Bulletin 167 **November 2014**

Butterworths Corporate Law Update

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

RECENT DEVELOPMENTS

BIS consults on new PSC Register

Further to the decision to implement a publicly accessible central register of the individuals who ultimately own and control UK companies (people with significant control), BIS is consulting on how this PSC register will be introduced. Provision for the register is made in the Small Business, Enterprise and Employment Bill currently before Parliament, but a great deal of detail as to how the register will work still remains to be worked out, hence this consultation on the detail of the PSC register.

The SBEE Bill requires the Secretary of State to publish guidance about the meaning of 'significant influence or control' and the paper seeks views on the structure, format and content of the guidance and asks whether an external Working Group would be a good way to develop it.

The paper also seeks views on the production of wider guidance, for example around the way PSC information must be obtained and held. This would accompany information produced by Companies House in relation to filing PSC information with the registrar.

It also seeks views on two key elements needed to implement the register that will be dealt with in secondary legislation. The first is the way a PSC's control over a company is recorded on the PSC register. The second is the way some PSC data needs to be protected from public disclosure. Responses are required by 9 December 2014.

The consultation document, *The Register of People with Significant Control* (*PSC Register*)*, Understanding the New Requirements, Recording Control on the PSC Register and Protecting People at Serious Risk of Harm* (October 2014) is available at www.gov.uk/government/uploads/system/uploads/attachment_data/file/367578/bis-14–1145-the-register-of-people-with-significant-control-psc-register-register-final-1.pdf.

UK Corporate Governance Code 2014

FRC updates Code and related Guidance

The FRC has issued an updated version of the UK Corporate Governance Code 2014 which applies to accounting periods beginning on or after 1 October 2014 for all companies with a Premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere.

Main changes include requirements regarding the directors' responsibilities with respect to going concern issues, both with respect to accounts, and with respect to liquidity and solvency (reflecting the recommendations of the Sharman Inquiry, see Update 153), hence:

- In annual and half-yearly financial statements, the directors should state whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements (see C.1.3).
- The directors should confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated (see C.2.1).
- Taking account of the company's current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so (and the expectation is that the period will be significantly longer than 12 months) and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary (see C.2.2).

On remuneration, the revised Code notes that schemes of performance-related remuneration for executive directors should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so (D.1.1). The inclusion of this provision is seen as indicative of the level of investor concern that companies should be in a position to clawback sums from directors in appropriate circumstances. The revised Code also makes amendments to Schedule A to the Code which considers elements of the design of schemes of performance-related remuneration for executive directors.

The revised code is available at www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf. The next version of the Code is expected in 2016.

In addition to the publication of the revised Code, the FRC issued revised 'Guidance on Risk Management and Internal Control and Related Financial and Business Reporting (The Risk Guidance)' which is an invaluable, updated, version of earlier (Turnbull) guidance on risk management and going concern issues. It is especially useful on how boards should address the issues raised by Section C of the Code, noted above. The Risk Guidance is available at www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Risk-Management,-Internal-Control-and.pdf.

ABI/IMA Principles of Remuneration reissued

Following the merger of the Investment Affairs division of the Association of British Insurers and the Investment Management Association (to be renamed the Investment Association, as of January 2015), the IMA has issued the latest version of what were the ABI Principles of Remuneration which provide influential guidance for listed companies as to shareholder expectations as to remuneration, as to the manner in which remuneration committees should approach their roles and on how variable remuneration should be approached.

The only significant change from the 2013 ABI version is that the Guidance address the issue of 'allowances' which seem likely to be the next focus for shareholder discontent. The Principles state that 'members consider that, in general, the use of allowances as part of fixed pay goes against the spirit of simplicity, clarity and pay for performance. If a remuneration committee considers that the payment of an allowance is necessary it should be clearly justified and explained within the context of the overall remuneration package'.

The IMA Principles of Remuneration (20 October 2014) are available at www.ivis.co.uk/media/10277/Principles-of-Remuneration-2014.pdf.

Implementation of the Kay Review

BIS reports on progress and highlights ongoing work

In July 2012, the Kay Review produced a wide-ranging report on UK Equity Markets and their impact on the long-term performance and governance of UK quoted companies which addressed a wide range of issues from the structure of shareholdings and the nature of the investment chain to the regulation of the markets and the importance of fiduciary duties (see Corporate Law Update 154). It provoked a range of initiatives, many from the Financial Reporting Council, some from the institutional investment community, others by the Department for Business, Innovation and Skills (BIS).

