

COMPANY LAW MEMO 2010

Newsletter Issue 4

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BIS summary of responses to consultation on the financial information required in statements of capital

See CLM ¶486, ¶1484

In 2009 BIS issued a consultation on the requirements of the Companies Act 2006 for financial information in statements of capital (see CLM Newsletter Issue 6 2009). The responses to the consultation have been summarised by BIS and the **key conclusions** are:

- » the vast majority of the respondents explicitly agreed with the problems listed in the consultation document;
- » the majority of respondents do not support the inclusion of the aggregate value of the share premium account in the statement of capital;
- » most respondents agreed that the statement of capital should be the same in all circumstances except on the formation of a company;
- » on formation, the majority of respondents agreed that the statement of capital requirements should remain as they currently are; and
- » the response to the suggestion that total paid up nominal value of shares should be included in non-formation statements of capital was relatively evenly split.

The Government will now consider the best way forward in light of the responses and will set out its intentions in due course.

For further detail please see:

<http://www.berr.gov.uk/Consultations/companies-act-2006-statements-of-capital-consultation>

Taxation changes announced

See CLM ¶607, ¶1781, ¶1790, ¶2726, ¶5343+, ¶5355+

The new coalition government has announced in the Budget on 22 June 2010 the following changes to:

1. **Corporation tax:** the exemption from corporation tax which applies to any income received by corporate shareholders in the form of distributions is to be extended to the receipt of dividends of a capital nature. This will be coupled with a widening of the definition of distribution to include a return of a reserve arising from a reduction in share capital;
2. **VAT:** the standard rate of VAT will increase to 20% from 17.5% with effect from 4 January 2011. Special measures will be introduced to prevent the 17.5% rate applying to supplies made on or after 4 January 2011 where the recipient of the supply is unable to recover all the VAT on the supply and either:
 - » the parties are connected; and/or
 - » the value of the supply exceeds £100,000 (unless prepayments or advance VAT invoices are usual commercial practice); and/or
 - » the supplier (or someone connected with the supplier) funds a prepayment; and/or
 - » an advance invoice is issued and payment is not due for at least 6 months;
3. **Income tax:** the basic personal allowance for income tax in 2011/12 will be £7,475; and
4. **Enterprise Investment Schemes (EISs) and Enterprise Management Incentive (EMI) schemes:** changes will be made so that they continue to receive approval from the European Commission. At present the company must carry on a trade wholly or mainly in the UK. This condition will be replaced by a requirement that the company must have a permanent establishment in the UK. In addition, in relation to EISs, relief will be denied in cases where it is reasonable to assume that the company raising the funds is in difficulty.

Further details of the changes and when they will take effect will be in the Finance Bill, to be introduced after the Parliamentary summer recess.

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In addition, two major changes to **capital gains tax** rates have already been implemented, effective from 23 June 2010:

- » a new capital gains tax rate of 28% applies to higher rate gains. In essence, where the total of an individual's gains, (taking into account their income after the personal allowance, the annual exemption, and any losses), would take them above the upper limit of the basic rate band for the year, the gain will be taken as the top slice and the amount falling above this limit will be taxed at the new rate. The existing rate will apply for all gains below this limit. The new rate also applies for trustees and personal representatives regardless of the level of income or gains. Gains that occurred this tax year prior to 23 June will remain to be taxed at 18% and will not be accounted for in ascertaining if the basic rate threshold has been exceeded; and
- » entrepreneurs' relief has been further extended to cover lifetime gains of £5 million. This will not affect gains made in the current tax year arising prior to 23 June 2010. The legislation will also be amended so that a flat rate of 10% is charged on eligible gains rather than reducing the gain by a fractional amount, as is currently the case.

Budget Announcement 22/06/2010

When will the OFT apply for a director's disqualification for a breach of competition law?

