



COMPANY LAW MEMO 2009

Newsletter Issue 1

January 2009

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Welcome to the *Company Law Memo 2009* newsletter, highlighting important recent developments in company and insolvency law. You can also access comprehensive updates to specific paragraphs via our online updating service. We always welcome suggestions from readers, so please contact us if you have any comments.

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NEWS ROUND-UP

Consultation on taxation of foreign profits of companies

See CLM ¶1790

Under UK law, UK companies have to pay tax on foreign dividends (i.e. dividends from a non-UK company). They can claim credit for the amount of foreign tax paid by the non-UK company but this may still result in some UK tax to pay (note, however, that the courts have recently found that this dual system of taxation infringes Article 43 of the EC Treaty (freedom of establishment) where the dividends are received from member states (*Test Claimants in the FII Group Litigation v the Commissions for Her Majesty's Revenue & Customs* [2008] EWHC 2893 (Ch)).

This dual system has been considered by many businesses as administratively burdensome and, as a result, the Government is proposing a foreign profits **reform package**, under which certain businesses (usually medium-sized and large businesses) will be exempt from tax for dividends received (regardless of whether such dividends are from a foreign source), unless the exemption is used for tax avoidance purposes.

To cater for this proposal, Revenue and Customs and the Treasury have recently published for consultation draft legislative provisions which will amend the proposed Corporation Tax Act 2009 to include this dividend exemption. The draft provisions also deal with various other issues, including for example the introduction of a worldwide debt cap on deductible interest (to prevent large tax deductions being taken by group companies for intra-group interest payments).

The consultation is available at: <http://www.hmrc.gov.uk/consultations/index.htm>. The deadline for public responses is 3 March 2009.

Proposed EC Directive to cut cost of compliance

See CLM ¶3199

In 2008, the European Commission proposed to alter four of the European Company Law Directives to reduce the administrative burden and cost to companies in complying with **company accounting** and **disclosure requirements** (See *CLM 2008 Newsletter Issue 3*). The Commission regards this as important for boosting the European economy, particularly in relation to the benefits it could bring for small and medium-sized companies.

The Commission has now published a draft Directive to amend:

- » the Fourth Company Law Directive (EC Directive 1978/660) by removing the requirement for **medium-sized companies** to explain their formation expenses in notes on their accounts and to break down their turnover by activity and geographical market (these exemptions are already available to small companies in the UK); and
- » the Seventh Company Law Directive (EC Directive 1983/349) by exempting a **parent company** from having to prepare consolidated accounts and reports if it only has non-material subsidiaries.

The draft Directive has had its first reading in the European Parliament. It is proposed that member states will be required to implement the Directive by 31 December 2010.

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NEWS ROUND-UP cont...

ICSA guidance: accessing the register of shareholders

See CLM ¶3932

The Institute of Chartered Secretaries and Administrators (ICSA) has updated its guidance for companies on how to assess whether a **request to inspect or be sent a copy** of the register of shareholders under the new Companies Act is for a “proper purpose”. If any person (including a shareholder) wishes to inspect or receive a copy of part or all of the register of shareholders, he must submit a request to the company containing specific information, including the purpose for which the information will be used. The company must comply with the request within 5 working days, unless it believes that the request has not been made for a proper purpose, in which case it can apply to court for an order directing the company not to comply (s 117 CA 2006).

The new guidance updates and revises the previous version published by ICSA in June 2007 (see *CLM 2007 Newsletter Issue 4*). It includes:

- » new examples of the industry view on what is likely to be a “**proper purpose**” such as requests from:
 - Revenue and Customs;
 - a regulated provider of financial services, or a credit institution, for the purpose of carrying out identity checks or as an anti-fraud measure in connection with providing credit services;
 - creditors or potential creditors, before accepting security over shares;
 - persons seeking the information with a view to enforcing a judgment against a shareholder; and
 - an insolvency practitioner seeking to determine the ownership of assets;
- » new examples of the industry view on what is likely to be an improper purpose, such as:
 - any representation or communication to shareholders that the company considers would be an unwarranted misuse of the shareholder’s personal information; and
 - requests from agencies which specialise in identifying and recovering unclaimed assets for their own commercial gain where the company is not satisfied that this is in the interests of the shareholders;
- » recommended best practice where access to the entry of one or more shareholders, rather than the entire register, would suffice;
- » a reminder that companies should have regard to their obligations under the DPA 1998 when considering requests. However, exemptions allowing for the lawful disclosure of personal information, for example for the prevention or detection of crime, may justify the company complying with the request; and
- » guidance on the procedure a company should follow in applying to court (para 1 CPR PD 49). This requires proceedings to be started by a Part 8 claim form. As there are not yet any reported cases of applications being made, it is unclear whether the rest of the procedure set out in Part 8 will apply. ICSA recommends that the application should be supported by a witness statement giving an explanation of the relevant events and the reasons for the company not complying with the request. The company should send a copy of the claim form and supporting evidence to the person making the request as soon as reasonably practicable after the claim form has been issued.

