UK Corporate Briefing

Issue 10 - Summer 2017

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

Queen's Speech: UK company law Brexit and beyond

As widely expected, Brexit-focused legislation dominates the legislative programme outlined in the Queen's Speech on 21 June.

Brexit: The centrepiece will be the European Union (Withdrawal) Bill (the Bill), which will:

- repeal the European Communities Act 1972 (ECA) and convert EU-derived law into UK law from the day the UK leaves the EU (Brexit day);
- create temporary powers to make secondary law, enabling corrections to laws which do not operate appropriately from Brexit day;
- allow changes to domestic law to reflect any withdrawal agreement under Article 50; and
- reproduce the common EU frameworks created by EU law in UK law.

Other legislation dealing with specific areas such as customs, trade and international sanctions will supplement the Bill.

Most of the law governing the establishment and operation of companies in the UK, although influenced by successive EU

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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 rather than the ECA, and so will largely fall outside the scope of the Bill and other Brexit legislation.

In contrast, pan-EU/EEA entities and regimes such as the European public company (Societas Europaea or SE), the cross-border merger regime and the passporting of prospectuses have been given effect in English law through secondary legislation made under the ECA. When the ECA is repealed, that secondary legislation will fall away, except and to the extent that it is saved.

Given that the main benefits of these entities and regimes come from mutual recognition across EU/EEA member states, their post-Brexit status is closely linked to whether the UK remains part of the single market. That in turn will drive the legislative changes necessary to reflect their post-Brexit status. For example, if mutual recognition is no longer available, it might be appropriate for the legislation to require UK incorporated SEs to convert to UK plcs. So, although some legislation will clearly be necessary to avoid legal "black holes", what that legislation will eventually look like is, at this stage, far from clear.

Beyond Brexit: The government also announced that it intends to bring forward proposals to consolidate and strengthen its powers to protect national security. This is to ensure that foreign ownership of companies controlling important infrastructure does not undermine British security or essential services. The UK government will have the power to scrutinise significant foreign investment and to intervene in those transactions that raise national security concerns. No detail has yet been given, so it remains to be seen how far these powers will go beyond the government's current powers in the Enterprise Act 2002 to intervene in certain mergers where there is a national security interest.

[The Queen's Speech and associated background briefing]

People with significant control regime: expanded scope and more regular reporting

Changes to the UK's regime for the disclosure by companies of their significant controllers (the PSC regime) took effect on 26 June 2017. The changes ensure that UK legislation is compliant with the EU's Fourth Anti-Money Laundering Directive.

Background: The UK introduced its PSC regime in April 2016. The purpose of the regime is to promote corporate transparency and to deter the abuse of UK companies (and LLPs), for example as vehicles for money laundering and tax evasion.

From 26 June 2017, the EU's Fourth Anti-Money Laundering Directive (the Directive) has introduced a regime for the disclosure of significant controller information across all EU and EEA countries. While the UK's existing domestic regime is broadly compliant with this Directive, some changes have been necessary to bring it into line with EU legislation. The main changes concern the categories of body corporate now within scope and the timing and frequency of reporting.

Companies within scope: Until now, AIM (and NEX Exchange) traded companies have been excluded on the basis that they, like their Main Market counterparts, were already subject to the disclosure regime in Disclosure and Transparency Rule 5 (DTR 5). However, under the Directive, only companies admitted to trading on an EU-regulated market are exempt from the Directive's disclosure requirements. AIM (and NEX Exchange) traded companies are therefore now within the scope of the PSC regime, even though DTR 5 continues to apply to them.

Unregistered companies that fall within the scope of section 1043 of the Companies Act 2006 (e.g. commercial companies incorporated in the UK by private Act of Parliament) are also now within scope.

The extended regime also covers Scottish limited partnerships and Scottish general partnerships in which all the partners are corporates. However, these partnerships will only have to comply with the Companies House reporting elements of the PSC regime and not keep their own PSC registers.

Entities newly within scope of the PSC regime must comply with it from 24 July 2017.

Reporting: For UK companies and LLPs already within scope, the main change is that from 26 June 2017 PSC changes have to be notified to Companies House as they occur. Until now, most companies and LLPs have only had to notify Companies House once a year through the annual confirmation statement. There are also new time limits, which mean any entity in scope must now:

- serve any information notice required under the legislation within 14 days of becoming aware of, or having reasonable cause to believe that there has been, a change to its registered PSC information;

- enter information about PSC changes in its PSC register within 14 days of receiving the relevant information or, where a PSC is an individual, within 14 days of the required particulars being confirmed to it; and

- file details of the changes at Companies House within 14 days of updating its own PSC register.

