UK Corporate Briefing

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Welcome to the first 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

Brexit: the Great Repeal Bill

Since the last issue of UK Corporate Briefing, the government has outlined its plans to bring forward a "Great Repeal Bill" in the next Queen's Speech.

The Great Repeal Bill will repeal the European Communities Act 1972 (ECA) and incorporate European Union law into domestic law "wherever practical". These legal changes will take effect on the day (Brexit day) the UK officially leaves the European Union. Assuming the UK triggers the Article 50 leaving process by the end of the first quarter of 2017, Brexit day is likely to be at or before the end of March 2019. The government has also signalled that the Great Repeal Bill will contain delegated powers to enable it to adapt any EU-derived laws on the UK statute book to fit the UK's new relationship with the EU.

Most of the law governing the establishment and operation of companies in the UK, although influenced by successive EU minimum harmonisation directives, has remained a matter of domestic law. It is contained mainly in the Companies Act 2006 and the secondary legislation made under that Act, and so will fall outside the scope of the Great Repeal Bill. However, any relevant secondary legislation made under ECA powers, rather than Companies Act 2006 powers, will require saving when the ECA is repealed.

At this stage, it is far from clear exactly how pan-EU/EEA entities such as the Societas Europaea and European Economic Interest

In this edition, our lawyers examine...

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Grouping will fare. Although the UK can save its legislation relating to these entities in the UK, their benefits derive from mutual recognition across the EU/EEA. Whether this remains in place after Brexit day depends on the deal which the UK strikes with the EU. The same is true of the EU cross-border merger regime, which is incorporated into UK law through the Companies (Cross-Border Mergers) Regulations 2007.

For capital markets issuers, the key issue will be "passporting", the method by which an issuer of securities can, without further consents or approvals, use a prospectus approved by the competent authority of an EU/EEA member state in other EU/EEA member states. Again, while on Brexit day UK domestic law will reflect EU law, the continued availability of passporting will depend on the deal which the UK strikes with the EU.

Despite such points, the Great Repeal Bill will give some certainty about the content of the UK statute book on Brexit day. After that, it will be for the UK government and Parliament to decide which parts of EU-derived law to keep on the UK statute book.

New non-financial reporting requirements for certain large listed companies

Changes to the UK's narrative reporting framework have come into effect for financial periods starting on or after 1 January 2017.

The UK introduced a new narrative reporting framework in October 2013 in the form of the strategic report. Since then, the EU has agreed a Directive to harmonise non-financial reporting requirements across member states. The EU's disclosure requirements broadly reflect the UK's framework, but have required some changes to it.

The changes, which take effect through changes to Part 15 of the Companies Act 2006, affect large listed companies, banks and insurance undertakings with over 500 employees. These companies will now have to prepare a non-financial statement as part of their strategic reports. The non-financial statement must disclose (to the extent necessary to understand the company's development, performance and position and the impact of its activity):

- environmental, social and employee-related matters; and
- respect for human rights and anti-corruption and bribery matters.

The information must include a brief description of the company's business model, a description of the company's policies in relation to these non-financial matters, the outcome of the policies, a description of the relevant principal risks and how the company manages them. If the company does not have policies, it must explain clearly and with reasons why this is the case.

There is some overlap with the enhanced business review that quoted companies must produce as part of their strategic report under the UK's existing regime. To prevent duplication, compliance with the new requirements is deemed to fulfil certain requirements of the existing regime.

Separately, the Directive requires large listed issuers to disclose information about their diversity policy in the corporate governance statement of their annual reports. This change has been implemented by the Financial Conduct Authority which has made the necessary changes to the Disclosure Guidance and Transparency Rules (Rule 7.2). There is overlap between this new requirement and the UK Corporate Governance Code. The latter provides that the report of an issuer's nomination committee in its annual report should contain a detailed description of the board's diversity policy.

The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016

Disclosure Guidance and Transparency Rules Sourcebook (Miscellaneous Amendments) Instrument 2016

Reporting on payment practices and performance

New rules requiring large companies and large limited liability partnerships to publish information about their payment practices and performance are likely to come into force in April 2017.

Section 3 of the Small Business, Enterprise and Employment Act 2015 gave the Secretary of State power to impose a requirement on companies to publish information about their payment practices and performance. Following a consultation process which started in November 2014, the Department for Business, Energy and Industrial Strategy has published its final response and revised draft regulations.

