UK Corporate Briefing

Issue 2 - Summer 2015

DENTONS

Welcome to the latest edition of Dentons' UK Corporate Briefing, a quarterly summary of the most significant recent and forthcoming developments in company law and corporate finance regulation in the UK.

Legislation update

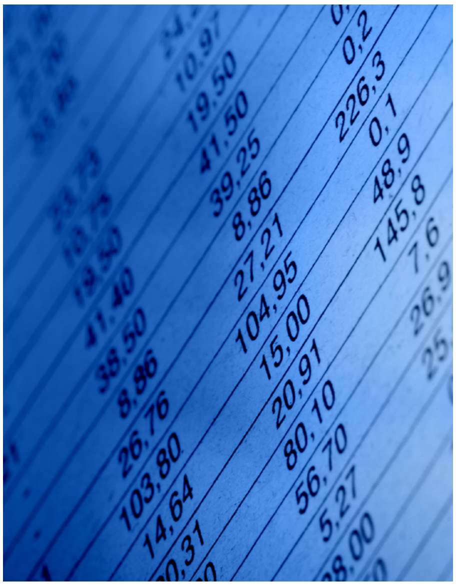
Bearer shares banned

The first of the corporate transparency provisions in the Small Business, Enterprise and Employment Act 2015 came into force on 26 May 2015 with the banning of share warrants to bearer, or bearer shares as they are more commonly known. (See **issue 1** for an overview of the Act.)

From 26 May it has been unlawful for a UK company to issue bearer shares. A company whose articles of association authorise the issue of bearer shares can amend its articles without having to pass a special resolution or comply with any provision for entrenchment.

On the same date a transitional nine-month period started during which existing bearer shareholders may surrender their bearer shares and convert them into registered shares. The legislation contains detailed rules about the procedures and imposes certain duties on companies with existing bearer shareholders.

If a bearer shareholder does not elect to convert his bearer shares within the surrender period, the affected company must apply to court to cancel those shares and make an associated payment of capital into court. This amounts in effect to a reduction of the company's capital. Typically it will therefore be simpler, cheaper and less disruptive for a company if any bearer shareholders exercise their surrender and conversion rights. Any funds paid into court will typically remain there for three years, after which the bearer shareholder loses any right to repayment and the funds go to the state.



Small Business, Enterprise and Employment Act 2015, sections 84–86 and **Schedule 4**

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Please contact us if you would like to discuss any subject covered in this issue.

Company accounts: amending regulations

New regulations came into force on 6 April 2015 to implement in the UK Chapters 1 to 9 of the EU Accounting Directive. The Directive provides an updated EU-wide accounting framework for statutory accounts. The new regulations apply to accounting periods starting on or after 1 January 2016, though early adoption is possible.

A significant change is to reduce the financial reporting burden for small companies. In particular:

- The regulations adopt the maximum turnover and balance sheet limits for small companies allowed by the Accounting Directive, enabling a larger number of companies to access the lighter touch small companies regime. The maximum permissible turnover limit is £10.2 million (up from £6.5 million) and the maximum permissible balance sheet total is £5.1 million (up from £3.26 million). There is no change to the maximum number of employees (50). There are equivalent increases to the limits for small groups.
- The regulations reduce the number of compulsory disclosures small companies must make. They also allow a small company to prepare an abridged balance sheet and profit and loss account, if approved by all the company's shareholders.

Other changes include:

- Allowing companies in the same group as a non-listed public company access to the small or medium-sized companies regimes.
- Allowing companies to use alternative layouts when preparing their profit and loss account and balance sheet, subject to certain qualifications.

The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015

Increase in fines for company law offences

Failure to comply with many of the requirements imposed by the Companies Act 2006 on a company and its officers is a summary offence.

Previously the maximum fine for a summary offence under any legislation was £5,000, the so-called "statutory maximum" or "level 5 on the standard scale". This cap has now been removed, meaning that magistrates now have the power to impose whatever fine for a summary offence they consider most appropriate in the circumstances, including for Companies Act 2006 offences.

The Legal Aid, Sentencing and Punishment of Offenders Act 2012 (Fines on Summary Conviction) Regulations 2015

Case law update

Amending drag-along rights in a company's articles

The Court of Appeal has rejected an appeal in an unfair prejudice claim based on a variation of drag-along rights in a company's articles. In doing so, it reviewed a line of cases in which the courts have considered the power of a company's shareholders to amend a company's articles.

