UK Corporate Briefing

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Welcome to the first 2016 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

Companies Act 2006: new rules on people with significant control

From 6 April 2016, UK-incorporated companies and LLPs will have to collect and keep information about people with significant control over them. The new rules form a key part of the government's drive to tackle tax evasion, money laundering and terrorist financing and to increase trust in UK corporates. They require new levels of corporate transparency regarding ultimate beneficial ownership and control.

Background

The broad framework of the new regime is in Part 21A to the Companies Act 2006 which was inserted by the Small Business, Enterprise and Employment Act 2015. However, much of the detail will be in secondary legislation.

To whom does the new regime apply?

The new regime will apply to all UK-incorporated companies other than those that:

- are subject to the existing disclosure requirements of DTR 5 (principally companies whose shares are traded on the Main Market of the London Stock Exchange and AIM); or

- have voting shares admitted to trading on a regulated market in the EEA outside the UK or on specified markets in Switzerland, the US, Japan and Israel.

The regime will also apply to UK-incorporated LLPs, but with modifications to reflect their different ownership structure. This note should therefore be read as applying also to LLPs.

Overseas entities operating in the UK, whether through a branch or otherwise, are not subject to the regime.

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Please contact us if you would like to discuss any subject covered in this issue.

From April 2016, companies will have to keep a register of those with significant control over them.

What are the key features of the new regime?

Companies will have to:

- keep a register of those with significant control over them (the PSC Register);
- take reasonable steps to identify those who are registrable on the PSC register;
- enter the required information on the PSC Register and keep that information up to date;
- make the PSC Register available for public inspection;
- as part of the new annual return regime, from June 2016, file information about their PSC Register at Companies House.

Who is a person with significant control?

A person with significant control (PSC) in relation to a company is any of the following:

- an individual who holds, directly or indirectly, more than 25% of the shares in a company;
- an individual who holds, directly or indirectly, more than 25% of the voting rights in a company;
- an individual who holds the right, directly or indirectly, to appoint or remove a majority of the board of directors of a company;
- an individual who has the right to exercise, or actually exercises, significant influence or control over a company
- an individual who holds the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm which is not a legal entity, but would satisfy any of the first four tests if it were an individual.

The Act includes detailed interpretive and anti-avoidance provisions on the tests.

Which PSCs are registrable on the PSC Register?

The legislation draws a distinction between PSCs which a company must register in its PSC Register and those which it need not register.

A company treats an individual as a non-registrable PSC if that individual has significant control of the company only because her or she has significant control over a "relevant legal entity" (RLE). This is a UK legal entity which (i) the company would have classed as a PSC had it been an individual, and (ii) must itself keep a PSC Register (or comply with DTR 5 or equivalent).

The following is an example.

John Smith

100% shareholding

A Ltd

100% shareholding

B Ltd

John Smith owns 100% of the share capital of A Ltd which in turn owns 100% of B Ltd. A Ltd and B Ltd are both UK companies. John Smith is a PSC in relation to A Ltd (direct control). John Smith is also a PSC in relation to B Ltd (indirect control). However, John Smith is only a registrable PSC for A Ltd. He is a non-registrable PSC for B Ltd, as he only has significant control over B Ltd because of his control of A Ltd. Therefore, only A Ltd must enter him on its PSC Register.

Which RLEs are registrable on the PSC Register?

An RLE which is the first legal entity in a company's ownership chain is registrable on the company's PSC Register. So, in the above example, B Ltd must record A Ltd as an RLE in its PSC Register.

In contrast, had A Ltd been an overseas company, it could not be an RLE. B Ltd would instead have to record John Smith as a registrable PSC on its PSC Register.

How does a company go about compiling its PSC Register?

Every company must take reasonable steps to find out whether it has any registrable PSCs or registrable RLEs and, if it does, to identify them. The legislation sets out detailed procedures for this. It also imposes certain proactive notification duties on registrable PSCs and registrable RLEs. In each case, there are penalties for failure to comply. Failure by a relevant person to respond to a company's requests for information may eventually result in the company being able to disenfranchise the affected shares.

Read more >

What information must go on the PSC Register?

The information which the PSC Register must include, and which must be updated as necessary, breaks down into three broad categories:

- information about the registrable PSC or registrable RLE (name, address etc.);
- which of the five PSC tests that person meets. This includes quantifying their shareholding or voting rights, if relevant, by reference to three broad bands (over 25% up to 50%, over 50% but less than 75% and 75% or over);
- status of the company's investigations and whether it has served any notices.

If a company identifies that it has no registrable PSCs or registrable RLEs, it must still keep a PSC Register and include a statement to that effect.

How must a company make its PSC Register available to the public?

The PSC Register is one of the company's statutory registers. The company must keep it at its registered office (or alternative inspection location). Anyone with a proper purpose may have access to the PSC Register without charge or have a copy of it for which companies may charge a small fee.