Businesses covered

The proposed regulations will apply to a company or LLP that, on its last two balance sheet dates, met two or more of the thresholds for a large company or a large LLP in the accounting provisions of the Companies Act 2006. The current thresholds are:

- Turnover: over £36 million
- Balance sheet total: over £18 million
- Employees: over 250

For these purposes, parent companies or LLPs which head large groups will only be required to report if they qualify as large in their own right. Each business in scope will be required to publish its own individual, non-consolidated report.

Contracts covered

The reporting requirement relates to business to business contracts for goods, services and intangible assets (including intellectual property). Financial services contracts are, however, excluded. Contracts must also have a significant connection with the UK.

Frequency of reporting

Businesses will report every six months. The first report will be due 30 days after the end of the first six months of a business' financial year. The second reporting period will end at the same time as the business' financial year, with the second report due 30 days later.

Form and location

Businesses will have to publish their report on a web-based service which the government will provide.

Content

Businesses will have to report on the following:

- Narrative descriptions of:
  - the organisation's payment terms, including its standard contractual length of time for payment of invoices, maximum contractual payment period and any changes to standard payment terms, and whether suppliers have been notified or consulted on these changes;
  - the organisation's process for dispute resolution related to payment.

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- Statistics on:
  - the average time taken to pay invoices from the date of receipt of invoice;
  - the percentage of invoices paid within the reporting period which were paid in 30 days or fewer, between 31 and 60 days, and over 60 days;
  - the proportion of invoices due within the reporting period which were not paid within agreed terms.
- Tick box statements about whether:
  - an organisation offers e-invoicing;
  - an organisation offers supply chain finance;
  - the organisation's practices and policies cover deducting sums from payments as a charge for remaining on a supplier's list, and whether they have done this in the reporting period;
  - the organisation is a member of a payment code, and the name of the code.

Approval and sanctions

It will be necessary for a director to approve the information. Failure to publish a report will be a criminal offence, with the company and directors liable to a fine on summary conviction. All directors will be liable, unless they can show they took all reasonable steps to ensure the requirement would be met. Equivalent rules will apply to LLPs and their designated members. It will also be an offence knowingly or recklessly to publish false or misleading information. Any person who does so will also be liable on summary conviction to a fine.

[Duty to report on payment practices and performance: government response and draft regulations]

Case law update

When is a merger a cross-border merger?

The High Court recently had to consider whether a transaction to merge several UK companies and a Dutch company into a UK company fell within the scope of the Companies (Cross-Border Mergers) Regulations 2007.

Background

The Companies (Cross Border Mergers) Regulations 2007 (the Regulations), which implement in the UK the EU Cross-Border Mergers Directive, enable cross-border mergers between companies in the UK and other EU/EEA member states.

The Regulations define a cross-border merger as being "a merger by absorption, a merger by absorption of a wholly-owned subsidiary, or a merger by formation of a new company". Merger by absorption, which was relevant to this case, requires there to be one or more transferor companies, a transferee company and that at least one of those companies is a UK company and at least one is an EU/EEA company. There is no express provision which requires any of the companies to be, or have been, trading.

The merger must be approved by the competent authority of the country where the merged entity will be registered. In this case, therefore, jurisdiction to sanction the merger lay with the High Court.

Facts

The proposed transaction involved the merger of several companies into Easynet Global Services Ltd (the Company). All except one of these were UK companies. The only non-UK EU/EEA company was a Dutch company. This was dormant, had never traded and its only asset was a small inter-group receivable. While the Dutch company had not been set up for the purpose of the merger, its only purpose in the merger was to bring it within the scope of the Regulations.

Decision

The High Court regarded the inclusion of the Dutch company as a "device" to bring the merger within the Regulations. As such, it held that the proposed merger was not the kind of transaction which the EU Directive and the Regulations were enacted to facilitate. Their purpose was to facilitate movement across borders, whereas the merger in question was not in reality a cross-border merger at all. The merger therefore fell outside the scope of the Regulations. The court added that even if the proposed merger could fall within the Regulations, based on the information available to it, it failed to see how a court could do anything other than refuse to sanction the merger.

Comment

This case reinforces the need to question, when considering a merger under the Regulations, whether the proposed transaction includes a genuine cross-border element. If it does not, a UK court is unlikely to sanction it, even though it involves a company incorporated in another EU/EEA member state.