Background

Mr Arbuthnott was a founding shareholder and director of Charterhouse Capital Limited. Over time, the retirement of senior shareholding executives resulted in a misalignment between the shareholders and the active executives running the business. An MBO team of the active executives made a bid to buy the shares of the retired and retiring executives. It was a condition of the MBO offer that the shareholders amend the existing drag-along rights in the company's articles. The offer was accepted and the changes to the articles approved by all the shareholders other than Mr Arbuthnott. He argued that the changes were invalid as their effect was to allow the majority shareholders through the drag-along rights to expropriate his shares at an undervalue.

Decision

In rejecting Mr Arbuthnott's appeal the court made the following observations:

- There are limits on the power to amend the articles. These arise because the power of the majority to bind a minority will not, without clear words, be taken to have been intended to be without limit.

- The basic test is that the shareholders must exercise the power in good faith in what they consider to be the interests of the company. It is for the shareholders and not the court to decide what amounts to a benefit to the company. However, this is subject to the caveat that it will not be for the benefit of the company if no reasonable person would consider it to be such. The burden is on the person challenging the validity of the amendment to satisfy the court that there are grounds for doing so.

On the facts, the shareholders considered they were acting in the best interests of the company as a whole. They wanted to resolve the alignment issue to secure the company's future. There was no evidence of bad faith or improper motive. The amendments to the drag-along rights were a tidying-up exercise and not inconsistent with original arrangements between the founding members.

Comment

The amendment to the articles did not introduce any major changes. The case therefore does not deal with the question of whether an amendment to insert drag-along rights for the first time or significantly change existing drag-along rights would be invalid or involve unfair prejudice.

On the best interests point, the court noted that a power to amend will be validly exercised even though a change is not for the benefit of the company itself because it concerns a matter in which the company as an entity has no interest, but is only for the benefit of the shareholders or some of them, provided "it does not amount to oppression of the minority or is otherwise unjust or outside the scope of the power".

Arbuthnott v. Bonnyman & Ors [2015] EWCA Civ 536

Read more >

Execution of contracts: overseas companies and conflicts of laws

A recent Court of Appeal decision is a good reminder that the issue of who can bind an overseas company that is party to an English law contract is governed by the law of the place where the company is incorporated.

Background

The case concerned a supply contract between two Swiss oil trading companies written under English law and subject to English jurisdiction. The claimant alleged that SCU-Finanz AG, the defendant, had agreed to supply it with oil under the contract, but had failed to do so. The defendant contended the contract was not binding on it because it had two prokurists (representatives) and only one of them had signed the contract. Under Swiss law when the general power to represent a company is given to more than one prokurist, as in the defendant's case, all must sign to bind the company.

Decision

The key question before the court was how to characterise the issue of who should sign. Was it an issue about the formal validity of the contract or was it a question about who had authority to bind the company?

The Court of Appeal held it was the latter. This meant that English common law conflicts rules were relevant for deciding the issue. These rules apply the law of incorporation to issues of a company's capacity and internal management, including who has authority to act on the company's behalf. In this case, therefore, Swiss law governed who should sign for the defendant. Given the evidence that under Swiss law both prokurists needed to sign for the defendant, the Court of Appeal agreed with the trial judge that the defence would succeed and dismissed the appeal.

Comment

Although the question of who has authority to sign for an overseas company is a matter for the law of its place of incorporation, the Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 set out the relevant execution formalities for an overseas company where the contract or document is under English law. It is important to consider both aspects when considering who has authority to bind an overseas company and whether they have executed the contract or other document correctly.

Integral Petroleum S.A. v. SCU-Finanz AG [2015] EWCA Civ 144

If a bearer shareholder does not elect to convert his bearer shares within the surrender period, the affected company must apply to court to cancel those shares and make an associated payment of capital into court.

Warranty claims: the importance of giving notice correctly

This recent High Court decision highlights the importance of following the relevant clauses of a share purchase agreement when giving notice of a warranty claim.

Background

Ipsos bought shares in companies in the Synovate Group, a worldwide market research business. The share purchase agreement included a warranty that no person who was not an employee claimed treatment as an employee.