See CLM ¶3032, ¶3072

The OFT has published **guidance** setting out how and when it (and other authorised regulators) will take action to disqualify directors for breaches of competition law ("Director disqualification orders in competition cases"). A five-step process for deciding whether to apply for a disqualification order will be used. In each case the following will be considered:

- a. whether there has been a **proven breach** of competition law as handed down in a decision or judgment of the OFT (or authorised regulator) itself, the Competition Appeal Tribunal, the European Commission, the European Court or any other competent court. Action will only be considered where the decision or judgment has an actual or potential impact in the UK and an application will not be made while the decision or judgment remains subject to appeal;
- b. the nature of the breach and whether any **financial penalty** has been imposed. An application is more likely to be made if a financial penalty has been imposed;
- c. whether the company in question benefited from **leniency** (i.e. immunity from, or any reduction in, financial penalty because it provided information about cartel activity in which it was involved and assisted in the investigations). An application will not be made against any current director of a company which benefited from leniency in relation to the activities for which the leniency was granted. However, an application for disqualification may still be made in relation to other activities, against former directors, or against directors who failed to co-operate with the leniency process;
- d. the extent of the **director's responsibility** for, **and involvement** in, the breach (whether by action or omission); and
- e. whether any **aggravating and mitigating factors** (or both) apply. The guidance sets out examples of aggravating factors (for example, the director being directly involved in breaches of competition law in the past) and mitigating factors (for example, the company being coerced into committing the breach by another undertaking).

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The publication of the guidance follows a lengthy consultation and indicates that the OFT is now more likely to apply for disqualification orders in order to deter anti-competitive activity. A copy of the guidance can be downloaded from the OFT website:

http://www.of.gov.uk/shared_of/business_leaflets/enterprise_act/oft510.pdf





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Financial Reporting Council (FRC) revises the UK Corporate Governance Code (formerly the Combined Code)

See CLM ¶3199

The FRC have revised and amended the Combined Code following a consultation which took place during 2009 (see *CLM Newsletter 2010 Issue 1*). The code has been renamed the UK Corporate Governance Code and aims, amongst other things, to improve the diversity, accountability and performance of company boards.

The key changes to the principles are:

1. **Director re-election:** For all FTSE 350 companies the directors should be re-elected annually;
2. **Increase boardroom diversity:** Companies should make boardroom appointments based upon "objective criteria which do not inappropriately restrict the talent pool from which the candidates will be identified";
3. **Board reviews:** FTSE 350 companies should have the performance of the board externally evaluated every 3 years;
4. **Business model transparency:** Companies should report on their business model and risk strategy in the annual report; and
5. **Performance related pay:** Non executive directors should not be eligible for performance related pay and payouts under incentive schemes should be subject to non-financial performance criteria.

The new Code **applies to** financial reporting years starting on or after the 29 June 2010. Where the changes to the Code apply to FTSE 350 companies, smaller companies are required to consider the principles imposed when conducting their business. The Code remains "self regulating" as there has been no change to the "comply or explain" formula.

For further details see:

<http://www.frc.org.uk/images/uploaded/documents/UK%20Corp%20Gov%20Code%20June%2020102.pdf>

Financial Reporting Council (FRC) have released the UK Stewardship Code

See CLM ¶3199

In July 2010, the FRC published the final form of the UK Stewardship Code together with a related report concerning the Codes' implementation. The Code is intended to provide **guidance** on how institutional investors should **engage** with investee companies and thereby provides an additional level of scrutiny on the performance of companies. It is hoped that the code will open up dialogue between a company and its institutional investors and encourage investors to be more proactive in the governance of their investee companies.

In common with the UK Corporate Governance Code, the Stewardship Code is "self-regulating" and employs the "comply or explain" system, whereby institutional investors will have to report, on their websites, how they have complied with the Code.

The code is constituted of **7 principles** which state that investors should:

1. **disclose** their policy on how they will monitor the investee companies, including any strategy they would have for intervention;
2. **act** in the best interests of their clients and beneficiaries;
3. **monitor** the investee companies and be able to satisfy themselves that board and committee structures are effective and be able to identify at an early stage any problem areas. This includes attending general meetings;



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4. have defined circumstances when they will **intervene** and regularly assess the outcomes of doing so. This can mean holding additional meetings, setting up meetings with the chairman or requisitioning general meetings;
5. be prepared to **act collectively** with other investors, if this is the most appropriate means of engaging with the company;
6. have a clear **policy** of voting; and
7. **report** regularly on the voting and stewardship activities.