BIS has now produced a lengthy report on progress which usefully summarises developments on issues of, inter alia, corporate governance, narrative reporting, and investment management and pension trustee responsibilities, etc over the past two years.

As for the next steps, amidst a welter of ongoing work, there are a few issues to note particularly: there will be a continuing focus on stewardship and the

Stewardship Code; the Government will continue to support the development of the Investor Forum as a mechanism for effective collective engagement by investors in UK companies; and the Government is monitoring the impact of the reforms to the governance of directors' remuneration and will publish its findings shortly. Further, the Government will consider whether the system for holdings of securities electronically works effectively and efficiently for investors and issuers and will explore the most cost effective means for individual investors to hold shares directly on an electronic register should they wish to do so, as recommended by the Kay Review.

The BIS Report, *Building a Culture of Long-Term Equity Investment, Implementation of The Kay Review: Progress Report* (October 2014) is available at file:///G:/bmh%20working/LLM%20Corporate%20Governance%2014–15/Documents%20for%20Blackboard/bis-14–1157-implementation-of-the-kay-review-progress-report.pdf.

The Community Interest Company (Amendment) Regulations 2014, SI 2014/2483

These Regulations amend The Community Interest Company Regulations 2005, SI 2005/1788, to remove the share dividend cap for community interest companies (CICs). This share dividend cap created a maximum amount of dividend that could be paid per share as a percentage of the paid up value of the share and it was part of a number of measures designed as an asset lock to stop CICs using their assets inappropriately. It is no longer thought necessary to maintain this aspect of the asset lock and the share dividend cap is removed in respect of dividends declared or proposed to be declared on or after 1 October 2014, regardless of when they are paid.

CASES

Construction of articles

Whether 'one member one vote' applied on a poll as well as a show of hands

The Court of Appeal has ruled on a difficult point of interpretation of the articles of association of a flat management company.

Each flat owner in a block of flats owned one share in the management company. The articles of the company provided that 'each member present in person or by proxy shall have one vote' and expressly disapplied the provision in the applicable Table A articles which would have given different voting rights on a show of hands and on a poll.

The respondents owned 66 flats in the block of 104 and successfully argued at first instance that, as a matter of construction, the provision in the articles meant that each member had one vote on a show of hands, but on a poll would have one vote per share, giving them 66 votes on a poll as they held 66 shares in the management company. Alternatively, the court concluded, if that was not the correct construction of the provision, the language of the article gave rise to a commercial absurdity and should be departed from.

On appeal, the Court of Appeal disagreed, and ruled that the provision meant each member had one vote whether on a show of hands or on a poll, so a member who owned 66 flats had one vote as did a member who owned 1 flat. The Companies Act 2006, s 284 allows for one vote per member on a show of hands and one vote per share on a poll, but it is subject (s 281(4)) to any contrary provision in the articles, so there is nothing inherently implausible in the articles disapplying this approach and the language of the article in this case was sufficient clear to oust s 284.

A system of voting based on one member one vote fell well short of commercial absurdity. The language was clear and unambiguous and the court was not entitled 'under the guise of construing the contract, to rewrite it in order to arrive at a meaning which most accords with our view of business common sense' (per Floyd LJ).

Briggs LJ, while in agreement with the majority, was slightly more concerned about the commercial absurdity argument, but concluded that, while a structure which gave each member the same say regardless of how many flats they owned was unusual and might appear unreasonable, uncommercial or even undemocratic, it was not absurd: *Sugarman v CJS Investments LLP* [2014] EWCA Civ 1239, [2014] All ER (D) 139 (Sept).

Director's liability

Negligent misrepresentation on behalf of the company

On a sale of an aircraft, the chairman of the corporate owner of the aircraft made a misrepresentation which was found to be negligent as to whether the plane had been in an accident. It had in fact been damaged on a hard grounding as was clear from the pilot's log and maintenance logs. The purchasers, having bought the plane for \$5m, were only able to re-sell it for \$2.6m. The trial judge found that there had been a negligent misrepresentation by the chairman and awarded damages against the vendor company which had no assets.

