Butterworths Corporate Law Update

BULLETIN EDITOR
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RECENT DEVELOPMENTS

Company Filing requirements

BIS consults as part of Red Tape Challenge

As part of the Government's Red Tape Challenge, the Department for Business, Innovation and Skills (BIS) has issued a consultation document considering whether some of the current filing requirements for companies could be simplified. Some of the proposals are for significant changes to current requirements. Comments are invited by 22 November 2013. The full text of the consultation paper, *Company Filing Requirements, Red Tape Challenge* (October 2013), is available at www.gov.uk/government/consultations/company-filing-requirements.

In part, the proposals also link into the earlier consultation paper, *Trust and Transparency* (see Update 160) which outlined plans to ensure transparency of company ownership. That consultation is now closed and the Government has indicated that it intends to proceed as planned with public disclosure at Companies House (CH) of the beneficial ownership of companies — BIS will publish a document setting out the Government response in early 2014.

The latest proposals on filing requirements include:

- *Annual return*. The paper suggests three options: to remove the requirement to complete an annual return but require each company to confirm, at least annually, that the information held on the register about it is correct; to remove the requirement to file an annual return and rely on event driven filing; and to retain the annual return.
- *Share registers*:
    - where directors and shareholders are the same, the proposal is to provide that the only register of members available for inspection is the public record at CH (this proposal would eliminate the need

  to make registers accessible at the registered office or at a single alternative inspection location, as currently required);

  - to allow private companies the option of holding their register of members and of directors (and register of secretaries, if any), at CH only — as entry on the register of membership determines membership and membership rights, if this proposal is adopted, the Companies Act 2006 will be amended to define clearly when legal ownership becomes effective where the register of members is being held at CH.

- *Share capital statements.* Statements of capital were introduced by the Companies Act 2006 but there have been difficulties in their completion, especially for companies with more complex share capital structures. The proposal now is to simplify the requirements for all companies, limiting it to the total number of shares in the company, the aggregate nominal value of those shares and the aggregate amount unpaid on those shares together with the equivalent information regarding classes of shares, if any.

  The frequency of statements of capital would also be reduced so that, where the company has filed a statement of capital in the preceding 12 months, then there would be no need to provide a statement of capital in the annual return (subject to whatever decisions are made about changes to the annual return).

- *Returns on allotment.* The paper seeks views on whether the requirement to submit a return on allotment (CA 2006, s 555) is onerous and whether the articles of association could be relied on to include details of share allotments.

- *Disclosure of subsidiaries.* In order to increase the transparency of group structures, the proposal is that companies should be required to state the total number of subsidiaries in their group and/or companies should be required to report on their subsidiaries in the annual report. This proposal would mean removing the current option for companies of noting only their main subsidiaries in their reports and annexing a list of all of their subsidiaries to their annual return (something which it is noted some companies currently fail to do).

- *Registered office.* To address disputes over the location and address of registered offices, the options put forward are to require all companies to have a demonstrable link to their registered office and, if that cannot be established and a complaint has been made, for CH (after various notifications to directors and the company) to proceed to fast-track dissolution of the company; or to replace the address of an ineffective registered office with the residential address of a director.

- *Consent to act as a director.* Currently directors on appointment have to indicate to CH that they ‘consent to act’. Nevertheless CH have about 400 cases a year where a person disputes that they have ever been a director. The proposals on this issue are to change the law so as to remove the need to provide 'consent to act' to CH, with the company merely confirming to CH that they have the consent of any new director and consent would be a matter purely between the company and the individual with the company being required to retain 'suitable evidence' of appointment which could be produced later in the event of a dispute.

- *Accelerated strike off.* At the moment, the Registrar can strike off companies under CA 2006, s 1000 (essentially not carrying on business or in operation). The process involves a series of notifications to the company etc. and the whole process can take about 6 months, at its quickest. The proposal is that in cases of company hijacking and where no contact can be made with the company or its directors, the Registrar will have a power of rapid strike off which would reduce the time scale to approximately 6 weeks.

