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Butterworths Corporate Law Update

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RECENT DEVELOPMENTS

Transparency and Trust

Government response

The Government has published its response to the consultation document launched last July entitled Transparency and Trust, Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business. It intends to proceed as follows across a wide range of issues:

- *Beneficial Ownership*: there will be a central public register maintained by Companies House of company beneficial ownership information – requiring disclosure of beneficial ownership by any person with an interest in more than 25% of the shares or voting rights or who otherwise exercises control over the management of the company; disclosure obligations will apply to the company and to the beneficial owner; the disclosure requirements will not apply to overseas companies, nor traded companies which comply with Disclosure and Transparency Rules (DTR) 5, but will extend to companies limited by guarantee and to LLPs; details of when the beneficial interest was acquired and how it is held will be required, as well as name, address, date of birth, nationality, country of residence; details will be provided to Companies House on incorporation and then updated at least annually; there will be criminal sanctions for non-compliance.
- *Bearer shares*: the issue of new bearer shares will be prohibited and there will be a short period (nine months is proposed) when existing bearer shares will have to be surrendered for conversion to registered shares. Thereafter, the company will apply to court for permission to cancel any shares which have not been surrendered with any money due paid into court.
- *Corporate Directors*: there will be a general prohibition on the use of corporate directors, with exceptions for categories yet to be finalised,

but exclusions are likely for groups containing a large listed company or a large private company and charities; existing corporate directors will be given one year to vacate office – there are thought to be about 67,000 corporate directors currently on the record at Companies House.

- *Disqualification*: there will be changes to the disqualification regimes, in particular Schedule 1 of the Company Directors Disqualification Act 1986 will be replaced with new, broader and more generic provisions focusing on culpability and the impact of the director's behaviour, his track record and any overseas convictions; the time limit within which 'unfitness' proceedings (s 6) may be brought will be increased from two years to three; it will be possible to bring disqualification proceedings against a person convicted of a serious criminal offence in connection with the promotion, formation or management of a company overseas; and the courts will get powers to make a compensation order against a director who has been disqualified where creditors have suffered identifiable losses from their misconduct; and the Insolvency Service will be able to accept compensation undertakings.
- *Claims on insolvency*: administrators will be given powers to pursue claims for wrongful and fraudulent trading (Insolvency Act 1986 (IA 1986), ss 213 and 214); and officer holders will be able to assign to creditors or other third parties claims for such trading and for transactions at an undervalue (s 238), preferences (s 239), and extortionate credit transactions (s 244).

Many of these matters will require primary legislation, however, and it is not clear when that Parliamentary time will become available.

The full Government Response and the original Consultation Paper, Transparency and Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business are available at www.gov.uk/government/consultations/company-ownership-transparency-and-trust-discussion-paper.

Company Filing Requirements: Red Tape Challenge

Government response

Linked to the Transparency and Trust response, noted above, the Government has published its response to the consultation launched last October on deregulatory measures affecting company filing requirements. It has decided to proceed as follows:

- *Annual filings*: companies that make changes within a 12-month period (for example, to appoint a new director) will be asked at the same time if they wish to check and confirm other information on the public record, if they do so, then they need not check and confirm for another 12 months. A company which has not confirmed its information will receive a reminder from Companies House around 11 months to check all their information no later than 12 months from the last confirmation. These requirements are instead of requiring a company to complete an annual return at a set point in the year.

- *Company registers*: private companies will have the option of keeping their registers of directors, of secretaries, of members, and the proposed register of beneficial ownership on the public register only rather than also maintaining company registers.
- *Statements of Capital*: the content will be simplified by removing the requirement to list the amount paid and unpaid on each share.
- *Lists of subsidiaries*: companies will have to provide a full list of subsidiaries in their annual accounts.
- *Companies House* will have greater powers to use electronic communications and companies will be able to opt in to receiving communications electronically. Companies which wish to add additional information (not required by the statute) to the public register may do so, for example, a trading address.
- *Registered offices*: the registrar of companies will be able to change a registered office address when there is evidence that the company is not authorised to use that address.
- *Directors and company secretary appointments*: companies will not need to file a 'consent to act' for newly appointed directors and company secretaries, instead the company will make a statement of truth that the person has consented to be a director/secretary. Directors will be able to object if they consider they should not have been entered on the record as a director.
- *Strike off and dissolution*: the timescale for these processes will be reduced.

The Government response and the original consultation document, Company Filing Requirements, Red Tape Challenge are available at www.gov.uk/government/consultations/company-filing-requirements.

CASES

Transactions at an undervalue

Was the company insolvent?

