



COMPANY LAW MEMO 2010

Newsletter Issue 3

May 2010

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New guidance on corporate governance for private companies

See *CLM* ¶3199+

The Institute of Directors has published new voluntary guidance and principles of governance setting out **best practice recommendations** for private companies in the EU (“Corporate Governance Guidance and Principles for Unlisted Companies in Europe” First Edition: March 2010). It has been developed by the European Confederation of Directors’ Associations (ecoDa) as a practical and pragmatic tool to help private companies plan for their development and establish an appropriate corporate governance framework. EcoDa believes that improved corporate governance can facilitate economic growth and help to ensure the long-term sustainability of companies. It is hoped that this guidance will also be used by each member state to develop, or update, national corporate governance codes for unlisted companies.

The guidance includes nine **principles of good governance** which apply to **all unlisted companies**:

1. Shareholders should establish an appropriate constitutional and governance framework for the company;
2. Every company should strive to establish an effective board, which is collectively responsible for the long-term success of the company, including defining the corporate strategy. An interim step towards an effective (and independent) board may be the creation of an advisory board;
3. The size and composition of the board should reflect the scale and complexity of the company’s activities;
4. The board should meet sufficiently regularly to discharge its duties, and be supplied in a timely manner with appropriate information;
5. Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully. There should be a clear distinction between the remuneration of executive and non-executive directors;
6. The board is responsible for identifying the main risks facing the company and should maintain a sound system of internal control to safeguard shareholders’ investment and the company’s assets;
7. There should be a dialogue between the board and the shareholders based on a mutual understanding of objectives. The board as a whole has responsibility for ensuring that this takes place and should not forget that all shareholders should be treated equally;
8. All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge; and
9. Family-owned companies should establish a family constitution or protocol that promotes co-ordination and mutual understanding amongst family members, as well as organise the relationship between family governance and corporate governance.

The guidance also sets out five further principles which are intended to apply only to **larger or more complex companies**:

1. There should be a clear division of responsibilities between the running of the board (by the chairman) and the running of the company’s business (by the CEO or managing director). No one person should exercise both of these roles, so as to have unfettered decision making powers;
2. Although board structures vary according to regulatory requirements and business norms, all boards should contain directors with a sufficient mix of competencies and experiences;
3. The board should establish appropriate board committees in order to allow a more effective discharge of its duties;
4. The board should undertake a periodic appraisal of its own performance and that of each director; and
5. The board should publish an annual report to present a balanced and understandable assessment of the company’s position and external prospects for external stakeholders, and establish a suitable programme of stakeholder engagement.

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The guidance is voluntary and in addition to the general mandatory principles of corporate governance which are applicable to all companies in the UK (for example, directors' duties and liabilities). Further detail and copies of the guidance can be found on the Institute of Directors' website at:

http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_article_corp_gov_unlisted_companies_eu.pdf

Comment: In the UK, best practice for the **governance of listed companies** is set out in the Combined Code appended to the Listing Rules of the Stock Exchange (see CLM ¶3199).

New company name search

See CLM ¶4091

Companies House has developed a new search which is freely available as part of its "WebCheck" service. The new "Company Name Availability Search" will reveal company names already registered at Companies House which are the 'same' as the proposed company name entered into the search engine. This should reduce the number of incorporation and change of name applications being rejected.

Competition Commission and OFT review of merger assessment guidelines

See CLM ¶5507+

On 14 April 2010 the Competition Commission (CC) and the OFT published a draft review of the Merger Assessment Guidelines as a result of work between the two authorities to combine and expand on guidance material contained in a number of prior publications (see *CLM 2009 Newsletter Issue 1* and *CLM 2008 Newsletter Issue 3*). The draft is the result of a public consultation which took place between April and September 2009. **Key developments** include the definition of 'market', which forms part of the test for substantial lessening of competition, part of the procedure used to assess mergers.

