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Butterworths Corporate Law Update

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

RECENT DEVELOPMENTS

Reporting by extractive industries

Payments to Governments to be reported to Companies House

The Government has published its response to a consultation on the early adoption of provisions in the new Accounting Directive (2013/34/EU) which will require large undertakings involved in extractive industries to report annually on payments made to Governments.

The Accounting Directive must be implemented by Member States by July 2015 and reports by extractive industries are required for financial years beginning 1 January 2016, but the UK intends to bring this measure into effective for financial years beginning on or after 1 January 2015.

The intention is to proceed as follows:

- Large UK companies which are admitted to trading on a regulated market and which are mining or quarrying or logging undertakings will be required to complete reports on payments (including taxes, licence fees and royalties, whether in money or kind, subject to a de minimis of £86,000) to governments (covering national, regional or local authorities) covering financial years beginning on or after 1 January 2015.
- A large undertaking for these purposes means an undertaking (including companies and LLPs) that meets at least two of the three following criteria –

  (a) its balance sheet total on its balance sheet date exceeds £18m;

  (b) its net turnover on its balance sheet date exceeds £36m;

  (c) average number of employees during the financial year to which the balance sheet relates exceeds 250.

- This report will not be included in the annual financial statements but will be a separate electronic report which will be required to be filed with Companies House within 11 months of the end of the financial year.
- In view of the early adoption of this reporting requirement, for one year there will be a transitional arrangement for UK registered subsidiaries of parent companies registered in other EU Member States which will not be required to file payment information in the UK if they would normally report through a parent company registered in the EU.
- The penalty regime for non-compliance will be based on similar penalties already used within the Companies Act 2006 and will include criminal offences, which may be punished by unlimited fines or possible jail terms.

A draft of the proposed regulations is available at (www.gov.uk/government/uploads/system/uploads/attachment_data/file/346331/bis-14–1019-draft-statutory-instrument-reports-on-payments-to-governments-regulations-2014.pdf; the Government's Response is available at www.gov.uk/government/uploads/system/uploads/attachment_data/file/343599/bis-14–1006-eu-accounting-directive-implementation-extractive-industries-reporting-response.pdf).

Takeover Code

Consultation on Miscellaneous Amendments

The Code Committee of the Takeover Panel is consulting on miscellaneous amendments to the Takeover Code including proposals to amend the deadlines by which competing offerors must clarify their intentions; to clarify the position of bidders who make a 'no intention to bid' statement; and to provide a new Appendix to the Code setting out the auction procedure for resolving competitive situations.

Further, the consultation draw attention to a degree of confusion between the distinct roles of the independent adviser and the board of the offeree company in relation to an offer for the offeree company. The intention, therefore, is to amend the Takeover Code, Rule 3.1 so as to make it clear that the principal role of the independent adviser is to advise the board of the offeree company as to whether the financial terms of the offer are 'fair and reasonable'.

Any recommendation to offeree company shareholders as to whether they should accept or reject an offer is a matter solely for the board of the offeree company and not for the independent adviser. In forming its opinion on the offer, the board of the offeree company will take into account the offer price (though the board is not required to consider that the determining factor), the independent adviser's advice and any other factors which it considers relevant.

For the consultation document, PCP 2014/1 (16 July 2014), see www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/PCP2014–1.pdf.

Interim Management Statements

FCA consults on removing requirements

The Financial Conduct Authority (FCA) is consulting on removing the requirement for companies with shares admitted to trading on a regulated market to prepare interim management statements (IMS). The requirement for IMS originated in the Transparency Directive (2004/109/EC) which has now been amended (2013/50/EC) to remove the requirement with effect from November 2015. Removal was also supported by the Kay Review on UK Equity Markets and Long-Term Decision Making (2012). This consultation is aimed at facilitating early implementation of this change and will remove Disclosure and Transparency Rule (DTR) 4.3 in its entirety and make consequential amendments. Companies may continue to publish IMS on a voluntary basis. See FCA, 'Removing the Transparency Directive's requirement to publish interim management statements' (CP14/12, July 2014), available at www.fca.org.uk/static/documents/consultation-papers/cp14–12.pdf.