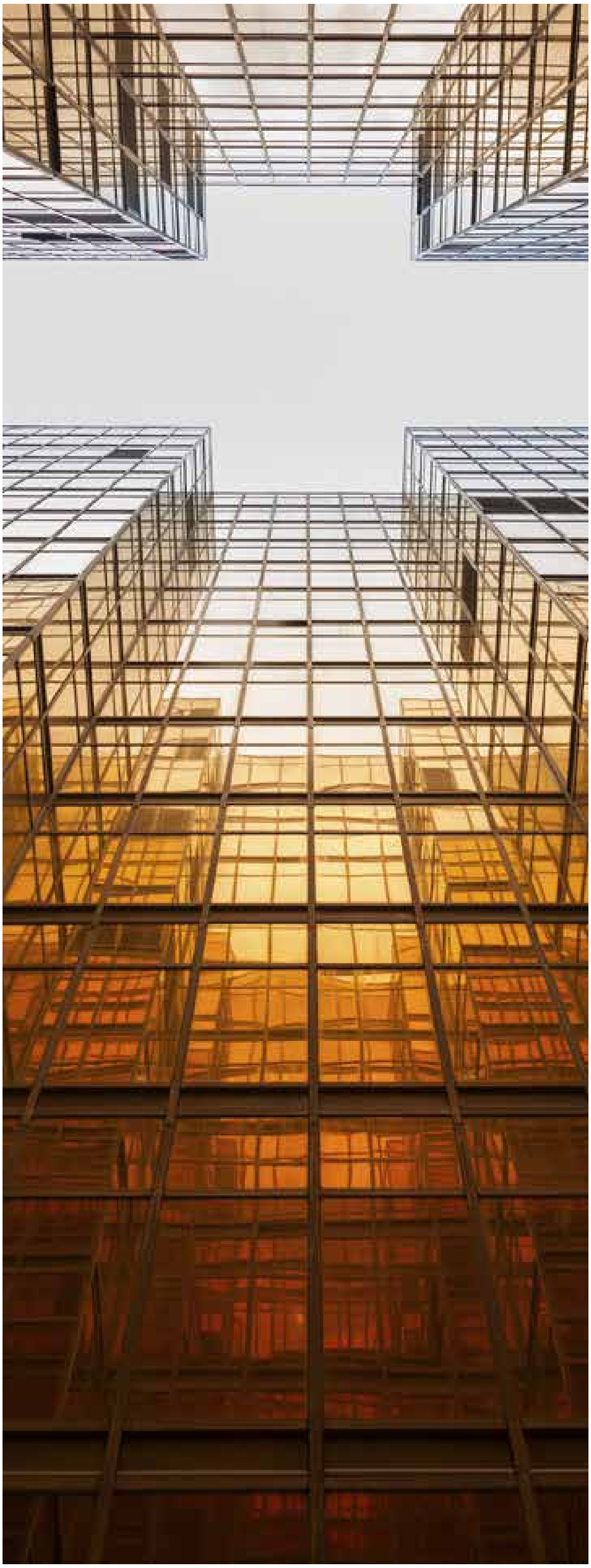
From June 2016, as part of the new annual return regime, companies will have to provide annual information about their PSC Register to Companies House. This information will also be publicly available.

The PSC regime includes some safeguards from public disclosure. The day of date of birth and residential address information of registrable PSCs will be subject to the same protections as for company directors. Additionally, if a registrable PSC considers that they or someone they live with would be at serious risk of violence or intimidation because of their wider PSC information being publicly available, they can apply to have it protected from disclosure.

What should companies be doing?

Companies will need to put in place the necessary internal systems to deal with the new regime from 6 April 2016.

Although all UK companies (which are not subject to DTR 5 or equivalent) will be subject to the new regime, compliance for those with complex ownership and control structures will be inevitably more complicated than for those with simple structures.



The government is producing detailed practical guidance, both long form and short form, on the new regime. There are links to the currently available consultation drafts at the bottom of this article. There will also be separate guidance, not yet available, for PSCs.

And finally?

Although the UK has led the way on transparency of ownership and control, the Fourth Money Laundering Directive introduces similar EU-wide measures which member states must adopt by 27 June 2017. This will mean some changes to the UK PSC regime before then. For companies already in scope of the PSC regime, the most significant change will probably be the need to inform Companies House of PSC Register changes as they occur, rather than yearly.

People with significant control: guidance for companies and LLPs

Summary guide for companies – register of people with significant control

Statutory guidance on the meaning of "significant influence or control" in the context of companies

Statutory guidance on the meaning of "significant influence or control" in the context of LLPs

Companies Act 2006: implementation of outstanding changes made by the Small Business, Enterprise and Employment Act 2015

The table below shows the current timetable for bringing in the remaining key changes to the Companies Act 2006.

