

CORPORATE AND PENSIONS

The Pensions Act 2004 and Corporate Transactions

The new Pensions Act 2004 (the "Act") contains a number of provisions which came into force on 6 April 2005 and which could significantly affect corporate transactions.

Significant powers have been given in the Act to the new Pensions Regulator to act against companies (and individuals) whose actions result in increasing a pension scheme's liabilities (the so-called "moral hazard" provisions) – this could affect proposed corporate transactions and restructurings.

Contribution notices can be issued by the Regulator where an employer or an associated person (including a company director) is party to an act or deliberate failure to act which has the effect of reducing a debt due from the employer, or compromising that debt or preventing its recovery. Such notice can require the employer or an associated person to pay all or part of the debt due. The Regulator has power to look back six years from the date of an act/failure to act in issuing contribution notices.

Financial support directions can, if the Regulator thinks it is reasonable to do so, be issued where an employer is 'insufficiently resourced'; that is the value of its resources is less than 50% of the estimated debt due from that employer on a wind-up and the value of resources of a connected company or associated person added together with the employer's resources would be 50% or more of that debt. Such directions would require the employer or any or all group companies to put in place financial support for the scheme and make them liable for the scheme pension liabilities for the duration of the scheme. If the financial support directions are not complied with, the Regulator can issue a contribution notice in respect of the scheme. This could potentially catch venture capitalists and companies in which they have invested, as well as group companies that are sold out of a group.

A company can seek confirmation from the Regulator that no contribution notice or financial support direction will be issued; the Regulator must make a decision 'as soon as reasonably practicable' but will not be bound if there is a material change in the circumstances of the company or the transaction (or if the details in the application are inaccurate).

Clearly the intent of the Government is to ensure that group companies with assets remain liable for pension liabilities within the group, not least in order to reduce the strain on the newly formed Pensions Protection Fund. This could potentially affect reorganisations and other corporate transactions, including investment by outside investors.



New Pension Protection on Business Transfers

Previously, pensions were excluded from the scope of the Transfer of Undertakings (Protection of Employment) Regulations ("TUPE"), which transfers employees and their contracts on a business sale or transfer and in many outsourcing situations. However, from 6 April 2005 the Pensions Act 2004 gives new protection to employees who are members of an occupational pension scheme and requires acquiring employers to provide transferring employees with a pension scheme which meets certain requirements.

The acquiring employer may offer membership of a defined benefit (i.e. final salary) scheme, which either provides benefits that satisfy the existing statutory reference scheme standard (used for contracting-out of state benefit) or provides benefits at a minimum level, essentially equivalent to six per cent of pensionable salary.

If not, the acquiring employer must provide a defined contribution (i.e. money purchase) or stakeholder scheme with contributions from the employer matching employee contributions up to a maximum of 6% of basic pay.

These provisions will have a significant impact on companies considering acquiring a business or inheriting a workforce under TUPE.

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Directors' Liability

Until 6 April 2005 the Companies Act 1985 prohibited a company from exempting its directors from, or indemnifying them against, liability arising out of negligence, default, breach of duty or breach of trust in relation to the company. This meant that a director personally had to finance the cost of defending any legal proceedings brought against him for a breach of his duties by a third party or the company itself. Only if judgment was given in the director's favour was he able to recover his legal costs from the company. Given the cost of lengthy court proceedings and the uncertainty of recovery if the claim was settled, this indemnification often came too late.

A company can arrange insurance to cover its directors for claims, although this can be expensive and limits on policies can still leave directors exposed.

The recent changes to the Companies Act relax the prohibition against indemnities in two important respects:-

- a company can pay the costs of a director's defence as they are incurred, whether the action is brought by the company itself or a third party. The director will, however, need to reimburse the company if the company's claim or the criminal or regulatory proceedings against him are successful.
- a company can indemnify a director in respect of proceedings brought by third parties, covering both legal costs and the financial costs of any adverse judgement. However, the indemnity cannot extend to criminal fines, penalties levied by a regulatory authority and the costs of successful criminal proceedings brought against directors.

