



COMPANY LAW MEMO 2010

Newsletter Issue 1

January 2010

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NEWS

Government targets to reduce administrative burdens for businesses

According to a report recently published by BIS, businesses are saving nearly £3 billion a year due to the Government's **simplification programme** (of which the new Companies Act formed part). The programme was introduced in 2005 with the target of cutting administrative burdens for businesses by 25% by March 2010. The Government has reported that it is on track to meet this target, with businesses saving £2.9 billion by December 2009.

A **new target** was set by the Government in October 2009 to reduce the administrative burden for businesses of **compliance with regulation** by a further £6.5 billion each year. The Government intends to achieve this by 2015, concentrating on:

- » business law: regulatory issues relating to setting up and operating a company (or other incorporated business) including auditing, accounting requirements, the provision of better guidance, insolvency regimes and data protection;
- » workplace health and safety: regulations and approved codes of practice, primarily dealing with the protection of workers in the workplace;
- » consumer issues: considering existing consumer law and retailing goods and services, basing this on clear, understandable principles to make compliance easier, especially for small firms;
- » employment and skills: including obligations within employment law in general, on-line services through government resources, pre-employment checks and integrated employment and skills services;
- » transport: the simplification of policies and regulations covering transport operations and transport service providers, and the regulation of the manufacturing of transport equipment where they relate to safety;
- » natural environment: considering the full range of environmental regulation;
- » built environment: considering planning and building regulations, home buying and selling and the regulation of private and social housing; and
- » health and social welfare: considering areas such as medicines, research and development (clinical trials), private healthcare, social care, opticians, pharmacy services, health protection and prevention (including alcohol and tobacco), animal health and other areas related to public health which impact on business.

In addition to engaging with various stakeholders, the Government has issued a **call for evidence** and is keen to receive suggestions from businesses of all sizes and other interested parties on which business processes could be improved and how. Responses are requested by 12 February 2010. Further details are available from the BIS website:

<http://www.berr.gov.uk/whatwedo/bre/policy/simplifying-existing-regulation/simplification-plans/page54027.html>.

Proposed changes to dividend and interest caps for CICs

See CLM ¶65

Following on from the recent consultation (see CLM 2009 Newsletter Issue 3) and wider research on access to finance in the sector, the Regulator of Community Interest Companies has proposed changes to the caps on dividends paid to non-asset-locked bodies and on interest on loans where the rate of interest is linked to the CIC's performance. The following proposed changes are intended to take effect from **6 April 2010**:

- » the **maximum dividend per share** will be 20% of the paid up value of the share, subject to any lower rate set by the CIC. This will apply to shares issued on or after 6 April 2010. It will not apply retrospectively to shares issued before that date. The maximum aggregate dividend per year of 35% of distributable profits will remain unchanged; and
- » the **cap on interest on loans**, where the rate of interest is linked to the CIC's performance, will be 10% of the average amount of the CIC's debt, or sum outstanding

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under the loan, during the 12-month period before the interest becomes due. This will apply to agreements to pay performance-related interest made on or after 6 April 2010 and will be subject to any lower contractual interest rate.

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The changes are being proposed to take into account the change in market conditions since the CIC format was introduced. For example, access to finance for all enterprises has become more constrained; an effect which is magnified for CICs because of the perceived higher risks and restricted financial returns. In addition, the ability to attract investment has become increasingly important in terms of the value provided to the public benefit and of being able to recycle the money within the sector and the activities of the CIC constituting a return on investment by a social investor, charity or trust. The Regulator considers that the proposed changes are reasonably cautious but will allow her to monitor their effect in the next review (likely to be in 2 to 3 years time).

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A copy of the decision can be downloaded from the Regulator's website:

<http://www.cicregulator.gov.uk/Response%20to%20the%20consultation%20January%202010.pdf>

FRC proposes to reform Combined Code

See CLM ¶3199

The FRC has launched a consultation on proposals to update the Combined Code, the standard on corporate governance that applies to listed companies. The proposed reforms come in the wake of scrutiny directed at big business in the current economic climate, as a result of which the FRC brought forward its regular review of the Code. Although it has concluded that the Code is generally fit for purpose, the FRC is keen to re-focus companies' approach to the Code from box-ticking compliance to a genuine consideration of and adherence to the underlying principles.

New principles are proposed to emphasise the roles of the different components of the board, including the chairman's leadership role and non-executive directors' responsibility to challenge where appropriate and assist in developing strategy. Overall, the board needs to have an appropriate mix of skills, experience and independence in order to function in the company's best interests. New principles are also proposed that deal with the board's responsibility for and handling of risk.

The other proposals include:

- » the chairman or board being re-elected annually;
- » the board being externally evaluated every 3 years;
- » the chairman carrying out a development review with each director on a regular basis; and
- » making sure that performance-related pay is linked to the company's long-term interests and risk policy.

