Bulletin 160 September 2013

Butterworths Corporate Law Update

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RECENT DEVELOPMENTS

Company ownership

BIS consults on corporate transparency and other matters

As noted in Corporate Law Update 159 (July 2013), the Government indicated during the G8 discussions in June 2013 that it intends to improve the transparency of company ownership and control in order to tackle tax evasion, money laundering and terrorist financing.

To that end, the Department for Business, Innovation and Skills (BIS) has published a wide-ranging discussion paper on issues pertaining to corporate transparency, including proposals for the disclosure of beneficial ownership and restrictions on the use of bearer shares and corporate directors.

The key proposals in the Discussion Paper are:

On disclosure of beneficial ownership

- That Companies House should hold information on the beneficial owners (i.e. individuals with 25% or more of the shares or voting rights or persons able to control the management of the company in some other way) of all UK companies, with the possibility that traded companies which already disclose this information by virtue of UKLA Disclosure and Transparency Rules should be exempt. The details as to what information should be provided to the registry, how frequently it should be updated and how to ensure that it is as accurate as possible, all have to be considered.
- All companies should be able to require legal owners to identify their beneficial owners (public companies currently have this power – see CA 2006, s 793); and a duty to disclose their interests should be imposed on beneficial owners.

- An issue is whether the information on beneficial ownership provided to Companies House would be made public or whether it would only be available to relevant authorities.
- For discussion is whether the creation of new bearer shares should be prohibited with existing holders of bearer shares given a set period within which they must convert to holding ordinary registered shares.

On directors' standards and possible penalties

- There should be greater transparency around the use of nominee directors, for example, disclosure of nominee arrangements may need to be made to Companies House; and, for discussion again, is whether the UK should ban the use of corporate directors, a matter previously considered (and rejected) by the Company Law Review ahead of the CA 2006.
- Also for consideration is whether, following the Parliamentary Commission on Banking Standards' recommendation that directors of banks should have a primary responsibility to ensure the safety and stability of their firms, directors' statutory duties should be amended in key sectors such as banking and whether sectoral regulators should be able to disqualify directors from acting as a director in any sector.
- It is suggested that the factors which the courts take into account in director disqualification proceedings (see CDDA 1986, Sch 1), such as the nature and number of previous company failures a director has been involved in, may be widened to include, for example, any material breaches of relevant sectoral regulations, the scale of loss to creditors, the impact of the collapse of a company on wider society etc.
- Issues around civil compensation when creditors have suffered from a director's fraudulent or wrongful trading are to be considered with a view to ensuring that such directors personally run the risk of having to compensate creditors. It may be appropriate to have the courts make compensation orders and for liquidators to be able to sell or assign these civil actions for fraudulent and wrongful trading to third parties.
- It is proposed that the time limit for bringing disqualification proceedings in insolvent company cases should be extended from two to five years; and that disqualified directors might be offered education or training to equip them with the skills they need to go on to run a successful company.
- Issues surrounding foreign disqualifications are also being considered. For example, it is proposed that individuals subject to foreign restrictions might be prevented from being a director of a UK company (using powers which exist in the CA 2006, but which have not been utilised); and it is proposed that it should be possible for disqualification proceedings to be brought here against directors convicted of a criminal offence in relation to the management of an overseas company.

Comments are sought by 16 September 2013.

For further details, see Department for Business, Innovation and Skills, Discussion Paper, *Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business* (July 2013), BIS/13/959, available at www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper.

Corporate responsibility

BIS call for views on proposed framework

BIS has issued a call for views on corporate responsibility with the intention of publishing a framework for action on corporate responsibility by the end of 2013. Corporate responsibility is defined in this context by BIS as the responsibility of an organisation for the impacts of its decisions and activities on society and the environment through transparent and ethical behaviour above and beyond its statutory requirements.