Under the transitional rules, changes to a company's PSC register which occurred before 26 June 2017 but since the company filed its last confirmation statement are also notifiable to Companies House.

The Information about People with Significant Control (Amendment) Regulations 2017

Case law update

The rules of interpretation: a seller indemnity in a share purchase agreement

The Supreme Court has dismissed an appeal over the meaning of an indemnity in a share purchase agreement, and in delivering its judgment has given guidance on the rules of contractual interpretation.

Facts: Under the indemnity, the seller agreed to indemnify the buyer in respect of "... all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on or required to be made by the Company following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against the Company ... pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product or service" in the period before the transaction took place.

The issue was whether the indemnity covered losses the buyer suffered as a result of the target company self-referring potential mis-selling to the FSA, as opposed to a customer making a claim or registering a complaint with the FSA. The Court of Appeal had held that it did not.

Decision: The Supreme Court upheld the Court of Appeal decision. The court held that, properly interpreted, the indemnity was not triggered in circumstances where the target self-reported mis-selling to the FSA.

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The court noted that the meaning of the drafting was avoidably opaque. About its task of interpretation, the court noted as follows:

- The court's task is to discover the objective meaning of the language of the agreement. This is not a literalist exercise focused solely on a parsing of the words of the particular clause. The court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context.

- Where there are rival meanings, the court can give weight to these by reaching a view about which construction is more consistent with business common sense. But the court must consider the quality of drafting of the clause. It must also be alive to the possibility that one side may have agreed to something which with hindsight did not serve its interest or that the relevant clause resulted from a compromise reached during negotiations.

- It does not matter whether the court's more detailed analysis begins with the factual background (contextualism) or a close examination of the relevant language in the contract (textualism). However, the court must balance the indications given by each.

- The court can use both textualism and contextualism as tools to discover the objective meaning of the contract. The extent to which each tool will help the court in its task will vary according to the circumstances of the particular agreement or agreements.

Turning to the facts, business common sense suggested that the buyer had an interest in getting as broad an indemnity against the adverse consequences of mis-selling as it could. But the sellers had, elsewhere in the agreement, given warranties of compliance with regulatory requirements. These covered mis-selling, subject to the agreed limits of quantum and time. The sellers had an interest in minimising their further exposure to liability after that time had elapsed. But, as the court noted: "… in the tug o' war of commercial negotiation, business common sense can rarely assist the court in ascertaining on which side of the line the centre line marking on the tug o' war rope lay, when the negotiations ended.".

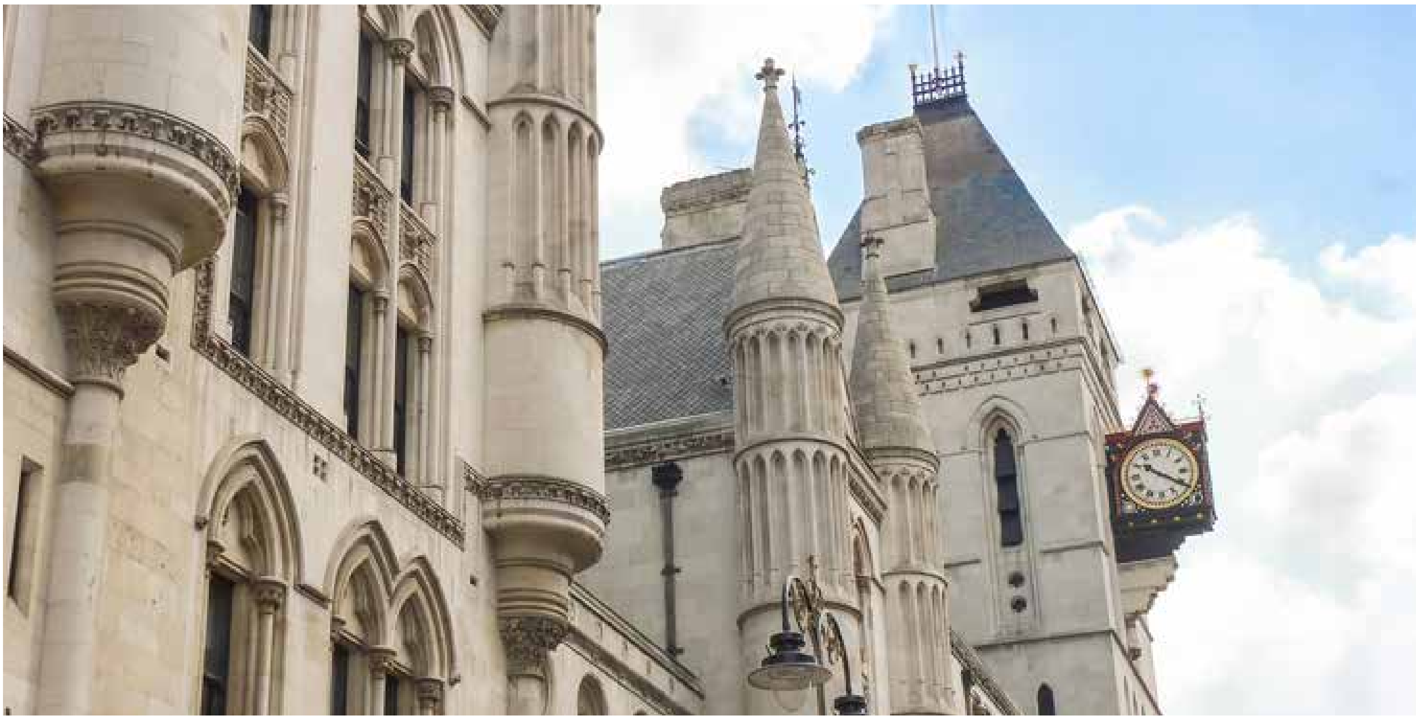
The court noted that, had the indemnity stood on its own, the requirement of a claim or complaint by a customer, and the exclusion of loss caused by regulatory action which was prompted in another way, might have appeared anomalous. However, the indemnity was additional to the wide-ranging warranties which probably covered the circumstances that had in fact come about. It was not contrary to business common sense for the parties to agree wide-ranging warranties, subject to a time limit, and also to agree a further indemnity, which was not subject to any limit but was triggered only in specific circumstances.

