of solvency and liquidity risks, and determining whether the company is able to adopt the going concern basis of accounting, the FRC has decided to bring together its guidance on all of these matters in one place – with one version for companies applying the UK Corporate Governance Code (the subject of the current consultation) and a simpler version for other companies (a consultation on which will follow in due course).

The Sharman Report identified two uses for the phrase 'going concern', one relating to the objectives of narrative reporting about solvency and liquidity risks and the other being the going concern basis of accounting. The FRC acknowledges, however, that to use the term in the first sense risks confusion, given that the term in the second sense has a very particular meaning in accounting and auditing standards and is widely used internationally in that context.

Therefore, the FRC has decided to use the term 'going concern' only in the accounting context and otherwise to talk of an assessment of solvency and liquidity risks and the terminology will be used in that way in the proposed Guidance. In keeping with this approach, the proposal is that the UK Corporate Governance Code be amended to establish a clear link between the disclosures a company makes on its principal risks in the strategic report and those it makes on its going concern status in the financial statements, while clarifying the distinction between the two.

See FRC, *Risk Management, Internal Control and the Going Concern Basis of Accounting*, Consultation Paper, November 2013, available at www.frc.org.uk/Our-Work/Publications/FRC-Board/Consultation-Paper-Risk-Management,-Internal-Contr.aspx.

Proposed amendments to FRSSE

FRC issues Exposure Draft for consultation

The FRC has issued an Exposure Draft (FRED 52) that sets out proposals to amend the Financial Reporting Standard for Smaller Entities (FRSSE) to reflect the enactment of the Small Companies (Micro-Entities' Accounts) Regulations 2013 (SI 2013 No 3008) (see further under *Statutory Instruments* below).

The amendments will enable micro-entities that take advantage of the new provisions, which permit reduced disclosure, to continue to apply the accounting principles of the FRSSE.

See FRC, *FRED 52 Draft Amendments to the Financial Reporting Standard for Smaller Entities* (*effective April 2008*), available at www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRED-52-Draft-Amendments-to-the-Financial-Reportin.aspx. The comment period ends on 12 February 2014.

Regulation of crowdfunding

FCA consultation

The FCA has issued a consultation paper on crowdfunding which it defines as 'a way in which people, organisations and businesses (including business startups) can raise money through online portals (crowdfunding platforms) to finance or re-finance their activities and enterprises'.

The background to the consultation is that the regulation of the consumer credit market will transfer from the Office of Fair Trading (OFT) to the Financial Conduct Authority (FCA) on 1 April 2014 and this consultation paper is part of a series of papers which will determine the FCA's approach to the regulation of consumer credit activities.

The paper notes that crowdfunding already falls within the scope of regulation by the FCA if it involves a person carrying on a regulated activity in the UK, such as arranging deals in investments, or the communication of a financial promotion. Where a crowdfunding platform enables a business to raise money by arranging the sale of unlisted equity or debt securities, or units in an unregulated collective investment scheme, this is 'investment-based crowdfunding' regulated by the FCA and the firm operating the crowdfunding platform needs to be authorised. But the FCA does not currently regulate firms running loan-based crowdfunding (also known as peer-to-peer lending platforms).

For loan-based crowdfunding, the proposal is to rely primarily on a disclosure-based regime to ensure that investors have the information they need to be able to make informed investment decisions and that all communications are fair, clear and not misleading, but also to subject firms involved in this area to a set of core requirements (conduct of business rules, client money protection rules etc).

For investment-based crowdfunding, the aim is to make this market more accessible to retail clients, but also to ensure that only investors who can understand and bear the risks participate in the market. The proposal is to restrict the direct offer financial promotion of unlisted shares or debt securities by firms to certain types of retail clients (i.e. sophisticated investors or high net worth investors, etc).

The full text of the FCA Consultation Paper, CP13/13, *The FCA's regulatory approach to crowdfunding* (*and similar activities*) is available at www.fca.org.uk/news/cp13-13-regulatory-approach-to-crowdfunding.