Company and Business Names

Government Response to Consultation

The BIS has published the Government's response to its earlier consultation, *Company and business names: Red Tape Challenge* (February 2013), which had sought views on the regulation of company names (see Update 157). In the light of comments received, the Government intends to merge the Company and Business Names Statutory Instruments with the Trading Disclosures Statutory Instruments, so that all the requirements will be in one place. The list of 'sensitive' words (names which require consent to their use) will be reduced by approximately one third and the regulations governing 'same as' names will be simplified, which will make it easier for companies to choose a name and for group companies to swap names. The Government response is available at www.gov.uk/government/uploads/system/uploads/attachment_data/file/246280/bis-13-1139-company-and-business-names-response.pdf.

Directors' remuneration — quoted companies

FRC consultation

Following on from the introduction of an expanded directors' remuneration report and additional shareholder voting rights in relation to such reports (quoted companies only, effective for financial years ending after 30 September 2013), at the request of the Government, the Financial Reporting Council (FRC) is consulting on three specific issues relating to remuneration to see whether changes should be made to the UK Corporate Governance Code. The three issues are whether the Code should be amended:

(a) to impose a requirement on quoted companies to have clawback provisions which would allow a company subsequently to reclaim variable components of remuneration in exceptional circumstances?

(b) to deter or end the appointment of executive directors to the remuneration committees of other listed companies?

(c) to require companies to report to the market in circumstances where there has been a significant lack of support for a resolution on remuneration (for example, perhaps, where there are votes against in excess of 20%) and whether the Code should specify the means of reporting to the market?

The consultation document is available at www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Directors%E2%80%99-Remuneration-Consultation-Document.aspx; comments are sought by 6 December.

Guidance from GC100 and Investor Group

In the light of the changes, for quoted companies, to the reporting of directors' remuneration and the requirement for a binding shareholder vote on remuneration policy which limits the payments which companies can legally make, the Government made clear that business and investors should come together to develop best practice guidance on the level of detail and type of information which needs to be included in the policy report.

Hence the GC100 and Investor Group have now issued Directors' Remuneration Reporting Guidance which is to be read alongside the legal requirements on reporting which are set out in Schedule 8 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, SI 2008/410, as amended. The Guidance is structured as commentary on each component of the reporting obligations. The Guidance is available from the BIS website at www.gov.uk/government/publications/directors-remuneration-reforms-frequently-asked-questions and the Group hopes to update it on an annual basis.

In general, the Group notes that remuneration committees may wish to consider the following two priorities:

(a) A policy should ensure that investors have sufficient information to be able to approve it, broadly knowing what to expect in terms of directors' remuneration whilst avoiding the risk of unexpected outcomes in future annual remuneration reports.

(b) The remuneration committee will also need flexibility to tailor the terms of remuneration arrangements for individual directors over the life of the policy without the policy becoming a 'shopping list' of possible components.

The Guidance states that when an exercise of discretion is disclosed in the remuneration report, investors expect that companies will report the circumstances leading to the exercise of discretion and why it was required and also its consequences for the remuneration outcomes. Unsurprisingly, the Group does not recommend including in the remuneration policy only a general statement that all of the components of remuneration are subject to appropriate adjustment at the complete discretion of the remuneration committee, noting that investors would find it hard to approve such a policy.

The Regulations require companies to put forward their remuneration policy for approval every three years, unless there are changes to the policy or the company fails to obtain approval of the annual remuneration report (see CA 2006, s 439A), and the Group makes it clear that investors would not wish to see companies bring forward approval annually as a matter of standard practice. Once a policy is approved, investors are generally in favour of the policy starting immediately following the annual general meeting where approval is obtained.

Fiduciary Duties of Investment Intermediaries

Law Commission consultation

The Law Commission has published a 300 page consultation paper entitled *Fiduciary Duties of Investment Intermediaries* (October 2013) (see lawcommission.justice.gov.uk/consultations/consultations-open.htm). This project was commissioned by the BIS and the Department for Work and Pensions and arises out of the Kay Review which reported in 2012 (see Update 154). Comments are invited by 22 January 2014. The Law Commission intends to publish its report in June 2014.