Where a company enters into a transaction at an undervalue with a connected person (IA 1986, s 238), there is a presumption (s 240(2)) that the transaction was at a time when the company was unable to pay its debts within the meaning of IA 1986, s 123, which contains what are known as the cash-flow and balance-sheet tests of insolvency.

A question before the Court of Appeal recently was whether, if it could be shown that a company was cash-flow solvent that ended the discussion without the need also to consider whether the company was balance-sheet solvent.

The application of the tests in IA 1986, s 123 was considered by the Supreme Court in *BNY Corporate Trustee Services Ltd v Eurosail* [2013] 1 BCLC 613 and this latest case gave the Court of Appeal an opportunity to apply that decision.

The Court of Appeal held that the balance-sheet test in IA 1986, s 123(2) was not excluded merely because a company was, for the time being, in fact paying its debts as they fell due. The tests of cash-flow insolvency and balance-sheet insolvency featured as part of a single exercise, namely to determine whether a company was unable to pay its debts as they fell due. In addition, when applying the cash-flow test, it was not enough merely to ask whether the company was, for the time being, paying its debts as they fell due, the court must go on to inquire, how it is managing to do so.

On the facts in the case, the company was only able to pay its debts by taking new deposits from customers, each deposit resulted in a liability to that depositor, but the circuit judge had not asked how those liabilities were to have been satisfied. The company could not properly have used the new moneys received to pay the old debts and therefore it was cash-flow insolvent at that time. It was also balance-sheet insolvent at the material time as a relevant asset, a loan to a connected company, had no value. The presumption that, at the relevant time, the company was unable to pay its debts had not been rebutted: *Re Casa Estates* (*UK*) *Ltd, Carman v Bucci* [2014] EWCA Civ 383, [2014] All ER (D) 33 Apr.

Tracing in the Court of Appeal

Inferences from banking transactions

A director had the company pay £500,000 from its bank account to another company (‘M’) in Latvia. The next day, a Ukrainian company (‘I’) paid an equivalent amount, less a commission of 1.3%, to V, to whom the director was indebted in the sense that the director had managed and lost a lot of V’s money and wished to make amends for those difficulties. The payment made the company insolvent and it went into a creditors’ voluntary liquidation.

The question was whether the liquidator for the company could trace the company’s money into the bank account of V though the company could not point to transactions between M and I showing how the company’s funds had been translated into the payment to V.

The Court of Appeal held that the liquidator was entitled to recover the proceeds of the company’s property by the process of tracing. The judge had been entitled to draw the inference that the company’s money had been the source of the money paid to V, a payment by I made on the faith of an arrangement that M would provide reimbursement and he was entitled to conclude that the first and second payments had been causally and transactionally linked. There had been plenty of material from which the judge had been able to draw the inference, in particular the similarity in timing and amounts, less commission.

It followed from established authority that when funds are transmitted through the banking system, what matters is that there is an exchange of the value of the claimant's property into the next product for which it is substituted and so on down the chain of substitutions. Money held on trust can be traced into other assets even if those other assets are passed on before the trust money is paid to the person transferring them, provided that that person acts on the basis that he will receive reimbursement out of the trust fund for the money he transferred.

In order to trace money into substitutes, it was not necessary, the court said, that the payments should occur in any particular order, let alone chronological order and so it did not matter that the payment was made to V by I before M reimbursed I. What the court has to do is establish whether the likelihood is that money could have been paid at any relevant point in the chain in exchange for a promise to reimburse.

The liquidator was entitled to trace the company's money to the payment by I to V who could not establish that he gave value for the payment so as to make him a bona fide purchaser for value: *Reflo Ltd v Varsani* [2014] EWCA Civ 360, [2014] All ER (D) 59 (Apr).

Unfairly prejudicial conduct

Conduct of the company's affairs

A petitioner appealed against the striking out of elements of a petition alleging unfairly prejudicial conduct of the company's affairs (Companies Act 2006 (CA 2006), s 994). One of the issues was whether the judge had been right to strike out allegations of non-compliance by shareholders with a pre-emption provision. The non-compliance in this case meant that the petitioner was denied an opportunity to secure a 27% shareholding.

Arden LJ noted that, on its own, non-compliance with a pre-emption agreement for the sale of shares in the company would not be an act which amounts to the conduct of the company's affairs, for an act done in the conduct of the shareholder's personal affairs is not the conduct of the company's affairs. There was a shareholders' agreement in this case, however (though its exact nature had yet to be established), which provided for remuneration for the directors (the petitioner had been a director until removed) by way of dividend which would mean that the size of shareholding would be important. Directors' remuneration and the company's distribution policy are matters, Arden LJ said, within the conduct of the company's affairs. There was then a possibility that the non-compliant share purchase allegation was capable of being an allegation with respect to the conduct of the company's affairs and therefore it should not be struck out of the petition.