Listed companies

FCA responds and consults on enhancing the Listing Regime

The FCA has published its much-awaited response to CP12/25, *Enhancing the Effectiveness of the Listing Regime* (October 2012) which considered a variety of issues with regard to the protection of minority shareholders and the strengthening of the Listing Regime (see Update 155). As the FCA notes, the discussion was initiated as a result of concerns about the governance of premium listed companies with a controlling shareholder.

The FCA intends now to proceed with Listing Rule changes which will introduce the following protections for minority shareholders:

- placing requirements on the interaction between a premium listed company and a controlling shareholder (i.e. someone who alone or in concert controls the exercise of at least 30% of the voting rights of a company), where one exists, via a mandatory, documented, relationship 'agreement' which would regulate the relationship between the company and the shareholder to ensure the independent operation of the company;
- providing additional voting power for minority shareholders when electing independent directors where a controlling shareholder is present by requiring that their election must be separately approved both by the shareholders as a whole and the independent shareholders as a separate class.
- enhancing voting power for the minority shareholders where a company with a controlling shareholder wishes to cancel its premium listing. In such circumstances, cancellation would require the approval of a majority of votes of independent shareholders in addition to 75% approval of all shareholders.

The FCA has decided not to increase the current requirement for 25% of shares to be distributed to the public, the so-called free float requirement. An additional Listing Principle will be introduced requiring that each share within a premium listed class should have equal voting power and that, where there are multiple classes, the voting rights of each class should be broadly proportionate to the relative interests of those classes in the equity of the company. There will also be additional disclosure requirements, for example, companies will be required to announce smaller related party transactions as soon as possible.

The full text of CP13/15, FCA, *Feedback on CP12/25: Enhancing the effectiveness of the Listing regime and further consultation* (November 2013) is available at www.fca.org.uk/news/cp13-15-enhancing-the-effectiveness-of-the-listing-regime.

Shareholder Engagement — Investor Forum to be established

Initiative arising from Kay review

One of the recommendations of the Kay Review (see Update 154) was that an investor forum should be created to facilitate collective engagement by investors in UK companies. A Collective Engagement Working Group was established in April 2013 supported by the ABI, IMA and NAPF. The Working Group has now published its recommendations which support the creation of a new Investor Forum for Collective Engagement to be operational by June 2014 and which will:

- ensure the opportunity for inclusion and participation of the broadest possible range of institutional investors (especially international asset owners and asset managers and sovereign wealth funds);
- operate Engagement Action Groups to maximise strength of voice and achieve positive results where there are shared concerns about a particular company;
- drive cultural change and promote the commitment of more resource to long-term stewardship and engagement by institutional investors.

Another recommendation of the Working Group is that major listed companies should hold an annual strategy meeting for institutional investors, outside the results cycle, where investors and company executives can link governance to the company's long-term strategy without the focus on short-term results. The full report of the Working Group can be found at www.investmentfunds.org.uk/press-centre/2013/press-release-2013-12-03/.

Statutory instruments

SI 2013 No 3008, the Small Companies (Micro-Entities' Accounts) Regulations 2013

These Regulations introduce an exemption from certain financial reporting requirements for very small companies (micro-entities) preparing Companies

Act individual accounts. The Department for Business, Innovation and Skills estimates that as many as 1.5m companies in the UK are micro-entities. The Micros-Exemption forms part of Directive 2013/34/EU (the 'New Accounting Directive') which repeals Council Directives 78/660/EEC and 83/349/EEC (the Accounting Directives) which have provided the accounting framework for companies for more than thirty years. The 2013 Regulations implement a part of the New Accounting Directive which deals with micro-entities.

The new Accounting Directive must be implemented by the Member States by 20 July 2015, but the Member State may provide that the new accounting provisions apply first to financial statements for financial years beginning on 1 January 2016 or during the calendar year 2016.

These initial Regulations have effect in respect of—

(a) financial years ending on or after 30 September 2013; and

(b) companies which deliver the accounts required by CA 2006, s 444 (filing obligations of companies subject to the small companies regime) to the registrar on or after the date on which these Regulations come into force.