The Kay Review raised concerns, in particular, about the length of the investment chain with growing numbers of intermediaries between an investor and the company in which they invest and about the nature of the relationships along the chain. A specific Kay recommendation was that fiduciary standards should be applied to all relationships in the investment chain which involve discretion over the investments of others or advice on investment decisions. Another recommendation was that the Law Commission be asked to review the legal concept of fiduciary duty as applied to investment, hence this consultation paper.

The initial position of the Law Commission is that:

- in general, the law of fiduciary duties which applies to pension trustees is satisfactory. The problems arise from other factors, such as the structure of the market;
- the Commission has concerns, however, about the way that fiduciary duties apply to contract-based pension providers and questions whether the duties on contract-based pension providers to act in the interests of scheme members should be clarified and strengthened;
- the Commission does not think that it would be desirable to reform the law of fiduciary duty by statute: this would create new uncertainties and have unintended consequences, but it might be useful to enact specific obligations. An alternative route, on which views are sought, is to extend the right to sue for breach of Financial Conduct Authority (FCA) rules (through the amendment and extension of Financial Services and Markets Act 2000, s 138D);
- overall, many of the problems raised can only be addressed through FCA regulation and the suggestion is that there should be a review of the FCA regulation of investment consultants and custodians, as stakeholders have expressed particular concerns about these areas.

Replacing the IR 1986

Draft Insolvency Rules

The Insolvency Service has published a working draft of new Insolvency Rules to replace the Insolvency Rules 1986. This project has been underway for some time. The draft (which can be accessed at www.gov.uk/government/consultations/modernisation-of-the-rules-relating-to-insolvency-law) reflects improvements in the layout, structure and language of the rules, together with technical changes, together with reforms arising from the Government's Insolvency Red Tape Challenge. Comments on the draft rules (379 pages) are invited by 24 January 2014.

CASES

Informal assent to director exploiting opportunities

Court of Appeal considers CA 2006, s 175

The Court of Appeal has considered the issue of informal shareholder assent to what would otherwise be a breach of CA 2006, s 175 (conflict of interests). The case arose out of divorce proceedings and concerned the exploitation of opportunities (acquisition of dental practices) by the wife (W) who was a (sole) director and 25% shareholder in a company with her husband (S, 25%) and his family (K, 25% and R, 25%). She argued that the shareholders had consented to her exploiting opportunities in her own right while S alleged she was in breach of fiduciary and statutory duties as the director of the family company.

W had acquired two dental practices in her own name before the family company was set up and subsequently the family company acquired a further five dental practices and she acquired a further five practices in her own name. It was conceded by counsel that, absent consent of the other shareholders, her conduct would have been a breach of the no conflict and no profit rule.

At first instance, the judge found that the shareholders had acquiesced in W's solo ventures and therefore there was no breach of duty. The Court of Appeal unanimously dismissed an appeal with Jackson LJ giving the only judgment. Jackson LJ said the court would apply the following principles in applying the statutory duty imposed by CA 2006, s 175 (the parties accepted that for present purposes there was no material difference between the statutory position and the pre-existing fiduciary duties imposed by equity):

(i) A company director is in breach of his fiduciary or statutory duty if he exploits for his personal gain (a) opportunities which come to his attention through his role as director or (b) any other opportunities which he could and should exploit for the benefit of the company.

(ii) If the shareholders with full knowledge of the relevant facts consent to the director exploiting those opportunities for his own personal gain, then that conduct is not a breach of the fiduciary or statutory duty.

(iii) If the shareholders with full knowledge of the relevant facts acquiesce in the director's proposed conduct, then that may constitute consent. However, consent cannot be inferred from silence unless:

(a) the shareholders know that their consent is required, or

(b) the circumstances are such that it would be unconscionable for the shareholders to remain silent at the time and object after the event.

(iv) For the purposes of propositions (ii) and (iii) full knowledge of the relevant facts does not entail an understanding of their legal incidents. In other words the shareholders need not appreciate that the proposed action would be characterised as a breach of fiduciary or statutory duty.

