Business Law Briefing

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Contents

Governance	Petrodel Resources-v- Prest: corporate veil upheld
Reward	Vigeland-v-Ennismore: deferred bonus awards in discretionary trusts
Protection	Fairstar-v-Adkins: Emails are information not property and not subject to a proprietary claim
Regulation	Government Consultation on Share buybacks for employee shareholders

Business Governance

Shareholder disputes

Partnership, LLP and LP Disputes

Offshore Structures: ownership and control

Statutory and Fiduciary Duties Of Directors, Partners and Members

Business Reward

Dividends and distributions

Stock plans, share schemes, options and incentives, LTIPs and Restricted Awards

Partnership share, co-investments, carried interest

Bonuses- Deferred and Variable Remuneration

Business Protection

Fraud, Bribery and Corruption

Freezing Injunctions, Asset Tracing

Unlawful competitive activity, Restrictive Covenants and Garden Leave

Confidential information

Springboard injunctions

Team moves

Economic torts

Business Regulation

Compliance

Whistleblowing

Regulatory & Disciplinary Action

Judicial Review of Regulatory Action

Procurement

Information Law

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Companies

Petrodel Resources Limited -v- Prest
[2012] EWCA Civ 1395

Court of Appeal upholds the Salomon principles of corporate separate legal personality and the separate ownership of company assets even in one man companies and stresses that piercing the veil of incorporation is only permitted in exceptional cases of impropriety

Findings

The CA (by a majority) upheld the *Salomon* principles - that the shareholders of a company have no interest in, or entitlement to, the company's assets even where one shareholder is a 100% owner of the company- in the face of claims that the Family Division could depart from them where justice required it in granting ancillary financial relief in matrimonial proceedings.

In a strong judgment disagreeing with Thorpe L.J. (ex Family Division) Rimer L.J. (with whom Patten L.J. agreed) said that the distinction between the respective legal personalities, rights and liabilities of a company and those of its shareholders was as valid today as when the House of Lords decided *Salomon v. A. Salomon and Company, Limited* in 1897 and applied as much in the disposition of matrimonial ancillary relief proceedings as in other proceedings. It was not open to Judges to lift the veil of incorporation simply where justice required it.

Even in a one-man company, the one man in such a company does not have unlimited power to procure the company to deal as he would wish with the company's assets. The one-man is not in a position lawfully to distribute to himself the entirety of his company's assets at any time. He is constrained by the capital maintenance provisions which limit such wholesale disposals. He cannot, for example, lawfully procure the making of distributions by the company save out of its distributable profits and, if he does, the distribution will be unlawful and void.

The only factual circumstances in which it was legitimate for a court to 'pierce the corporate veil' and thereby identify the company with those in control of it so as then to depart from the separate identity principle were where special circumstances existed indicating that there was impropriety in the sense of a misuse of the company as a device or façade to conceal wrongdoing. The rationale for that exceptional jurisdiction was that the controllers of the company had used the fact of its separate identity for improper purposes such that it was appropriate for the court disregard its separate identity in order that its controllers might not derive the advantage from such abuse that they intended to achieve.

Commentary

- The case will be of particular assistance to foreign companies which are involuntarily joined into UK divorce proceedings. The judgment represents a set-back to those Judges of the Family Division who have regarded themselves as free to treat property owned by companies controlled by husbands as falling within their jurisdiction to make property transfer orders. Indeed, Thorpe L.J. said that Rimer L.J.'s approach gave an open road and a fast car to delinquent husbands.
- The case is also a reminder of the continuing significance of the common law doctrine of capital maintenance which aims to ensure that a company must not return to shareholders funds it has received as its share capital (and which provide some measure of protection to creditors) except in limited controlled circumstances.
- The analysis of the law on piercing the corporate veil follows VTB Capital plc v Nutritek International Corp & Ors [2012] EWCA Civ 808 which is under appeal to the Supreme Court.

11KBW Business Law members represent Companies in all aspects of asset protection

Business **Reward**

Bonuses

Vigeland-v-Ennismore [2012] EWHC 3099 (Ch)

Consideration of the degree of independence and relationship between an employer settlor and the trustee of an offshore discretionary Employment Benefit Trust into which deferred bonus awards had been invested

Findings

Claims by a former fund manager - against (i) his fund management company employer for breach of an oral contract as to his bonus entitlements, alternatively for misrepresentation, and (ii) against the trustee of the offshore EBT, into which deferred and conditional elements of his bonus awards were paid, for breach of trust and breach of fiduciary duty in failing to take into consideration all relevant and no irrelevant factors when determining whether to exercise a discretion to distribute in his favour - all failed at trial. The Claimant was found to have received the cash element of the bonuses and the company was found to have lawfully clawed back part of the deferred element from the EBT when investment losses had occurred. The trustees of the EBT had acted properly and not in breach of fiduciary duty in declining to make any distribution to the claimant of other invested awards pending proceedings in the Cayman Islands addressing the claimant's investment performance. It was a properly constituted discretionary trust and the claimant as a mere member of the class of discretionary beneficiaries had no absolute right to a distribution.

The trustee had admitted in cross-examination the reality that companies which set up employee benefit trusts often behaved as if they were in a position to give directions to the trustee and seek to instruct it in various ways. In considering the claim against the Trustee of the EBT, Asplin J. found that the trustee had not been overly deferential to the employer or acted as its cipher. In response to the submission that the trustee of the EBT had never made a distribution on its own initiative but had relied exclusively upon the employer, the Judge accepted that in a well run trust it was to be expected that there would be a harmonious relationship between settlor, trustee and beneficiary and in those circumstances, where the settlor made a reasonable request as to how the trustee should exercise its discretion, it would be exceptional for the request to be refused. The Judge also accepted that it was common practice when an onshore settlor established an offshore trust that the trustee obtained relevant information from the settlor though once it was aware of any hostility should also obtain and receive information from the beneficiary. Whilst the criteria for the exercise of the trustee's discretion set out in the deed of Settlement required the trustee to take account principally of the contribution of an employee to the company, that did not prevent other relevant matters from being considered and whilst the term "Employee" was not defined so as to include "former employee" that could not prevent a trustee with an absolute discretion from taking account of relevant matters post employment when considering the exercise of its discretion.

