Business Law Briefing

June 2014

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Business **Governance**

Transparent beneficial ownership

Transparency and Trust DBIS Consultation Response April 2014

The Government has set out its plans to implement legislation to require companies to file with a public registry information on individuals who ultimately own or control more than 25% of a company's shares or voting rights, or who otherwise exercise control over the company or its management

A central registry of company beneficial ownership information

The UK's G8 Action Plan set out the Government's commitment to implement a central registry of company beneficial ownership information, to make it easier to identify and tackle the misuse of companies. In response to the views received during consultation, the DBIS has now set out its intended approach to implementation.

Definition of "beneficial ownership"

The statutory definition of 'beneficial ownership' to be used for the registration requirements will require companies to hold and file information on those individuals who ultimately own or control more than 25% of a company's shares or voting rights, or who otherwise exercise control over the company or its management. Where a qualifying beneficial interest in a company is held through a trust, the trustees or any other natural person exercising effective control over the activities of the trust will be required to be disclosed as the beneficial owner of the company.

Requirement on Companies and Individuals

UK bodies corporate that currently register information on their members at Companies House will be required to obtain and hold beneficial ownership information and provide it to Companies House. This will therefore include Limited Liability Partnerships. The statutory means by which public companies obtain shareholder information will be extended to private companies. In parallel, individuals with a qualifying beneficial interest will be required to disclose this to the company, as significant investors in listed companies are already required to do.

Abolishing bearer shares

The creation of new bearer shares will be prohibited and existing bearer shareholders will be required to surrender their shares for conversion to registered shares.

Changes to the CDDA 1986

The directors' disqualification regime will be updated to replace the current description of the matters determining unfitness of a director in the Company Directors Disqualification Act 1986 with a new, broader and more generic provision. This will cover consideration of the materiality of a director's conduct, including breaches of law and the nature and extent of harm caused. It will also render conduct overseas relevant.

11KBW Business Law members regularly advise and act in disputes concerning beneficial ownership.

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Business **Governance**

Sole shareholder and director: breach of fiduciary duty, attribution of fraud to company, and shareholder's power to ratify

Goldtrail Travel Ltd v Aydin & Ors

[2014] EWHC 1587

A Company's sole shareholder could not ratify his misconduct as the Company's sole director.
The fraud of the sole director not attributed to the Company of which he was sole shareholder.

Goldtrail, a company in liquidation, alleged that Mr. Aydin, its sole director and shareholder, had breached his fiduciary duties and s.175 CA 2006 by misapplying the company's monies and that the other defendants had dishonestly assisted him. The 2nd and 3rd Defendants contended that the claim should be struck out because:

a) The pleaded claim was of misapplication of company money as if a free standing form of breach of fiduciary duty and no breach of the statutory duties in ss. 171 to 177 CA 2006 was identified.
b) The fraud of a director was to be attributed to the company of which he was the sole directing mind and beneficial owner, in accordance with the principle in Stone & Rolls.
c) As Mr. Aydin was sole shareholder and sole director, he was to be taken to have, as shareholder, approved or ratified his conduct, as director.

These contentions were all dismissed by Rose J. on the following grounds.

As to (a) that despite the provision in s. 170 (3) CA 2006 that the statutory duties 'have effect in place of those [common law] rules and [equitable] principles as regards the duties owed to a company by a director', there were a number of duties remaining uncodified including the director's duty not to misapply the company's property: *Re Paycheck Services 3 Ltd, HMRC v Holland*.

As to (b) that the judgment of the CA in *Bilta (UK) Ltd (in liquidation) and others v Nazir and others (No 2)* distinguishing *Stone & Rolls* made clear that where proceedings are brought by a company against a former director and his dishonest assistants for breach of fiduciary duty, the company is to be treated as the victim of that breach. A company was only to be treated as perpetrator, rather than victim, in the context of claims between the company and the defrauded third party.