The guidance also applies to companies considering requests for access to the **register of debenture holders** (see CLM ¶4006+) and the **register of interests in shares** held by public companies (see CLM ¶2043+, ¶3990+).

The full guidance note can be found on ICSA’s website: www.icsa.org.uk.

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EC recognition of non-EU GAAP

See CLM ¶4212

The European Commission has accepted the recommendation of CESR to grant equivalence to the generally accepted accounting principles (GAAP) of **certain third countries** (see *CLM 2008 Newsletter Issue 6*).

From 1 January 2009 the GAAP of the US and Japan are considered to be equivalent to International Financial Reporting Standards as adopted by the EU (IFRS) for the purposes of **listed companies** preparing their consolidated financial statements. For a transitional period of three years, the GAAP of China, Canada, South Korea and India will also be considered equivalent to IFRS. These countries have undertaken to adopt IFRS or converge their own accounting standards with IFRS by 31 December 2011. During the transitional period the EC will continue to monitor the development of their GAAP towards IFRS.

New guidance on financial reporting challenges in the current economic conditions

See CLM ¶4226+, ¶4312+

The FRC and the APB have both published new guidance **for directors and auditors** to assist them in preparing for their forthcoming end of year reporting requirements.

The FRC's "Update for Directors of Listed Companies: Going Concern and Liquidity Risk" will be useful to all directors in preparing for their company's year end and meeting their reporting responsibilities. It provides guidance on:

- » the **assessment of the company's viability as a going concern** including the review period and relevant disclosures. This will require more rigour and formality than in normal circumstances; and
- » the **business review** element of the directors' report (required for large and medium-sized companies).

The FRC's guidance on "Challenges for Audit Committees arising from current economic conditions" will be helpful to all auditors in highlighting potential challenges that they may need to address. It identifies some **suggested questions** which may need to be considered in four key areas:

- » year end planning considerations;
- » liquidity risk and going concern;
- » reliance on models for cash flow analysis and valuation information; and
- » significant accounting and reporting judgments.

Neither document published by the FRC imposes any additional requirements on directors or auditors. They bring together existing guidance under UK GAAP and IFRS in the context of the current economic climate and draw attention to several challenges that may arise. For example, bankers may be reluctant to provide positive confirmation that existing facilities will continue to be available. The FRC confirms that this would not in itself necessarily cast doubt on a company's ability to continue as a going concern, nor would it necessarily require auditors to qualify their reports.

The APB has issued additional guidance for auditors emphasising that the current economic situation does not of itself justify **modification of auditors' reports** in every case (APB Bulletin 2008/10 "Going Concern Issues During Current Economic Conditions"). The Bulletin highlights that auditors will need to carefully consider the economic situation at all stages of forthcoming audits and pay particular attention to directors' disclosures and assessment of going concern. However, it also makes clear that auditors should only refer to going concern in their reports if appropriate based on the particular facts and circumstances of the company concerned. They should take into account and assess the effectiveness of any strategies identified by the directors that may mitigate any adverse factors.

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The Bulletin also discusses parts of the FRC update for directors which may be relevant to auditors and includes an updated summary of the **key factors and issues** that can affect going concern and risk which may have increased in significance. It is based on existing standards and does not impose any new requirements.

The FRC documents and the APB Bulletin can be freely downloaded from their websites:

<http://www.frc.org.uk/press/pub1781.html>

<http://www.frc.org.uk/apb/publications/pub1824.html>.

APB Bulletin 2008/10 is supplementary to and does not replace APB Bulletin 2008/1 "Audit Issues when Financial Markets are Difficult and Credit Facilities may be Restricted".

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ASB amends Financial Reporting Standard on related party transactions

See *CLM* ¶4238

The Accounting Standards Board (ASB) has **amended** the Financial Reporting Standard on "Related Party Transactions" to reflect changes to the law applying to accounts for financial years starting on and after 6 April 2008 (FRS 8). These were introduced by the accounting regulations for large and medium-sized companies under the new Companies Act (SI 2008/410); see *CLM Newsletter 2008 Issue 2*.