Companies are permitted, but not required, to enter into such indemnities. If they do, details must be disclosed in the company's annual report and accounts and copies must be made available for inspection by shareholders. Shareholder approval, however, is not required. Listed companies will want to ensure any indemnity is not treated as a Class 1 transaction under the Listing Rules and so require shareholder approval.

Articles of association often contain indemnity provisions that mirror the previous legislation and so changes to Articles may be required. However, separate indemnity arrangements between a company and individual directors may be necessary.

The changes give rise to a number of commercial and technical legal issues and, while it remains to be seen how the changes will work in practice, they should be welcomed by directors, particularly given the much more demanding standard of care, skill and diligence now imposed on directors by the courts.

Share and Business Sales - Knowledge of Breach of Warranty

The legal position regarding a seller's liability for breach of warranty where a buyer had prior knowledge of the breach but where the breach was not disclosed by the seller has never been clear. The state of the law has now moved on as a result of the *Infiniteland* case, although it still remains somewhat unclear. This case rejected, as a general proposition, an argument by the seller that if a buyer knew a warranty was incorrect and still entered into the agreement it could not claim breach of that warranty. The judge took a very different stance on the effect of a buyer's knowledge on a warranty claim from that taken in the *Eurocopy* case.

The *Eurocopy* case suggested that where a buyer had actual knowledge of facts amounting to a breach of warranty, but which were not disclosed in the disclosure letter, it could be prevented from claiming breach of warranty, regardless of what the sale and purchase agreement said about this.

The *Eurocopy* decision was only a ruling on certain preliminary matters and not a final decision on the issue, although it was a decision of a higher court and so it is possible that a future case may yet decide to adopt the *Eurocopy* approach. In the meantime, however, *Infiniteland* may well signal a change in approach to this issue. Buyer's and seller's will, however, obviously have conflicting views in seeking to resolve this issue.

SHARE OPTIONS

Relaxation of EMI Rules

Previous rules provided that a company that had subsidiaries was only a qualifying company for the purposes of Enterprise Management Incentives ("EMI") if it, or another of its subsidiaries, owned at least 75% of the shares of those subsidiaries. This requirement has now been relaxed and the relevant provisions now allow companies that own between 51% and 75% to qualify for EMI purposes.

EMI options are available for independent trading companies trading in the UK with gross assets not exceeding £30 million. Such companies can grant EMI options to any number of employees, up to a total market value of £3 million. Each employee is able to hold options over shares worth up to £100,000 at the time of the grant. No income tax or national insurance is payable by the employee on the exercise of the options so long as the options are granted at market value, nor will there be a national insurance charge to the employer. On sale of the shares, capital gains tax is chargeable but business assets taper relief will be available, starting from the date of the grant of the options (as opposed to the date of exercise of the option under a company share option plan).

No formal approvals procedure is required, as individual EMI share option agreements are entered into with each employee to whom options are granted.

As options can be granted individually to qualifying employees, no scheme as such is necessary, and hence it is an attractive possibility for companies wishing to incentivise employees, especially as the limit on options per employee is higher than in an approved company share option plan (£100,000 as opposed to £30,000).

Unprotected Overseas Credit Card Transactions - OFT to Appeal High Court Decision

As reported in the December edition of Rollits' E-Bulletin (which you can subscribe to by clicking on the "E-Bulletin" link on our website at www.rollits.com), the Office of Fair Trading ("OFT") recently lost a high profile consumer credit case brought against Lloyds TSB, Tesco Personal Finance and American Express. The High Court decided that statutory safeguards on credit card purchases enjoyed by consumers in the United Kingdom do not apply to purchases made from overseas internet retailers or whilst abroad.

The OFT has now decided to take the case to the Court of Appeal in an attempt to have the High Court's decision overturned.