On appeal, the appellants sought to argue that the chairman had made a fraudulent misrepresentation and had made it personally rather than on behalf of the company.

The Court of Appeal dismissed the appeal. There had been no evidence of dishonesty on the part of the chairman and nothing to justify the Court of Appeal interfering with the trial judge's view that the misrepresentation had been negligent.

Of greater interest is the issue of whether the chairman might have been personally liable for the misrepresentation. On this issue, Longmore LJ (with whom Gloster and Underhill LJJ agreed) noted: 'The natural way to bring home to a company director personally a charge of negligent misrepresentation would be to assert that the director made it clear that he was himself assuming responsibility for his representation in addition to his company. Such a claim has always had its problems since in a company context representations by directors are almost always considered to be made on behalf of their companies', citing *Williams v Natural Life Health Foods Ltd* [1998] 1 BCLC 689.

He went on: 'If a company is already actively present behind a director who negotiates a deal that will be very difficult to prove; the same must usually be true if the intention is that a contract will be made with the company of which the director is a director'. Later he described such a negligence claim as 'difficult and problematic', all of which offers reassurance to company directors with respect to representations made by them in the course of their duties: *Foster v Action Aviation Ltd* [2014] EWCA Civ 1368, [2104] All ER (D) 298 (Oct).

Bribery and secret commissions

Recovery of payments

In a comprehensive judgment reviewing the main (difficult) authorities in this area, HH Judge Havelock-Allan has provided a detailed account of the law of bribery and secret commissions and the basis of recovery in such cases.

The case concerned claims by Airbus Operations Ltd against three people, B who was the controlling mind of a sub-contractor (BTL), Wy who was a senior manager with Airbus and owed it fiduciary duties in that capacity and Ws who was a senior manager at a main contractor to Airbus.

BTL had a lot of work available to it from Airbus via the main contractor and to help with the workload B engaged Wy and Ws, through their private consulting companies, to assist in their evenings and weekends – the consulting companies received payments in the region of £½m each for this work. These arrangements whereby the net income derived by BTL from this work was split three ways were not revealed to Airbus. The work carried out by BTL was entirely satisfactory and the price was fixed and not influenced by these arrangements so there was no net loss to Airbus.

The court ruled that:

(i) This was a case of a secret commission rather than a bribe as there was no evidence of corruption on the part of the donor or the recipients. The payments substantially exceeded fair compensation for the work done and were explicable only on the basis that the positions which Wy and Ws held were advantageous.

(ii) The fact that Airbus suffered no loss was no impediment to the claim for the payments made. The fact that there was no privity of contract between BTL and Airbus made no difference, all that is required is that the payment is made by a donor who intends to do business with the principal, whether the business relationship is direct or indirect or down a contractual chain.

(iii) Wy was in a fiduciary relationship with Airbus and liable to account for the payments made to him and B was liable to account as the donor.

(iv) Ws was not in a fiduciary relationship with Airbus but was liable, as was B, in dishonest assistance to account for any profit which they received by virtue of assisting Wy in his breach of fiduciary duty to Airbus. The amount of that profit was their respective shares of the proceeds of the arrangement.

(v) The fact that the payments were made by the private company of B and received by the private companies of Wy and Ws made no difference. This was a case where, consistent with *Prest v Petrodel Resources Ltd* [2014] 1 BCLC 30, the court was lifting but not piercing the corporate veil. In each case the companies were being used to conceal what had occurred and on that basis, Wy and Ws and B were all personally liable.

Airbus Operations Ltd v Withey [2014] EWHC 1126

Application of Prospectus Directive

Whether applicable to forced sales of securities

On a preliminary reference from the Supreme Court of the Netherlands, the Court of Justice has ruled that the obligation to publish a prospectus prior to any offer of securities to the public is not applicable to an enforced sale of securities.

In this case, two Dutch companies had failed to meet their obligations under a particular agreement and their counterparty sought and obtained an attachment of shares held by the companies and an order for their sale by a judicial officer following advertisement in a national newspaper. The two companies claimed an enforced sale should be subject to an obligation to publish a prospectus.

The court noted that enforced sales are very different from normal trading in securities and are not intended as a means of participation in securities markets, but merely as a means to satisfy the rights of an attaching creditor. In these circumstances, potential purchasers are aware of the circumstances of the sale and do not require the level of protection of ordinary investors. To require a prospectus would involve delay and practical difficulties since it would require the cooperation of the management of the company whose shares are being sold and would raise issues as to who would be responsible for drawing up the prospectus and for its contents.