The document indicates some of the issues for consideration such as reaching a common understanding of what corporate responsibility is, securing greater adoption of corporate responsible practice by businesses that takes into account international principles and guidelines; encouraging more small and medium-sized enterprises to adopt responsible business activities; exploring how to strengthen the relationship between business and society and the role of business in upholding human rights. Views are sought by 27 September 2013.

See BIS, Corporate Responsibility, A call for Views (June 2013), available at www.gov.uk/government/uploads/system/uploads/attachment_data/file/209219/bis-13-964-corporate-responsibility-call.pdf.

Statutory instruments

SI 2013 No 1970 — the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013

These Regulations aim to simplify and restructure companies' narrative reports and amend the Companies Act 2006 to create a separate strategic report to replace the existing requirement in CA 2006, s 417 (which is repealed) for a business review. All companies, other than companies which qualify for the small companies accounting exemptions, must prepare a strategic report.

It is worth noting that the Financial Reporting Council has said that there is a commonly held misconception that the strategic report will be a higher level summary of strategic information of a different level of materiality or importance to the business review. However, the FRC says, the purpose and required content of the strategic report does not differ significantly from the business review which it replaces (see FRC Staff Guidance Note on the Strategic Report regulations available at http://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRC-Staff-Guidance-Note-Strategic-Report-Regulatio.pdf).

The Regulations also remove some reporting obligations from all companies (for example, they are no longer required to state their principal activities in the course of the year) and require quoted companies to make some additional disclosures (on gender diversity, human rights issues, companies' greenhouse gas emissions).

The Regulations, which come into force on 1 October 2013, have effect with respect to financial years ending on or after 30 September 2013.

SI 2013 No 1971 — the Companies (Revision of Defective Accounts and Reports) (Amendment) Regulations 2013

The Regulations, which come into force on 1 October 2013, have effect with respect to a company's financial year beginning on or after that date. The Regulations make consequential amendments to SI 2008/373, the Companies (Revision of Defective Accounts and Reports) Regulations 2008, as a result of amendments to the CA 2006 Act to make provision for a revised directors' remuneration report and for the preparation of a strategic report instead of a business review.

SI 2013 No 1972 — the Unregistered Companies (Amendment) Regulations 2013

These Regulations amend SI 2009/2436, the Unregistered Companies Regulations 2009, to disapply the requirements regarding strategic reports and binding shareholder votes on remuneration policy from unregistered companies. The Regulations, which come into force on 1 October 2013, have effect with respect to financial years ending on or after 30 September 2013.

SI 2013 No 1973 — the Companies (Receipt of Accounts and Reports) Regulations 2013

The Regulations, which come into force on 1 October 2013, have effect with respect to financial years ending on or after 30 September 2013. These Regulations concern the circumstances under which companies may send to members, in place of the company's full accounts and reports, a copy of the company's strategic report with supplementary material in accordance with CA 2006, s 426.

SI 2013 No 1981 — the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013

These Regulations, which come into force on 1 October 2013, provide for a substitute Schedule 8 to replace the existing Schedule 8 to SI 2008/410, the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008. Schedule 8 specifies the information to be included in the directors' remuneration report which the directors of a quoted company are required to prepare under CA 2006, s 420.

SI 2013 No 2005 — the Companies and Partnerships (Accounts and Audit) Regulations 2013

The principal effect of these Regulations is to amend the scope of application of those provisions of the CA 2006 and other Regulations that implement the Fourth Company Law Directive, to make sure that all the partnerships and unlimited companies covered by the Directive are also covered in the UK's implementation. Those 'qualifying partnerships' and unlimited companies are then subject to the same accounting, reporting and auditing requirements as limited companies under the CA 2006. In particular, the Regulations, in reg 4(3), replace the defective definition of 'qualifying partnership' with a longer, clearer, systematic definition.

CASES

Provable debts or expenses in administration

Financial Support Directions by Pensions Regulator

The Supreme Court has reversed the decision of the Court of Appeal in the Nortel litigation regarding the priority to be accorded to Financial Support Directions (FSDs) issued by the Pensions Regulator.