CASES

Bribes and secret commissions, again

Supreme Court rules

The Supreme Court has delivered its eagerly anticipated judgment in *FRH European Ventures v Cedar Capital* on the contentious issue of whether the recovery of bribes and secret commissions paid to a defaulting fiduciary gives rise to a personal or proprietary remedy (see previously Update 157). The 'simple answer' is the remedy is proprietary and the long-standing obstacle to that outcome, the Court of Appeal ruling in *Lister v Stubbs* (1890) 45 Ch D 1, has been overruled.

In this case, the respondent agent, who had been charged by the buyers (the claimants) with negotiating the purchase of hotel, received a €10m secret commission from the sellers of the hotel. The buyers paid €211.5m for the hotel and sought to claim the €10m. At first instance, the court held that the claim was a personal and not a proprietary claim; the Court of Appeal overruled that decision, finding that the agent had denied his clients the opportunity to acquire the hotel for €201.5m rather than €211.5m. He exploited the situation to obtain a personal benefit which he must be taken to hold on constructive trust for his principals and the claimants were entitled to a proprietary remedy.

The Supreme Court has now agreed with the Court of Appeal that the remedy in the case of secret profits and commissions made by a fiduciary is a proprietary remedy. There was no plainly right or plainly wrong answer to the nature of the liability, as a matter of pure legal authority, the court said, but considerations of practicality and principle supported the case that a bribe or secret commission accepted by an agent is held on trust for his principal. Bribes and secret commissions undermine civilised society and trust in the commercial world and one would expect the law to be particularly stringent in relation to a claim against an agent who has received a bribe or secret commission.

That the claim should be proprietary can be justified on the basis that the amount of the benefit should never have been part of the agent's estate (and so should not be available to his creditors); that the bribe or commission will have reduced the benefit to the principal of the transaction (it must be quite likely that, in the absence of the commission, the vendor here would have been prepared to sell for less than €211.5m); and it should be possible for the principal to be able to trace the proceeds of a bribe into other assets and to follow them into hands of knowing recipients. A proprietary claim was accepted in other common law jurisdictions such as Australia, New Zealand, Canada and Singapore and it was highly desirable at least to lean in favour of harmonising the development of the common law around the world.

The law took a wrong turn in *Metropolitan Bank v Heiron* (1880) 5 Ex D 319 which was followed in *Lister v Stubbs* (1890) 45 Ch D 1 and those decisions and decisions relying on either of these cases should be treated as overruled: *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45, [2014] All ER (D) 156 (Jul).

Remedies in respect of dishonest assistance

Accounting for profits

The Court of Appeal has delivered a significant ruling on liability in dishonest assistance which brings considerable clarity to the law in this area.

The facts in the case are complex and have been the subject of much other litigation as well, but the essence was that M, an agent for P, had received bribes in relation to certain ship charters which he had negotiated between P as owner of the ships and third parties, and he had shared the bribes with Nn. In contemporaneous transactions, M also negotiated charters between P and Nn at market rate (hereafter described as the commercial charters).

In these proceedings, P was attempting to recover the profits made by Nn on those commercial charters on the basis of Nn's dishonest assistance in M's continuing breaches of fiduciary duty to P. Nn and his companies had made profits of around \$109m on the commercial charters when market rates moved in their favour.

It was argued that, as the commercial charters were at market rates and in the interests of P, there could be no dishonest assistance for there was no breach of fiduciary duty in relation to these transactions.

- On this point, the Court of Appeal ruled that if an agent or employee receives a bribe which he then shares with another, he is in breach of his fiduciary duty in then negotiating other transactions with that other person for as long as he has not disclosed the matter to his principal.
- Hence M was in breach of his fiduciary duty to P in negotiating new and different contracts with Nn, with whom he was contemporaneously

sharing bribes earned under the other charters. Nn in conducting those negotiations for the commercial charters in the knowledge or belief that M had not informed P of the bribes assisted in that breach of duty and assisted dishonestly given his knowledge and receipt of the bribes.

The key question then was whether the trial judge was correct to order an account of the profits made by Nn (or his companies) on those commercial charters.