For further details please see:

<http://www.frc.org.uk/publications/pub2307.html>

Plans for compulsory Operating and Financial Review

See CLM ¶4252

The coalition government has outlined plans to make the provision of an Operating and Financial Review (OFR) in **directors' reports** (to accompany the company accounts) compulsory. This would replace the current requirement for a non-mandatory business review to be provided in directors' reports of **large and medium-sized companies**, which covers key performance indicators and social and environmental issues. The new proposals are designed to improve corporate accountability and reporting transparency, particularly with regard to companies' social and environmental obligations.

Proposals for a new restructuring moratorium announced

See CLM ¶6530, ¶7325, ¶7342

The Insolvency Service has published a **consultation** paper on proposals for a restructuring moratorium, intended to help companies which have a core business that is viable but where there is a need to reach some form of compromise with its creditors or restructure its debts. The aim is to provide the option of a **protected breathing space**, during which a restructuring could be negotiated and implemented, outside of a formal insolvency procedure. According to the Insolvency Service, this would help safeguard jobs, improve the outcome for creditors and support investment and growth by ensuring that companies can access finance, or restructure existing debts, to avoid the prospect of being forced into a formal insolvency process.

The restructuring moratorium would:

- » be **available to** companies that satisfy certain eligibility criteria, can demonstrate that they are likely to have sufficient funds to carry on their business whilst the moratorium is in force and that are seeking a contractual (or informal) compromise with their creditors, or are preparing either a CVA or scheme of arrangement;
- » **last for** 3 months initially, with extensions available for complex negotiations or where more time is needed to obtain the required formal approval of a statutory CVA or scheme of arrangement. Companies would not be permitted to apply for successive moratoria, under this or other formal insolvency procedures, within a period of 12 months;
- » **require** the sanction of the court, to help safeguard creditors' interests by allowing them to raise objections at the hearing;
- » **prevent** the presentation of a winding up petition, the appointment of an administrator, forfeiture of a lease, the enforcement of security over the company's property, legal proceedings being taken against the company and meetings of the company being held;
- » **involve** an authorised insolvency practitioner at key stages of the application process and as a "monitor" whilst the moratorium is in force; and
- » **subject** the company's **directors** to specific obligations and potential penalties to deter misconduct or abuse. The directors would, however, retain control of the company's affairs during the moratorium.

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Responses are requested by 18 October 2010. The consultation paper can be downloaded from the Insolvency Service website:

http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/RestructuringMoratoriumConsultationDocument.pdf

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OFT recommends reform of corporate insolvency regulation

See CLM ¶7300+

The Office of Fair Trading (OFT) has recommended a **broad package of reform** following a market study of the current regulatory system for corporate insolvencies ("The market for corporate insolvency practitioners"). The study focused on the appointment, actions and fees of corporate insolvency practitioners, particularly in relation to administrations and creditors' voluntary liquidations (CVLs). It found a number of failings in the current regime including the fact that it is unable to protect or effectively engage small creditors in the insolvency process. In order to restore trust and create more proportionate regulations focussed on correcting these market failures the OFT recommends:

- a. establishing an **independent complaints body**, funded by the profession, with the ability to review insolvency practitioner's fees in appropriate circumstances;
- b. changing the **structure and process of the current regime** to increase its focus and efficiency by:
 - » setting clear objectives for the regulatory regime to ensure that the rules are effectively maintained and enforced and future changes are clearly focused on correcting problems in the market;
 - » establishing the Insolvency Service as the regulator of the Recognised Professional Bodies (RPBs) (for example, the Institute of Chartered Accountants in England and Wales (ICAEW)), while decreasing its role as direct regulator of individual insolvency practitioners;
 - » streamlining the decision making process between RPBs to increase the efficiency and agility of the self-regulatory regime; and
 - » focussing the Insolvency Practices Council on assessing how well the objectives are met; and
- c. amending some of the existing regulation to assist **unsecured creditor involvement** (such as enhancing the opportunity for creditors to review the appointment of the insolvency practitioner where an administration moves to a CVL and requiring the liquidator's proposals for his remuneration in a CVL to be voted on separately from other proposals so that creditors can see that they do not have to accept the entire package of proposals).

