

## The Companies Act 2006

The Companies Act 2006 ("the Act") is probably the most significant overhaul of company law for the last 20 years. Although the Act was enacted on 8 November 2006, only a handful of its provisions have so far been brought into force, which include provisions relating to electronic communications. The remainder of the Act is due to come into force in stages with all of it in force by October 2008. One of the main aims of the Act was to deregulate private company administration with a 'think small first' approach. We have summarised on pages 4 and 5 some of the main provisions that will affect private companies and their implementation date.

### Tax

#### Arctic Systems: An end to this Monkey Business?

First the good news:

After the case of Jones v Garnett ran its full course, the House of Lords unanimously ruled in favour of the tax payer. Existing arrangements whereby husband and wife each own ordinary shares in a company in which one does most of the "proper" work are likely to be effective in the married couple paying less tax overall.

Now the reality check:

1 Not all existing arrangements will fall within the rule in Jones v Garnett. In particular, if the less involved spouse holds shares which do not have the full rights associated with ordinary shares (for example, if they have an entitlement to receiving dividends only), the comments of the House of Lords

strengthen HM Revenue & Customs argument that the married couple should be paying more tax.

2 The day after (!) the House of Lords judgment, in a written statement to Parliament, the Government vowed to "bring forward" legislation that will counter the effect of the Jones v Garnett decision.

*Nasim Sharif*

### Contracts

#### Reasonable endeavours - specific steps

Contracts often contain obligations on a party to use reasonable endeavours or best endeavours to do something. The High Court has decided that where a contract required a party to use reasonable endeavours to obtain a third-party consent and it contained specific steps that had to be taken as part of the exercise of reasonable endeavours, the party was obliged to take those steps, even though they might be detrimental to the party's own commercial interests.

Not surprisingly, the Court expressed the view that an obligation to use "reasonable endeavours" is less stringent than one to use "best endeavours".

The court said that a party using reasonable endeavours towards an end does not require that party to sacrifice its own commercial interests. The obligation to use reasonable endeavours requires a party to go on using endeavours until the point is reached when

all reasonable endeavours have been exhausted. However, where the contract actually specifies certain steps have to be taken (such as the provision of a parent company guarantee in this case) as part of the exercise of reasonable endeavours, those steps will have to be taken, even if that could on one view be said to involve the sacrificing of a party's commercial interests.

*Tom Farrington*



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# Pensions

## Debt on the employer - update

We have reported in previous Alerts on the provisions relating to calculation and payment of a debt due from an employer when that employer ceases to participate in a final salary (defined benefit) scheme, and the ability for the employer to enter into a withdrawal arrangement to deal with that payment.

A High Court case has shed some light on one way in which an employer may withdraw from a scheme (generally on an internal reorganisation) whilst minimising the debt due from it. Often, scheme rules do not specify how a debt in respect of the scheme is to be allocated between participating employers. In such cases, the scheme actuary will calculate the total debt due and apportion it in accordance with the proportion of debt relating to the liability of a particular employer to the scheme.

**The regulations on employer debt allow scheme rules to be amended to change how a deficit is allocated between employers, or where the rules do not provide for any such allocation, for one to be made. This could enable an unequal apportionment of the debt, if it were felt, for instance, that one particular employer should not be left with a debt.**

In this case, the rules of the scheme were amended so as to apportion a nominal amount of debt to the sponsoring employer, in order to prevent the insolvency of that company, with the remainder being apportioned to a new company. The aim was for the new company to be made insolvent so that the scheme could enter into the Pension Protection Fund (PPF) and receive its protection. The PPF pays compensation to members where the sponsoring employer is insolvent and the scheme is insufficiently funded to pay out benefits to members.

There was a concern that the scheme would not be accepted into the PPF, as a scheme can cease to be eligible for the PPF if the trustees enter into a legally enforceable agreement the

effect of which is to reduce the amount of any debt on employer that may be recovered by the trustees.