The Regulations apply only to companies formed and registered under the CA 2006, or companies treated as so formed and registered. A new CA 2006, s 384A, inserted by the Regulations, prescribes the thresholds relevant to qualification as a micro-entity. The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements—

(1) *turnover*: not more than £632,000;

(2) *balance sheet total*: not more than £316,000;

(3) *number of employees*: not more than 10.

CA 2006, s 393 is amended to identify, in the case of micro-entities, relevant considerations for company directors, when deciding whether to approve accounts on the basis that they give a true and fair view of the financial position of the company; equivalent amendments are made regarding the auditors and the contents of the auditors' report. CA 2006, s 396, is amended to introduce a presumption that micro-entities' accounts which comply with certain minimum requirements give a true and fair view.

CA 2006, s 472 is amended to provide that the minimum prescribed notes to the accounts for micro-entities must appear in the balance sheet and not in a separate document. Micro-entities are exempt from the obligation to draw up notes to the accounts other than the prescribed minimum notes.

CASES

Duty of care

Solicitors' advice to remuneration committee

The decision of Proudman J in *Newcastle International Airport Ltd v Eversheds* was considered in Update 155. In a wide ranging judgment, Proudman J considered the role of the remuneration committee and, especially, of the chair of that committee in approving executive service contracts and the extent to which the relevant executives (whose contracts were being changed) had authority to instruct the company's solicitors to draw up those contracts.

On appeal, the Court of Appeal has agreed in general with Proudman J's analysis of the standard of care to be expected of the remuneration committee (RC) and its chair. It also concluded, however, that the solicitors, while entitled to rely on the actual and apparent authority of the executives to instruct them as to the drafting of the contracts, were in breach of their duty to their client, the company, in not providing, at the conclusion of the drafting process, a document outlining the key changes in the executive contracts. Such a document would have enabled the chair and the RC to have a comprehensive understanding of the new contracts before deciding whether they wished to commit the company to them.

Rimer LJ acknowledged that the solicitors gave evidence that in practice, although the company is the client, instructions as to the terms of executive contracts invariably come from the executive directors, subject albeit to review by the company's RC before sign off.

But Rimer LJ questioned the absence of advice to the RC in such circumstances and noted that, while advice to instructing executives can be treated as advice to the company in many circumstances, that cannot be the case where the instructions to the solicitors are being given by the counterparties to the contract.

In the circumstances of this case, once the draft contracts were ready, the solicitors should have ensured that a memorandum summarising and explaining the changes made to the contracts was provided to the chair of the RC. The failure to do so put the solicitors in breach of their duty of care to their client, the company.

The court accepted the trial judge's findings, however, that the chair of the RC often did not read documents or misread or misunderstood them and so, even if the solicitors had produced the required memorandum of explanation, the contracts would still have been signed by her. The breach of duty by the solicitors was not causative of substantial loss, therefore, and nominal damages of £2 were awarded to the company: *Newcastle International Airport Ltd v Eversheds LLP* [2013] EWCA Civ 1514, [2013] All ER (D) 328 (Nov).

Fraudulent trading

Dishonesty and the two limbs of CA 2006, s 993

Two individuals (H and B) appealed against their conviction for fraudulent trading arising from a sale of insurance businesses owned by H to companies controlled by B who previously worked in the businesses with H. The sale was for the purpose of hiding the involvement of H in the businesses as H had been the subject of an earlier DTI investigation. The companies later collapsed into administration and required the intervention of the Financial Services Authority.

The appeal was on the basis of errors in the judge's summing up, so the case offered the Court of Appeal (Criminal Division) an opportunity to review the two limbs of CA 1985, s 458, now CA 2006, s 993, which provides that 'if any business of a company is carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, every person who is knowingly a party to the carrying on of the business in that manner commits an offence'.

The prosecution case with respect to the sale of the businesses was that the case fell within the second limb of fraudulent trading with B and H being parties to the carrying on of business 'for any fraudulent purpose'.

Macur LJ, giving the judgment of the court, held that if the jury were sure that the sale had been a sham, then they were entitled to infer that the machinations behind the false trail of sales agreement was for a fraudulent purpose. If the jury were sure that the sale was genuine but, nevertheless, H was effectively pulling B's strings whilst publicly and falsely renouncing control, they were entitled to infer fraudulent purpose subject to being sure that such actions were 'beyond the bounds of what ordinary decent people engaged in business would regard as honest'.