The OFT is urging the regulators to consider making these changes as soon as possible to benefit the wider economy, increase trust and demand for insolvency practitioner advice. However, it is for BIS to consider whether to act upon these recommendations.

The report can be downloaded from the OFT website:

http://www.of.gov.uk/shared_of/reports/Insolvency/of1245

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How useful are Insolvency Service statistics?

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See CLM ¶7360

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The Insolvency Service has published a **consultation** paper seeking views on how useful users find its quarterly statistics (and other official statistics on personal insolvencies and individual voluntary arrangements). The consultation follows a report on Insolvency Statistics carried out by the United Kingdom Statistics Authority earlier this year, but is also being undertaken in the light of the current public expenditure constraints.



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The quarterly statistics are produced and published by the Insolvency Service as a National Statistic publication and contain information on company liquidations and procedures to provide users with an overview of the level of, and trends in, insolvencies within England and Wales. The Insolvency Service is **seeking views on** the methodology it uses to produce the statistics, their scope, the presentation of the data, the format of the statistics and the way in which they are made available.

The consultation is open until 18 October 2010 and copies can be downloaded from the Insolvency Service website:
http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/con_doc_register/Insolvency%20Statistics_ConDoc_July%202010.pdf.

A formal response is expected to be published by the Insolvency Service by the end of this year.

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CASES

Existence of a Partnership

See CLM ¶17+, ¶550

Roger Marsh v Simon Marsh & Anor [2010] EWHC 1563 (Ch)

Where a partnership has existed it is possible to trace assets of that partnership into a successive company. However, with no partnership agreement in place, the **court will look to** the historic dealings of the company in order to establish whether a partnership existed.

This case involved RM, the father of SM, appealing to the court to trace assets of the alleged partnership, SMS, into a new company, TCIL, which SM had incorporated without the involvement of RM. RM claimed that SMS had been a partnership between himself and SM. However, the court found that in key documentation of SMS, the company details described SM as being a "sole proprietor" and, when asked by the court, RM had declared that he would not have been prepared to stand by any legal obligation to pay an indebtedness of SMS should SM have failed to pay. In doing this he denied one of the key constituents of a partnership.

The court held that there was a great deal of difference between a father helping his son set up a business and a father and son entering into business together as a partnership. Although SM may have received help and guidance from RM in filing VAT returns and sourcing custom, this did not amount to a partnership in the face of the contrary evidence. Accordingly, the appeal was dismissed.

Bills of Sale Acts do not apply to companies

See CLM ¶4638

Online Catering Limited v Acton and anor [2010] EWCA Civ 58

The Court of Appeal has recently clarified the position in relation to the **registration of certain charges** by companies. Companies are bound by the provisions of the CA 2006, which states that charges created by an instrument or document, where executed by an individual and which require registration as a bill of sale, must be registered at Companies House (s 860 CA 2006). The Court of Appeal confirmed that the Bills of Sale Acts, which require bills of sale executed by individuals to be registered with the High Court, are confined to individuals and do not apply to companies. Therefore, charges entered into by companies will not require separate registration at the High Court as a bill of sale.

Indemnity for costs in derivative claims

See CLM ¶7127

Stainer v Lee and others [2010] EWHC 1539 (Ch)

In a recent case, the High Court granted an indemnity for the applicant's costs when granting him permission to proceed with a derivative claim (i.e. proceedings brought on behalf of the company by a shareholder) but **limited this by** placing a **financial cap** on the amount of costs covered by it. Shareholders wishing to bring such claims must apply to court for permission to continue with it. This is known as the "filter stage" as it ensures that only genuine claims continue. The indemnity was capped in this case because it was granted at the filter stage, and the amount of recovery on behalf of the company was at that time uncertain. The court confirmed that the applicant would be at liberty to apply to extend the scope of the indemnity if necessary.