McCombe and Vos LJJ agreed, but from a slightly different perspective it seems, with each emphasising that the dilution of the petitioner's shareholding was part of the alleged exclusion of the petitioner from the management of the company which is the sort of conduct which s 994 is designed to address. It is not entirely clear whether it suffices to show dilution as an aspect of unfairly prejudicial conduct such as exclusion, or whether it is necessary to show dilution and unfairly prejudicial conduct as a consequence of the dilution, points on which there seemed to be some divergence between McCombe and Vos LJJ. On a strike out appeal, these points did not need resolution.

There was also a cross-appeal by the respondents on the basis that the petitioner should have accepted an offer to buy him out and his failure to do so justified striking out the petition. The Court of Appeal disagreed as the offer made did not comply with the established guidelines on these offers laid down in *O'Neill v Phillips* [1999] 2 BCLC 1, not least because the petitioner had not been able to make submissions to the valuer and had not been sent a copy of the valuation report at the time of the offer. The appeal against striking out was allowed and the cross-appeal dismissed: *Graham v Every* [2014] EWCA Civ 191, [2014] All ER (D) 260 (Feb).

Unfair prejudice

Unfair exclusion, behaviour of petitioner, fair offers

Shareholders in a private company had fallen out and the petitioner alleged that the failure of the company to comply with an exclusive supply agreement which he had with the company was unfairly prejudicial conduct (CA 2006, s 994) as was his unfair exclusion from the management of the business (he had been removed as a director after a period of complaining of exclusion).

The respondents argued that there was no exclusive supply agreement and that it was the petitioner's own conduct in making unfounded allegations about the conduct of the majority shareholders and directors which justified his exclusion.

The court accepted that the evidence did not support the existence of an exclusive supply agreement, but equally it did not accept that the petitioner's conduct justified his exclusion. HHJ Cooke said that in principle there may be cases in which the conduct of a member after admission to a company may mean that his exclusion from management, although prejudicial to his interest as a member, is not unfair, but he considered such cases would be relatively rare. In most cases, where a minority shareholder has been admitted on the basis that he will participate in management, if the majority thereafter for whatever reason conduct the business so that he is excluded or practically excluded from it, the court will be likely to find that this is unfair.

The petitioner had been justified in feeling that the affairs of the company were being conducted without involving him in the manner that had been agreed when he became a member and, while his behaviour was a substantial cause of the deterioration in relationships within the company, it was not the sole cause and he was already suffering from unfair exclusion from the affairs of the company at that stage. Where, as here, there is a degree of fault on both sides, it will not normally be productive, HHJ Cooke said, to inquire into the relative degrees of such fault and whether they excuse what would otherwise be an unfair exclusion.

On the facts, however, the respondents had made a fair offer to purchase the petitioner's shares and his only objection to it was that he wished to buy their shares, but there was nothing on the facts which would justify such an unusual order. The result was that any prejudice that he had suffered was not unfair as he had been offered the opportunity to realise his shares for a fair price. The petition was dismissed: *Khoshkhou v Cooper* [2014] EWHC 1087.

Unfair prejudice

Proposed unfairly prejudicial conduct, risk of repetition

Majority shareholders (55.9%) sought summary judgment dismissing a petition brought by a minority shareholder (43.6%) under CA 2006, s 994, alleging in essence that proposals for a voluntary winding up of the group (comprising the company and a subsidiary), giving her a return of less than a quarter of the group's net assets, would be unfairly prejudicial to her interests as a member. The proposals were subsequently withdrawn and the applicants sought summary judgment dismissing the petition while the respondent sought permission to amend the petition, essentially to refocus on the degree to which the majority had received disproportionate financial benefits from the company compared to the dividends received by the respondent and that the risk of a repetition of the proposals meant that the respondent had no confidence that the group would be managed with regard to her interests.

The application for summary judgment dismissing the petition was refused and the application for permission to amend the petition was granted as the court considered that there was a reasonable prospect of the court concluding that there is a risk of a repetition of what looks like an attempt to draw disproportionate and unjustified benefits from the group in favour of the majority and in a manner which is unfairly prejudicial to the interests of the minority: *Hurd v TPL Holdings Ltd* [2014] All ER (D) 266 (Mar).