As to (c), that Mr. Aydin could not, in his capacity as shareholder, have approved his misapplication of the Company's funds because the company was insolvent or of doubtful insolvency and as director he no longer owed duties solely to himself as shareholder but also to the creditors of the company- *Vivendi SA v Richards* – and ought to have considered the interests of the creditors of Goldtrail as well as his own interests as shareholder before making the payments. Further, s.239 CA 2006 prevents a director in breach of duty from voting to ratify his breach of duty and this inability of a sole director to ratify his own wrongdoing in general meeting is not alleviated by the *Duomatic* principle as the Court of Appeal made clear in *Ultraframe* because such conduct could not be considered a *bona fide* distribution of profits and would be a reduction of capital and *ultra vires* the company without the sanction from the court.

11KBW Business Law members regularly act in cases involving director's breach of duty including misapplication cases.

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Business **Reward**

Changes to the Remuneration Code

BoE Consultation prior to 1 January 2015 implementation

All vested variable remuneration is to be made subject to repayment under ‘clawback’ in circumstances of malfeasance, material downturn or material failure of risk management

The Bank of England has consulted on proposals to require all firms authorised by the Prudential Regulation Authority to amend employment contracts to ensure the employer's right to claw back bonus awards post vesting.

The conditions in which vested remuneration would be clawed back under the proposals in the consultation paper are:

• Where there is reasonable evidence of employee misbehaviour or material error;

• Where the firm or the relevant business unit suffers a material downturn in its financial performance;

• Where the firm or the relevant business unit suffers a material failure of risk management.

It is not intended that clawback should be limited to employees directly culpable of malfeasance but should extend, in cases involving a material failure of risk management or misconduct, to those employees who:

• could have been reasonably expected to be aware of the failure or misconduct at the time but failed to take adequate steps to promptly identify, assess, report, escalate or address it; or

• by virtue of their role or seniority could be deemed indirectly responsible or accountable for the failure or misconduct, including senior staff in charge of setting the firm’s culture and strategy.

The Bank says that the proposed rules would come into force on 1 January 2015 and clawback could be applied to awards made before that date but which vest after that date, subject to a six year time limit due to the statute of limitations for contracts.

Comment

The change in the law, which the proposals envisage, will be directed to the obligations of affected employers to implement changes in contractual terms of those affected.

This gives rise to 2 immediate legal issues which employers will have to confront:

- How can employers after 1 January 2015 enforce a change in bonus terms entered into before 1 January 2015 without employee consent to the amendments?

- How can employers construct clawback terms applying to vested rights which (a) do not offend the Penalties doctrine in English contract law and (b) which represent viable mechanisms to overcome the courts' far greater reluctance to interfere with vested proprietary rights than contingent expectancies?

11KBW Business Law members have consistently advised on and appeared in the most prominent disputes involving bonus and performance related remuneration obligations.

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Business **Protection**

Jurisdiction Agreements and Article 23 of the Jurisdiction Regulation

Sanders v Trigor One Limited

[2014] EWHC 1646 (Comm)

[2014] All ER (D) 187 (May)

A Gibraltar investment fund company failed to set aside service on it effected out of the jurisdiction based on a jurisdiction clause which it alleged to have been the result of a drafting error

The claimant had invested in Loan Notes in a fund operated by the defendant Gibraltar incorporated company, the purpose of which was to invest in English volume consumer credit litigation. The fund had lost its entire capital.

The claimant brought a claim in negligence and breach of contract against the defendant, alleging its failure to observe the investment policies to which it had contracted by the terms incorporated into the Loan Notes Deed. The claimant served the claim form, without permission, outside the jurisdiction under CPR 6.33(2)(b)(iii) and Article 23 of Council Regulation (EC) 44-2001 on the grounds that the Loan Notes Deed incorporated a clause amounting to a jurisdiction agreement by which the parties had chosen England as a non-exclusive forum.