The High Court discussed a similar issue in the subsequent case of *Re Portman Insurance plc*. This concerned a merger by two companies, one UK and one French, to form a Societas Europaea under the EU Regulation on the Statute for a European Company. A similarity was that, as in *Easynet*, one of the companies was a dormant, non-trading company. Also, as in *Easynet*, there was no express requirement in the underlying legislation for the companies to be, or have been, trading. However, the court concluded in this case that the dormant company was not a "device" to achieve a merger of other companies, but a genuine merger between the companies concerned. It therefore sanctioned the merger.

Re Easynet Global Services Limited [2016] EWHC 2681 (Ch); *Re Portman Insurance Plc* [2016] EWHC 2994 (Ch)

Unfair prejudice and wrongful dismissal: combining claims

The High Court has considered whether it is possible to bring a claim for wrongful dismissal within a petition for unfair prejudice under section 994 of the Companies Act 2006.

Background

Under section 994 a shareholder may apply to the court for an order on the ground that the company's affairs are or have been conducted in a manner that is unfairly prejudicial to the interest of all or some of its members including at least the petitioner. The court has a wide discretion as to the relief it may give to a successful petitioner.

Facts

Mr Wootliff was a member and chief executive officer of a company. The company dismissed him from his employment and then removed him from office as director. Mr Wootliff brought a claim in the Employment Tribunal for, among other matters, wrongful dismissal. He later withdrew all his Employment Tribunal claims, but reserved his right to bring the wrongful dismissal claim in an alternative jurisdiction. Later, he presented an unfair prejudice petition in the Chancery Division. He claimed the company had no grounds to dismiss him and that both his removal and the issue of further shares after his dismissal, which diluted his shareholding, were unfairly prejudicial. The unfair prejudice claim included a claim for compensation for wrongful dismissal which the respondents applied to have struck out.

Decision

The court, noting there is no previous authority dealing directly with a challenge to a claim for wrongful dismissal in an unfair prejudice petition, declined to strike out the application. As the language of the court's discretion to give relief to a successful petitioner was so wide, it did not shut out relief for compensation for breach of a service agreement. A shareholder's right in an unfair prejudice petition may be wider or greater than just his rights as shareholder. Much will depend on how closely the interests of the shareholder are connected to the company and how the shareholder relates to the company in other capacities.

Comment

This was a preliminary application and not a determination of the substantive issue. As the court noted, at the full hearing the court will have to decide whether the separateness of the petitioner as member and the petitioner as employee excludes him from the relief sought. If the petitioner as member and employee

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"formed part (and an essential part) of the arrangements entered into for the venture to be carried on" by the company, this will overcome the objection that the petitioner is not bringing his claim as a member.

Wootliff v. Rushton-Turner and others [2016] EWHC 2802 (Ch)

Informal shareholder resolutions: the *Duomatic* principle considered

A recent High Court decision has considered whether a company's shareholders had informally amended the company's articles of association under the so-called *Duomatic* principle. The case highlights issues which can arise from the principle.

Background

Under the *Duomatic* principle the informal consent or acceptance of all the voting members of a company can bind the company as if the members had passed a formal shareholders' resolution. Earlier cases, including most recently *The Sherlock Holmes International Society Ltd v. Aidiniantz* [2016] EWHC 1076 (Ch), confirm that it is possible for a company's articles to be amended informally in this way.

Facts

Administrators of a company were appointed by a decision of a sole director (DW). However, the company's articles stipulated a quorum of two for a board meeting. They also stated that a sole director could only call a general meeting or appoint another director. The administrators' appointment was therefore, on the face of matters, invalid.

The quorum for a shareholders' meeting was also two. DW was the registered holder of a 75% shareholding in the company, although he held those shares for his father (RW). The other 25% of the shares were registered in the name of an Isle of Man company. This had been dissolved many years previously, although it was likely that RW was also the beneficial owner of these shares.

After the administration, the applicants had obtained legal title to the 75% shareholding in the company that DW held for RW. The applicants tried to claim that the administrators had not been validly appointed.

Decision

The court rejected the applicants' claim. It found that, under the *Duomatic* principle, there had been an effective variation or departure from the company's articles. This had allowed the exercise of all the directors' powers by one director alone. In its decision the court made various observations about the scope of the *Duomatic* principle.

- The 25% shareholder no longer existed and no-one capable of voting had been entered on the register in place of the dissolved company. Therefore, the acquiescence of the 75% shareholder alone ought to be enough to trigger the application of *Duomatic*. But if it was necessary to go further, the requirement of unanimous consent was satisfied because the beneficial owner did acquiesce in the exercise of the board's powers by the sole director. There being no registered shareholder of the 25%, only the beneficial owner could count, if it were necessary to look beyond the 75% at all.