The agreement stated that no claim would lie against the seller "… unless … the Purchaser shall have given to the Seller written notice of such Claim … (a 'Claim Notice') specifying in reasonable detail: (i) the matter which gives rise to the Claim; (ii) the nature of the Claim; and (iii) (so far as is reasonably practicable at the time of notification) the amount claimed in respect thereof (comprising the Purchaser's good faith calculation of the loss thereby alleged to have been suffered) … ".

Another clause required the buyer to notify the seller of a claim that it received from a third party which might lead to a warranty claim.

After completion, contract workers filed claims against a Brazilian subsidiary alleging they should have been treated as employees. Ipsos later issued proceedings against the seller for breach of warranty. The seller argued that the claim was barred as Ipsos had failed to give a Claim Notice as required by the agreement.

Ipsos relied on two letters which it had written to support its case that it had given a Claim Notice. The first letter notified the seller of the employment claims which the contract workers had made against the Brazilian subsidiary. Ipsos had sent this to comply with its notice obligation for third-party claims, and it expressly stated that it was not a Claim Notice. The second letter was a follow-up providing further details about these claims, including the sums involved, and gave notice of some further third-party claims. It also asked the seller to clarify its position on the third-party claims. It stated that after that Ipsos would provide a further breakdown of its losses, costs and expenses.

Ipsos argued that a reasonable person with the knowledge of the background, including the history of claims made by contract workers and the contents of the first letter, would have read the second letter as constituting a Claim Notice.

Decision

The court held that the second letter did not constitute a Claim Notice. The question was whether a reasonable recipient with knowledge of the context in which it was sent would understand it to be a Claim Notice. In this case, the second letter was very much a follow-up from the first, it did not say it was a Claim Notice, it did not make it explicit that a claim was being made and it did not specify the matter giving rise to the claim or the nature of the claim.

Comment

This case is a further example of the courts requiring strict compliance with the claim notification provisions in a share purchase agreement. It is a reminder to a party making a warranty claim that it is important to ensure that its notice complies strictly with the relevant agreement. If the agreement requires a notice to specify a matter, the notice should deal with it expressly as it is unlikely to be enough that it is possible to infer the matter. Failure to give valid notice of a claim can, as in this case, where the time period for serving a valid Claim Notice had expired, deprive a claimant of its claim and therefore has potentially serious consequences.

IPSOS S.A. v. Dentsu Aegis Network Limited [2015] EWHC 1171

Restoration to register: limitation of claims

When restoring a company that had been struck off the register under section 1032 of the Companies Act 2006, the High Court allowed a winding-up petition to be backdated to the date on which the company was dissolved.

Background

The claimant had a potential claim against a company that had been struck off and dissolved. The claimant wanted to have the company restored and then wound up. This would enable a liquidator to rely on the reviewable transaction provisions of the Insolvency Act 1986 to claw back the assets of the company. These would then be available to meet the claimant's potential claim.

The reviewable transactions in question had taken place more than two years before the company's restoration. A liquidator whose appointment was effective from restoration would not have been able to challenge them. This is because under the relevant insolvency legislation transactions which occur more than two years before the date of presentation of the petition for a company's winding up are not subject to review.

Decision

The court made use of section 1032(3) of the Companies Act 2006. This allows the court to give directions that seem just for placing a company and all others in the same, or as nearly the same, position as if the company had not been dissolved. The court therefore ordered that the period between the company's dissolution and the date of its restoration was not to count for limitation purposes and that, for the purpose of pursuing any reviewable transactions claim, the claimant's winding-up petition would be treated as presented on the date of the company's dissolution.

Comment

This case shows the willingness of the courts to help a claimant in circumstances where a company was aware of a potential claim but nonetheless applied to be struck off the register and was struck off and dissolved.