The amended version includes:

- » a **new definition** of "related party" equivalent to that in international accounting standards, as required by the regulations. FRS 8 still requires the disclosure of all material related party transactions, whereas the regulations only require disclosure of those transactions that have not been concluded under normal market conditions. The ASB states that compliance with the amended FRS 8 will ensure compliance with the requirements of the law. The exemption for medium-sized companies regarding related party transaction disclosures is still reflected in FRS 8;
- » reference to "**key management personnel**" which is more specific than the previous reference to "key management". International accounting standards require disclosure of key management compensation, whereas FRS 8 does not; and
- » a change to the exemption from providing **disclosures in the financial statements of subsidiaries**. The exemption will only be available to wholly owned subsidiaries, whereas before it was available to 90% subsidiaries. As a transitional arrangement, in the first year of adopting this amendment, the disclosure of corresponding amounts for 90% subsidiaries is not required where the information cannot be obtained. International accounting standards do not provide relief from disclosure of transactions entered into between wholly owned subsidiaries.

FRS 8 is not yet fully converged with international accounting standards.

The amendment applies to financial years starting on or after 6 April 2008 and can be freely downloaded from the ASB website: www.frc.org.uk/asb.



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NEWS ROUND-UP cont...

New guidance on auditor liability limitation agreements

See CLM: ¶4304

GC100 has published a guidance note on the **issues that companies should consider** before entering into agreements which seek to limit the liability of their auditors.

Since 6 April 2008, companies have been able to restrict the liability of their auditors to what is fair and reasonable in the circumstances, provided the agreement is approved by an ordinary resolution of the shareholders (ss 534-538 CA 2006). The GC100 note draws together existing guidance published by the FRC and the Institutional Shareholders' Committee. It highlights the issues that a board should take into account when considering recommending such an agreement to the company's shareholders, including:

- » ensuring that any relevant factors are properly documented in board papers and minutes;
- » the directors' general duties, in particular their duty to promote the success of the company (s 172 CA 2006);
- » the context of any existing contractual relationship that the company has with its auditor, which may also limit the auditor's liability;
- » the fact that there is an increased risk that the company may not be able to recover all of any loss suffered if it enters into the agreement; and
- » a detailed analysis of the company's own position and why the agreement would benefit it.

While companies are now allowed to enter into these agreements, they are not obliged to do so. GC100 recommends that shareholders approach them with caution, given the uncertainty of whether any claim against an auditor would succeed where an agreement is in place.

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EC consults on changes to the Prospectus Directive

See CLM ¶4845+

The European Commission has published a consultation paper on proposed changes to the Prospectus Directive as **part of its review** of the Directive (EC Directive 2003/71). The commission aims to reduce excessive administrative and costs burdens for companies and simplify the application of the Directive. The proposals are only an indication of the approach the Commission may take to achieve these aims and are not a statement of its final policy position.

The **suggested amendments** include:

- » extending the scope of the definition of "qualified investors";
- » clarifying the responsibilities of drafting and supplementing a prospectus and the level of information required where securities are sold by an intermediary;
- » extending the exemption from preparing a prospectus for employee share schemes to include companies listed on third country exchanges or in EU exchange regulated markets or non-listed companies. Currently the exemption is only available to companies listed on an EU-regulated market;
- » removing the requirement to produce an annual disclosure document. There is a comprehensive periodic and ongoing disclosure regime under the Transparency Directive and therefore a duplication of this requirement (EC Directive 2004/109);
- » harmonising the period within which investors may withdraw previous acceptances to at least two days following the publication of a supplement to the prospectus; and
- » removing the threshold on the free denomination of the home member state for issues of non-equity securities.



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The Commission also seeks comments on **other issues identified** including:

- » whether or not the correct balance is achieved between the overriding standard that each prospectus should achieve and the need to ensure that it is comprehensible and user friendly;
- » disclosure obligations for small companies;
- » whether disclosure obligations should be exempted where a member state acts as guarantor; and
- » the possibility of exempting the obligation to publish a prospectus for rights issues, provided that a document is available containing the reasons for and details of the offer.

Comments are invited by 10 March 2009. The Commission particularly welcomes the views of SMEs, investors and consumers. The consultation paper is available from the European Commission website at:

http://ec.europa.eu/internal_market/consultations/docs/2009/prospectus/background_en.pdf.

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New merger remedy guidelines published

See CLM ¶5507+

Under UK law, the OFT may refer a merger to the Competition Commission for investigation if it believes that the merger results in a “substantial lessening of competition” within a market for goods and services in the UK. If the Commission’s investigation concludes that a merger is likely to substantially lessen competition, then it will decide what actions it or other bodies should take to remedy any adverse effects resulting from it.