- Where the registered holder holds shares in trust as bare trustee for the beneficial owner, there is much to recommend the view that the wishes of the beneficial owner are those that count. The registered holder must act as the beneficial owner dictates and therefore has no say in the matter. However, as DW and RW had acted in agreement with each other, the court did not have to decide whether what mattered for *Duomatic* purposes was beneficial ownership or being on the register as bare trustee for the sole beneficiary.

Comment

This case is a useful reminder of the *Duomatic* principle and highlights areas of uncertainty which can arise. Perhaps the most controversial part of the decision is the suggestion that, in the circumstances, it was possible to disregard the 25% shareholder. The applicants have appealed the decision. The Court of Appeal may, therefore, in due course clarify the uncertainties highlighted by the case.

Randhawa & Ors v. Turpin & Anor [2016] EWHC 2156 (Ch)

Regulatory update

AIM disclosure and social media

AIM Regulation has published guidance on the interaction between social media and other forms of electronic communication (e.g. Twitter, the AIM company's website, a non-regulatory news feed) and an AIM company's disclosure obligations under the AIM Rules.

The guidance clarifies that any form of public communication is subject to the AIM Rules for Companies (AIM Rules). An AIM company should consider with its nominated adviser how to manage social media and other forms of electronic communication against its obligations under the AIM Rules.

AIM Rule 10 (Principles of disclosure) requires the AIM company to notify information using a regulatory information service on or before publication elsewhere. Disclosure by social media alone will therefore not satisfy AIM Rule 10.

If disclosure by social media leads to a breach of AIM Rules 10 (Principles of disclosure) or 11 (General disclosure of price sensitive information), AIM Regulation will investigate and take appropriate disciplinary action. Where directors or others representing the company make comments on social media which are inconsistent with notifications through a regulatory information service, AIM Regulation may require a clarification notification.

AIM Rule 31 (AIM company and directors' responsibility for compliance) requires an AIM company to have in place sufficient procedures, resources and controls to enable it to comply with the AIM Rules. These should all take into account the use of social media and other forms of electronic communication.

An AIM company must, of course, also have regard to the Market Abuse Regulation. Where there is premature or selective disclosure, or where communications are designed to cause share price volatility (e.g. through a tip or leak of confidential information about the AIM company), this may also give rise to market abuse issues.

AIM Regulation statement on interaction of social media and obligations under the AIM Rules

Changes to the Shareholder Rights Directive

The representatives of the EU Council and EU Parliament have agreed the text of a new EU Directive to strengthen shareholder engagement and increase transparency in listed companies in the EU/EEA.

The proposed Directive will amend the existing Shareholder Rights Directive (Directive 2007/36/EC) in several areas. These include:

Remuneration of directors

Shareholders will have the right to vote on the remuneration policy of the directors of their company. That policy should contribute to the overall business strategy, long-term interests and sustainability of the company and not link to short-term objectives. Directors' performance should be assessed on both financial and non-financial performance criteria, including, where relevant, environmental, social and governance factors. The policy will have to be publicly disclosed without delay after the shareholders vote.

Identification of shareholders

To encourage shareholder engagement, companies will be able to identify their shareholders and get information on shareholder identity from any intermediary in the chain that holds the information. Member states may decide to implement a threshold minimum of up to 0.5% of shares or voting rights before companies can ask for identification.

Facilitation of exercise of shareholder rights

Intermediaries will have to facilitate the exercise of the rights by the shareholder, including the right to take part in and vote in general meetings.

Transparency for institutional investors, asset managers and proxy advisors

Institutional investors and asset managers will have to develop and publicly disclose a policy on shareholder engagement or explain why they have chosen not to do so. Proxy advisors will also be subject to transparency rules and a code of conduct.

Related party transactions

Material related party transactions will require approval by the shareholders or the board of the company. A company will have to announce a material related party transaction publicly by the end of the transaction, including all information necessary to assess the fairness of the transaction.

Following the final adoption by the Council and the European Parliament next year, the new Directive will be published in the EU's Official Journal. Member states will then have up to two years to incorporate the new Directive into domestic law. This raises interesting questions of timing for the UK from a Brexit perspective, though in practice the UK already has rules in many of these areas.

Proposal for a Directive of the European Parliament and of the Council

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