- a. The guidance includes:
- b. a study of the overarching questions the OFT and the CC are required to consider when conducting their merger reviews. Those questions are:
 - has a merger situation been created; and
 - will the situation lead to a substantial lessening of competition?
- c. The guidance explains how and why the criteria used in the preliminary review by the OFT when answering the overarching questions are necessarily less stringent than the criteria used by the CC;
- d. an explanation of what is meant by 'relevant merger situation' and the three criteria which must be met (see CLM ¶5508);
- e. an explanation into the OFT and CC's approach to the concept of 'substantial lessening of competition'. The test for whether a merger constitutes a substantial lessening of competition is described as having two distinct elements: the first being an identification of the relevant market or markets; and the second being an assessment of the competitive effects of the merger in that market or markets; and
- f. guidance on public interest and special public interest cases.

Comments on this draft are requested by 31 May 2010. Further details of the draft guidelines can be found at:

http://www.of.gov.uk/shared_of/mergers/Consultations/Merger_Assessment_Guidelines.pdf

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The Insolvency Service consults on how to improve the transparency of and confidence in pre-pack sales in administration

See CLM ¶8901

The Insolvency Service has published a consultation paper seeking views on **whether to amend** the current **regulatory regime** for pre-pack sales in administrations. A pre-pack sale is a tool used in insolvency practice for the purposes of preserving economic value and saving jobs by negotiating the sale of a company's business or assets prior to the appointment of an administrator, with the administrator then effecting the sale immediately on, or shortly after, his appointment. Since January 2009, insolvency practitioners are required to comply with Statement of Insolvency Practice (SIP16) when following the pre-pack procedure (see *CLM 2009 Newsletter Issue 1*). SIP16 was introduced as a result of a lack of confidence and transparency in the pre-pack process. However, compliance with SIP16 has been monitored during 2009 and it has been discovered that many SIP16 disclosure statements were not fully compliant (see *CLM 2009 Newsletter Issue 4* and *CLM 2010 Newsletter Issue 2*). As a result, the Insolvency Service is investigating ways in which the regime can be strengthened, taking into account the changes to the Rules which came into effect on 6th April 2010. Five **proposals** have been identified for consideration:

- a. **make no change.** Provided the administrator obtains creditor approval, the Rules now allow insolvency practitioners to recover their pre-appointment costs from the administration estate. This may encourage insolvency practitioners to be more transparent in relation to their pre-appointment work;
- b. **give statutory force to the disclosure requirements of SIP16.** Incorporating the current requirements into legislation would allow for greater penalties for non-compliance and provide greater encouragement for insolvency practitioners to fully comply. But, this solution would not allow creditors any opportunity to challenge the sale before it takes place;
- c. **restrict the exit from a pre-pack administration to compulsory liquidation** thereby subjecting the pre-pack to automatic scrutiny by the official receiver. This option would improve transparency as the official receiver has a statutory duty to investigate the circumstances of the company's failure, providing opportunity to scrutinise the pre-pack as an independent party (see CLM ¶8277+). One of the key downsides to this proposal is that there may be an increased cost to the administration as funds would need to be reserved by the company for the cost of putting the company into compulsory liquidation;
- d. **require different insolvency practitioners for the pre- and post-administration work.** A concern frequently raised by creditors and stakeholders is that there is a conflict of interest where an insolvency practitioner advises a company to use a pre-pack administration as they stand to benefit financially from the subsequent appointment as the administrator. As mentioned in (a) above, pre-appointment costs can now be recovered and, as a result, there is an argument that pre- and post-administration work should be carried out by different insolvency practitioners in order to remove the conflict. The downsides to this proposal may be the increased cost to the administration, the risk of duplication of work, as well as an increased possibility of delay; and
- e. **require court or creditor approval of the pre-pack when the business or assets are being sold to a connected party.** This would address the concern that sales to connected parties may be contrived at an undervalue. The requirement for approval would be enforced by amending the Rules to impose a personal liability on the purchasers of the company where the sales were executed without the requisite approval. However, one weakness to this proposal is that many of the creditors who are required to approve the pre-pack will not stand to gain anything financially from the sale as there is often a shortfall to secured creditors leaving unsecured creditors without a dividend. This results in parties with no financial interest in the outcome of the sale being able to influence the process of the sale. In addition, advance notice to creditors of the sale of a company may result in a diminution in value of that company.