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Notice of appointment of administrator when time barred

See CLM ¶8762+

Re Cornercare Ltd [2010] EWHC 893 (Ch)

A company, wishing to make an **out of court** appointment of an administrator is required to do so within the time permitted by the IA 1986 following the filing of a notice of their intention to do so. If the permitted period expires, a fresh notice of intention to appoint can be filed at court to restart the brief window in which the appointment can be made.

C Ltd was in financial difficulties and its directors had filed at court a notice of their intention to appoint an administrator using the out of court procedure. The legislation provides that no appointment can be made after 10 business days from the date at which the notice of intention to appoint had been filed (para 28(2) Sch B1 IA 1986). However, C Ltd did not appoint an administrator **within** the allotted **10 days**. Despite this fact the directors applied to the court for a declaration that they could still appoint an administrator, or alternatively, apply for an administration order.

The court held that, in this case, they were satisfied that there was a **genuine reason** for C Ltd's failure to appoint an administrator within the permitted time. Whilst no appointment could be made pursuant to the original notice due to its expiry, a fresh notice of intention to appoint could be filed at court instead, thereby restarting the 10-day window. However, the court made it clear that it was not approving of successive filings of intentions to appoint administrators where there was no real intention to do so, particularly if the primary intention was simply to obtain the benefit of a moratorium.

Electronic delivery of statutory notices

See CLM ¶8780+

Gould and anor v Itmo Advent Computer Training Ltd and anor [2010] EWHC 459 (Ch)

Electronic delivery of statutory notices was held to be permissible in instances where there is **no uncertainty** about whether the emails would reach the recipients.

This case involved an educational services company in financial difficulties. The company's clients were students who, as part of their contract with the company, were obliged to give their email addresses. Many of these students were creditors to the company as they had paid in advance for the company's services. The administrators were required to send out a notice of their appointment to the student creditors and wished to do so by email. As such, the administrators applied to the court for a ruling that they would be permitted to send the notices electronically.

The legislation requires notices to be "sent" to the relevant parties. The court held that, in this case, as there was certainty as to the email addresses of the creditors, sending the notices using electronic means could properly fall within the meaning of the Act.

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Appeal to set aside a CVA due to unfair prejudice

See CLM ¶9513+

Mourant & Co Trustees Ltd and anor v Sixty UK Limited (in administration) and ors [2010] EWHC 1890 (Ch)

Where a CVA does not show **parity** between creditors, is **unfairly prejudicial** to certain creditors and/or there has been a **material irregularity** in the conduct of the CVA, the court has the power to set aside the arrangement.

In this case the applicant, M Ltd, was the landlord of S UK Ltd, which was in financial difficulties. S UK Ltd sought to establish a CVA between itself, as a tenant and M Ltd, which had the benefit of a third party guarantee, to require M Ltd to forsake its guarantee even though it was neither the company who was proposing the arrangement or a party to it.

S UK Ltd's administrators arranged the CVA so that all creditors would be fully repaid but M Ltd would receive £300,000 as full compensation for their liability and would be required to give up the guarantee given by S UK Ltd's parent company. M Ltd appealed against the CVA on the basis that it was unfairly prejudicial to it as the sum proposed by the administrators was based on numerous flawed assumptions and was not a correct reflection of the liability owed to it. Further, it was the only creditor who was required to accept a substitute for its contractual rights.

The court held that it was both unreasonable and unfair to require M Ltd to give up its guarantee and to force it to do so, especially when the solvency of the guarantor was not an issue, would be to undermine the commercial function of the guarantee. In addition, the sum proposed by the administrators was unfair and amounted to a dereliction of the administrators' duties. As such the CVA was set aside and the administrators were reported to the professional bodies to which they were answerable.

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