In order to explain the Commission’s approach to remedies in merger investigations, it has, following consultation back in May 2008, published new guidelines on this topic. The guidelines **provide** an **overview** of the more common remedies, including divestiture (i.e. requiring the merger parties to dispose of certain assets to independent third parties to preserve the level of competition in the market), prohibition and behavioural measures (such as price caps). In addition, the guidelines also discuss the principles used by the Commission when selecting and implementing these remedies.

The new guidelines aim to provide a single point of reference regarding merger remedies and will accordingly supersede the Commission’s various existing guidance notes on divestiture remedies, interim and remedial measures in the Commission’s general merger guidance.

The new guidelines are available on the Commission’s website:

<http://www.competition-commission.org.uk/>.

Takeover Panel issues response statements to consultations

See CLM ¶6872+

As reported in *CLM 2008 Newsletter Issue 4*, the Panel on Takeovers and Mergers issued two consultations in July 2008 (one of which was on the proposed amendments to the City Code on Takeovers and Mergers to facilitate the use of electronic communications to send out information in takeovers, and the other was on other miscellaneous amendments to the City Code).

The Takeover Panel has recently published response statements to these consultations (RS 2008/2 and RS 2008/3). Amongst other things, the Panel has decided to adopt its proposed approach in relation to the issue of electronic communications and allow parties to send Code documents to a target’s shareholders via electronic means (e.g. websites and emails).



NEWS ROUND-UP cont...

Miscellaneous changes to the Code have also been adopted to clarify existing Code provisions or codify current practice in relation to matters previously not covered by the Code. The revised Code will apply to all takeover offers and possible offers from 30 March 2009.

The response statements are available on the Panel's website:

<http://www.thetakeoverpanel.org.uk/>

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Insolvency Service modernisation and consolidation project

See *CLM* ¶7364, ¶7896, ¶8166, ¶8339, ¶8449, ¶8648, ¶8856, ¶9501

The Insolvency Service has laid a draft order before Parliament to implement its proposal to remove the requirement for the **initial creditors' meeting in a CVL** to be **advertised** in local newspapers. This proposal is part of the Service's wider project to reform insolvency law by modernising and consolidating various statutory instruments (including the Insolvency Rules) and making related amendments to the Insolvency Act 1986.

Currently, the initial creditors' meeting in a CVL has to be advertised in at least two newspapers published locally to the company, as well as in the *Gazette*. This is also the case where a company is in MVL and the liquidator has to call a creditors' meeting to convert the procedure to a CVL because the company is in fact insolvent. At a cost of around £300 per advertisement, this requirement inevitably places a financial burden on CVLs. Following consultation, the Service came to the conclusion that this cost was no longer justified since very few creditors come forward as a result of these advertisements. It considered that most creditors would find out about the financial state of their debtors by other means, such as carrying out Companies House searches and checking debtors' websites (which now have to state that the company has entered into an insolvency procedure).

If the order is approved in its current form, companies entering into CVL will be able to advertise the creditors' meeting in whatever way the directors think is appropriate. In many cases, it will not be necessary to advertise at all because the company's list of creditors is reliably complete. The revised section also gives the company the freedom to advertise the meeting in forms other than a local newspaper advertisement, for example on the internet or in a national newspaper, if this would be necessary in the circumstances. Where an MVL is converted into a CVL, it is the liquidator who will make this choice. In reality, where the company is entering directly into CVL, the directors will take the prospective liquidator's advice on the matter. As CVL is a voluntary procedure, the Insolvency Service did not consider that there was a significant danger of directors failing to follow the insolvency practitioner's instructions.

These changes are due to come into force on 6 April 2009, applying to CVLs where the resolution to wind up was passed on or after this date.

The other changes due to be made to the Insolvency Act as part of the modernisation and consolidation project (see *CLM 2007 Newsletter Issue 7*) are due to be made on 1 October 2009. There are some exceptions, as the following proposals have been dropped since the consultation:

- » the proposal to remove the requirement for the Insolvency Services Account to be held at the Bank of England (the Service wishes to carry out further consultation before going ahead with this proposal, given the recent uncertainty in the banking sector);
- » the proposal to remove the requirement for two reports on the directors' conduct to be filed where an administration is converted into voluntary liquidation, even where the circumstances have not changed (the Service has decided that such a change should not be made by Legislative Reform Order, and it plans to consider how to implement the proposal in another way); and
- » the requirement for creditors to opt-in to receive information during the insolvency process (the Service has decided that there is insufficient support for this).