The second limb of the fraudulent trading provision does not necessarily incorporate intent to deceive or actual deception of creditors. Concealment of ownership to obtain business advantage that would otherwise be denied is sufficient if the jury were sure of dishonest intent.

Dishonesty is an essential ingredient of the offence of fraudulent trading, whether first limb (intent to defraud creditors) or second limb (any fraudulent purpose). The court considered that it is impossible to abstract the notion of dishonesty from the adjective 'fraudulent' but, in relation to the second limb, there must be more than dishonesty per se, that is, there also has to be a 'purpose' for the dishonesty.

The Court of Appeal considered that the trial judge's summing up had been in these terms and the convictions were safe. The appeal was rejected: *R v Hollier, R v Booth* [2013] EWCA Crim 2041.

Winding up

Insolvent though creditors with limited recourse

The directors of a Luxembourg registered company applied for the company to be wound up, on the basis that it was just and equitable to do so. The company issued bonds and invested in life insurance policies in the US. It failed to secure a licence to operate from the Luxembourg regulator and it did not have sufficient funds to repay the bonds in full. The terms of the bond provided that bondholders could only recover sums due from available funds held by the company and could not attach assets or apply for a winding up order.

David Richards J ruled that, as all decisions which governed the administration and management of the company were taken in London, a fact that was clear to all third parties with whom the company dealt, the presumption in the EC Insolvency Regulation 1346/2000 that a company's centre of main interests lay where the company was registered was rebutted.

If it was necessary for the purposes of the Regulation to show that the company was insolvent, this company was, as a matter of ordinary language insolvent, as the company's liabilities on the bonds exceeded the assets available to it, even if the rights of creditors were restricted to the available assets.

While the power to wind up a company on the just and equitable ground was normally invoked in the case of disputes between shareholders, it was not limited to those circumstances. It was appropriate to appoint a provisional liquidator pending the hearing of the petition, as a provisional liquidator would be better placed than the existing directors to propose a CVA or scheme of arrangement for the orderly realisation of the company's assets: *Re ARM Asset Backed Securities SA* [2013] EWHC 3351 (Ch), [2013] All ER (D) 107 (Nov).

Authority of de facto managing director

Whether transactions in best interests of company

Loans of £2.62m had been made to a football club which involved a breach of football regulations which could have resulted in severe consequences for the football club. When the lender sought repayment, the club, a company, argued that the then owner who had acted as the de facto managing director had had no actual or apparent authority to enter into the loan agreements and that the lender's agent must have known that the loans were in breach of the football regulations and therefore that they could not be in the best interests of the club, given the potential consequences.

The court held that the club had vested the de facto managing director with authority to enter into these transactions. The transactions were relatively conventional dealings in a footballing context — the funding was to complete work on a stand at the club's ground, there was nothing to suggest to the lender's agent that the transaction was secret or that the funds would not be used for the club's purposes. There was no personal gain by the de facto managing director from the transactions. It was well known that 'in professional football business affairs are often informal and rumbustious'. The decision not to notify the Football League of the transactions in breach of the regulations was taken after the transactions had taken place.

An issue also considered was the presumption of due execution of a document in favour of a purchaser in good faith for valuable consideration in CA 2006, s 44(5). The question is the conduct which renders a purchaser not in good faith.

The court favoured setting a threshold of whether the purchaser's belief in the authority of the company's agent would have been dishonest or irrational, relying on dictum by Lord Neuberger to that effect in *Thankaharn v Akai Holdings Ltd* [2010] HKCFA 64, at [62]. Lord Neuberger was addressing the matter in the different context of reliance on apparent authority at common law, but counsel submitted and the court agreed that the position should not differ as between the common law and the statutory presumption in CA 2006, s 44(5). It should be said that the higher English courts have yet to comment definitively on the approach taken by Lord Neuberger.

Finally, the court noted that it is open to a company to delegate wide ranging authority to a managing director but it then has to take the consequences of doing so. On the facts, the club was liable to repay the money: *LNOC Ltd v Watford AFC Ltd* [2013] EWHC 3615 (Comm), [2013] All ER (D) 263 (Nov).