The triggering event for applying the debt on employer provisions in this case (ie the winding-up of the scheme) had not occurred and the judge therefore ruled that the agreement to amend the rules did not amount to an agreement reducing the total amount of debt due, and consequently the scheme would not be excluded from the PPF.

Although there does appear to be some scope for allocating debts by amending scheme rules, the legislative provisions regulating amendment of rules will still apply and must be complied with, and it is advisable for both the company and the scheme trustees to seek clearance from the Pensions Regulator to such course of action to ensure that they do not see this as a debt avoidance mechanism.

The Government has now announced proposals to amend the debt on employer regulations to increase the scope for companies to enter into arrangements with trustees of schemes to apportion a debt when an employer ceases to participate in a scheme. Further changes may therefore be in the offing.

*Craig Engleman*



# Tax

## Dividends of assets

A company can only lawfully pay a dividend if it has sufficient available profits. If a dividend is paid where there are insufficient available profits then the Company can demand repayment.

In the context of determining whether or not a company can make a lawful dividend, "profit" is given a specific meaning in company law. In general, the profit must represent realised trading profits and capital gains by reference to properly prepared accounts. However, that rule is relaxed where the dividend comprises an asset (also known as a distribution in specie or dividend in kind) so that any unrealised gain on that asset is treated as if it were realised for the purpose of deciding whether

or not the dividend is lawful.

The dividend of assets rule can be useful in a variety of situations, including giving out valuable assets from a trading company to preserve business asset taper relief, demergers and partitioning assets as part of estate planning. There is the additional benefit that assets being transferred as dividends, in the right circumstances, are not subject to stamp duty/stamp duty land tax.

*Nasim Sharf*

# Deal Alert

Over recent months, transactions we have acted on include:

## Croda

**Sale of Croda Food Services business to Hull-based specialist vegetable oil group AarhusKarlshamn UK for £7.4m.**

The Rollits Food Group, headed by Julian Wild, Food Group Director, was responsible for negotiating the sale of the CFS business to AAK UK. Julian was supported by a multidisciplinary legal team from Rollits, led by Senior Partner, Steve Trynka, and included Tom Farrington and John Flanagan (Corporate), Nasim Sharf (Tax), Craig Engleman (Pensions), Chris Crystal (Commercial Property) and Neil Maidment (Employment).

## McGurk Group

**Sale to SGS International, Inc.**

Rollits acted as corporate finance and legal lead advisors to the McGurk Group providing both corporate finance and legal advice and support throughout the firm on the sale to US-based SGS International, Inc.

The deal was handled by Rollits' corporate team, led by Senior Partner Steve Trynka and

assisted by Shona Unwin and John Flanagan (Corporate), Nasim Sharf (Tax) and Alison Barr (Property), while Neil Jenneson delivered the corporate finance aspects of the deal.

## Cooplands

**Acquisition by Cooplands of Scarborough of Hull-based Skeltons from administration in a deal which saved more than 500 jobs.**

Following the takeover, Cooplands, a family-owned firm, increased its estate from 43 to 77 shops which makes it the UK's fourth-largest bakery chain.

The deal included 34 of Skeltons' 43 shops as well as the Skeltons bakery in Hull, which is now set for a major investment programme.



The team from Rollits was led by Managing Partner, Richard Field and included Neil Jenneson (Corporate Finance) Nasim Sharf (Corporate) Glenn Craft and David Myers (Property), Neil Maidment (Employment) and Craig Engleman (Pensions).

## Rollits' Commercial Group Continues to Thrive

The first six months of 2007 have been especially busy for Rollits' Commercial Group during a period when the firm has seen significant expansion across all areas of practice.

Rollits, was one of the first law firms in the region to establish a dedicated Commercial Group to work alongside its corporate lawyers. The Commercial Group specialises in providing advice in areas such as international trading agreements, intellectual property, data protection, information technology, ecommerce and competition law.

Rollits is one of the few firms in the region recognised in the Legal 500 as leaders in all three categories of intellectual property, information technology and media and entertainment law.