It followed that the objective pursued in the context of enforcement sales is entirely different from the objectives of the Prospectus Directive which therefore does not apply to forced sales: *Almer Beheer BV v Van den Dungen Vastgoed BV*, C-441/12, [2014] All ER (D) 130 (Sept).

Shareholders' agreement

Confidential information

A confidentiality clause in a shareholders' agreement required each party to 'treat as strictly confidential all commercially sensitive information' relating to the affairs of the company. There were standard exceptions allowing disclosure to bankers and legal advisers, subject to requiring those persons to treat the information as confidential, but no express exemption with respect to sales of shares to third parties.

The claimants argued that the defendants had disclosed information to prospective purchasers which had damaged the company's prospects by suggesting all the shares in the business were for sale. The defendants argued that they were allowed to disclose information to prospective purchasers, provided they required those persons to treat the information as confidential.

The court ruled that there was no scope for construing the clause in the shareholders' agreement in this way. The natural and obvious meaning of the clause was that information could not be disclosed or transmitted to anyone outside of the classes mentioned in the clause.

Disclosure outside of the permitted class was a breach of the shareholders' agreement. However, it was not possible to establish that the breach of this clause had caused any loss to the company for, while the company's business had declined, there was nothing to justify inferring that the drop in business was caused by the breach. Nominal damages of £1 were awarded for breach of contract: *Richmond Pharmacology Ltd v Chester Overseas Ltd* [2014] EWHC 2692, [2014] All ER (D) 92 (Aug).

Foreign companies

Winding up – connection with this jurisdiction

The High Court has rejected an attempt by English investors to wind up two companies (B and H) which had been incorporated in Saint Vincent and the Grenadines (SVG). The preliminary issue for the court was whether the English court should exercise its jurisdiction to hear winding-up petitions based on undisputed or largely undisputed debts, when neither of the companies was incorporated in England and Wales.

The case is important because the fact situation is not uncommon, of UK investors placing money in overseas investments which then fail to generate the expected returns.

The proceedings concerned debts which allegedly arose out of a hotel development in SVG. The petitioners were all investors who had paid deposits of 30% of the purchase price of individual hotel rooms sold as freehold investments, subject to a management agreement, under which they were to receive 10% of the purchase price for the first two years after completion of the hotel and, thereafter, 50% of the net rental income from the room. The petitioners contended that they had not received title to their hotel rooms and they claimed a total of £1.8m in respect of money due under finance agreements and in respect of the non-return of outstanding deposit monies.

The petitioners contended that the English court had jurisdiction on the grounds, inter alia, that the companies had acted via their main shareholder and sole director (who had dual English/SVG nationality and a home in

Essex) to sign all their contracts in England; had employees in England and dealt with the English investors in England.

The court dismissed the application. While the court has jurisdiction to wind up an unregistered company which is unable to pay its debts under Insolvency Act 1986 (IA 1986), s 221, the three core requirements under that jurisdiction are that: (i) there has to be a sufficient connection with England and Wales which might, but did not necessarily have to, consist of assets within the jurisdiction; (ii) there has to be a reasonable possibility, if a winding-up order is made, of benefit to those applying for the winding-up order; and (iii) one or more persons interested in the distribution of assets of the company must be persons over whom the court could exercise a jurisdiction. In addition to the three requirements, the court will always consider whether there is a more appropriate jurisdiction.

In the present case, while it was possible that (i) and (iii) were satisfied, it was clear that (ii) was not. Practically all the assets of these companies were situated in SVG, and there was undisputed evidence that SVG had a perfectly satisfactory winding-up process which was available to the petitioners. An English liquidator would be likely to face considerable and possibly insuperable difficulties in gaining control of the company's assets. It was clearly a case in which SVG was by far the more appropriate forum. Accordingly, it was not a case in which the court should allow a petition to wind up the companies to go forward.

