UK Corporate Briefing

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DENTONS

Welcome to the spring 2017 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

Modernisation of UK limited partnership legislation: private investment funds

A new form of limited partnership, the private fund limited partnership (PFLP), has been introduced in the UK from 6 April 2017. This follows industry lobbying to modernise UK limited partnership law and preserve the UK limited partnership as a structure of choice for private equity and venture capital funds.

Limited partnerships in the UK are regulated by the Limited Partnerships Act 1907 (the 1907 Act), legislation which, until now, had remained largely unchanged for over 100 years. The Legislative Reform (Private Fund Limited Partnerships) Order 2017 amends that legislation to provide for the PFLP.

Only those UK limited partnerships which qualify and elect to be PFLPs will be within the new regime. A limited partnership can become a PFLP if it is:

- subject to a written agreement; and
- a collective investment scheme within the meaning of section 235 of the Financial Services and Markets Act 2000 (or would be but for the exemptions in section 235(5)).

Application to be a PFLP: Provided a limited partnership satisfies these conditions, the general partner can apply to Companies House for PFLP designation either on first registration of the partnership or afterwards.

A certificate of designation as a PFLP issued by Companies House is conclusive evidence that the limited partnership is a PFLP.

In this edition, our lawyers examine...

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A general partner of a limited partnership which existed on 6 April 2017 and meets the private fund conditions can, subject to any internal requirements, apply immediately for PFLP status for the partnership.

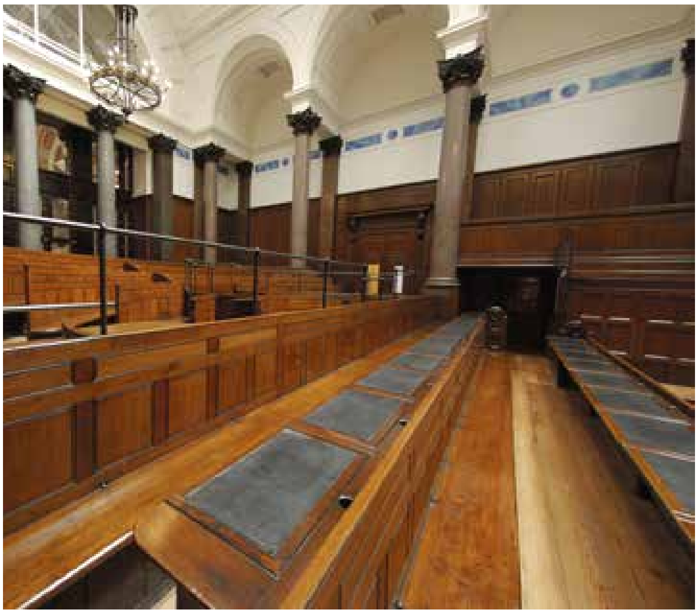
A limited partnership which is a PFLP will still have a name ending with "limited partnership" or "LP".

White list actions: The 1907 Act provides that a limited partner may not take part in managing the partnership business. Any limited partner who does so can be liable for all debts and obligations of the limited partnership as if they were a general partner.

There has been much uncertainty about the boundaries of this restriction. A significant change, therefore, for PFLPs is a new, non-exhaustive, list (a so-called "white list") of actions which will not be considered management of the business. The actions on the white list are intended to provide limited partners of a PFLP with enough scope to monitor and assess investment performance and to approve actions of the general partner. The white list is not intended to prejudice the role of the general partner, and the actions on the list are not rights for limited partners. Whether a limited partner can carry out white list actions or not remains dependent on the terms agreed in the partnership agreement.

Examples of white list actions are:

- taking part in a decision about changing the partnership agreement or business;
- appointing a person to wind up the partnership;
- approving the accounts;
- discussing the prospects of the partnership business;
- taking part in a decision about changes in those responsible for the day-to-day management of the partnership;
- acting as a director, member, employee, officer or agent of, or a shareholder or partner in, a general partner (or another person appointed to manage or advise the partnership) provided this does not involve a limited partner taking part in managing the partnership business;
- taking part in a decision approving an action proposed by the general partner or another person appointed to manage the partnership.



The white list does not create any presumptions for limited partners in limited partnerships which are not PFLPs.

Capital contributions: The 1907 Act requires a limited partner to make a capital contribution to the partnership and makes the limited partner liable for any capital contributions withdrawn during the life of the partnership. In contrast, for all new PFLPs there is no capital contribution requirement.

For limited partnerships which existed before 6 April 2017 and are transferring to PFLP status, capital contributions already made are treated as under the former regime. For limited partnerships registered on or after 6 April 2017 which later transfer to PFLP status, the treatment of capital contributions will also transfer. This means that all capital, whenever contributed, can be withdrawn.