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In addition, the proposal allowing insolvency practitioners to make information available via a website has been modified so that they can do so without having to obtain prior consent from creditors.

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Ethical code for insolvency practitioners

See CLM ¶7424

The Insolvency Service has published the new "Insolvency Ethical Code", which is designed to assist insolvency practitioners to undertake their work to high professional and ethical standards. The Code has been approved by the Joint Insolvency Committee following consultation, and is based on five fundamental principles (integrity; objectivity; professional competence and due care; confidentiality and professional behaviour). The Code covers various issues such as referral fees, obtaining work and the use of specialist agents.

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RECENT CASES

Director disqualified in the public interest

See CLM ¶3030

Secretary of State for BERR v Sullman and another [2008] EWHC 3179 (Ch)

The court may make a disqualification order against a director in the public interest where it is satisfied that his **conduct in relation to the company** makes him unfit to be concerned in the management of a company. The High Court has held that “conduct in relation to the company” is wider than conduct prejudicing the company itself.

Mr S was a director of CD plc. His conduct had been investigated by the CIB, leading to an application for his disqualification in the public interest. The court found him to be seriously at fault in seeking to establish a business by widespread misrepresentations. The court exercised its discretion to make a disqualification order, even though the conduct of Mr S did not prejudice the company. It considered that the public interest ground for disqualification is **wide enough to include** conduct that prejudices shareholders, customers, funders or anyone else who has a commercial relationship with the company and so refers to the way its business is run. Mr S was disqualified for a period of 7 years to protect the public and to deter other directors who might engage in similar conduct.

The fact that Mr S had sought advice from a professional did not prevent him from being disqualified. Seeking advice from a competent professional, and acting on it, will tend to demonstrate fitness but it is not a deciding factor.

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Case law



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FOCUS ON... “PRE-PACK” ADMINISTRATIONS

New rules for administrators engaged in pre-packaged sales were introduced on 1 January 2009. With so many retailers and other businesses currently falling into administration, this issue's *Focus on...* looks at administrations generally and why pre-packaged sales are so contentious.

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The **economic crisis** has seen many businesses fall into financial difficulty, most recently in the retail sector. The poor housing market, increases in the cost of commodities (fuel, energy and food) and the shortage of credit have all taken their toll on consumer spending, which has resulted in several large retail chains falling on hard times. Homewares retailer The Pier, childrenswear chain Adams, furniture giant MFI and entertainment group Zavvi UK (to name only a few) all went into administration towards the end of 2008 and Woolworths' administrators closed its last store on 6 January 2009. The country is now officially in a recession and already this year many more retailers, including furniture specialist Land of Leather, electrical retailer Empire Direct plc and china and ceramics group Waterford Wedgwood, have gone into administration. Unfortunately, the financial troubles of retailers and other companies are far from over, with some insolvency experts predicting an increase in administrations of 50% by mid-2009.

Administration **aims to** rescue a company from its financial troubles so that (where possible) it can continue in business afterwards, to maximise returns to creditors or to realise the company's assets to make a distribution to one or more secured and/or preferential creditors. An administrator takes over the management of the company's affairs, business and property for a relatively short period of time, reforming it and/or selling off certain parts of the company's business or assets as necessary to achieve the aim of the administration (see CLM ¶8845+). Administration also triggers a moratorium ensuring that any pending winding up proceedings are put on hold and preventing most types of legal action being taken against the company during the administration. This gives the company some breathing space while the administrator attempts to revive its fortunes (see CLM ¶8813+).

Administrators must be qualified insolvency practitioners and are **appointed by** the court, the company (or its board), or a qualifying floating charge holder. They have a wide range of powers to achieve the aim of the administration, but they must also follow several statutory requirements and adhere to specific duties. The court may also give directions on how the administrator should perform his functions (see CLM ¶8995+).

When an administrator takes up his appointment he must investigate the company and identify its assets, looking for opportunities to increase them. The administrator must then prepare his **proposals** for the conduct of the administration and how its purpose will be achieved. Ordinarily these proposals must be approved by the company's creditors. The creditors, particularly unsecured creditors, will be keen to maximise their chances of recovery and so this gives them an opportunity to have some input on the administrator's proposals.

What is a pre-packaged sale?