Partner and head of the Company and Commercial Department, Keith Benton said: "Rollits has always been recognised as a leader for its commercial law expertise. Over the years the firm's reputation and the specialist advice that we are able to provide to clients has continued to grow".

The Commercial Group, which has acted in a number of high

RALPH, TOM AND KEITH



profile matters including buying the Flying Scotsman locomotive for York National Railway Museum, currently comprises four specialist lawyers. In addition to Keith who is based in the Hull Office, Partner Ralph Coyle is based in the York office. Consultant Lesley Dowson and Associate Tom Morrison make up the rest of the team.

"Each of us has our practice areas within commercial law" says Keith. "It enables the firm to ensure that our clients obtain advice from lawyers who are specialists in their respective fields."

One of the more interesting aspects of practising in commercial law is that it often involves work with an international dimension. Many of Rollits' clients have trading arrangements overseas and require advice on how to protect their interests when dealing with trading partners in other countries. The Commercial Group also advises clients in Europe and further afield who need assistance with their trading arrangements and intellectual property rights in the UK.

Other work of the Group includes IT and ecommerce. Tom, who advises the Orlando Theme Parks Division of Universal Pictures in relation to its website, said: "There is a considerable raft of legislation that must be observed by companies which operate websites. Even companies that operate simple brochure websites are not exempt. Many of the legal requirements can be addressed in carefully drafted Terms of Use and Privacy Policies."

Ralph adds: "There is a belief in some law firms that legal advice is a commoditised product. That is not the case, every client has its own requirements and it is our job as lawyers to tailor our advice to meet those requirements."

# Companies Act 2006

The following is a summary of some of the main provisions of the Act that will affect private companies and their implementation date

## Already in Force

### Electronic communications

The Act allows all companies to communicate with their shareholders in electronic form or by putting information on their websites. Shareholders will, however, retain the right to receive information in hard copy form.

A company can send documents by email where the recipient has individually agreed and provided an email address.

A company can provide information and documents to shareholders on its website where the recipient has agreed to it being done that way. However, if the shareholders generally agree that websites can be used, or if there is such provision in the Articles, then individual shareholders will generally be regarded as having agreed if they are asked for agreement and do not respond within 28 days. In

any event a company must notify the relevant shareholder each time information is published on the website.

## October 2007

### Written resolutions of shareholders

Written resolutions will no longer need to be signed by all shareholders. Instead a simple majority of eligible votes will be required for ordinary resolutions or 75% for special resolutions. It is likely that, in the vast majority of situations, private companies will take shareholder decisions by written resolution rather than by holding a meeting. However, meetings will still need to be held in certain circumstances, for example, to remove a director or an auditor, as these cannot be done by written resolution.

### Shareholder meetings

Private companies will no longer need to hold annual general meetings unless 10% of shareholders (or 5% in certain circumstances) demand one.

General meetings can be held on 14 days notice, regardless of the type of meeting or the type of resolution proposed. Meetings can still be held on shorter notice if 90% (rather than 95%) of shareholders agree.

### Directors' duties

Directors' general duties to their companies are, for the first time, set out in the Act.

### Loans to Directors

Loans to directors will cease to be prohibited. The Act will allow all companies to make loans with the prior approval of shareholders.

## April 2008

### Company secretary

Private companies will no longer have to appoint a company secretary unless they choose to. If they do, the secretary will still have the same authority and responsibility as now. If they do not, a director or person authorised by the directors can do anything required to be done by the secretary.

# Employee Share Incentives

## Exercise of discretion in company share option plans

Rules of a share option plan often give the directors or a remuneration committee a discretion in relation to certain matters, for example whether options can be exercised in certain circumstances and, if so, the number of options that can be exercised.

The High Court has ruled that any such discretion must be exercised in accordance with those rules, and must not take into account extraneous factors. This decision has recently been confirmed by the Court of Appeal.

An ex-director of the company sought on retirement to exercise his subsisting share options under the company's schemes for executives. The relevant scheme rules provided that on cessation of employment the remuneration committee

"shall in its absolute discretion determine whether the option will be exercisable having considered the extent to which the performance condition has been achieved at the date of termination. If the remuneration committee so decides the option holder may exercise all or a proportion of his option(s) during the period which begins on the date of such cessation and ends 12 months later, such proportion being determined by the remuneration committee pro rata to the achievement of the performance condition".