Davy v. Pickering and others [2015] EWHC 380

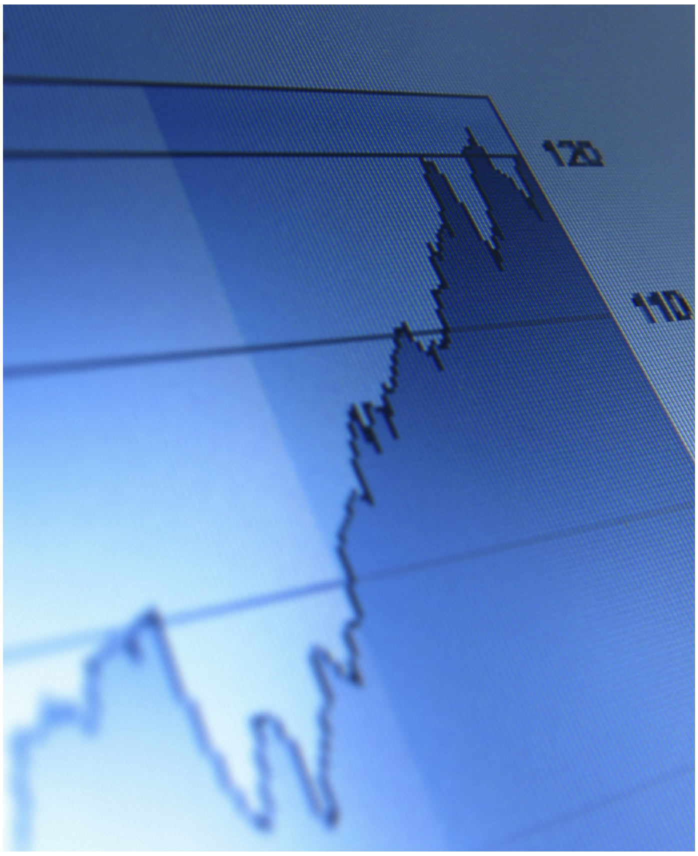
Regulatory update

AIM: guidance on free float and AIM Rule 31

AIM, unlike the Main Market of the London Stock Exchange, does not prescribe a level of free float (i.e. shares that are publicly traded) for companies traded on it. However, it considers the issue of free float to be an important part of the work that a nominated adviser (Nomad) undertakes when bringing a company to market. An adequate free float is fundamental to the orderly trading and liquidity of the securities once admitted to AIM.

AIM Regulation, the team at the London Stock Exchange which oversees the AIM market, has published guidance clarifying some matters it commonly discusses with the Nomad of a company seeking admission to AIM. These include:

- There should be consideration of how the securities are likely to trade when admitted to AIM, following discussion with the company's broker(s) and potential market makers.
- Failure to raise initial target funds (which in itself might result in free float questions) may be indicative of more fundamental issues of appropriateness and the Nomad should properly explore that failure.
- Limited free float should raise questions about the rationale for the applicant to seek admission to AIM.
- Where there are concentrated shareholdings (e.g. connected due to family, business or other interests/connections) free float issues should be considered with issues of undue influence, control and ongoing corporate governance arrangements within the company.



Under AIM Rule 31, AIM companies must have in place sufficient systems, procedures and controls to enable them to comply with the AIM Rules. Recent guidance highlights that, when a Nomad considers a company's financial policies and procedures for the purpose of this Rule, it should undertake this exercise in a meaningful way. It should go beyond merely reviewing the relevant documents and assess whether those policies can work in practice, using its knowledge of the company and its management.

Inside AIM (June 2015)

Pre-Emption Group Statement of Principles

The Pre-Emption Group, whose members represent listed companies, investors and intermediaries, has published an updated Statement of Principles on the disapplication of pre-emption rights, replacing those published in 2008.

The Principles apply to non pre-emptive issues of equity securities for cash, i.e. issues which are not to existing shareholders in proportion to their existing shareholdings. They apply to companies wherever incorporated whose shares are admitted to the Premium Listing segment of the Official List of the UK Listing Authority and to trading on the Main Market for listed securities of the London Stock Exchange. Other publicly traded companies are encouraged to adopt the Principles.

The updated Principles make no change to the key thresholds for the general disapplication of pre-emption rights. That is, the Principles provide that companies can expect to receive shareholder support for a special resolution effecting a general disapplication of pre-emption rights of up to 5 per cent of issued ordinary share capital in any one year. They also provide that companies should not in any three-year rolling period issue non-pre-emptively for cash equity securities that represent more than 7.5 per cent of its issued ordinary share capital.

However, the updated Principles introduce the right to seek a disapplication in respect of a further 5 per cent of issued ordinary share capital per year in connection with an acquisition or specified capital investment, subject to certain conditions. Other changes include:

- Clarification that the Principles apply to all issues of equity securities undertaken to raise cash for the issuer or its subsidiaries, irrespective of the legal form of the transaction, including, for example, "cashbox" transactions.
- Greater transparency on the discount at which equity securities are issued non-pre-emptively.

[Disapplying Pre-emption Rights – A Statement of Principles](#) (March 2015)

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