The Court of Appeal held:

- A knowing recipient or dishonest assistant has, in principle, the responsibility of an express trustee which would include, in an appropriate case, a liability to account for profits and while receipt of trust property is essential to found liability for knowing receipt since that is the gist of the action, misuse of trust property is not a prerequisite to a liability to account for profits for dishonest assistance in a breach of fiduciary duty.
- A fiduciary's liability to account for a secret profit does not depend on any notion of causation, it is sufficient that the profit falls within the scope of his duty of loyalty to the beneficiary. But Nn was not a fiduciary and was not sued for breach of fiduciary duty, he was sued because he committed an equitable wrong. In that case the common law rules of causation, remoteness and measure of damages apply by analogy so that a distinction is drawn between a breach which is the effective cause of a loss and one which is merely the occasion for the loss.
- In the court's judgment what Nn acquired as a result of his dishonest assistance (and as a result of M's breach of fiduciary duty) was the use of the vessels at the market rate. That was merely the occasion for him to make a profit. The real or effective cause of the profits he made was an unexpected change in the market rates of hire. There was then an insufficient direct causal connection between entry into the commercial charters and the resulting profits to justify an accounting for profits.
- Further, whether the court will grant an account of profits against a non-fiduciary is a matter for the court's discretion. The ordering of an account in a non-fiduciary case is not automatic and it may be withheld, for example, where it would be disproportionate in relation to the particular form and extent of wrongdoing, as would be the case here.

The appeal against an account of profits made on the commercial charters was allowed: *Novoship (UK) Ltd v Nikitin* [2014] EWCA Civ 908, [2014] All ER (D) 63 (Jul).

Valuation of company shares

Challenging a value determined by an expert valuer

Following a compromise of a dispute as to removal from employment, it was agreed that the respondent's 40% shareholding in the company would be bought by the company and the majority shareholder (R). The company was successful, but depended to a large extent on the personal contribution of R who had no contract with the company, likewise the company had no contracts with its main customers, and everything depended on trust and good working relationships. The issue was the valuation of a 40% shareholding in a company of that nature.

It had been agreed that valuation would be by Grant Thornton as expert valuers. The letter of engagement noted that valuation would be on a fair value basis, on a pro rata basis without any minority discount, and it would be assumed 'that the relationships in place on the agreed date of 30 June 2012 continue to exist for the purposes of valuation'.

Having valued the shareholding at £4.218m, the company and R sought to overturn the valuation, alleging inter alia that it should have been valued on the basis that the relationships between R and the company and the company and its customers were precarious and could end at any moment. It was also alleged that it was intended that all questions of law should be for the court to determine and on none of them was the valuer's decision to be binding.

The Court of Appeal rejected the submissions noting that:

- Questions of law are likely to pervade many of the issues which a valuer will have to decide and it is inherently unlikely that the parties intended that on none of them should the valuer's view be binding. 'Parties who refer a dispute to an expert must be taken to have recognised that mistakes may be made, both of fact and law, but they are prepared to take that risk because they place a high degree of confidence in their chosen expert'. There was nothing in the letter of engagement which suggested that the parties intended that the court should exercise such a degree of control over the performance of the valuer's functions.
- While the instruction as to the valuation of the business on the basis of things as they stood on 30 June 2012 was somewhat obscure, the court thought the language admitted of only one meaning; it required the valuers to assume that the relationships on which the company was based would continue to exist in the future.
- The effect was to attribute to the business a degree of stability and permanence which its formal arrangements lacked but which in practice it could be expected to enjoy. This was what the valuers understood to be the instruction and that was how they applied it and therefore there were no grounds on which the valuation could be challenged.

The appeal was dismissed and the order for summary judgment granted at first instance was approved: *Re Premier Telecom Communications Group Ltd, Ridge v Webb* [2014] EWCA Civ 994, [2014] All ER (D) 168 (Jul).

De facto directors

The overarching question of capacity

The Court of Appeal has considered an appeal from a dismissal of a claim that an individual (N) was a de facto director and liable accordingly for breach of duty. The company was a joint venture and N was the chairman of the majority shareholder. He also had significant business dealings with the (financial services) company through connected parties and so was a client of the company as well.

The court at first instance rejected the claim that N was a de facto director concluding that all of the alleged conduct on his part was that to be expected of a major client and chairman of the majority shareholder of the company and that he had in fact acted in that capacity.