Sometimes an arrangement for the sale of all or part of a company's business or assets may be negotiated **before an administrator is appointed**, with the administrator effecting that sale immediately on, or shortly after, his appointment. This is commonly known as a “pre-packaged” or “pre-pack” sale. The courts have held that administrators have the power to effect such arrangements without prior approval of the creditors or permission of the court, if appropriate in the circumstances.

Pre-pack sales can potentially improve returns to creditors because a company is usually worth more as a going concern than if its assets are sold individually. In addition, a **quick** administration process often means that creditors receive payments sooner and fewer costs eat into the pot of money available to them. Pre-pack sales can also safeguard jobs by **preserving the business** of the failed company. However, the buyer can purchase the failed company's assets or business without the company's liabilities, leaving unsecured creditors unable to recoup their debts.

Focus on...



FOCUS ON... “PRE-PACK” ADMINISTRATIONS cont...

With the present economic downturn and the number of companies going into administration, pre-pack sales are proving to be very **popular**. Several high profile pre-pack sales have recently taken place. For example, in December 2008, immediately after going into administration, Whittard of Chelsea was bought out by private equity group EPIC.

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What specific duties do administrators have in these circumstances?

A new **Statement of Insolvency Practice** was introduced on 1 January 2009, SIP 16 “Pre-packaged Sales in Administrations”. This sets out the basic principles and essential procedures, with which administrators engaged in pre-pack sales must comply. The purpose of the new statement is to increase transparency in pre-pack sales and give creditors better access to information about the administration process.

Administrators must:

- » keep a detailed record of the reasoning behind the decision for the pre-pack sale to take place and be able to explain and justify why it was appropriate in the circumstances;
- » make it clear to the directors of the company that they are advising the company and therefore cannot also advise the directors on their personal positions;
- » encourage the directors to take independent advice, particularly when the directors may acquire assets or other interests as part of the pre-pack sale;
- » demonstrate that they have:
 - performed their functions in the interests of the creditors as a whole; and
 - avoided unnecessary harm to the interests of the creditors as a whole, where the aim of the administration is to realise the company’s assets to make a distribution to a secured or preferential creditor; and
- » disclose certain information to the creditors in all cases (unless there are exceptional circumstances) with the first notification to the creditors, including:
 - the identity of the buyer in the pre-pack sale;
 - details of the business or assets involved and the nature of the transaction;
 - any valuations obtained of the business or assets of the company;
 - the consideration payable and terms of payment;
 - the alternative courses of action that were considered by the administrator;
 - any connection between the buyer and the directors, shareholders or secured creditors of the company; and
 - the names of any directors or former directors who will be involved in the management or ownership of the buyer.

Where no initial creditors’ meeting is to take place and it is impracticable to send the required information to the creditors with the first notification, the information should be provided in the administrator’s statement of proposals, which should be sent to the creditors as soon as possible after his appointment.

Why are pre-packaged sales a problem?

Pre-pack sales tend to be used where there is a commercial **need for urgency** and so the company’s creditors generally do not have the opportunity to approve the sale before it takes place.

In addition to the characteristic lack of creditor approval, the **buyer** is **often connected** with the company in some way, whether as a director, former director or shareholder, or another person or company connected to them (see CLM ¶9930 for the meaning of “connected”). For example, prior to the retail company USC entering into administration in December 2008, a pre-pack sale was agreed whereby a director of USC would buy up to 43 of the company’s 58 stores through another company within his group. This may be because when such a quick sale of the company’s business as a going concern is required, usually only those who know the business extremely well will be willing to buy it at such short notice.

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The **press** has been keen to focus on pre pack sales, particularly those entered into with directors or former officers of the company (or persons connected to them), suggesting that as they are negotiated in advance of the administration, there must be something underhand in the process, even when it can be the best solution for all concerned. **Creditors and the public** are often **suspicious of** pre-pack sales. Creditors feel disenfranchised and believe that they may have missed out on returns by not being involved in the process. The public perceive these arrangements as unfair and unjust by allowing those who were involved in the management of a failing company to be able to benefit from its administration.

There is the potential for these arrangements to be **misused** by directors and/or those connected to them to disadvantage creditors or to seek to gain benefit for themselves. Reports suggest that the Government is launching an investigation into whether pre packs are being abused (as part of its current inquiry into the operations of the Insolvency Service) and whether the rules need to be changed. It also recognises that small businesses often have large numbers of unsecured trade creditors (relying on trade credit to finance their business) and is concerned that pre-pack sales have a particular impact on small businesses, possibly inflicting more damage to the economy in the current downturn.