Meeting improprieties

Working men's club

While the rules for meetings of working men's clubs are not the same as those for company meetings, a recent Court of Appeal case on meeting improprieties in a club offers some interesting comments equally relevant to company meetings, not least the point that if a meeting is called to correct procedural deficiencies in an earlier meeting, it is important that every care is then taken to follow the correct procedures, particularly so when the meetings are to resolve differences between rival factions over compliance with the rules.

The trial judge's view that an election by acclamation or show of hands when the rules required a ballot was a failure of form rather than substance was incorrect. While the judge had been influenced by the fact that the election was unanimous, Lewison LJ noted that unanimity is easier to achieve in an open election than in a secret ballot which is itself a reason why it is important that elections be conducted by ballot rather than by acclamation or a show of hands. In this case, the sole business of the meeting was to elect officers in accordance with the rules so as to resolve the disagreements between the rival factions. In that context, it was all the more important for the rules to be scrupulously complied with. It followed that the elections were invalid.

A failure of a committee expressly to fix the date of a meeting as required by the rules could be cured by the application of the *Duomatic* principle applicable to companies (informal unanimous assent is as good as a formal resolution passed by a majority: *Re Duomatic Ltd* [1969] 2 Ch 365) which must apply also to club committees: *Speechley v Allott* [2014] EWCA Civ 230, [2014] All ER (D) 89 (Mar).

Group companies

Management charges – failure to act in the interests of the subsidiary

A claim was brought against directors of a subsidiary company (which had gone into administration and been sold to a third party) by the company's former administrators to whom the claim had been assigned. Essentially, the claim alleged that the directors had procured the payment of management fees (£412,739) to the parent company in the final financial year prior to administration through the management services rendered were of uncertain value and the subsidiary's financial position was deteriorating rapidly. The directors of the two companies were essentially identical, all members of the same family, and about 2/3 of the management fee received by the parent company was paid out in directors' salaries.

The judgment highlights a number of errors made by the directors, many of which probably commonly occur in family-run groups of this nature. The court found that:

- There was a surprising lack of documentation surrounding the terms of the service agreement, the nature of the management services to be provided; and their value to the subsidiary.
- There were no board minutes or other documentation showing that the directors either considered the management charge from year to year or made declarations as to their interest in the payment of the management charge, given the common ownership and boards of the two companies.
- The court was unimpressed by the argument that the lack of documentation reflected the informality with which these types of companies are commonly run, suggesting that where an agreement is made with the same individuals acting on both sides, and perhaps especially when they are the same family, it may understandably be said there is a heightened need for some formal, written, record, especially with respect to an agreement which endures for years and involves sums of the magnitude in this case. If the lack of documentation now caused the directors' problems, the court considered that they were problems entirely of their own making.
- There was no evidence to show that the directors had considered at any time:

(a) whether and to what extent it was appropriate and in the best interests of the subsidiary to commit it to incurring a liability to pay management charges to the parent company;

(b) whether and to what extent the subsidiary was receiving value for money for such charges;

(c) whether they had placed themselves in a position of conflict (given their relationship with the parent company) and how such a conflict might be resolved;

(d) whether paying the parent company in the final year when financial difficulties were mounting might be preferring the parent over other creditors.

The directors were found liable for breach of fiduciary duty and of the duty of care owed to the subsidiary: *McTear v Engelhard* [2014] EWHC 1056, [2014] All ER (D) 150 (Mar).

Directors' duties

Conspiracy to injure by unlawful means

Recent years have seen an increasing reliance on claims against directors and others for conspiracy to injure by unlawful means coupled with more traditional claims for breach of fiduciary duty and breach of contract.

The High Court recently considered such a case where E, a director of a company (BSW) left and formed a new, competing company with X, another former director of BSW who had been unfairly dismissed by BSW. While much of the judgment, as is typical of these cases, contains an exhaustive analysis of the facts, what is of interest is the useful guidance given by Norris J on the key ingredients needed to establish such a conspiracy claim.

Noting that 'the tort of conspiracy to injure by unlawful means requires an agreement, combination, understanding or concert to injure, generally referred to as "concerted action taken pursuant to an agreement" (though the "agreement" must be taken as referring not to a contract but to a combination with a common intention) (Clerk and Lindsell on Tort (20th Edn) paras 24–92), Norris J went on to comments on as follows:

a) Coincident events are not by themselves sufficient to establish a combination. There must be a connection between the events through the participants in the events.

b) To establish that connection it is not necessary to show anything in the nature of an express agreement (formal or informal). Deliberate (if tacit) combination to achieve a common end is sufficient, and that fact will almost invariably have to be inferred from overt acts: *Kuwait Oil Tankers v Al Bader* [2002] 2 All ER 271.

c) Inferring the fact of a combination to achieve a common end requires scrutiny of the acts relied on to see what inferences might properly be drawn from them.

d) The expression ‘concerted action’ is a useful reminder that conspiracy is distinct from conversation. Talking and speculating and planning which do not result in a settled and agreed course or which do not result in concerted action do not in my judgment amount to the tort of ‘conspiracy’. The tort of conspiracy does not inhibit freedom of expression: it prohibits action taken in combination.’