The remuneration committee took into account certain aspects of the former director's conduct whilst an employee in making its decision that he could exercise 75% of his options, even though the performance conditions that applied to

# Companies Act 2006

## Accounts

The deadline for private companies to file their accounts at Companies House will reduce from ten to nine months from their year end. As the requirement for private companies to hold an annual general meeting has been abolished, companies will no longer need to send out their accounts to shareholders before a meeting. Instead, the accounts must be sent to shareholders by the time they are due to be filed.

## October 2008

### Directors

All companies will have to have at least one natural person as a director and cannot just have companies acting as directors. All directors will have to be at least 16 years of age. Directors will also only be required to file a service address on the public record at Companies House, which can be their company's address rather than their private home address. Companies House will hold a director's home address as protected information.

### Articles of Association

New companies formed under the Act will be able to have new default model Articles which will be simpler and more tailored to small companies. As at present, companies can choose to exclude some or all of the provisions of the model Articles. Existing companies can also choose to adopt these new Articles.

### Financial assistance

The rule that private companies cannot give financial assistance for the purchase of their own shares will be abolished.

### Share capital

The requirement to have an authorised share capital will be abolished.

Directors of private companies will no longer need authority to allot shares if the company has only one class of shares unless the Articles require this. The pre-emption rights imposed by the Act on

the issue of shares will, however, still apply unless they are disapplied by the Articles or by special resolution.

### Company Names

Whilst it will still be possible to change a company's name by special resolution, companies will have the flexibility to include a different procedure in its Articles (for example by ordinary resolution or by resolution of the directors). Existing companies may wish to amend their Articles to allow this.



### Reduction in share capital

Private companies will be able to reduce their share capital without court approval by passing a special resolution supported by a statement of solvency by the directors. These simpler procedures are similar to those which apply now when a company redeems or purchases its own shares out of capital.

### Objects

There will be no requirement in future for companies to state their objects; these are currently usually included in the memorandum of association. So companies need not be restricted in what they do, although they can choose to be restricted if they wish.

*How the Act will apply to existing companies has yet to be finalised and so this is an important area which is likely to be the subject of detailed secondary legislation.*

*Tom Farrington and Shona Unwin*

the exercise had been fulfilled at the date of termination.

The Court interpreted the scheme rules as providing for a two stage procedure to be undertaken by the remuneration committee:

- First stage - this allowed the company an absolute discretion as to whether or not the options could be exercised at all. It was relevant to take into account the performance conditions and factors related to the achievement of the performance target in reaching this decision;
- Second stage - having made the decision to allow exercise, the second stage did not allow any discretion at all.

This was merely an exercise in determining the pro-rata amount of shares over which options could be exercised based solely on the attainment of the performance targets. In the present case the performance targets had been met in full, and accordingly that was the determining factor in the exercise of the options.

The Court ruled that the remuneration committee had not exercised their discretion correctly because they took into account the employee's conduct, which had had no effect on the attainment of the performance targets. They were not right, therefore, to allow the exercise but reduce the number of options which could be exercised.

While this is perhaps not a surprising decision, it does highlight that rules allowing a discretion should be carefully worded, that no irrelevant factors are taken into consideration in the exercise of a discretion and that any exercise is undertaken fairly and bona fide in accordance with the rules of the scheme.

*Craig Engleman and Tom Farrington*

# Commercial

## Information Commissioner exposes illegal trade by the media in personal information

Following a report made by him to Parliament the Information Commissioner has repeated his call for tougher sentencing for those who trade unlawfully in personal information. He wants provision for a two year jail term in respect of serious such breaches of the Act.

He referred in his report to the developing trend for various types of organisations to buy personal information, in particular by journalists looking for a story. A raid at premises in Hampshire had led to prosecution of private investigators. The raid identified records and information which had been wrongfully supplied to 305 journalists working for a range of newspapers and magazines (including many well known daily and Sunday nationals), which he named in his report.