Winding-up: Under the 1907 Act only the general partner can wind up a limited partnership unless a court orders otherwise. Where the general partner has been removed, this can be administratively burdensome. For a PFLP with no general partner, the limited partners can appoint a person who is not a limited partner to carry out the winding-up. Where a PFLP has a general partner, the partners generally may agree that a person other than the general partner should carry out the winding-up.

Gazette notices: Under the 1907 Act if a general partner becomes a limited partner or a limited partner assigns its partnership interest, these are only effective once advertised in the Gazette. In contrast, for PFLPs there is no requirement to advertise the transfer of a limited partnership interest. A general partner of a PFLP must still advertise on becoming a limited partner. However, the date of the notice does not decide the effective date of the change.

Exemption from statutory duties: Limited partners in a PFLP are exempt from the requirement for limited partners to comply with the statutory duties in sections 28 and 30 of the Partnership Act 1890. (These require partners to render accounts and information about matters affecting the partnership to other partners, and to pay to the firm profits made in competing businesses. These requirements were considered inappropriate for passive limited partner investors.)

The Legislative Reform (Private Fund Limited Partnerships) Order 2017

Case law update

Filing the wrong articles at Companies House: what is the effect?

The High Court has had to consider the impact on a company's members of the company filing the wrong version of its articles at Companies House.

Background

A company can usually change its articles by special resolution of its shareholders. The company must then file a copy of the special resolution, with the amended articles, at Companies House.

Facts

The claimant was disputing how the company had valued his shares under the compulsory transfer terms in its articles. These compulsory transfer terms were triggered when the claimant stopped being an employee of the group. One of his arguments related to the status of the articles filed at Companies House.

The company had amended its original articles in 1995 and again in 1998. Due to a mistake, the form of articles filed at Companies House in 1998 did not reflect the 1995 amendments. It, therefore, did not include the changes made in 1995 dealing with how to value shares on a compulsory transfer. When the company's solicitor later realised the mistake, a special resolution was sent to all shareholders inviting them to adopt the correct form of the articles. However, the company did not file this version at Companies House.

The claimant argued that the effect of filing the 1998 articles was that they became the true articles of association of the company, despite the fact that the company had mistakenly filed the wrong form.

Held

The court rejected this argument. The articles are what the members have resolved on from time to time. If the members resolve on an amendment by special resolution, the articles, as amended, become the new contract and new articles. Their status as articles does not depend on registration. When the company files a copy of the articles at Companies House, it is fulfilling a

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statutory obligation. If it files the wrong form of articles, it does not fulfil the statutory obligation, but the articles as adopted by the members remain the articles.

Comment

Although decided under the Companies Act 1985, the decision on these facts would have been the same under the Companies Act 2006. However, note that, where the change is to the company's objects, section 31 of the Companies Act 2006 requires the company to give notice (on form CC04) of the change to Companies House. A change to the objects is not effective until the form is on the register at Companies House. There are also special rules which apply to any "entrenched" provisions in the articles.

Gunewardena v. Conran Holdings Ltd [2016] EWHC 2983 (Ch)

Directors' dealings and company assets

A recent challenge in the High Court by liquidators to recover assets from a director of an insolvent company has highlighted various points of company law. In particular, the court had to consider directors' authority, share buybacks, and transactions between a company and its directors.

Facts

The claimant (D) was the managing director and controlling shareholder of the defendant company (the Company). The Company at first had one other director, D's wife, and later a second (W).

The liquidator challenged three transactions:

- the transfer of the Company's factory to D for less than its market value (the Factory Sale);
- a buyback by the Company of most of its shares from the shareholders for £2.5 million, but with the price payable by the Company left outstanding as a loan on D's director's loan account secured against the Company's assets (the Buyback); and
- the sale by the Company of one of its subsidiaries to D for £1 (the Share Sale).

All but the first of these transactions took place when the Company was facing claims for environmental nuisance and had the effect of reducing the Company's assets available to meet claims.

Held

The court considered each of these transactions and came to the following conclusions:

The Factory Sale: D had acted outside his authority in relation to the Factory Sale. At the relevant time, the Company had only two directors. Under the Company's articles the quorum for a valid directors' meeting to approve the transaction was two and as an interested director D could not count in the quorum. The other director could not have passed the resolution herself. The court, therefore, found that the Factory Sale was void and that D held the property on trust for the Company.