The case has far-reaching implications for consumers who buy goods from overseas retailers using their credit cards. Consumers paying for products or services with a credit (but not debit) card in the United Kingdom are offered protection by the Consumer Credit Act 1974 ("CCA") in addition to that offered by other consumer legislation such as the Sale of Goods Act 1979 and the Consumer Protection (Distance Selling) Regulations 2000.

The CCA permits consumers to claim directly against their credit card issuer as well as the retailer if they discover problems with products or services purchased with their card which give rise to a cause of action against the retailer (e.g. because the retailer has made a misrepresentation about the product or service, is in breach of contract or has contravened consumer legislation). In order to take advantage of this additional protection, the amount charged to the credit card must be between £100 and £30,000, and the credit limit on the card must be no more than £25,000.

Consumers should bear in mind that the High Court's ruling (and therefore the law as it stands today) is that whilst consumers enjoy this protection when using their credit cards in the United Kingdom, they are not generally protected in transactions involving overseas retailers.

DATA PROTECTION

To Notify or not to Notify?

A law firm in Rochdale was recently fined over £3,000 and ordered to pay more in costs for failing to notify the Information Commissioner of its data processing activities under the Data Protection Act 1998. The case highlights that no matter what industry your business operates in, it (and if it is a limited company its Directors) risks committing a criminal offence if it does not notify when it is under an obligation to do so.

Freedom of Information and Implications for Businesses

The Freedom of Information Act 2000 came fully into force on 1 January 2005. Since then anyone requesting information from a public authority has to be informed in writing by the authority whether it holds the information and, if so, to have that information communicated to them. The Act lists public authorities who are covered by the Act including government departments, local authorities, the NHS, courts, police authorities, armed forces and maintained schools. It also contains a provision allowing the government to review the list and add bodies they consider are carrying out a public function.

Those who deal with public authorities may well find that they are affected by the Act even though they are not required to respond to a party requesting information. This is because organisations dealing with public authorities provide information to them which may be disclosable by authorities under the Act.

There are several exemptions from disclosure under the Act. The most relevant for bodies dealing with public authorities are the confidentiality and commercial interests exemptions.

Information is exempt if disclosing it would amount to an actionable breach of confidence. To be actionable there must exist a legal obligation of confidentiality and the information must be of a confidential nature. The commercial interests exemption prevents disclosure of a "trade secret" where disclosure would or would be likely to prejudice the commercial interests of any person. This is a qualified exemption requiring the authority to consider whether the public interest in maintaining the exemption would outweigh the public interest in disclosing the information.

Organisations dealing with public authorities have to consider what steps they can take to protect what they consider to be sensitive information from disclosure under the Act. Organisations should consider a number of steps including reviewing the information they provide to public authorities and consulting with authorities to ensure that they are part of the disclosure process in respect of information supplied by them to authorities.

It may be worthwhile seeking to include a confidentiality provision in respect of contractual negotiations with public authorities and in contracts themselves. However, the government's code of practice on the responsibilities of public authorities provides that they should not accept such provisions except in exceptional cases where a schedule could be agreed setting out information which should be kept confidential.

It is already becoming apparent that public authorities are having some difficulty in dealing with responses from persons seeking information. The confidential information and commercially sensitive information exemptions are likely to cause problems both for public authorities and those who deal with them. Those providing information to public authorities need to note the risk of their sensitive information being disclosed by public authorities and consider steps that might be taken to prevent disclosure.

INFORMATION

If you have any queries on any articles in this newsletter or other corporate or commercial matters generally please contact:

Richard Field or Tom Farrington on (01482) 323239

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It is for general guidance only. It provides useful information in a concise form.

Action should not be taken without obtaining specific advice.

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Mrs. Pat Coyle, Rollits, Wilberforce Court, High Street, Hull, HU1 1YJ.

**The law is stated as at 26 April 2005
Wilberforce Court, High Street, Hull HU1 1YJ**

Rowntree Wharf, Navigation Road

York YO1 9WE

www.rollits.com