The Information Commissioner also referred to the sending to prison of Clive Goodman, a journalist at the News of the World, who was jailed under the Regulation of Investigatory Powers Act for reading text messages of the Royal Family in order to develop stories for the News of the World. This also led to the resignation of the editor of the News of the World.

**The Information Commissioner's office is now working on guidance for journalists when tasking third parties to obtain information on their behalf. In the future the Information Commissioner will prosecute both journalists and newspapers employing them. The guidance will take account of the important role of investigative journalism and will be developed in the light of "public interest".**

The Press Complaints Commission has stated that it will agree to make it clear that it does not approve of journalists and newspapers obtaining personal information unlawfully, particularly obtaining information about the private life of individuals without their consent or by bribery, impersonation, subterfuge or payment. However, it says this would not apply where it could be demonstrated that the activity was justified in the public interest. The National Union of Journalists has defended the right of journalists to obtain information where it is in the public interest but is considering the impact of the Data Protection Act on its code of conduct.

A number of newspaper bodies, such as the Society of Editors and the Newspaper Publishers Association, have jointly released statements stating they take the issue of such breaches very seriously and they will work with the Information Commissioner to ensure a better understanding of the provisions is made known to senior managers and journalists. They do not, however, support the custodial sentence line being taken by the Information

Commissioner believing it will have an effect on investigative journalism and freedom of speech.

The Information Commissioner has also been critical of the practice of some solicitors who have used private investigators to obtain personal information. In one case a solicitor asked a private investigator to obtain bank information and the private investigator subcontracted this work to a "blogger" (i.e. someone who obtains information by pretending to be someone they are not) who unlawfully obtained the information. The information was then given to the law firm. The private investigator and the "blogger" were convicted. The solicitor was cautioned. In future similar situations the Information Commissioner has warned that solicitors would be prosecuted.

If a business asks a third party to carry out investigations into a person's private life and do not make clear that the investigator must not breach the Data Protection Act, it may find itself on the wrong end of enforcement action brought by the information Commissioner.

*Ralph Coyle*



# Commercial

## Has your business got an Information Security Policy?...

...and just as importantly, have your employees received information security training? In a survey almost two thirds of office workers questioned disclosed their work-related passwords to a stranger.

So whilst employers are investing significant sums in complicated IT systems to keep information secure, careless employees are effectively giving the key to the front door to would-be thieves.

**Such a significant breach in security exposes employers to falling foul of Principle Seven of the Data Protection Act 1998, which obliges organisations to take appropriate technical and organisational measures to safeguard the security of personal information (that is, information from which individuals can be identified).**

We recommend that all businesses implement new, or review existing, Information Security Policies as a matter of urgency and make sure that staff are given appropriate training. If you would like any assistance please contact us: we have significant experience in drafting and reviewing Information Security Policies and holding one-to-one and group management and front-line staff training sessions. *Tom Morrison*

## Freedom of Information Doesn't Come Cheap

Members of the public are entitled under the Freedom of Information Act 2000 to request disclosure of information held by public authorities such as local councils and Government departments. There are exceptions to the right to demand disclosure, including if certain aspects of the costs of retrieving and disclosing the information exceed the prescribed threshold.

The relevant provisions of the Act, which have been in force for over two and a half years, are now coming under fire from the Government for placing too great a strain on public authorities. It is proposed, therefore, that changes are made to enable public

authorities to include in the calculation of the cost of retrieval activities which so far have been disregarded. The net effect would be to enable public authorities to decline disclosure on cost grounds more frequently.

The Information Commissioner's Office is largely against the Government's proposals, which have been outlined in a formal Consultation; the Government is due to respond to the replies received to the Consultation by the end of October.