The Combined Code is to be renamed the "UK Corporate Governance Code".

The consultation can be found on the FRC's website:

<http://www.frc.org.uk/press/pub2175.html>.

Comments are invited by 5 March. The revised Code is intended to apply to accounting periods starting on or after 29 June 2010.

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Improvements to FRSs

See CLM ¶4211+

The APB has issued improvements to certain FRSs in order to maintain convergence between UK GAAP and international financial reporting standards. The FRSs that have been amended are:

- » FRS 11: Impairment of fixed assets and goodwill;
- » FRS 20: Share-based payment;
- » FRS 26: Financial instruments: Recognition and measurement;
- » UITF Abstract 42: Reassessment of embedded derivatives; and
- » UITF Abstract 46: Hedges of a net investment in a foreign operation.

The amendments can be freely downloaded from the FRC website: <http://www.frc.org.uk/asb>.

Support for the EC's proposals to reduce administrative burdens for micro entities

See CLM ¶4356

The European Economic and Social Committee (EESC) has confirmed its opinion in support of the EC's proposal to allow member states to exempt very small companies (to be known as "micro entities") from certain **administrative and accounting requirements**. The EESC acknowledges that the current requirements can be burdensome and disproportionate for micro entities, which often only operate at a local or regional level. The EESC considers that exemption measures for micro entities should be obligatory and introduced promptly throughout the EEA, but also flexible and geared to individual member states. It considers that the changes should be easy to implement and be applied in a transparent manner.

The Takeover Code Committee adopts amendments to the Code

See CLM ¶6765+

The Takeover Code Committee has published two response statements in which it sets out amendments to the Code, made as a result of two recent consultations (see *CLM 2009 Newsletter Issue 3* and *CLM 2009 Newsletter Issue 4*). The Code Committee has adopted most of the amendments proposed, with some minor changes.

Various **amendments, which took effect on 25 January 2010**, apply to all offers and possible offers which are announced on or after that date. Of the more substantial amendments that were proposed:

- » **management incentivisation:** the application of the Code has been extended to management incentivisation arrangements, but only in relation to members of management who are also interested in the target's shares (unless the incentivisation arrangements are significant or unusual, in which case the Panel must still be consulted). The target's independent adviser is required to publicly state its opinion on whether the arrangements are fair and reasonable both where agreement on the arrangements has been reached and where discussions have reached an advanced stage. However, they need only consider whether the incentives are fair and reasonable in the context of managers acting in their capacity as such or whether the arrangements also include incentives to them in their capacity as shareholders of the target. The proposed inclusion of the words "as far as the shareholders are concerned" has not been adopted, but the Code Committee has stated that the independent adviser should take all relevant circumstances into account in forming their opinion;

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- » **mandatory offers:** currently, if a bidder makes a mandatory offer for a company ("B") where B owns at least 50% of another company ("C"), a "chain principle" can apply in which the Panel may require the bidder to make a separate offer for C (r 9.1 City Code note 8). The Committee has decided not to adopt the lower percentage threshold proposed of 30%, as this might significantly increase the number of situations where this, relatively rare, chain principle would apply. The percentage threshold therefore remains at 50%;
- » **documents on display:** certain documents which are required to be available for inspection in hard copy form, from the time the offer document or the target board's circular is published, must also be made available on a website. These documents include, for example, the auditors' report where a profit forecast has been used;
- » **proceeding with an offer:** a bidder must consult the Panel before deciding not to proceed with an offer that has been announced, and may do so if, for example, a competitor has announced a firm intention to make a higher offer; and
- » **offers subject to competition clearance:** a bidder is prohibited from making a new offer for the target where an offer has lapsed because it was referred to a merger control authority (which decided that the offer could not proceed) for a period of 6 months from the date of the relevant authority's decision.

The disclosure regime **amendments, to take effect on 19 April 2010**, will apply to all offers and possible offers from that date. They include:

- » the introduction of a new **opening position disclosure** requirement, in addition to the current Code requirement to disclose interests and dealings in the relevant securities during the offer period. This means that persons with disclosure obligations under the Code will have to disclose their opening positions in the relevant securities:
 - shortly after the offer announcement (if it is a securities exchange offer); or
 - when the offer period commences (for all other offers);
- » extension of the disclosure to a **composite basis**. This means that disclosures must be made not only in respect of the target's securities as currently required, but also those of other parties to the offer, except in the case of a cash bidder;
- » amendments to the contents of a **firm intention announcement**; and
- » deleting the Code **definition** of "associate", so that the current rules which refer to a party's associates will be amended to refer instead to "persons acting in concert". This is intended to avoid the overlap between the two concepts.