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Comments on the consultation paper are requested by 24 June 2010. The consultation paper, including questions contained therein, can be downloaded from the Insolvency service website at:

http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/Pre-pack%20consultation%2031march%2010.pdf

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Companies House Northern Ireland – change of address

See *CLM* ¶9905

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On 1 June 2010 Companies House Belfast are moving to:
Companies House
Second Floor
The Linenhall
32-38 Linenhall Street
Belfast, BT2 8BG
DX 481 N.R Belfast 1

Further details can be found at:

<http://www.companieshouse.gov.uk/about/miscellaneous/belfastMove.shtml>

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Corporation tax – trading or investment company

See CLM ¶1795

Dawsongroup Plc v HMRC [2010] EWHC 1061 (Ch)

D Plc decided to change its status from a public company to a private company. This process **cost** them £433,000, which they **deducted** from their profits for the purposes of corporation tax. This would be a proper deduction provided the company was considered an investment company and if the funds could properly be considered expenses of management. Revenue and Customs held the view that the company was a trading company and that the funds were not expenses of management. At trial the judge found in Revenue and Customs' favour. D Plc appealed against that decision.

On the matter of whether or not D Plc was an investment company the Court of Appeal held the trial judge was wrong in deciding that they were not. The Court of Appeal found that D Plc's trading activities were ancillary to the investment activities and as such it could properly be held to be an investment company. However, on the matter of whether the cost was an expense of management, the Court of Appeal found that the real **reason for de-listing** was to restructure share capital with a view to improving the companies share price and that this could not be considered an expense of management. Accordingly the appeal was dismissed.

Charges over cash deposits – are they fixed or floating?

See CLM ¶4632, ¶4638

Re F2G Realisations Ltd (in liquidation), Gray and others v G-T-P Group Ltd [2010] All ER (D) 80 (May)

The High Court has recently held that a charge over a company's cash deposits **in a designated bank account** was a floating charge. This was because, although the bank account was in the charge holder's name, the company held the beneficial interest over the account as it was entitled to call for the monies (except in specified circumstances) without any withholding, deduction or set-off by the charge holder. Furthermore, the court found that the floating charge did not fall within the definition of security over financial collateral (which does not have to be registered where certain conditions are met) and so should have been **registered** at Companies House.

F2GR Ltd, a retailer, entered into an agreement with G-T-PG Ltd for the supply of payment card-related services. Under the arrangement monies would be deposited into a designated bank account held in G-T-PG Ltd's name. F2GR Ltd was able to withdraw from the account without any withholding, deduction or set off by G-T-PG Ltd, provided that F2GR Ltd had paid the sums properly due for the provision of the services. F2GR Ltd entered into administration, and subsequently liquidation. The administrators terminated the agreement with G-T-PG Ltd and sought repayment of the balance held in the bank account. G-T-PG Ltd did not pay over the balance, seeking to set it off against sums allegedly owing to it by F2GR Ltd, and contended that it held a fixed charge over the monies in the account. The High Court disagreed. It found that the account was a simple trust account held for F2GR Ltd in G-T-PG Ltd's name and that, in all the circumstances, it constituted a floating charge. As it had not been registered at Companies House, the floating charge was void against the liquidators of F2GR Ltd.

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Guarantors not bound by an unsigned variation to a guarantee

See CLM ¶4696

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Investec Bank (UK) Ltd v Zulman and anor [2010] EWCA Civ 536

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Where it was contemplated that the guarantors would obtain legal advice before signing a variation to a guarantee (as is often the case) they were **not bound** by it unless and **until** they had signed the new guarantee document, which they never did.