From the buyer's standpoint the agreement may have become a poor bargain, as the buyer did not appear to have notified the sellers of a warranty claim within the contractual time limit. However, it was not the role of the court to improve a party's bargain.

Comment: Some commentators had interpreted a previous Supreme Court decision, *Arnold v. Britton* [2015] AC 1619, as signalling a move away from the use of business common sense as an aid to interpretation to a more literal approach. However, in this case, the Supreme Court rejected the idea that Arnold had involved any "rowing back" from the guidance on contractual interpretation given by the Supreme Court in *Rainy Sky SA v. Kookmin Bank* [2011] 1 WLR 2900 and stated that the two cases "were saying the same thing".

The principles of contractual interpretation summarised by the Supreme Court in this case were relevant because there was ambiguity in the drafting. Where the language of a contract is clear, the courts are unlikely to intervene, even if the result is a bad bargain for a party. So the case is a reminder of the importance of clear and precise drafting. It is also a reminder that the court will look at all drafting in the context of the contract as a whole and, therefore, of the importance of ensuring that a contract works as a whole.

Wood v. Capita Insurance Services Limited [2017] UKSC 24



Negligence liability: parent and subsidiary companies

The High Court has considered the circumstances in which a parent company may be liable to third parties in negligence for the acts or omissions of its subsidiary.

Background: The starting point when considering whether a person owes a duty of care to another is the tripartite test as set down by the House of Lords in *Caparo Industries v. Dickman* [1990] 2 AC 605. The three limbs to the test are:

1. Is the damage a foreseeable result of the defendant's conduct?
2. Were the parties in a sufficient relationship of proximity or neighbourhood?
3. Is it fair, just and reasonable to impose a duty of a given scope on one party for the benefit of the other?

Facts: Two different sets of proceedings were brought in the High Court against Royal Dutch Shell plc (RDS), the ultimate holding company of the Shell Group, and its Nigerian operating subsidiary, Shell Petroleum Development Company of Nigeria Ltd (SPDC). In both cases the claimants were seeking damages resulting from alleged ongoing pollution and environmental damage. They claimed that under the *Caparo* test RDS owed them a duty of care as a result of the control which they alleged RDS exercised over SPDC's operations.

RDS argued that the claims against it were a device by the claimants to bring their case before the English courts. It argued that the claims had nothing to do with the UK and challenged the English court's jurisdiction.

Decision: The High Court found that RDS was not liable for the acts of SPDC as the claimants did not meet the requirements of the second and third limbs in *Caparo*.