The judge's findings of fact could not be challenged. On the basis of those findings, the parties had specifically turned their minds in a family meeting to the possibility of W acquiring further dental practices in her own name. All the material evidence had been clearly put before the family. On the evidence, K had expressly consented to this possibility. S and R had remained silent during those discussions, however, in the factual circumstances of the case (including the fact that they invariably deferred to K), their silence had amounted to consent. On the basis of the judge's findings of fact, the shareholders with knowledge of the material facts acquiesced in an arrangement whereby the director (W) was free to acquire some dental practices for the company and others for herself: *Sharma v Sharma* [2013] EWCA Civ 1287, [2013] All ER D (291) (Oct).

Damages for trespass

No aggravated damages for companies

The Court of Appeal has considered the availability of aggravated damages for companies in a trespass case concerning a dispute between a landlord (L) and tenant (T) over the location of air-conditioning units on the roof of a building. The substance of that dispute is not of interest, particularly, but the Court of Appeal also considered whether the trial judge (having found in favour of L) had been correct in refusing to award aggravated damages to L which was a company.

Patten LJ (with whom Clarke and Tomlinson LJJ agreed) ruled that aggravated damages are not recoverable by a limited company because the focus of such damages is on the effect of the defendant's conduct on the claimant's subjective feelings which in the case of a company is not a possibility. In so far as Caulfield J had awarded such damages to a company in *Messenger Newspapers Group Ltd v National Graphical Association* [1984] IRLR 397, that decision should be viewed as wrongly decided: *Eaton Mansions* (*Westminster*) *Ltd v Stinger Compania* [2013] EWCA Civ 1308, [2013] All ER (D) 11 (Nov).

Identifying beneficial interests

Power to impose restrictions in the articles

Given the consideration currently being given by the Government to the extension of CA 2006, s 793 (notice by public companies requiring information about interests in shares) to all companies, it is timely that the High Court recently considered an exercise of that power and its consequences. CA 2006, s 793 allows a public company to serve notice on any person requiring the disclosure of interests held in the company's shares (including interests held in the preceding 3 years).

In this case, the company was concerned about a possible takeover 'raid' and served notice on the claimants. In the face of what the company considered to be inadequate answers, the board proceeded to exercise powers in the company's articles which, in such circumstances, allowed for restrictions to be imposed on the shares, in particular, restrictions on their voting rights. The impact which this had would be to make it more likely that various resolutions would be passed at a general meeting some days later (about board composition, allotment of shares, pre-emption rights and purchase back of the company's shares). Interim relief was secured which resulted in the meeting proceeding and the claimants being allowed to vote, subject to the court's subsequent ruling on the validity of the restrictions. This validity issue then was before Mann J whose judgment contains a very useful (and rare) analysis of the scope and nature of these powers in s 793 and Part 22 of the CA 2006.

The court ruled that the notices under CA 2006, s 793 had been validly served, the questions asked had been sufficiently clear and were valid questions, and the board of the company had reasonable grounds for believing the responses to be inadequate, such that the powers under the articles to impose restrictions on the shares could be exercised.

However, the court found that the majority of the board saw the imposition of the restrictions on the shares as a useful counter to the 'raiders' and their plans and as something which maximised the chances of getting the resolutions passed at the general meeting which the directors thought was in the best interests of the company. Mann J accepted that there was no challenge to the genuineness or reasonableness of the directors' belief as to what was in the best interests of the company. However, they had used a power given for a limited purpose (to obtain information as to interests in shares) for another purpose (to stop the 'raiders' in the interests of the company) and this impermissible purpose was a substantial, if not the principal, purpose for exercising the power to impose restrictions. The exercise of the power was therefore voidable and should be set aside, Mann J held: *Eclairs Group Ltd v JKX Oil & Gas plc* [2013] EWHC 2631 (Ch), [2013] All ER (D) 17 (Sep).

Fiduciary duties

Whether shadow directors owe fiduciary duties

An interesting case concerning allegations of breach of fiduciary duty by a director (B) and by another person (R) alleged to be a shadow director (SD) has been before Newey J in the High Court. The allegations centred on the withdrawal of £10m at a time when the company was in significant financial difficulties.