Winding up on just and equitable ground

Alternative remedy available

In a dispute between two shareholder/directors whose personal and then business relationship had broken down, the court found that there was no basis for relief on the grounds of unfairly prejudicial conduct (CA 2006, s 994) as the petitioner had not been locked into the company, rather the respondent had made various payments to her and offered to buy out her remaining minor financial interest in the company, an offer which she had not taken up. She did not then cross the threshold for relief under CA 2006, s 994.

On the other hand, the company was in deadlock and the personal relationship out of which the company had sprung and on the basis of which it had operated had dissolved. The petitioner would be entitled to relief by the winding up of the company on the just and equitable ground in the absence of any other remedy (IA 1986, s 125(2)). However, there was another remedy available to her which was to seek repayment of the small sum outstanding to her in the directors' loan account. On the payment of such an amount to her (the court calculated it at roughly £10,000), she would be bound to transfer her share in the company to the respondent and the company would not be wound up.

The court accepted that there was a degree of approximation in the calculation but, Norris J said, 'I have seen my task as providing a just outcome according to law by the application of resources appropriate to the dispute. Further refinement would come at a cost that would be ruinous to the parties (who have probably devoted to this case more than it is worth). Those who present petitions of this sort for companies like [this] must understand that that is likely to be the approach adopted: and would be wise to adopt the same approach in settlement negotiations': *Maresca v Brookfield Development and Construction Ltd* [2013] EWHC 315, [2013] All ER (D) 240 (Oct).

Scheme of arrangement

Whether foreign company had sufficient connection with this jurisdiction

Foreign companies continue to seek to use the flexibility of UK schemes of arrangements to restructure their businesses when faced with mounting financial difficulties.

In this case, the company was registered in the Netherlands, it was a member of a group of companies of which the main operating company was a Hungarian company, the ultimate parent of the group was based in Guernsey and managed from London, the creditors were noteholders whose notes were governed by New York law. The question was whether the English courts would consider it appropriate to sanction a scheme of arrangement in such circumstances.

David Richards J ruled that first the court has to be satisfied that the company proposing the scheme is a 'company' for the purposes of CA 2006, Part 26 (schemes of arrangement). The company in this case satisfied the requirements which are merely that the 'company' should be liable to be wound up under the IA 1986, s 895(2). A foreign-incorporated company is so liable, even if its circumstances at the time of the application to the court are such that the English court would not at that time exercise its jurisdiction to wind up the company, provided a sufficient connection with England was shown.

In addition to ensuring that the company is a 'company' for these purposes and before the court sanctions a scheme, it also requires to be satisfied that the scheme will achieve its purpose. David Richards J stated that he considered that the requirement to show a connection with England and the need to show that the scheme, if approved, would have substantial effect are closely related questions. He said serious issues arose as to whether the court would consider it appropriate to sanction the scheme, given that the company was registered in the Netherlands and the notes were governed by New York law and the scheme would affect the rights enjoyed by the noteholders under New York law.

However, the evidence established that the company had moved its centre of main interests (COMI) to England. The significance of this move, the court said, was not so much in the establishment of a connection between the company and England, but as any insolvency process affecting the company would be undertaken under English law in England, as providing a solid basis for a scheme under English law which altered contractual rights governed by a foreign law. The evidence was that the US courts would, under Chapter 15 of the US Bankruptcy Code which gives effect to the UNCITRAL Model Law on Cross-Border Insolvency, recognise and give effect to the scheme, notwithstanding that it alters and replaces rights governed by New York law.

On the basis of the evidence that there was a sufficient connection with England and the scheme would substantially achieve its purpose, the court could and would sanction the scheme.

Finally, David Richards J noted that, while entirely satisfied with the reports provided to the court on US and Hungarian law, they had been provided by overseas offices of the lawyers acting for the company. He considered that the important feature of independence would be enhanced if such reports were provided by experts unconnected with law firms professionally engaged in the scheme: *Re Magyar Telecom BV* [2013] EWHC 3800 (Ch), [2013] All ER (D) 20 (Dec).

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