Commentary

- The judgment offers a rare if somewhat brief analysis of the legal relationship between companies settling discretionary trusts in favour of employees and the trustees administering such discretionary trusts.
- The judgment will offer comfort to company settlors and trustees operating trusts as a deferred variable remuneration mechanism than to employees who will view it as confirming the distance in reality between deferred awards put into employment trusts and their distribution.

11KBW Business Law members practice in all aspects of deferred and variable remuneration, bonus schemes and the FSA Remuneration Code

Information

Fairstar Heavy Transport Nv V (1) Philip Jeffrey Adkins (2) Claranet Ltd [2012] EWHC 2952 (TCC)

The content of emails was information and was not property. There was no binding authority to the effect that there was a proprietary right in information. The claimant company therefore failed in its proprietary claim to emails in the possession of its former CEO relating to his work for the company

Findings

The claimant company's former CEO provided his services to the company via a service company. As a result of that arrangement, emails sent to him at the company were automatically forwarded to him at his service company's email address. Emails he sent on behalf of the company were not kept on the company's server. The company made a proprietary claim to the emails sent and received by him whilst acting as its CEO. It claimed that materials created by or which come into the possession of an agent whilst acting for the principal are the property of the principal. It did not advance any alternative claim to the emails under contract, copyright or as its confidential information.

The former CEO contended successfully that the company had no proprietary claim because the contents of an email are information and not property.

Edwards-Stuart J. held that the preponderance of authority pointed strongly against there being any proprietary right in the content of information even though that could not be said to be settled law. There was no authority binding the court to hold that there was a proprietary right in information and there would be practical difficulties if that were so. There would then be five possibilities in relation to the ownership of any particular email: (a) title to the content remained throughout with its creator; (b) when an email was sent, title to the content passed to the recipient; (c) title remained with the creator, but the recipient had a licence to use the content for any legitimate purpose consistent with the circumstances in which it was sent; (d) title passed to the recipient, but the sender had a licence to retain the content and use it for any legitimate purpose; (e) title was shared between sender and recipient, and then shared with all others to whom it was forwarded. Options (a) and (b) were impractical and unrealistic: under option (a) the creator would be able to require any recipient, however far down the chain, to delete the email; under (b), if the email was sent to several recipients the question of title would become hopelessly confused. Under (c) and (d), any proprietary interest would be deprived of any value. Option (e) was also unrealistic and could result in parties being able to demand access to each other's servers to see emails, with considerable ramifications.

Commentary

- The judgment is a warning to companies to ensure that they have express contractual rights to access employees and officer's emails sent or received in their company capacity.
- Though the outcome of the case is surprising, the judgment is a valuable analysis of why the property theory relating to information cannot work in practice.

11KBW Business Law members practice in all aspects of the law relating to information, data protection, the law of confidence and privacy and related Injunctive Relief

Companies

Nuttall Review of Employee Share Ownership Consultation on Share buybacks

Proposals For The De-Regulation Of Share Buybacks By Companies With Employee Shareholders

Findings

The Nuttall Review commissioned by the Department for Business Innovation and Skills and published on 4 July 2012 identified key barriers to the uptake of employee ownership and made a number of recommendations on how to reduce these barriers. The barriers identified as disincentivising the uptake of direct employee ownership included the Companies Act provisions regulating the share buy back process.

On 18 October 2012, DoBIS published a Consultation Paper seeking views on how the government should implement employer owner status and a specific consultation document upon de-regulating share buy backs.

Where employee ownership is achieved by direct employee share ownership, rather than by an employee trust model, in order to avoid loss of ownership by the existing workforce, employee-owned companies need a mechanism by which to buy back shares owned by employees who are leaving or who have left the company in order to re-distribute them to new starters. Buy back arrangements depend on the selling shareholder agreeing a price with the buying company either on departure or pursuant to a buyback agreement entered into at the commencement of employment as a condition of the employee being awarded shares by the company. Although a number of former restrictions on a company purchasing its own shares -in particular those in s.151 CA 1995 - were repealed in Part 18 CA 2006, buy back still requires compliance with a number of provisions which regulate the process.

Companies may only buy back shares off-market if they have a buy back contract authorised by a special resolution of the shareholders in General Meeting (i.e. with 75% agreement, excluding the votes of the seller) (ss.693-695 Companies Act 2006). This provides protection to existing shareholders by preventing company directors from entering into share buy backs that are not in the company's or other shareholders' interests.

Whilst the finance for the purchase may come from either distributable profits or from the proceeds of issuing new shares, if a private company wishes to finance the buy back out of capital, the requirements include a declaration of solvency, auditors' report, special resolution of shareholders and advertisement to creditors. In addition, there are a number of other regulatory safeguards such as the director's statutory duties and the ability of shareholders by special resolution to alter the company's Articles to prevent buy backs.

The Nuttall Review concluded that these provisions were overly burdensome, and recommended that Government simplified them. The Government has accepted this recommendation and is now consulting on solutions.

Commentary

The difficulty the Government faces is ensuring that any further deregulation of buybacks in the case of employee shareholders does not undermine the remaining restrictions aimed at capital maintenance and the protection of creditors.

11KBW Business Law members regularly deal with issues of employee share ownership, restrictions on transfer and restrictive covenants