- The scheme under the Pensions Act 2004 allows for FSDs to be made against associated companies (target companies) of a corporate employer requiring them to support the employer's under-funded pensions scheme, and also allows for Contribution Notices (CNs) in the event of non-compliance with an FSD.
- As the target companies in this case were also in administration or liquidation, the question was whether the cost of complying with an FSD, or the monetary obligation imposed by a CN, ranks in the administration or liquidation of the target company as a provable debt (ranking pari passu with other unsecured creditors), or as an expense (with super-priority over other creditors and the office holder's remuneration), or neither of those.

The Court of Appeal unanimously confirmed the (reluctant) High Court ruling that neither a FSD nor a CN issued after the onset of insolvency gives rise to a provable debt, but they are payable as a necessary disbursement by the office-holder, whether a liquidator or administrator, and therefore have super-priority over other creditors, see [2012] 1 BCLC 248.

In a widely welcomed decision, the Supreme Court unanimously has reversed that decision, holding that:

- The liability of a target company pursuant to a FSD issued before or after it goes into administration ranks as a provable debt of the company and not as an expense of the administration, because it is a 'liability under an enactment' within IR 1986, r 13.12(4) and therefore a liability for the purposes of r 13.12(1)(b), and it arises 'by reason of an … obligation incurred before' an insolvency event such as going into administration.

- A disbursement fell within IR 1986, r 2.67(1)(f) (expenses in the administration) if it arose out of something done in the administration (normally by or on behalf of the administrator) or if it was clear that the statutory liability to make the disbursement fell on the administrator as part of the administration, either because of the nature of the liability or under the terms of the statute.
- However, the mere fact that an event occurred which gave rise to a debt which was payable during the period of the administration was not enough to render payment part of the administration or a natural incident connected with it so as to make it an expense of the administration.
- A potential liability under the FSD regime neither resulted from an act or decision taken by or on behalf of the administrator nor from any act or decision taken during the administration, since self-evidently the liability arose out of events which occurred before the insolvency event.
- There was no indication in the Pensions Act 2004 that Parliament intended that payment of liability under a contribution notice issued after a target company's insolvency event was to rank ahead of provable debts as an expense of that company's administration.
- *Per curiam*. The court had no residual discretion to direct the administrator of a company to treat an unprovable debt as a provable debt, since there was nothing in the IA 1986 or the IR 1986 which was intended to give the court a roving commission to vary the clear statutory ranking of liabilities in an administration or liquidation, applying *Re Toshoku Finance UK plc* [2002] 1 BCLC 598.

Re Nortel GmbH; Re Lehman Brothers International (*Europe*) (*Nos 1 and 2*) [2013] 2 BCLC 135.

One man company

Confiscation orders — his benefit or the company's benefit

The Court of Appeal has considered the appropriate confiscation order to be made under the Proceeds of Crime Act 2002 (POCA 2002) against an individual, X, who bribed an employee at Network Rail (NR) in order to secure a number of contracts (total value £1.9m) for a company of which X was the sole shareholder.

- A confiscation order under POCA 2002, s 6, requires the court to identify the extent to which X has benefited from his criminal conduct. The judge made an order which represented the total sum paid to the company by NR (£1.9m).
- The defendant appealed on the basis that the order wrongly looked at the company rather than at the defendant's benefit and it failed to take into account that the contracts were performed entirely satisfactorily, the company was not a sham and the offences were personal to the defendant and did not involve using the company for crime. The figure

of £1.9m was disproportionate in that it failed to take into account the cost incurred in performing the contracts.

- By the time of the Court of Appeal hearing, it was an agreed position that the appellant had personally benefited from the contracts in the sum of £125,000 (salary and dividends) and the company had made a gross profit, after costs, of £197,683.