The Share Buyback: The Share Buyback was also void, as a company can only buy its shares as permitted by the Companies Act 2006. On the facts, the Company had failed to comply with section 691(2) of that Act. This provides that: "Where a limited company purchases its own shares, the shares must be paid for on purchase." The court rejected the argument that the loan arrangement counted as payment: recognising a debt by making an entry in the Company's books did not constitute payment. There had to be a movement of funds (which the court suggested could be by payment of cash, transfer of funds, transfer of some other property, set-off or some other way) on purchase, even if an equivalent amount was then loaned back to the Company.

The court also held that a share buyback can be a transaction at an undervalue under section 423 of the Insolvency Act 1986 (transactions defrauding creditors), and that in this case the Share Buyback was such a transaction.

The Share Sale: In this case, there had not even been the pretence of a board meeting. D had taken all decisions alone without involving the other (by now) two directors. This raised similar points about his authority to those raised in relation to the Factory Sale.

Further, although D had paid only £1 for the subsidiary, it had in fact been worth £214,000 at the time. This meant the transaction was a substantial property transaction needing the approval of the Company's shareholders under section 190 of the Companies Act 2006. The shareholders had not given that approval and the Share Sale was therefore voidable at the instance of the Company. It was also a transaction at an undervalue under section 423 of the Insolvency Act 1986.

Directors' duties: The court found that all three directors were in breach of their duties to the Company. D had not acted in the best interests of the Company and so had failed in his duty to promote the success of the Company. The other two directors, by entirely abrogating their responsibilities, had also breached their duties as directors. However, the immediate cause of the Company's loss was that D had procured it to enter transactions for which he required, but did not get, the authority of the board or shareholders. The court therefore found that, on the facts, neither of the other two directors was financially liable.

Comment

This decision covers a wide range of issues and much of it is inevitably fact specific. However, of particular general interest from a corporate law perspective is the court's consideration of the share buyback rules and what constitutes payment on purchase. Another point which the case highlights well is that, when a director buys an asset from a company, it is the actual value of that asset (not what the director is paying for it) that determines whether shareholder approval is necessary.

Dickinson v. NAL Realisations (Staffordshire) Ltd [2017] EWHC 28 (Ch)

Schemes of arrangement: share splitting and exercise of voting power

In a decision on a previously undecided point, the High Court has held that a share-splitting exercise, carried out by a shareholder to boost the number of shareholders voting against a scheme of arrangement, did not defeat the scheme.

Background

The members of a company (or of the relevant class of members) must approve a scheme at a meeting convened at the court's direction. At the meeting, a majority in number representing 75 per cent in value of the members (or class of members) voting must approve the scheme. This is a twofold test. It looks at both the number of members who approve the scheme and the value of their holdings.

Facts

In November 2016 Severn Trent Plc (Severn Trent) made a recommended cash offer for Dee Valley Group plc (Dee Valley) to be effected as a scheme of arrangement. Seven individuals who were shareholders in Dee Valley opposed the Severn Trent scheme, as did the competing bidder. One of these individuals, after Severn Trent had made the offer, bought more ordinary shares in Dee Valley. He then gifted these to 443 separate individuals, each of whom became the owner of one ordinary share in Dee Valley. These individuals voted against the scheme of arrangement at the meeting.

Held

The court held that members voting at a class meeting directed by the court must exercise their power to vote for the benefit of the class as a whole, and not merely individual members only.

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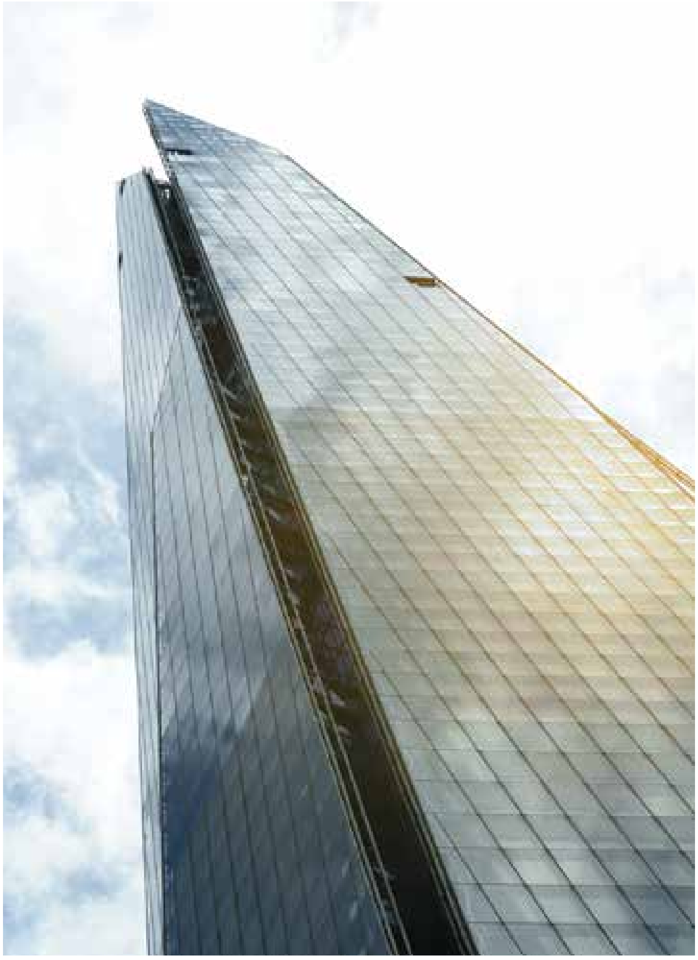