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Messrs Z were directors of AC Ltd, a company that manufactured chocolates and other confectionery. Financing totalling £2.5 million was agreed with IB(UK) Ltd ("the Bank"). £2 million was immediately drawn down; however, the further £500,000 was not required by AC Ltd until approximately 12 months later. The Bank was unwilling to provide the further funding unless Messrs Z entered into a personal guarantee. Under the terms of the guarantee their liability to the Bank only arose if AC Ltd's debt exceeded £2 million. Some months later AC Ltd's borrowing was reduced by £1 million. A variation letter and amended guarantee were prepared by the Bank and sent to Messrs Z. In due course the variation letter was agreed and signed, but the amended guarantee was never signed by either of Messrs Z. AC Ltd subsequently went into administration and the Bank sought to enforce the guarantee against Messrs Z. The Bank's claim was dismissed by the High Court because, as AC Ltd's debt was now less than £2 million, the guarantees could not be called upon. The Bank appealed the court's decision on the grounds that there had been an oral agreement between the Bank and Messrs Z at the time when AC Ltd's borrowing was reduced that the requirement of indebtedness over £2 million before Messrs Z's liability under the guarantee arose would no longer apply.

The Court of Appeal dismissed the appeal. It was clear that Messrs Z were to sign the new guarantee before they were to be bound by it, particularly as it was always contemplated (and expressly stated within the new guarantee) that they would receive independent legal advice before signing the document.

Costs order in derivative claim

See CLM ¶7130, ¶7156+

Carlisle and Cumbria United Independent Supporters' Society Limited v C.U.F.C Holdings Ltd and others [2010] EWCA Civ 463

The Court of Appeal was recently required to consider a costs award in a derivative claim against CUFC Holdings together with one of its directors, Mr S. The derivative **claim** itself **had been settled** but the claimant was appealing a costs order in which Mr S was required to pay the claimant's costs until a cut-off date, after which the claimant was required to pay Mr S' costs. In addition, the court was also required to consider the costs as between Mr S and CUFC Holdings.

It was held that, in relation to the claimant's costs, the trial judge was wrong to impose a cut-off date. The cut-off date had been imposed because after this date, due to the claimant's demands, the parties had agreed matters beyond the scope of what was required to be negotiated in accordance with the parties' instructions from the court. As a result, the trial judge found that the claimant should be responsible for the additional costs incurred. The Court of Appeal held the view that the trial judge should not have decided on what matters should form part of the parties' negotiations. As such, the cut-off date was revoked and the claimant was only required to pay some of Mr S' costs.

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In relation to the costs between CUFC Holdings and Mr S, it was held by the Court of Appeal that, despite the company's articles containing a provision permitting the company to indemnify directors' costs, Mr S should reimburse the company the indemnification money. The Court of Appeal found that it was the actions of Mr S which led to the trial and those actions had constituted a breach of directors' duties. Therefore, it was held that the company should not indemnify Mr S' costs of the action.

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Costs of an unsuccessful action – should they be awarded on a standard or indemnity basis?

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See CLM ¶7156

Digicel (St Lucia) Ltd (a company registered under the laws of St Lucia) and others v Cable & Wireless Plc and others [2010] EWHC 888 (Ch)

When assessing whether costs should be awarded on the standard or indemnity basis the court must not award costs on the **indemnity basis** without finding sufficient circumstances to take the **case outside of the norm**.

The High Court was required to consider the basis for determining a costs award in an action in which the claimants had been largely unsuccessful. The claimants submitted that costs should be assessed on the standard basis and that they should be responsible for 80% of the defendants' costs. The defendants submitted that costs should be assessed on the indemnity basis and that the claimants should pay 100% of their costs.

Costs are normally determined on the standard basis. The judge considered that there had to be something 'outside of the norm' before it would be appropriate for the court to award costs on an indemnity basis.

The defendants' **key submissions in favour of costs being awarded on the indemnity basis** included:

- » the claimants did not follow pre-action protocol;
- » the claimants courted widespread publicity;
- » the claimants made serious and unwarranted allegations;
- » the claimants' claims were speculative and weak; and
- » the quantum of the claim was exaggerated.

The court found that the defendants had established a sufficient number of their criticisms to take the case outside of the norm and justify an award of costs on the indemnity basis. However, when considering one aspect of the claim where there had been conduct contrary to honest practices on the part of the defendant, the judge held that the proportion of the defendants' costs relating to those dishonest practices should not be paid by the claimant and that it would be inequitable for the costs in relation to those costs to be paid on an indemnity basis.