Dismissing the appeal, Arden LJ sets out to consider the nature of a de facto directorship and, while her judgment is not entirely easy to follow, the essence of her approach is that the question of whether someone is a de facto director is not to be approached by asking whether the individual performed acts which a director would normally do. It is not enough that the act in question could have been done by a director; the burden is on the claimant to establish that the individual did indeed do that act in that capacity. The assessment of the capacity in which a person acts is one of fact and degree and is to be determined objectively, taking all the circumstances into account.

On the facts, the trial judge had been entitled to make the findings she did that N was not a de facto director because he was protecting his or others' interests in some other capacity. The appeal on that ground was dismissed.

The Court of Appeal also dismissed an appeal on a further point involving CA 2006, s 190 (substantial property transactions). The lower court had held that instructions given by N (as a director of the holding company) for the entry by the company into contracts for differences with respect to a particular company on behalf of N and companies connected with N did not infringe CA 2006, s 190.

The Court of Appeal agreed with that ruling. Under these contracts for differences there was the possibility that N or his companies might at some point in the future acquire the underlying shares, but CA 2006, s 190 applies only to arrangements under which a director or a connected person 'acquires or is to acquire' a non-cash asset. There was no basis for interpreting 'is to acquire' as 'may acquire' so s 190 was not engaged: *Smithton Ltd v Naggar* [2014] EWCA Civ 939, [2014] All ER (D) 118 (Jul).

Groups of companies

Whether role of English parent dictates domicile of foreign subsidiary

A claimant wanted to bring tort proceedings in the UK against a South African company and needed therefore to establish that the company was domiciled here for the purposes of the Brussels Regulation, 44/2001, article 60 which provides, in the case of a company, that it is domiciled for the purposes of the Regulation where it has its statutory seat (which it was accepted was in South Africa), where it has its principal place of business (which it was accepted was in South Africa) or where it has its central administration.

Hence everything hinged on whether a good arguable case could be shown that the South African company had its central administration in the UK, which allegation was based primarily on the fact that the company's parent company is an English company with its head office in London and listed on the London Stock Exchange. The court at first instance rejected the claim.

On appeal, the Court of Appeal held:

- It is the central administration of the company sought to be sued that has to be identified and there is nothing to suggest that a different approach should apply where a company is part of a group of companies. Of course, if on the facts of a particular case, Company A in a group has taken over or usurped the relevant functions of the organs of Company B, which is the company sought to be sued, then it may well be arguable that the 'central administration' of Company B is where Company A makes those decisions on Company B's behalf. But that was not alleged on the facts here.
- The correct interpretation of 'central administration' in article 60 of the Regulation is that it is the place where the company concerned, through its relevant organs according to its own constitutional provisions, takes the decisions that are essential for that company's operations.
- The fact that a parent company may have the power to exert or usurp control over the subsidiary is irrelevant for article 60 is not dealing with possibilities but actualities. Otherwise, it would lead to all sorts of discussions with respect to parent and subsidiary companies and their constitutional provisions whereas the whole aim of article 60 is to cut out such possible complications.
- Asking where were the main entrepreneurial decisions taken which determine the activity of the company was the wrong question. The essential question was where does the company has its central administration.

The first instance judge was correct to concentrate on the position of the subsidiary itself and to search for the place where its central administration lay. The fact that the English parent company plainly guided and even heavily influenced the decisions of the board of the subsidiary does not alter the position. On the facts, the central administration of the subsidiary was in South Africa and it could not be sued in England: *Young v Anglo American South Africa Ltd* [2014] EWCA Civ 1130, [2014] All ER (D).

Administration

Liability for gas and electricity supplies in administration

It is accepted that the price of gas and electricity supplied to premises of a business in administration during the administration while the companies continue to trade from them is an expense of the administration, but what was uncertain until recently was whether subsequent energy liabilities incurred when the administrators had vacated the premises were also an expense of the administration and entitled to priority over unsecured creditors.

On the facts in the particular case, the sum involved was a £1.2m energy bill in respect of a chain of retail outlets which were in administration, the administrators having closed and vacated the stores after a period of trading in administration. Of course, if it was not payable as an expense, giving the financial position of the business, it was unlikely that the energy supplier would recover the £1.2m.

The court was asked to determine the issue as a preliminary matter.