As part of the consultation the Panel also considered requiring disclosures of **securities borrowing and lending positions** in the target. In the light of responses received it has decided not to introduce any proposals at this stage but intends to take a further review of this, and financial collateral arrangement generally, at some point in the future.

Further details, the revised Code and new specimen disclosure forms are available from the Takeover Panel's website: <http://www.thetakeoverpanel.org.uk>.

Date set for first corporate manslaughter trial

See *CLM* ¶7179+

The trial date for the first **company prosecution** under the Corporate Manslaughter and Corporate Homicide Act 2007 has been set (see *CLM 2009 Newsletter Issue 3*). It is due to take place in Bristol Crown Court from 23 February 2010 and is expected to run for 6 weeks. The case will be very interesting to follow, being the first of its kind. A successful prosecution could set an important precedent in relation to the level of fines likely to be imposed and it will be particularly interesting to see how the court deals with the **sentencing** guidelines recently published for consultation by the Sentencing Guidelines Council (see *CLM 2009 Newsletter Issue 6*).





CASES

Employment Tribunal misdirects itself in deciding that a 'controlling' shareholder had not been an employee

See CLM ¶2020, ¶2627

Ashby v Monterry Designs Ltd [2010] EAT case 0226/08

The Employment Appeal Tribunal (EAT) **applied** the **guidance given by the Court of Appeal** in *Secretary of State for BERR v Neufeld* (see *CLM 2009 Newsletter Issue 3*) in allowing an appeal against a decision of the Employment Tribunal (ET). The ET had decided that it had no jurisdiction to hear a claim for unfair dismissal because the claimant had not been an employee of the company for the requisite 12-month qualifying period.

Mrs A, Mr K and Mrs W were all equal shareholders and directors of MD Ltd, a company set up by them in 1985. Mrs W left the company in 1992 when it fell into financial difficulties. Her shareholding was split equally between Mrs A and Mr K, resulting in them both becoming **50% shareholders**. They both also remained the only directors. Mrs A took on the **day to day management duties** of the company. MD Ltd was sold by way of a share sale in April 2007 and immediately afterwards Mrs A continued working as an embroidery machinist, as she had done since the company was formed. This came to an end in August 2007 when Mrs A resigned and brought a claim for constructive unfair dismissal. No written contract of employment was produced at the hearing.

The EAT found that the ET had misdirected itself in regarding Mrs A's shareholding of fundamental importance in determining whether or not there was a contract of employment prior to April 2007. The Court of Appeal had made it clear that the fact that a claimant's shareholding gave them control of the company is not of special relevance in determining whether there was a valid contract of employment. In addition, the EAT highlighted that if the conduct of the parties is evidence of the existence of a true contract of employment, tribunals should not reject a claim simply because there is no written agreement.

Company allowed to proceed with claim for damages against directors whose actions caused breach of competition law

See CLM ¶2434+

Safeway Stores Ltd and others v Twigger and others [2010] EWHC 11 (Comm)

SS Ltd and two other companies brought a claim against their former directors and employees for **breach of contract**, breach of their **fiduciary duties** and/or **negligence** in taking part in price-fixing initiatives with various other supermarkets in relation to dairy products. The initiatives resulted in the increase of the price of milk and other dairy products for consumers. Following an investigation by the OFT, the claimant companies were found to have infringed UK competition law and were exposed to a significant penalty. They sought damages and/or equitable compensation from their former directors and employees in respect of the loss and damage suffered as a result of the penalty.

The directors applied for the claim to be struck out on the basis that it was barred as a matter of public policy because:

- » the companies should not be able to recover a benefit from their own illegal or unlawful acts (known as the defence of *ex turpi causa non oritur actio*); and
- » it was fundamentally inconsistent with the UK competition law regime.

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The High Court dismissed the application to strike out the claim. It found that the claimant companies had a real prospect of defeating any defence of *ex turpi causa* as that would only apply where the unlawful acts are those of the company “personally”, for example if the acts were committed by the sole directing mind and will of the company. That was not the case here. The claimant companies were vicariously liable for the unlawful acts of their employees and for the unlawful acts of their directors under the general principles of the law of agency. Therefore the defence of *ex turpi causa* did not apply. In addition, the High Court found that passing on a penalty to the very people who caused the unlawful acts was not inconsistent with the Competition Act 1998.

Consideration of relevant factors when determining the length of a director’s period of disqualification

See CLM ¶3013

Kotonou v Secretary of State for BERR [2010] EWHC 19 (Ch)

Mr K was a director of OCS Ltd, a company which entered into CVL with a deficiency of over £1.7 million. The nature of OCS Ltd’s business was the provision of management services to associated companies within a group. As a result of proceedings commenced by the Secretary of State, Mr K was found to be unfit to be a director on a number of charges and was disqualified for a period of 8 years. The charges against Mr K included:

- » breaches of his fiduciary duties to OCS Ltd in causing it to fund another group company (even though it was failing to pay its own debts when due and the other company itself was insolvent) and causing it to incur the costs of significant improvements to a property that belonged to yet another group company;
- » causing OCS Ltd to pay him remuneration that it could not reasonably afford; and
- » various failures to file accounts and returns.