The head of the Insolvency Service, Mr Stephen Speed, has stated that he has had no systematic evidence of the system being exploited. Whilst the current economic circumstances have brought administrations and pre pack sales into the spotlight, Mr Speed says that it is wrong to draw an inference from that, that the law is not fit for purpose. However, the Insolvency Service will be proactively **policing** compliance with SIP 16 to encourage transparency and ensure that administrators are able to explain why they decided that a pre-pack sale was appropriate in the circumstances. They intend to review each and every statement prepared by an administrator under the requirements of SIP 16 and will use their enforcement powers to take action where administrators have failed to comply and/or in cases of wrongdoing by directors. The Insolvency Service can take disciplinary action against administrators and disqualify directors in appropriate cases and we are likely to see an increase in such measures being taken as a deterrent to those who might be tempted to abuse the system.

What can aggrieved creditors do?

Administrators' conduct

If a creditor is not satisfied with the administrator's conduct during the administration they may seek **redress by** complaining directly to the administrator concerned, complaining to the administrator's professional body, or if the administrator has committed a particular breach, taking court action against him (see CLM ¶9016+).

A creditor may apply to the court:

- » seeking **inspection of information** forming part of the records of the administration, if the administrator has refused to allow such inspection (for example, to find out more information about the pre-pack sale);
- » on the basis that in negotiating and/or effecting the pre-pack sale the administrator proposes to act, or has **acted, in a way which is unfairly harmful** to the creditor's interests (either individually or in common with other creditors);
- » on the basis of **misfeasance**, for example, on the ground that the administrator has misapplied money or other property of the company; or
- » to have an administrator removed. However, the creditor will have to persuade the court that there is good cause before it will make any order for **removal**.

Directors' conduct

Directors owe many **duties** to their company including agency, fiduciary, common law and statutory duties. They owe additional specific duties to the company if it is insolvent. However, because these duties are owed to the company, rather than to third parties (such as creditors), creditors are not generally able to take any specific action against directors in the case of any breach of duty. Instead the directors may incur civil liability to the company and/or

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commit a criminal offence. Directors can also be **disqualified** from acting as a director for a period of between 2 and 15 years if their conduct leading up to insolvency proceedings is considered to be unfit (see CLM ¶3000+). Administrators are obliged to report any conduct of the directors which could lead to their disqualification (see CLM ¶8856).

Creditors are able to bring actions against directors:

- » for **misfeasance** (with the court's permission) which can cover the misapplication or retention of company money or property, breach of duty and any other misfeasance (see CLM ¶7457+); or
- » in relation to **transactions defrauding creditors** (see CLM ¶7826+).

However, in the case of misfeasance the court can only order the director(s) to repay, give back or account for misapplied property to the company or compensate the company by contributing to its assets. Similarly, in the case of transactions defrauding creditors any action is deemed to be taken on behalf of every victim of the transaction. Therefore any **relief** granted by the court in successful actions against directors is unlikely to benefit an individual creditor bringing the action. It may also be difficult for a creditor in a vulnerable financial position itself, perhaps as a result of the pre-pack sale, to fund court proceedings. This is particularly true for small unsecured creditors, who many argue are left without an adequate remedy.

The **Insolvency Service** is encouraging aggrieved creditors to use its **hotline** if they wish to complain about a pre-pack sale or consider that they have been unfairly disadvantaged by an administration (or other insolvency procedure). Creditors can contact the Insolvency service by telephone: 0845 601 3546, or email: enforcement.hotline@insolvency.gsi.gov.uk.

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COMPANIES ACT 2006: IMPLEMENTATION

The text of the Companies Act 2006, explanatory notes and tables of destinations and origins are freely available to download at: <http://www.opsi.gov.uk/acts/acts2006a.htm>.

To see when specific sections of the Act will or have come into force, check the *implementation timetable* on the FL Memo Ltd newsletter homepage (follow the link to "Companies Act 2006 implementation timetable"). The implementation timetable is up to date to the final version of the Eighth Commencement Order.

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New regulations published

See CLM ¶152, ¶401, ¶519, ¶526, ¶527, ¶682, ¶1395, ¶1415, ¶2044, ¶2513, ¶2668, ¶2669, ¶3869, ¶3894, ¶3928, ¶3930, ¶3976, ¶3993, ¶4002, ¶4004, ¶4006, ¶4007, ¶4019, ¶4027+, ¶4049, ¶4080, ¶9910

As anticipated in *CLM 2008 Newsletter Issue 6*, the Government has published a final version of the Companies (Company Records) Regulations 2008 (SI 2008/3006), which deals with the location, inspection and copying of company records. Their substantive requirements are the same as those in the April 2008 draft, apart from some minor amendments in relation to the notice period and timing of inspections of private companies' records.