The proximity test:
Applying the second limb of the *Caparo* test, the court found that several factors indicated that the relationship between RDS and the claimants was not sufficiently proximate. In particular:

- RDS did not hold shares directly in SPDC, but did so instead through another company;
- RDS did not conduct any of SPDC's operations;
- the two officers of RDS on the Executive Committee of the Shell Group (the central decision-making body of the Shell Group of companies) were only a minority of its membership;
- Shell did not have a licence to conduct operations in Nigeria;
- there was a joint venture in existence engaged in operations in Nigeria, but RDS was not a member; and
- imposing a duty of care on RDS would potentially impose "liability in an indeterminate amount, for an indeterminate time, to an indeterminate class" as there were 1,366 other companies in the Shell Group active in over 100 countries.

In considering the proximity point, the court had regard to the four factors identified by the Court of Appeal in *Chandler v. Cape* [2012]

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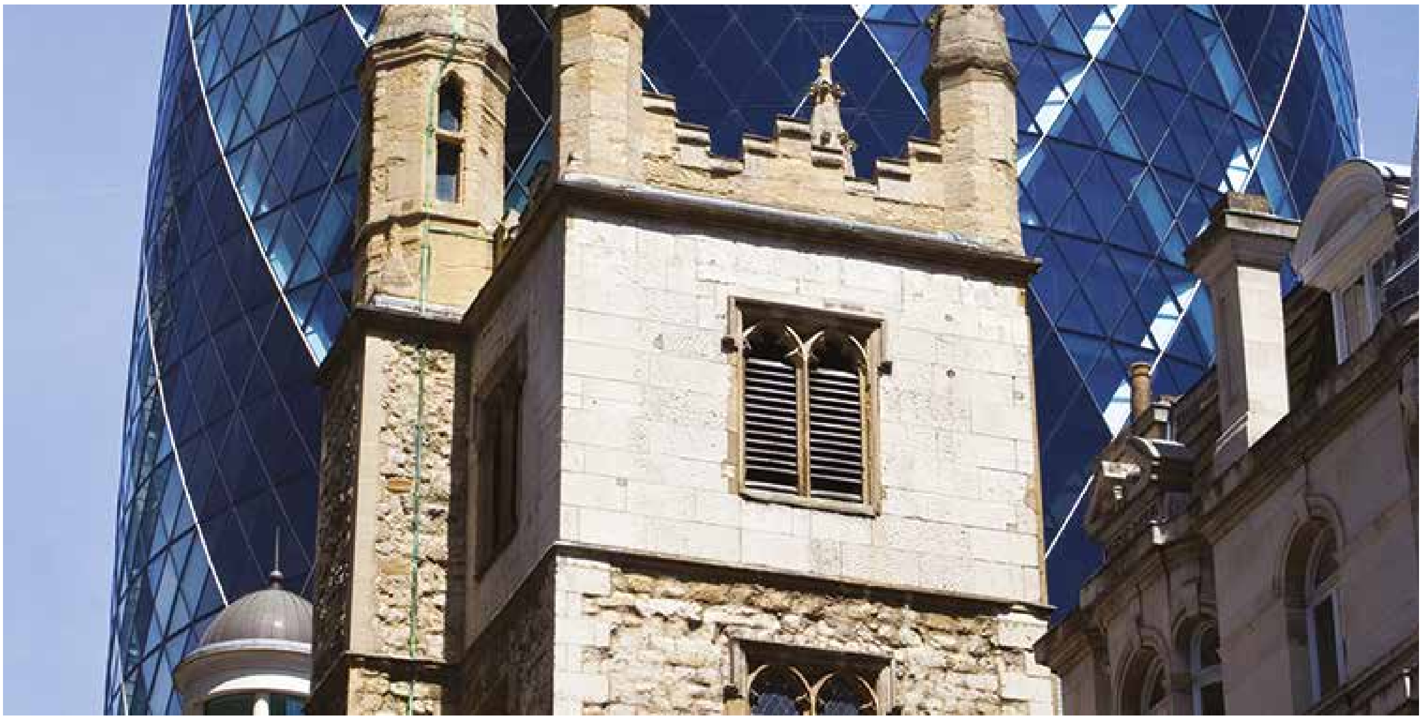

EWCA Civ 525, a case which dealt with the liability of a parent company for the health and safety of its subsidiary's employees. These were whether:

- the parent and subsidiary were operating the same businesses;
- the parent had, or ought to have had, superior knowledge on some relevant aspect of the particular industry;
- the parent knew, or ought to have known, about the subsidiary's system of work; and
- the parent knew, or ought to have foreseen, that the subsidiary was relying on it to protect the claimants.

Although the factors were non-exhaustive, the higher the number of those four factors that were present, the more likely that the parent would owe a duty. On the facts, the court found that none of these four factors was present.