There was a second interesting point as to whether, if it had been established that the companies' centre of main interests (COMI) was in England, the court had jurisdiction by virtue of the EU Regulation on Insolvency Proceedings, art 3(1), and no further regard needed to be given to the considerations, (i) to (iii), above. While the court's comments on this point were clearly obiter, the court concluded that the only effect of art 3(1) is to give the court jurisdiction and while, if a company's COMI is in this jurisdiction, it is highly likely that, by definition, the court will be satisfied of a substantial connection with this jurisdiction, otherwise the discretionary factors remain the same and apply. On that basis, even if COMI had been established in this jurisdiction, the court would still have refused to make winding-up orders: *Re Buccament Bay Resort Ltd*; *Re Harlequin Property* (*SVG*) *Ltd* [2014] EWHC 3130 (Ch), [2014] All ER (D) 32 (Oct).

Disqualification orders

Whether order can be sought when Crown Court has refused to disqualify

The Secretary of State sought a disqualification order against two directors under the Company Directors Disqualification Act 1986 (CDDA 1986), s 2, in circumstances where the two defendants had been convicted of fraud offences, but the Crown Court had expressly declined to disqualify them.

The court rejected the application for disqualification orders on the basis that this civil application for disqualification would cover exactly the same issues as founded the case for the criminal convictions. The application was no more than an attempt to obtain a different decision from the civil court than was given on identical issues by the criminal court which had the disqualification issues placed before it and which had made a positive decision to refuse an order.

The position might be different if the application for disqualification was brought under CDDA 1986, s 6 (unfitness) where the court would be likely to be looking at a much wider set of facts than those that founded the criminal conviction. The applications for disqualification were refused: *Secretary of State for Business Innovation and Skills v Weston* [2014] EWHC 2933, [2014] All ER (D) 43 (Sept).

Transactions at an undervalue

Assigning trademarks on insolvency to parent company

The High Court was asked to consider the assignment of trademarks by a company at a time when it was insolvent. The trademarks were transferred for £1 to the parent company of the group.

Application for relief by the company's liquidator were made under IA 1986, s 238 (transactions at an undervalue) and IA 1986, s 423 (transactions defrauding creditors), though as the court noted the heading is misleading as dishonesty is not required for s 423.

The court heard that the sole controller of the group considered that he was effectively the owner of the trademarks, wherever they happened to be within the particular corporate structures, because he controlled all the companies. The court noted that this is not an unusual approach from the perspective of an entrepreneur, but it is not, of course, the law.

As the expert evidence was that, on a going concern basis, the trademarks at the date of transfer had a value of £360,000, there was a ready concession by the defence that the (£1) transaction was at an undervalue and, as it happened, even the £1 was not paid. It was also clear that the purpose of the transaction was to put the trademarks out of reach of the company's creditors and that the company was insolvent at the time, so the court found it easy to conclude that relief should be granted on either ground, s 238 or s 423.

The question then was as to the appropriate relief which, under either provision, would put the parties in the position they would have been in if the impugned transaction had not occurred. The defence argued that, as the company would have gone into liquidation, if the trademarks had not been assigned, their value to the liquidator would only have been a break-up value.

The court disagreed, the correct approach was to look to the broad discretion of the court under IA 1986, s 423 as to the orders that might be made, including in s 425(1)(d) and a similar provision in s 241(1)(d), to make an order requiring any person to pay to any other person, in respect of benefits received from the debtor, such sums as the court may direct. That provision justified the court looking at the value of the assets in the hands of the recipient where the recipient was privy to the improper purpose in question.

The parent company got the benefit of the trademarks which enabled the existing and future businesses to be conducted on a going concern basis, and that is what the company lost. Therefore the parent company was liable to pay the liquidator the going concern value of the trademarks which was £360,000: *Re Husky Group Ltd* [2014] EWHC 3003, [2014] All ER (D) 319 (Oct).

Correspondence about this bulletin may be sent to Victoria Burrow, Content Acquisition and Development Specialist, LexisNexis, Lexis House, 30 Farringdon Street, London EC4A 4HH (tel: +44 (0)20 7400 2707, email: victoria.burrow@lexisnexis.co.uk). If you have any queries about the electronic version of this publication please contact the BOS and Folio helpline on tel: +44 (0)845 3050 500 (08:00–18:00 Monday – Friday) or for assistance with content, functionality or technical issues please contact the Customer Service teams between 08:00–18:30 Tel: +44 (0)800 007777; Email: contentsupport@lexisnexis.co.uk

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

ISBN 978-1-4057-8356-9
9 781405 783569