The Government has also published the Companies (Fees for Inspection of Company Records) Regulations 2008 (SI 2008/3007) and the Companies (Registration) Regulations 2008 (SI 2008/3014). They include the same requirements as their previous drafts.

All of the above regulations are due to come into force on 1 October 2009.



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New model articles regulation finalised

See CLM ¶445

The final version of the new model articles under the Companies Act 2006 has been published. The Companies (Model Articles) Regulations 2008 include separate new model articles for private companies limited by shares, private companies limited by guarantee and public companies (SI 2008/3229). These articles will become the equivalent of Table A default articles for companies incorporated under the new Companies Act on or after 1 October 2009. Existing companies will also be able to adopt them if they wish.

The final draft is in substantially the same form as the previous draft. However, as well as some minor drafting amendments, some notable changes have been made.

The provision in the articles for private companies limited by shares enabling them to make deductions from **distributions** in relation to a share if an enforceable lien has arisen on it has been deleted. The Government felt that it overcomplicated the form of model articles for small private companies with simple structures. If larger private companies wish to include such a provision, they can of course use the model articles for public companies as a guide. As a result of this change the numbering of the rest of the model articles for private companies limited by shares has changed.

The articles on **board decisions** have been clarified to remove inconsistencies in the previous draft between decisions taken in meetings and written decisions, and to make it clear that written decisions can only be taken by those directors that would have been able to vote and count in the quorum if the decision had been made at a board meeting instead. This ensures that directors cannot take advantage of their freedom to make decisions without a meeting to circumvent quorum requirements and the rules governing who can vote (respectively, CLM ¶3258+, ¶3268+). The following changes relating to board decisions have been made to the model articles for public companies only:

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- » board decisions “may” (as opposed to “must” in the previous version) be made at a meeting or in writing. This gives the boards of public companies the freedom to set out rules for making decisions in other ways (under article 19);
- » the board can terminate the appointment of a deputy or assistant chairman (as well as a chairman) at any time; and
- » notice to the company of the appointment or removal of an alternate director must be effected in writing.

The only changes of note relating to **shareholder decisions** affect the model articles for public companies. The articles dealing with the procedure on a poll have been changed to:

- » enable the chairman to direct when, where and how a poll should be held (as opposed to just when and how in the previous version); and
- » clarify when proxy notices must be submitted in order to be effective for a vote on a poll not taken during the meeting, but taken less than 48 hours after it was demanded.

A **director’s retirement** from office is no longer included in the list of situations in which his appointment will terminate. In terms of a director’s office (as opposed to his employment), there is no difference between retirement and resignation. Therefore, a director who wishes to retire due to his age will simply notify the company that he is resigning from office. If a public company director retires by rotation and is not reappointed, he has effectively been removed by the shareholders and the company will be notified via the proceedings at the relevant AGM.

The **indemnity and insurance** articles have been amended so that they only apply to directors and former directors. Therefore, if a company wishes to indemnify other officers, or obtain insurance in relation to them, it will have to alter its articles accordingly.

Some changes are specific to the model articles for **private companies limited by guarantee**:

- » the articles now set out the circumstances in which members may be liable to contribute to the assets of the company, as set out in the new Companies Act; and
- » the reference to persons, other than members, entitled to exercise members’ rights in general meetings has been removed. The Government decided that it was superfluous as there can be no transmittees in private companies limited by guarantee.

The relevant paragraphs in *CLM 2009* have been updated accordingly, including noting the renumbering of the new model articles for private companies limited by shares where relevant. See the *CLM 2009 online*, or click on the “Online updates” link to the left, for details. The CLM new model articles *destinations table* has also been updated.

These regulations are freely available on the OPSI website:
http://www.opsi.gov.uk/si/si2008/uksi_20083229_en_1.

Draft regulations withdrawn

See *CLM* ¶4049, ¶4080

The draft Companies (Registrar of Companies and Applications for Striking Off) Regulations 2008, which were laid before Parliament on 24 November 2008, have been withdrawn.

The draft regulations deal with various issues relevant to **Companies House** including which documents can be filed in Welsh (without an English translation), which documents can be filed in other languages (with translations in English) and the circumstances in which the register can be rectified or annotated, see *CLM 2008 Newsletter Issue 3* for further details. No explanation has been given by the Government as to why the draft regulations were withdrawn or what further amendments will be made. An amended version is expected to be published in draft in early 2009. Readers should check the online updates and further newsletters for developments.