The Court of Appeal held that:

- In the circumstances of the case, where the appellant was the sole controller and there was a very close inter-relationship between his corrupt actions and steps taken by the company in advancing those corrupt acts and intentions, the reality was that the activities of both the appellant and the company were so interlinked as to be indivisible. What the company did served to hide what the appellant was doing, but the court was entitled to discover the facts which the corporate structure would otherwise conceal so as properly to identify the appellant's true benefit.

- The true benefit was the whole of the value of the contracts (£1.9m) together with a pecuniary advantage in the market place, having secured the contracts at the expense of legitimate competitors. The court was required, however, to ensure that a confiscation order was proportionate to the purposes of POCA 2002 which is to recover the financial benefit which an offender has obtained from his criminal conduct, but not to act as an additional form of fine or other punitive sanction.

- An appropriate confiscation order would cover the profit made and the pecuniary advantage, but allow for the expenses involved in carrying out the contracts which were expenses that could be distinguished from the expenses of the criminal activity such as the costs of the bribes. There was no difficulty in attributing the profit and pecuniary advantage to the appellant as proportionately representing his benefit since he was the sole shareholder in the company.

- Accordingly, a confiscation order of £1.9m was disproportionate. However, the agreed figure of £197,683.12 represented a generous order since it failed to take account of the pecuniary advantage identified. However, since there was no material before the court to put a value upon the pecuniary advantage obtained, it could not properly add to that sum. In future cases, the court indicated that the prosecution should be alert to this aspect of the case so that the real benefit or pecuniary advantage derived by the wrongdoer can be taken into account in the order: *R v Sale* [2013] EWCA Crim 1306, [2013] All ER (D) 367 (Jul).

Fraudulent directors — is the company the victim or the wrongdoer?

Ex turpi causa, again

In a case involving a VAT fraud, a company (through its liquidators) wished to sue, inter alia, its former directors (one of whom was also the sole shareholder) on the basis of breach of duty and conspiracy. They also claimed against third parties for fraudulent trading (IA 1986, s 213: civil liability of 'any persons' knowingly party to the carrying on the business in this manner). An initial attempt by the defendants to have the claims struck out failed and they appealed.

Essentially, their argument was that the company itself was a wrongdoer, since its directors and controllers were wrongdoers, and therefore a claim by the company against the directors could be met by the defence of ex turpi causa. There was a second issue concerning the extra-territorial scope of IA 1986, s 213.

The questions for the Court of Appeal were:

(a) whether, in the light of the Supreme Court decision in *Stone & Rolls Ltd v Moore Stephens* [2009] 2 BCLC 563, a claim by the company against its own directors could be met by the defence of ex turpi causa; and

(b) whether a claim under IA 1986, s.213, in respect of 'any persons' lies against a Swiss company and a French national — i.e. does it have extra-territorial effect.

The Court of Appeal dismissed the appeal.

- It is settled law that a director, even of a one-man company, can be held liable to account for breaches of fiduciary duty which he has committed against the company. The law will not attribute the fraud or other unlawful conduct of the director to the company when it is itself the intended victim of that conduct. The law will not allow the enforcement of directors' duties to be compromised by the director's reliance on his own wrongdoing.
- Nothing in *Stone & Rolls v Moore Stephens* [2009] 2 BCLC 563 affects the general company law principle laid down in *Belmont Finance Corpn Ltd v Williams Furniture Ltd* [1979] 1 All ER 118 (more broadly expressed as the rule in *Re Hampshire Land* [1896] 2 Ch 743) that an agent's dishonesty should not be attributed to the company if attribution has the effect of defeating the right of the company to recover from the dishonest agent or third party. The court emphasised that to allow the defendant director to defeat a claim against him, by seeking to attribute to the company the unlawful conduct for which he is responsible so as to make it the company's own conduct as well, would be to allow the defaulting director to rely upon his own breach of duty to

defeat the operation of the provisions of CA 2006, ss 172 and 239 'whose very purpose is to protect the company against unlawful breaches of duty of this kind'.