The chairman had enough evidence to conclude that the shareholders who had accepted the gift of one share each were not casting their votes to benefit the class as a whole, but were engaged in a strategy to defeat the scheme. The court therefore upheld the chairman's decision to reject the votes of those shareholders. The chairman was entitled to protect the integrity of the meeting against manipulative practices that would frustrate its statutory purpose.

The court went on to exercise its discretion to sanction the scheme.

Comment

The effect of this decision should be to discourage shareholders who are against a scheme from using share splitting as a means to oppose it. The decision is therefore likely to preserve the attractiveness of schemes as a way to implement recommended takeovers. In this case, the actions of dissenting shareholders were blatantly manipulative. In other circumstances, the factual matrix may be less clear.

Re Dee Valley Group plc [2017] EWHC 184 (Ch)

Regulatory update

Financial Conduct Authority: primary markets review

The Financial Conduct Authority (FCA) has published two papers as part of its review of the structure of the UK's primary markets to ensure that they continue to serve the needs of issuers and investors.

The discussion paper "Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape" (the Discussion Paper) raises broad questions about the effectiveness of the UK primary markets, the listing regime and the FCA's regulatory role. The Discussion Paper focuses on the standard listing segment and certain categories within that segment. The FCA notes in the Discussion Paper that there is evidence suggesting the premium listing regime works well. It is therefore at the moment proposing to make only technical changes to the premium listing regime. These are set out in the FCA's consultation paper "Review of the Effectiveness of Primary Markets: Enhancements to the Listing Regime" (the Consultation Paper).

Key points in the Discussion Paper

Standard listing: The FCA is looking at whether the distinction between standard listings (based on EU minimum standards) and premium listings (which are more burdensome) remains relevant. Standard listings were originally intended to be attractive to overseas companies that might find the more onerous requirements of the premium listing regime unattractive. However, standard listings are generally regarded as unattractive because there is a lack of clarity about their purpose and the standards they require. The name, which implies "second best", is also unhelpful.

International segment: International issuers in practice favour a global depositary receipt listing if a premium listing is not appropriate. However, typically, these are not available to retail investors who might wish to invest in mature overseas companies. The FCA is therefore seeking views on whether there should be a distinct international segment available to large international companies. The FCA envisages that the key to its success would be developing a package of investor protections, appropriate to the segment's aims and capable of fostering investor confidence.

Exchange traded funds: Open-ended investment companies currently cannot apply for a standard listing, but can have a premium listing if they are authorised or recognised. However, open-ended investment companies are also subject to regulation outside the Listing Rules.

Stakeholders generally view this regulation outside the Listing Rules as providing the main source of investor confidence, with the premium rather than standard listing being a potentially unnecessary overlay.

Science and technology companies: The FCA addresses specific concerns about the effectiveness of the UK's primary equity markets in providing growth capital, in particular for early-stage science and technology companies.

If, after receiving feedback on the Discussion Paper, the FCA decides to take forward any specific policy proposal, it will issue a further consultation paper.

Key points in the Consultation Paper

Eligibility: The eligibility criteria in Listing Rule 6 will be rewritten to simplify and clarify them and there will be two new Technical Notes covering financial information and the track record and independent business requirements.