The Chancellor of the High Court, Sir Terence Etherton, concluded that such liabilities under deemed supply contracts (express supply contracts having been terminated on administration) are provable only as an ordinary unsecured debt and not as expenses of the administration with priority over the debts of the general body of unsecured creditors.

Citing with approval from Lord Neubeger in *R*e *Nortel GmbH* [2013] 2 BCLC 135, the court noted that the mere fact that an event occurs during the administration of a company which a statute provides gives rise to a debt on the part of the company cannot, of itself, be enough to render payment of the debt an expense of the administration. It would be a debt payable 'during the period of' the administration but it would not be 'part of' the administration or a payment which was one of the 'natural incidents connected with' the administration.

Further, a liability can only be an expense of liquidation or administration if the nature of the liability is such that it must reasonably have been intended by the legislature that it should rank ahead of provable debts.

There was no evidence that Parliament intended to confer on a supplier of gas or electricity the power unilaterally to achieve priority over unsecured creditors in respect of liability under a deemed contract of supply: *Laverty v British Gas Trading Ltd* [2014] EWHC 2721, [2014] All ER (D) 76 (Aug).

Missing trader VAT fraud

Guidance on appropriate disqualification orders for directors involved

In a recent case, Judge Hodge, sitting as a judge of the High Court, has provided useful guidance as to the appropriate period of disqualification of directors of companies involved in missing trader intra-community VAT fraud (MTIC fraud).

- In his view, given the threat of MTIC fraud is so persistent and so pervasive and the loss to the state is potentially so great (there was evidence that HMRC estimate the annual VAT loss from this type of fraud in the UK alone is between £1.06bn and £1.73bn per annum), he could not conceive of any case in which disqualification for a period in the bottom bracket (of two to five years) would be appropriate.

- In any case where the respondent director has been knowingly involved and has played a significant role in MTIC fraud, then a period of disqualification in the top bracket (of over ten years) should be imposed. This is also likely to be appropriate in cases where the director wilfully closes his eyes to MTIC fraud. Within that bracket, the minimum period should be 11 years and where a defendant seeks to justify his conduct unsuccessfully, then such conduct may only serve to reinforce his unfitness to be concerned in the management of the company, and it is likely to justify a period of disqualification of 12 years or more.
- In any case where it is proved that the respondent director did not actually know but (without wilfully closing his eyes to the obvious) ought to have known of the MTIC fraud, the period of disqualification should be within the middle bracket (of more than five and up to ten years). In such a case, absent extenuating circumstances, the disqualification period is likely to fall in the top half of that bracket and thus between 7½ and 10 years.

In the instant case, while the court found that the director (who acted essentially as the company's accountant) was not personally involved and did not actively participate in the fraudulent dealings, and did not know and did not wilfully shut his eyes to the fact that the company's deals involved MTIC fraud, the court found that the director should have known of the fraud.

His due diligence with regard to the transactions at issue was wholly perfunctory and it was entirely inadequate for the due discharge of the serious responsibilities which the director had assumed (including an express obligation set out in his letter of appointment to check the due diligence procedures on the company's deals) against the known background of rampant VAT fraud in the company's business sector (mobile phones).

The court concluded that the director's conduct in this regard involved such gross negligence, or total incompetence, in the discharge of his assigned functions as a director as to make him unfit to be concerned in the management of a company. The starting point therefore was the top half of the middle bracket (and thus between 7½ to 10 years). The extenuating circumstances were that he was 59 years of age and had not previously been involved in any dishonest, underhand, or dubious business practices and he had not derived nor stood to derive any personal financial gain from the MTIC fraud. During the period in question, he had been preoccupied with his mother's illness and subsequent death. In the circumstances, the appropriate disqualification period was six years: *Re Chapter 6 Ltd, Secretary of State for Business, Innovation and Skills v Warry* [2014] EWHC 1381.

Correspondence about this bulletin may be sent to Victoria Burrow, Content Acquisition and Development Specialist, LexisNexis, Lexis House, 30 Farringdon Street, London EC4A 4HH (tel: +44 (0)20 7400 2707, email: victoria.burrow@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 (08:00–18:00 Monday – Friday) or for assistance with content, functionality or technical issues please contact the Customer Service teams between 08:00–18:30 Tel: +44 (0)800 007777; Email: contentsupport@lexisnexis.co.uk

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