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Wrongful trading claim against a sole company director

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See CLM ¶7449+, ¶7454

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Singla v (1) Hedman and others [2010] EWHC 9002 (Ch)

The High Court was recently required to adjudicate upon allegations made by the liquidator of NMD (UK) Ltd. One of the key allegations to be considered was whether Mr H, as sole company director, was guilty of wrongful trading when NMD (UK) Ltd entered into a contract for the provision of production services with a third party.





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It was found that, at the time of entering into the contract for production services, Mr H was aware, or should have been, that NMD (UK) Ltd didn't have sufficient financing or an important contract in place. In addition it was found that he lied to the third party provider of the production services regarding the solvent status of NMD (UK) Ltd. Furthermore Mr H had filed a false set of accounts at a time when, due to the company's insolvency, he no longer had authority to file any accounts.

As a result of these findings, amongst others, it was held that the liquidator was justified in his application.

Comment: The court was also required to consider further allegations made by the liquidator against two other parties connected with the company in relation to intellectual property infringement and breach of warranties.

Company in administration – should the moratorium be lifted in relation to employment claims?

See *CLM* ¶8818

Re Nortel Networks UK Limited, Unite the Union and another v Nortel Networks UK Ltd (in administration) [2010] EWHC 826 (EH)

It was recently held by the High Court that employment claims made against a company in administration are not sufficiently exceptional to warrant **permission from the court** for their continuation.

NN UK Ltd went into administration on 14 January 2009. On 30 March 2009 37 employees were given notice of the termination of their employment. Those employees, together with a number of other employees under Unite the Union (UTU), commenced proceedings in a Northern Ireland Industrial Tribunal. However, in accordance with the IA 1986, most legal proceedings may be instituted against a company in administration other than with the consent of the administrator or with the permission of the court.

Consent from the joint administrators was sought on 14 May 2009 but was refused. UTU and the employees then applied for consent from the court to continue the proceedings. The employees' claim could be divided into five separate categories:

- » protective awards (under s 189 Trade Union and Labour Relations (Consolidation) Act 1992);
- » unfair dismissal;
- » breach of contract;
- » expenses claims; and
- » discrimination claims.

On 11 November 2009 the joint administrators gave permission to the UTU and the employees to pursue the protective award claim because, if successful, the employees would be entitled to apply to the Government for immediate payment of the statutory element of the award without recourse to any of the administration assets. However, the remaining claims were not permitted by the joint administrators and court adjudication was required.

The High Court held that the key issue was whether the claims were sufficiently exceptional so as to warrant the grant of permission for their continuation. The judge considered that the claims were no different from that of any other trade creditor or unsecured lender. More specifically, each of the claims (i.e. breach of contract, unfair dismissal and discrimination) were monetary claims and so were considered to be debts of the company. As such they should be treated as the other debts would be. The court considered it undesirable to allow for a category of claim to be excluded from the insolvency process. Therefore it held that the claims advanced by the employees and the UTU were not sufficiently exceptional and the moratorium would not be lifted to allow them to continue.

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Assets in insolvency – when does a third party gain a proprietary interest?

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See CLM ¶8900

Re Kaupthing Singer and Friedlander, Margaret Mills and ors v Sportsdirect.com Retail Ltd [2010] EWHC 1072 (Ch)

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Immediately prior to the onset of KSFs administration, SD had been **negotiating** with KSF for the repurchase of shares worth millions of pounds. The issue in this case was whether SD had acquired a proprietary interest in those shares **prior** to the **administration** and, if so, should they be required to pay the increase in price in shares from when they were allegedly bought and when they were transferred.

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The problems with the deal arose when neither party was prepared to fulfil their obligations before the other party had completed theirs, i.e. KSF would not transfer the shares until they had received the funds and SD would not transfer the funds until they had received the shares. An agreement was reached and based upon this the judge held that a trust had been created, not least because the shares had been segregated from other shares for the benefit of SD. As such beneficial ownership in the shares passed to SD. Crucially, this occurred prior to the onset of administration, resulting in the cost of the shares being fixed. Therefore, SD was not responsible for the increase in the cost of the shares.