The fair, just and reasonable test: Applying the third test in *Caparo*, the court considered that it would not be fair, just and reasonable to impose a duty of care of the nature alleged by the claimants on RDS. In particular:

- Nigeria had a statutory framework under which SPDC had strict liability for oil spills and there was evidence that the claimants could claim compensation only from SPDC under the Nigerian statute;
- RDS was prohibited from performing operations in Nigeria under Nigerian law, and it did not have any pipelines or infrastructure in Nigeria; and
- RDS held the shares in its subsidiaries as if it were an investment company.

As there was no arguable duty of care owed by RDS to the claimants, there was no real issue that it would be reasonable for the English courts to try. The English courts therefore had no jurisdiction.

Comment: The fact that two companies are part of the same group does not of itself mean that the parent company has liability in negligence for the acts of its subsidiary. This decision shows that whether such liability exists is to be dealt with on a case-by-case basis, by reference to the various criteria discussed above. It also emphasises the significance of the relationship between corporate group structure and operational issues, highlighting as it does the difficulties of establishing parent company responsibility where the parent has no involvement in the business operations of the subsidiary.

A similar point has also recently come before the High Court again in *AAA and Others v. Unilever plc and Unilever Tea Kenya Ltd* [2017] EWHC 371. In this case the claimants were seeking to bring a claim against a UK incorporated parent company in relation to events on a tea plantation in Kenya owned by its Kenyan subsidiary. Again the court applied the *Caparo* test and found that, on the facts, it had not been satisfied.

Okpabi and others v. Royal Dutch Shell plc and another
[2017] EWHC 89

Regulatory update

New EU Prospectus Regulation published

The EU Prospectus Regulation (the Regulation), which will replace the current Prospectus Directive, has been officially published. A couple of the Regulation's provisions will apply from 20 July 2017, while most of it will apply from July 2019.

The Regulation forms part of the EU's capital markets union project. Its purpose is to create deeper and more integrated capital markets in the EU member states and to make it easier for firms, particularly smaller ones, to raise funding and reach investors cross border.

From 20 July 2017:

- An issuer with securities admitted to trading on a regulated market may admit further securities without a prospectus so long as they represent less than 20 per cent of the same class of security (calculated over a 12-month period). This is an increase from the current 10 per cent.

- A similar 20 per cent limit will apply to shares to be admitted to trading on a regulated market where those shares result from the conversion or exchange of other securities. There is at present no limit.

From July 2018, no prospectus will be necessary for capital raisings below €1 million, calculated over a 12-month period. Further, member states will be able to exempt offers of securities to the public from the prospectus requirement if the total consideration for these in the EU does not exceed €8 million over a 12-month period. Offers of securities made under this exemption will not benefit from passporting.

Most of the Regulation's provisions will apply from July 2019. Key points to note are as follows:

- There will be a new, simplified prospectus for companies that have had securities listed for at least 18 months and want to raise more capital by a secondary issue. Unlike the current proportionate disclosure regime for secondary, the new regime will not be limited to pre-emptive offers.

- A "growth prospectus" will be available, principally for offers by small and medium-sized enterprises that do not already have securities admitted to trading on a regulated market. This will be a simplified, standardised form of prospectus, with reduced disclosure requirements.

- There will be a new annual "universal registration document" for use by companies that often access the capital markets, containing all the necessary information on a company that wants to list shares or issue debt.

- The form of prospectus summary will be more straightforward and less rigidly prescribed. It will be modelled on the key information document required under the Packaged Retail and Insurance-based Investment Products Regulation.

- For offers to the public or the admission to trading of securities in connection with a takeover, merger or division, the current requirement for a document "equivalent" to a prospectus will be simplified.

In the draft Regulation there was a proposal to increase the number of people to whom an offer may be made before a prospectus is necessary. However, this has not been taken forward in the final version of the Regulation. The figure therefore remains at fewer than 150 natural or legal persons per member state, other than qualified investors.

The Financial Conduct Authority has already set out its proposals to update its Prospectus Rules in advance of those provisions of the Regulation that will come into force on 20 July 2017.

By July 2019, the UK will, on the current Brexit timetable, have already left the EU and the Regulation will therefore no longer be directly applicable. However, given the approach that the UK government has outlined on legislating for Brexit, it would seem likely that equivalent rules will insofar as is possible be put in place.

[Prospectus Regulation (EU) 2017/1129]

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CSBrand-4072-UK Corporate briefing summer 2017_05 — 19/07/2017