Mr K appealed against the disqualification on a number of grounds, but largely on the basis that the judge failed to give sufficient regard to the context of the group’s situation. The High Court was unable to find any merit in any of the arguments put forward on Mr K’s behalf and dismissed his appeal against the disqualification.

Mr K also appealed against the length of the period of disqualification on the basis that, amongst other things, there was a failure to give sufficient weight to particular factors which were taken into account. The High Court also dismissed this appeal and upheld the 8-year period of disqualification. **Questions of the weight to be attached to particular factors** are matters for the trial judge. An appellate court should only interfere if the resulting period of disqualification is manifestly wrong. However, in this case the High Court had no doubt that the trial judge had not erred in fixing the period of disqualification and that the period was not manifestly wrong. It commented that the period of disqualification fixed for the protection of the public was well understood, given that Mr K did not understand that he had fallen below the normal standards of commercial probity or that he had done anything which would warrant the description of serious misconduct.

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Directors disqualified for breach of regulatory rules

See CLM ¶3023+

Secretary of State for BIS v Aaron and others [2009] EWHC 3263 (Ch)

DMA(PFP) Ltd provided investment services and was regulated by the FSA. As part of an industry-wide review of the sale of Structured Capital at Risk Products (known as SCARPS) the financial ombudsman upheld complaints against DMA(PFP) Ltd relating to the mis-selling of SCARPS in **contravention of FSA rules** and awarded compensation. Shortly afterwards DMA(PFP) Ltd was placed into administration owing over £17m.

Disqualification proceedings were subsequently brought by the Secretary of State against two of DMA(PFP) Ltd's directors, who were also regulated by the FSA as **independent financial advisers**. The allegations of unfitness against them included:

- » failing to adequately understand or take account of the risks associated with SCARPS;
- » failing to ensure compliance with FSA rules relating to how the risks associated with SCARPS should have been presented in advertising and other marketing materials; and
- » failing to keep adequate records.

There was no allegation of dishonesty, but the High Court found that the directors' failure to ensure that DMA(PFP) Ltd complied with regulatory requirements provided the context in which the mis-selling and consequent insolvency of the company took place. There was a lack of commercial probity from which the public needed to be protected. The directors were disqualified for a minimum of 2 years.

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LEGISLATION

Insolvency Service's modernisation and consolidation project update

See CLM ¶7362+

The **final version** of the Legislative Reform (Insolvency) (Miscellaneous Provisions) Order 2010 was published on 6 January. The final version is the same as the previous draft (see *CLM 2009 Newsletter Issue 6* and *CLM 2009 Newsletter Issue 3*). In addition, a **revised version** of the Draft Insolvency (Amendment) Rules 2010 has been published. They will both come into force, as expected, on 6 April 2010.

Further details are available at the Insolvency Service's website:

<http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/consolidation/UpdateJan2010.htm>

Civil Law Reform Bill consultation

See CLM ¶8021+, ¶8610, ¶8952+

The **draft** Civil Law Reform Bill has been **published** for consultation. Amongst other things, the Bill proposes to reform the **law relating to how pre- and post-judgment interest** is calculated on claims for debt and damages. Court action to recover debt or damages often takes a significant amount of time to complete and enforce. Therefore, the court is allowed to add interest to the sum awarded to compensate for the cost of this delay.

At present pre-judgment interest (the interest that may be awarded in respect of the period from the time that the cause of action arose to the date of the award made by the court or, if payment is made earlier, the date of the payment) is generally a discretionary relief that may be awarded at such rate as the court thinks appropriate. Post-judgment interest (the interest payable on a sum awarded by the court from the date of the award to the actual date of payment) is prescribed by the Lord Chancellor; the current rate is 8%. Both pre- and post-judgment interest are simple, not compound.

The **Bill proposes** to replace the existing statutory provisions (set out in various pieces of legislation, for example s 17 Judgments Act 1838) with a single set of modern provisions to provide flexibility in setting the interest rate so that it can be adapted to different circumstances. The proposals are:

- » to give the Lord Chancellor power to prescribe the rates of pre- and post-judgment interest;
- » to enable the Lord Chancellor to specify different rates of interest for different cases;
- » the rate of interest may be simple or compound; and
- » the prescribed rate may be linked by reference to the Bank of England base rate or determined by a formula.

The consultation ends on 9 February 2010. The consultation paper can be found on the Ministry of Justice's website: <http://www.justice.gov.uk/consultations/civil-law-reform-bill.htm>.

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