- In so far as Lords Walker and Brown in *Stone & Rolls v Moore Stephens* supported a sole actor exception (i.e. where the company was a one man company, the dishonesty of the one man was attributed to the company so as to make it a wrongdoer and not a victim) to the *Belmont* principle, in the view of the Court of Appeal that case can be distinguished and limited to its facts. In the context of a claim by a company against its fraudulent directors, the court said, the sole actor exception has no place in English law.
- As for the territorial scope of IA 1986, s 213 which applies to 'any persons', the Court of Appeal saw no reason to distinguish between that phrase in s 213 and in s 238 (preferences). It was decided in *Re Paramount Airways* [1992] BCLC 710, with respect to s 238, that the provision has extra-territorial effect and that reasoning applies equally to s 213. The provision can therefore be applied to a Swiss company and a French national: *Jetivia SA v Bilta* (*UK*) *Ltd* [2013] EWCA Civ 968, [2013] All ER (D) 390 (Jul).

Disclosure and inspection of documents

Recovery of documents from former CEO

A company sought access to business emails sent and received by the former CEO of the company on his personal computer. The company had contracted for the CEO's services under a written agreement with a company controlled by the CEO. There was no express contract of employment between the company and the CEO, rather, as the court put it, his contract of employment was with his creature company. At first instance, the action was dismissed on the basis that the company had failed to establish an enforceable proprietary claim.

Allowing an appeal, the Court of Appeal ruled that the discussion at first instance had concentrated unnecessarily on 'proprietary rights' which was a distraction from the centrality of the agency relationship and its legal incidents.

The assertion of a right to inspect and copy the content of the emails on the former CEO's computer relating to the claimant's business affairs had arisen from the legal incidents of an agency relationship that had survived its termination. It had been unnecessary to explore the question whether information in the content of the emails was property owned by the claimant.

Accordingly, the claimant had been entitled to the relief claimed against their former CEO on the grounds that, inter alia:

- their former relationship had been that of principal and agent;

- as a general rule, it was a legal incident of that relationship that a principal was entitled to require production by the agent of documents relating to the affairs of the principal; and
- that materials held and stored on a computer, which might be displayed in readable form on a screen or printed out on paper were, in principle, covered by the same incidents of agency as applied to paper documents.

An order would be made for the inspection of the emails on the computer: *Fairstar Heavy Transport NV v Adkins* [2013] EWCA Civ 886, [2013] All ER (D) 239 (Jul).

Expenses in liquidation or administration

Solicitors' fees in opposing winding up petition

A firm of solicitors acted for Portsmouth City Football Club Ltd (the 'old' company to be distinguished from the current company) in opposing a threatened winding up petition. Shortly afterwards, an out of court appointment of the defendant administrators was made. There were sufficient realisations to pay the expenses of the administration, but subsequently, when the administration came to an end and the company was wound up, there were no assets or funds available for distribution by the liquidators.

The applicant applied for the payment of its fees incurred during the period that it was instructed by the company on the basis, inter alia, that those fees were to be determined as an expense of the administration of the company (governed by IR 1986, r 2.67).

At first instance, [2013] 1 BCLC 572, the court ruled that the company's costs, reflected in the applicant's fees, were expenses of the liquidation in accordance with IR 1986, r 4.218(3)(h), but not expenses of the administration. The court noted that in substance the solicitors were looking, unsuccessfully, for an order under the Senior Courts Act 1981, s 51 (court's discretion to determine by whom the costs of proceedings should be paid) which would indirectly turn the costs re the winding up petition into an administration expense, though such expenses are not within the permissible class of administration expenses set out in IR 1986, r 2.67.

The Court of Appeal has now affirmed the first instance decision. The IR 1986 do not provide that solicitors' fees for acting in opposing a winding up petition prior to administration are payable as an expense of administration. The court has no power to treat those solicitors' fees as an administration expense. Those fees are not incurred in connection with the performance of the administrators' functions.