In a lengthy and interesting judgment Newey J accepted that B had been accustomed to act in accordance with directions or instructions from R, hence, R was a SD of the company. The question then was as to the duties of a SD and Newey J considered, at [142], that there are a number of reasons for thinking that SDs commonly owe fiduciary duties to at least some degree, an issue on which there is little authority. Newey J considered that:

(i) A SD will have assumed to act in relation to the company's affairs and to ask the de jure directors to exercise powers that exist exclusively for the benefit of the company.

(ii) A person who gives directions or instructions to a company's de jure directors in the belief that they will be acted on can fairly be described as assuming responsibility for the company's affairs, at least as regards the directions or instructions he gives.

(iii) Although Parliament has not designated SDs as directors for all purposes in the Companies Acts, it has provided for important consequences to flow from the status. For example, a SD is treated as a director in the context of CA 2006, Part 10, Ch 4 (transactions with directors requiring approval of members) and a SD can be the subject of proceedings under the Company Directors Disqualification Act 1986 and can be held liable for wrongful trading (see IA 1986, s 214(7)).

(iv) There is a compelling analogy with the position of promoters. Promoters owe fiduciary duties as a result of their acceptance and use of powers 'which so greatly affect the interests of the corporation'. A SD, too, can be said to choose to make use of powers which 'greatly affect the interests of the corporation'.

(v) A SD's role in a company's affairs may be every bit as important as that of a de facto director, and de facto directors are considered to owe fiduciary duties.

(vi) That a SD may not subjectively wish to assume fiduciary duties cannot matter as such.

(vii) Public policy, so far as it may matter, points towards fiduciary duties being imposed on SDs.

To the extent that Lewison J in *Ultraframe* (*UK*) *Ltd v Fielding* [2005] EWHC 1638 (Ch), [2005] All ER (D) 397 (Jul), at [1289], had indicated to the contrary, Newey J thought that decision understated the extent to which SDs owe fiduciary duties.

In making the payments which they did, B and R were trying dishonestly to extract the company's remaining cash before it failed and, thus, to thwart the company's creditors. Their conduct was dishonest by normally accepted standards of honest behaviour (so the claim fell within the Limitation

Act 1980, s 21(1)(a) and no limitation period applied) and they were liable: *Vivendi SA v Richards* [2013] EWHC 3006 (Ch), [2013] All ER (D) 112 (Oct).

Breach of duty and of shareholders' agreement

Extent of restraint on competing business

A director (T) was found in breach of his duties as a director and of his obligations under his employment contract when he took advantage (via another company which he set up) of lucrative business opportunities which had come his way during his work for the company (I Ltd).

The court also considered whether he was in breach of a shareholders' agreement which precluded him from being involved in any business which would be in competition with I Ltd. T sought to deny such a breach by a detailed examination of the products made by I Ltd when compared with the products of T's other company.

On this issue, Mrs Justice Rose said that, when considering the scope of I Ltd's business for the purpose of applying the restraint provision in the shareholders' agreement, it would not be right to draw very fine distinctions between the different kinds of products supplied in this sector (monetizing video content on the internet). I Ltd was a start-up company and its products were likely to evolve. Therefore, the correct approach to the question of whether the companies competed with each other is not to look at a snap shot of what they are actually selling to clients at any particular moment, she said, but to look more broadly at the kinds of products they sell and the way that such products are likely to develop. On that basis, T was also, as a shareholder, in breach of the shareholders' agreement: *Invideous Ltd v Thorogood* [2013] EWHC 3015 (Ch), [2013] All ER (D) 204 (Oct).

Directors' duties

Misfeasance, recouping payments in disregard of creditors' interests

Joint liquidators of a company brought a misfeasance claim (IA 1986, s 212) against a director (C) in respect of a number of payments which he caused the company (H Ltd) to make between November 2005 and October 2008, a period during which H Ltd's net liabilities increased from £535,000 in 2004 to £2.7m in 2007. Some of the payments were to his own benefit, others to the benefit of particular creditors of H Ltd.