As to whether persons are co-conspirators, Norris J said it is not a case of being confined to looking for positive evidence of meetings between co-conspirators or evidence of an express agreement, rather it is a case of looking for actions on the part of the alleged conspirator from which it can properly be inferred, on the balance of probabilities, that they were actions taken pursuant to an express or tacit agreement or as part of a concerted action plan.

As for the mental element of the tort, Norris J said:

> ‘A conspiracy to compete is not necessarily a conspiracy to injure. Competition between businesses regularly involves each business taking steps to promote itself at the expense of the other. Far from prohibiting such conduct the common law seeks to encourage and protect it, recognising the economic advantages of competition. A conspiracy to injure must involve an intention to bring about what the law will regard as “an injury” by doing something that the civil or (in some cases) the criminal law does not allow. As regards the necessity for “intention”, it is important to underline that the requisite intention does not (in this branch of the tort) have to be a predominant intention: but an intention to harm must be proved.’

Norris J declined to endorse the existence of any tort of ‘inducing breach of fiduciary duty’, noting that there are well-developed principles within equity itself covering accessory liability based on knowing receipt and dishonest assistance.

On the facts, he concluded that E had been a party to a conspiracy to injure BSW by unlawful means, not by setting up a competing business, but in breach of fiduciary duty by the misuse of confidential information belonging to BSW which had been used by E in bidding against BSW for certain contracts: *First Subsea Ltd v Balltec Ltd* [2014] EWHC 866, [2014] All ER (D) 239 (Mar).

Provisional liquidators appointed

Stay on proceedings in Luxembourg

Where a company whose centre of main interests was in England had sought and secured the appointment of provisional liquidators in England, those proceedings were recognised as main insolvency proceedings within the Insolvency Regulation, EC1346/2000 and subject to the provisions of the IA 1986, including s 130, which imposes an automatic stay on actions and proceedings against a company in liquidation. Hence liquidation proceedings opened in Luxembourg against the company, without the permission of the

English courts, were an action or a proceeding that was stayed by s 130(2): *Re Arm Asset Backed Securities SA* [2014] EWHC 1097 (Ch), [2014] All ER (D) 88 (Apr).

Administration

Order to assign claims to company controllers

A company having gone into administration, a husband and wife who controlled the company but who were not shareholders, wanted the administrators to assign to them mis-selling claims (with respect to interest rate swaps products) against the company's banks. The administrators did not wish to pursue the claims directly.

The husband and wife brought a claim against the administrators relying on IA 1986, s 74 which allows claims on the basis that the administrator is acting or has acted so as unfairly to harm the interests of the applicant, whether alone or in common with some or all other members or creditors. To bring a claim, the applicant must be a creditor or member so the first defence was a lack of locus standi. The court agreed that, on the evidence, neither applicant was a member, but the wife was found to be a creditor and therefore she alone had standing.

It was also contended for the defence that the court should only interfere with the administrators' decision if it was perverse, drawing an analogy with the approach to challenging liquidators' decisions. The court rejected that contention saying there was no basis for looking to liquidation authorities when IA 1986, Schedule B1, para 74 applies a different test, of unfair harm, which should be applied without further gloss.

The court also rejected a defence claim that unfair harm necessarily required discrimination as between one creditor or member and another (which could not be established here) and noted that differential treatment is not the only form of unfairness capable of satisfying IA 1986, Schedule B1, para 74. A lack of commercial justification for a decision causing harm to the creditors as a whole may be unfair in the sense that the harm is not one which they should be expected to suffer.

The court accepted that the decision of the administrators not to pursue the mis-selling claim was entirely justifiable, on the basis that the claims could be made good only by reliance on evidence from directors who would have nothing to lose and the administrators would be spending creditors' money on the costs. But the court did not consider it justifiable also to decline to assign the claims. There would be some recovery (10%) to the administrators if the claims were successful and so it would unfairly harm the creditors if all the claims were simply lost. The court would therefore order an assignment of the claims subject to an indemnity for the company and the administrators against third party costs orders: *Hockin v Masden* [2014] EWHC 763, [2014] All ER (D) 206 (Mar).

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