The court has an inherent jurisdiction to give directions to administrators as officers of the court, but it would not be a correct exercise of that jurisdiction to direct the administrators to pay those solicitors' fees as an expense of the administration. That would be inconsistent with the Insolvency Rules 1986 listing those items that are payable as expense of an out of court administration.

Further, the court had no power under the Senior Courts Act 1981, s 51 to make an order that would, either directly or indirectly, result in the payment of the solicitors' fees as an expense of an out of court administration of the company.

The solicitors' fees in relation to the company's defence of the winding up petition were payable as an expense of the liquidation — they were not payable as an expense in the out of court administration of the company. The appeal was dismissed: *Neumans LLP v Andronikou* [2013] EWCA Civ 916, [2013] All ER (D) 284 (Jul).

Unfairly prejudicial conduct

Non-member respondents

In a complex case concerning permission to serve a petition alleging unfairly prejudicial conduct (CA 2006, s 994) out of the jurisdiction on a number of respondents, none of whom were members of the company, an issue for the court was whether, if the facts alleged were established, relief under CA 2006, s 996 can be ordered against non-member respondents.

The court ruled that:

- It was an established principle that CA 2006, ss 994–996 (unfairly prejudicial conduct) provide a wide and flexible remedy. Non-members of a company who were alleged to have been responsible for such conduct could be joined as respondents, and, in an appropriate case, such non-members could be made primarily or secondarily liable to buy the petitioners' shares. Artificial limitations ought not be introduced, Vos J said, to reduce the effective nature of the remedy introduced by ss 994–996.
- On the evidence, there was a serious case to be tried as to whether the company's affairs were being or had been conducted in a manner that was unfairly prejudicial to the interests of the petitioner and the Registrar had been right to permit the petition to be served out of the jurisdiction on each of the three respondents: *Apex Global Management Ltd v Fi Call Ltd* [2013] EWHC 1652 (Ch), [2013 All ER (D) 194 (Jun)

Conduct approved by all the shareholders

An unfairly prejudicial petition (CA 2006, s 994) was brought by a petitioner who from 1981 onwards was the beneficial owner of 32.8% of the company's shares which were held by trustees on trust for him. The respondent (the petitioner's brother) held 67.2% of the company's shares.

In 2011 the petitioner became a member of the company following a transfer of shares from the trustees to him and he now brought a petition alleging unfairly prejudicial conduct in respect of a purchase by the company of its own shares in 2001. That transaction was formally recorded and carried out with the assistance of accountants, tax advisers and solicitors and culminated with written resolutions that were passed unanimously by all the directors and shareholders of the company.

The respondent succeeded in having claims in the petition with respect to this buy-back transaction struck out and the petitioner appealed. The issue before the court was whether a petitioner could complain of unfairly prejudicial conduct which occurred before the petitioner had become a shareholder, and to which all the shareholders at the material time had expressly consented.

The court held that the unfairly prejudicial conduct asserted was based on what was said to have been a serious mismanagement of the company affairs, breaches of company law rules, and breaches of director's duties; but irrespective of the facts, it was a complete answer to the complaint of unfairly prejudicial conduct that that conduct had been authorised, or ratified, by the unanimous agreement of all of the company's shareholders, including the trustees, who held the shares of the petitioner on trust for him.

Unless the petitioner had pleaded, and at trial were to prove, the existence of some legitimate expectation that the members would not consent to such conduct, then there was no basis for any assertion that the matters complained of in the relevant paragraphs of the petition had been unfairly prejudicial to the petitioner. There was no such plea, and nor was there any evidence from the petitioner to support it. The appeal against the striking out of these elements of the petition was dismissed: *Bateson v Bateson* [2013] EWHC 2530 (Ch), [2013] All ER (D) 195 (Aug).

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

ISBN 978-1-4057-7442-0
9 781405 774420