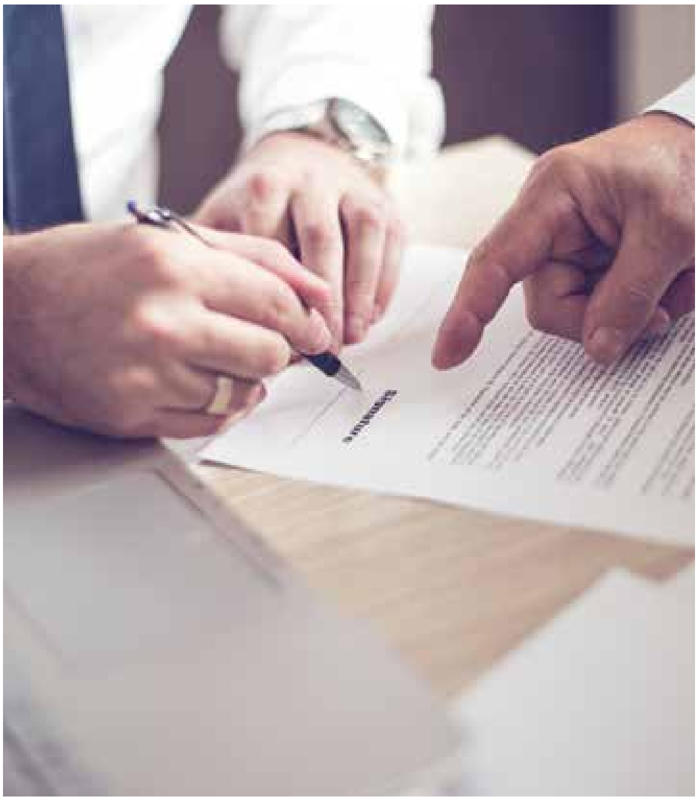
There will be a new concessionary route to premium listing for certain types of property company that cannot meet the three-year revenue-earning track record. There will also be new Technical Notes with extra guidance on the existing concessionary routes for mineral companies and scientific research based companies.

Class tests: There will be changes to the current profits test used to classify the size of transactions for premium listed companies. The purpose of the changes is to avoid the anomalous results which the current test often produces. The FCA is also seeking views on whether there are any other potential adjustments to the profits test.

Reverse takeovers: When a reverse takeover becomes public the FCA will no longer assume that there is insufficient information in the market about the target of the transaction, with a resulting suspension of listing. Principally as a result of the Market Abuse Regulation, the FCA is proposing to assume that companies will have disclosed all relevant information on the target and therefore remove the presumption of suspension for reverse takeovers. This proposal will extend to all issuers with a premium or standard listing of securities but not to shell companies. The FCA will continue to hold a general power to suspend listings to protect the smooth operation of the market. It will also still typically seek to cancel the issuer's listing when it completes a reverse takeover.

The FCA is proposing that, following the consultation, it will publish the new rules in the second half of 2017.

Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape



Review of the Effectiveness of Primary Markets: Enhancements to the Listing Regime

Financial Conduct Authority: reforming the availability of information in the UK equity IPO process

The Financial Conduct Authority (FCA) has published its proposed reforms to improve the timing, sequencing and quality of information in the UK IPO process.

It has set out its proposals in a consultation paper "Reforming the availability of information in the UK equity IPO process".

As the consultation paper notes, the prospectus, which should be the primary source of information on the issuer, is currently made available late in the process. Arguably, investors do not have access to this document early enough for it to play its proper role in informing their investment decisions. Rather, it is "connected" research, produced by analysts within banks that are part of the IPO's book-running syndicate providing underwriting or placing services to the issuer, that drives investor education and initial price discovery. Further, analysts within non-syndicate banks and independent research providers lack access to the information they need to produce "unconnected" research on an offering.

To address these issues, the FCA is proposing a package of changes to its Conduct of Business Sourcebook. These would apply to any investment bank that has agreed to carry on regulated activities that include underwriting or placing equity securities in an IPO on a regulated market for which a prospectus is necessary. This would include an IPO on the Main Market of the London Stock Exchange but not AIM. The new rules and guidance would provide as follows:

- A range of unconnected analysts must have the opportunity to join the bank's connected analysts in any communication with the issuer's management. Alternatively, before publication of any connected research by syndicate bank analysts, they must have the opportunity to otherwise interact with management enough to enable them to form a substantiated opinion. If the bank does not comply with either of these requirements, it must prevent its own connected analysts from communicating with the issuer or its advisers.
- If the unconnected analysts are allowed to join the bank's connected analysts in any communication with an issuer's management team, connected research may be published one day after publication of the prospectus or registration document. If not, connected research cannot be published until seven days after publication of the prospectus or registration document.
- To mitigate the risk of bias to connected research, analysts will not be able to interact with an issuer to whom the investment bank is proposing to provide underwriting or placing services. The prohibition will apply until the investment bank has accepted an underwriting or placing mandate and the parties have contractually agreed and documented the bank's position in the syndicate.

Depending on the nature of the feedback it receives, the FCA expects to publish a policy statement outlining changes to the Conduct of Business Sourcebook later in 2017.

Reforming the availability of information in the UK equity IPO process

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