*Tom Morrison*

## Another Data Protection Prosecution

A firm of private investigators has been prosecuted under the Data Protection Act 1998 for unlawfully obtaining information relating to over 250 individuals from the Department of Work and Pensions and disclosing it to third parties. The firm, which contracted with a finance company to trace debtors, has been fined and ordered to pay costs. Its Managing Director has also been prosecuted personally. The contract between the firm and the finance company stated that the firm would comply with the Act.

This case highlights the importance for businesses dealing with private investigators and debt collection agencies of giving clear and unambiguous instructions, and incorporating robust provisions in all contracts, requiring the investigator or agency to comply with the Act.

*Tom Morrison*



# Corporate

## Change in Rules relating to Disclosure of Major Shareholdings in Quoted Companies

The new Disclosure and Transparency Rules ("DTR") came into effect earlier this year and implemented the European Union Transparency Directive. The effect was that three new chapters were introduced into the Disclosure Rules sourcebook for listed companies.

One change introduced by the DTR was the repealing of the Companies Act 1985 major shareholding disclosure regime for public companies. In the past the requirement to disclose a shareholding over 3% only applied where the shareholder actually held an "interest in shares". This has now been extended to include the situation where a shareholder controls the exercise of voting rights. In brief this means that the disclosure requirements have been extended to cover indirect holdings of shares where the shareholder is entitled to acquire, dispose or exercise the voting rights attached to shares and would include for example shares held on trust.

Where a shareholder acquires or disposes of shares in a company that have voting rights attached he is required to

notify the company if his shareholding reaches, exceeds or falls below the thresholds set out in Rule 5 of the DTR:-

- For UK companies, whose shares are traded on a regulated market in the UK (including markets such as the London Stock Exchange and the AIM and PLUS markets), the DTR retains the 3% disclosure threshold from the Companies Act, along with the subsequent 1% thresholds thereafter.
- For non-UK companies whose shares are traded on a regulated market for which the UK is their home member state, the DTR uses thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75%, which are the minimum disclosure requirements set out in the Transparency Directive.

*John Flanagan*

## Obligations to disclose information

Corporate agreements such as share and business sale and purchase agreements, investment agreements, shareholders' agreements and facility agreements can often contain obligations on one party to provide information to the other. A recent Court of Appeal case provides useful insights on how the courts will interpret such obligations.

In this case a clause required one party (the Borrower) to disclose "all information which comes to the attention of the Borrower and which is material to the decision whether to waive any condition of the Offer . . . . and will disclose to the Lender . . . . all other information which has come to its attention which is or was material to any decision whether to waive any condition of the Offer . . . ."

The judgment includes the following points:

- The obligation to disclose information which comes to the attention of a company extends to information held by the board of directors as a whole;
- Information relevant to a company's affairs that comes into the possession of one director, however that may occur, can properly be regarded as information in the possession of the company itself. This applies even if the director concerned has not shared that information with the rest of the board;
- Materiality in the context of such a clause means information which reasonable persons in the position of the directors of [the Lender] would wish to take into account when reaching a decision of that kind. Information acquired by one director concerning a bribe given to one of the directors of the Borrower to waive a condition of the offer was considered material;
- Where a duty of disclosure is implied by law (such as in the case of contracts of insurance) it does not usually extend to facts that already are, or should be, known to the person to whom disclosure is to be made; and

- Where a duty to disclose information is imposed by contract, it will extend to information already in the possession of the person to whom disclosure is to be made, unless it is clear that the contract should be construed otherwise.

While the above points are perhaps not surprising, it does highlight that care may be needed when drafting such clauses if, for example, "material" is intended to mean something else or if a party is not intended to be under an obligation to disclose information already known to the other party. *Tom Farrington*

### INFORMATION

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

Keith Benton or Tom Farrington on (01482) 323239

This newsletter is for the use of clients and will be supplied to others on request. It is for general guidance only. It provides useful information in a concise form.

Action should not be taken without obtaining specific advice.

We hope you have found this newsletter useful. If, however, you do not wish to receive further mailings from us, please write to Mrs. Pat Coyle, Rollits, Wilberforce Court, High Street, Hull, HU1 1YJ.

*The law is stated as at 28 August 2007*

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