Administration and setting off debtor creditors

See CLM ¶8976

Re Kaupthing, Singer and Friedlander Limited (In Administration) [2010] EWCA Civ 518

The Icelandic bank, KSF, went into administration on 8 October 2008. In the process of the administration, an application was made by the administrators to the court in June 2009 concerning how claims and cross-claims between KSF and its depositors should be calculated and set off against each other. As part of the judgement it was decided that where a creditor is also a debtor of the company and the sums have been set off leaving an **outstanding debt to the company**, that debt should be **discounted** to the **present value**. The case reported here concerns the administrators' appeal against that decision.

KSF had given loans which amounted to a substantially larger sum of money than they held on deposit. Many of these loans were not repayable until 2018 and a large amount of those debtors were also creditors. When calculating set off with the debtor/creditors, the amount of the loans and deposits were discounted to their present day value in accordance with the Insolvency Rules 1986 (the Rules). However, according to s 2.85(8) IR 1986 the balance of the outstanding loans after set off is not repayable until the contractual date for repayment and the administrators argued that these amounts should not be discounted to their present day value.

The respondents to the appeal argued that the administrators submitted a strained and artificial reading of the Rules and the true reading was that the outstanding sums should be discounted, as held by the trial judge. However, the Court of Appeal found that this interpretation of the Rules did not align with the policy objective of the procedures of administration. Further, if the intention of the Rules was to preserve and maximise the value of the company, they should be read to prevent the money owing to the company after set off being discounted thereby increasing the pool of funds available to other creditors. Accordingly the appeal was allowed.

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[Application for an additional administrator](#)

See CLM ¶9002

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Bloomsbury International Limited and ors v Mark Alan Holyoake and ors [2010] EWHC 1150 (Ch)

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In a recent High Court case, the court was required to decide whether it was appropriate to appoint an additional administrator upon an application to do so by Mr H, a director of one of four companies which entered into administration by order of the court on 19 February 2010.

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The administrators claim to have uncovered significant fraud on the four companies involved and have commenced proceedings against Mr H and a number of others in respect of this fraud. Mr H applied to the court for the appointment of an additional administrator on the basis that he was a former client of the current administrator's firm, Deloitte. The **court** has the **power to appoint** an additional administrator in circumstances where there is considered to be "good cause". In order to establish good cause, Mr H submitted that Deloitte:

- » could not be seen as independent;
- » should not be entitled to bring fraud proceedings on a previous client; and
- » possessed confidential information which made it inappropriate for them to act in these proceedings.

The court found that the termination of the retainer between Mr H and Deloitte also terminated any fiduciary obligation which arose when Mr H was a client and no longer prevented Deloitte from acting independently. On the matter of the possession of confidential information, the court held that there were sufficient information barriers within Deloitte that there was no risk that the information would be passed to the administrators. Therefore, the court found that Mr H had not shown good cause why an additional administrator should be appointed and the application was dismissed.

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Industrial and Provident Societies to be renamed

See CLM ¶121

The Co-operative and Community Benefit Societies and Credit Union Act 2010 was given Royal Assent on 18 March 2010. It has not yet come into force. The **key changes** that will be implemented by the Act are:

- » the re-naming of the Industrial and Provident Societies are as either co-operative societies or community benefit societies;
- » the requirement for new societies carrying on any industry, business or trade to be registered as either a co-operative society or a community benefit society;
- » the application of the Company Directors Disqualification Act 1986 to societies in the same way as it applies to companies; and
- » giving the Treasury power to apply company law relating to the investigation of companies, company names, dissolution and restoration to the register to societies. As yet, no regulations to do so have been made.

Further details and the full Act can be found at:

http://www.opsi.gov.uk/acts/acts2010/pdf/ukpga_20100007_en.pdf

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New Edition

Be on top of the latest changes with VAT Memo 2010-2011



VAT Memo 2010-2011, published in April, has been fully revised and updated for the Budget 2010 announcements, and will include commentary on the following:

- restitution of the VAT rate to 17.5% (effective January 2010)
- new place of supply rules for cross-border services (effective January 2010)
- TOMS changes (effective January 2010)
- new tribunal and appeals system (effective April 2009).

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