The defendant contested jurisdiction and applied to set aside service on the grounds that the English jurisdiction clause was a drafting error and that the intention had been to make Gibraltar the exclusive forum for resolving disputes concerning the Fund which was incorporated and regulated in, and operated from Gibraltar.

The Commercial Court dismissed the defendant's application to set aside the service of the claim, finding that in order to establish jurisdiction, the claimant had to show that it had a good arguable case, meaning a much better argument than the defendant, that there has been a concluded jurisdiction agreement within Article 23, either in or evidenced by writing.

That was amply made out on the evidence because the terms and conditions of the Loan Notes Deed were in writing; they were the defendant's terms which the claimant accepted by applying and paying for the Loan Notes, having read the Placement Memorandum which contained the terms.

The defendant's contention that the jurisdiction clause was a mistake made no difference. There was no evidence that the claimant knew of the alleged mistake, and therefore no case for rectification.

The jurisdiction clause was not inconsistent with other terms.

11KBW Business Law members regularly litigate forum questions. 11KBW's Julian Wilson appeared for the Claimant investor in this case.

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Business **Regulation**

The Senior Managers and Certification Regimes, and Conduct Rules

Financial Services (Banking Reform) Act 2013, amending the Financial Services and Markets Act 2000 ('FSMA')

Financial Conduct Authority ('FCA') and Prudential Regulation Authority ('PRA)

Action against individuals is a strategic priority for the FCA. The Banking Reform Act gives the regulators a dramatic new set of tools to "*make individual responsibility a reality in banking*". Most eye-catchingly of all, Senior Managers will face a reverse burden of proof in respect of regulatory failures within their area of responsibility.

Two systems of regulation

When the Banking Reform Act and the FCA/PRA's new rules come into effect in 2015, there will be two systems for the regulation of individuals working in the financial services industry. The Banking Reform Act creates the 'Senior Managers' and 'Certification' regimes which will apply to banks (see s.71A FSMA). The Approved Persons Regime, which currently applies to all individuals in the financial services industry, will apply to financial services firms other than banks. The FCA/PRA are due to issue a consultation paper setting out detailed rules in the summer of 2014.

New conduct rules and reporting requirements

What both banks and the rest of the financial services industry will share is a new set of Conduct Rules issued under s.64A FSMA, to replace the Statements of Principle for Approved Persons (s.64 FSMA is repealed). It is likely that the Conduct Rules will apply to all employees in banks, and not only to Certified Persons and Senior Managers; whereas in non-banks the Conduct Rules will only apply to Approved Persons. Consequently, the FCA may apply a financial penalty to any employee of a bank, but to only approved persons in non-banks. The BRA also creates extremely onerous reporting requirements for banks (only) in relation to employee misconduct (s.64B and 64C FSMA).

Senior Managers Regime

The Senior Managers regime will apply only to the most senior individuals in banks, and is unlikely to extend beyond the board. Senior Managers must produce Statements of Responsibility under s.60(2A), so that it is clear who is responsible for what in a bank. If there is a regulatory failure in a Senior Manager's area of responsibility, he faces a reverse burden of proof: he is guilty of misconduct, regardless of personal culpability, unless he can show that he took such steps as a person in his position could reasonably have been expected to take to avoid the failure (s.66A(5)). Senior Managers will also be required in the new rules to produce 'Handover Certificates' on leaving their posts; face annual re-appraisal by the bank (s.63(2A) FSMA); a new criminal offence of causing a bank to fail (s.36 BRA); and the FCA may subject approval to conditions or time-limits (s.61 FSMA).

Certification Regime

The Banking Reform Act also creates a new Certification Regime that will apply to a wider pool of employees than the current Approved Persons regime (see s.63E). The emphasis here is on banks vetting their own employees, rather than the FCA/PRA, in the hope banks will take misconduct seriously.

11KBW members practicing in its Business Law and Regulatory and Disciplinary teams deal with cases involving the Approved Persons Regime. 11KBW's Tom Ogg is currently on secondment to the FCA in the Enforcement Division's Legal Group.

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