The court found that, on the evidence, H Ltd had been insolvent throughout the period during which the payments complained of were made. The decision to make the payments was made by C without any consideration to the best interests of H Ltd's creditors as a whole.

The court noted that established, definite, insolvency before the transaction or dealing in question is not a pre-requisite for a duty to consider the interests of creditors to arise. The underlying principle is that directors are not free to take actions which put at real (as opposed to remote) risk the creditors' prospects of being paid, without first having considered their interests rather than those of the company and its shareholders. Exactly when the risk to creditors' interests becomes real for these purposes will ultimately have to be judged on a case by case basis.

In effect, the court said, C had been choosing which creditors to pay, and which to leave exposed to a real risk of being left unpaid. An intelligent and honest man in C's position could not, in the circumstances, have reasonably believed that making the payments had been for the benefit of H Ltd, nor of its creditors as a whole. Accordingly, he had acted in breach of duty with regard to the payments. C had not satisfied the court that he had acted reasonably in making the relevant payments. Accordingly, he had no grounds for statutory relief under CA 2006, s 1157.

The appropriate relief was to order C to pay (or repay so far as the payments had been made to him) to H Ltd the sums which he had wrongfully caused to be paid out, but where the payments had discharged genuine liabilities of H Ltd, C was entitled to any dividend payable in the liquidation in respect of that debt. C would also be entitled to prove in the liquidation in the normal way for sums which H Ltd owed him: *Re HLC Environmental Projects Ltd, Hellard v De Brito Carvalho* [2013] EWHC 2876 (Ch), [2013] All ER (D) 240 (Sept).

Administration

Director's application for administration order opposed by two directors subsequently appointed

Where a sole director made an application for an administration order (AO) and, subsequent to the application, the shareholders appointed two further directors, as they were entitled to do, and those two directors opposed the application, the court could refuse to make the order though it had jurisdiction to do so.

The court clearly thought there would be little harm in what might just turn out to be a delay in obtaining the AO, particularly as the three directors would continue to be subject to the duties imposed on them as directors to have regard to the interests of creditors as well as members of the company. It would be incumbent upon them rapidly to form a view, the court said, as to the future direction of the company and as to whether it was appropriate for steps to be taken to put it into an insolvency proceeding.

In all the circumstances, therefore, the court held it would not be right to take that step at the instant time and, accordingly, the court would refuse to make an AO on the application of the sole director, as he was at the time of the application: *Popham v Information Governance Holdings Ltd* [2013] EWHC 2611 (Ch), [2013] All ER (D) 262 (Oct).

Power of directors to challenge appointment

An issue before the High Court recently was the question of whether, following the appointment of administrators by a bank, the directors had power to challenge the validity of the appointment in the light of IA 1986, Sch B1, para 64 which provides that an officer of a company in administration may not exercise a management power without the consent of the administrator. 'Management power' being defined in para 64 as a power which could be exercised so as to interfere with the exercise of the administrator's powers.

The court held that, on the true construction of IA 1986, Sch B1, and applying settled law, the concept of 'management power' was primarily intended to catch powers which, if exercised by the directors, could impede the exercise of similar powers by the administrators. Paragraph 64 was not intended to catch a power on the part of the directors to cause the company to make an application challenging the logically prior question of whether the administrators had any powers to exercise at all.

It was settled law that, even after the appointment of a provisional liquidator, the board of directors of a company retained a residuary power to instruct lawyers to challenge the appointment of the provisional liquidator, to oppose the petition and, if a winding up order was made, to appeal against the making of that order. Likewise, it was common for directors to challenge the appointment of receivers and there was no reason in principle why the position should be any different with regard to the appointment of administrators. Directors have the authority to challenge the appointment of administrators and such authority is not dependent upon the provision by them of an indemnity for costs: *Closegate Hotel Development* (*Durham*) *Ltd v McLean* [2013] EWHC 3237 (Ch), [2013] All ER (D) 308 (Oct).

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