Change	Date
New procedures for dealing with certain registered office and director appointment disputes	April 2016
Companies must keep a register of people with significant control	April 2016
Companies must file information about people with significant control at Companies House	June 2016
Check and confirm statement replaces annual return	June 2016
Private companies can elect not to keep private registers	June 2016
Simplification of amounts unpaid on shares part of statement of capital form	June 2016
Ban on corporate directors (subject to certain exceptions)	October 2016

Case law update

Do directors owe fiduciary duties to shareholders?

The High Court has held that where directors give shareholders information to enable them to decide how to vote, that engages a duty to provide sufficient information, but does not, in the absence of a special relationship, impose wider fiduciary duties on the directors to the shareholders.

Facts

The case arose from claims brought by Lloyds shareholders against its directors in connection with Lloyds' acquisition of HBOS and its recapitalisation. The claims concerned the directors' advice and recommendations to Lloyds shareholders and the completeness and accuracy of the information provided to them to enable them to decide how to vote. The claimants alleged that the directors had breached various fiduciary duties which they owed to the claimants, including the duties to act in good faith and for a proper purpose, to act in the best interests of the claimants and to advise them clearly.

The directors accepted that they were under a duty to provide claimants with sufficient information to enable them to make an informed decision on how to vote in relation to the transactions. However, they applied to have the other claims against them for breach of fiduciary duty struck out. Their argument was that directors of a company do not in general owe fiduciary duties to the company's shareholders, and there was nothing in the facts relied on to warrant the conclusion that the directors owed the claimants anything other than the duty to provide sufficient information.

Decision

The court noted that it is well established that, although a director of a company can owe fiduciary duties to the company's shareholders, he does not do so merely by being a director. There has to be some "special factual relationship" over and above the usual relationship of a director with the company's shareholders. It is not enough that the director, as a director, has more knowledge of the company's affairs than the shareholders have. Nor is it enough that the actions of the directors will have the potential to affect the shareholders. Typically, such a special relationship has been found to exist where there had been a personal relationship or particular dealing or transaction between the director and shareholders.

The court found that, on the facts, a duty to provide sufficient information was engaged. This includes a duty not to mislead or hide material information, and a duty to give advice and information in clear and readily comprehensible terms. However, there was nothing which came close to a relationship in which the directors had in a more extended sense undertaken to act for the shareholders in a fiduciary capacity giving rise to other fiduciary duties. The court therefore ordered various parts of the particulars of claim to be struck out.

Comment

The decision is not new law but a useful reminder of the basic principle that, absent a special relationship, directors do not owe shareholders fiduciary duties. In the context of a large listed company that special relationship will be difficult to establish.

Sharp and others v. Blank and others [2015] EWHC 3220

Directors' duties: the proper purpose test

The Supreme Court has held that the proper purpose test applies to a decision by the directors of a public company to issue, under the terms of the company's articles, restriction notices which disenfranchise shareholders from voting. It is not enough that the directors have acted in what they believed to be in the best interests of the company.

Background

Part 22 of the Companies Act 2006 gives a public company the right to investigate who has an interest in its shares by sending out section 793 notices. Where a person fails to comply with a notice within a reasonable time, the company may apply to court for an order imposing restrictions on the shares. In practice, many public companies include provisions in their articles allowing the company itself to impose restrictions if a person fails to respond to a section 793 notice.

Facts

The appellants between them held around 39% of the share capital of JKX Oil & Gas plc (JKX). In 2013 the board of JKX considered that the company was the subject of a "corporate raid" by the appellants. The board therefore served notices seeking information about interests in the shares held by the appellants. JKX's articles allowed the directors to impose voting and transfer restrictions where information provided was known or reasonably thought to be false or materially incorrect. The board considered that it had reasonable cause to believe that the responses to its notices were false or materially incorrect. In response, it issued voting and transfer restrictions on the shares held by the appellants. An effect of these was to prevent the appellants from voting at the company's AGM.

The appellants challenged the propriety of the board's purpose in exercising its power to issue restriction notices. Under what is now section 171(b) of the Companies Act 2006, a director must only exercise his powers for the purposes for which they are conferred. The appellants contended that the predominant purpose of the board was to prevent the appellants from voting rather than information gathering. At first instance, the High Court accepted the appellants' arguments and decided that the board of JKX had acted for an improper purpose.

However, on appeal, the majority of the Court of Appeal considered that the proper purpose test had "no significant place" in the operation of the relevant articles or Part 22 of the Companies Act 2006. It was enough that the directors had acted in what they believed to be in the best interests of the company. They therefore overturned the High Court decision.

Decision

The Supreme Court rejected this view and restored the High Court decision. It found unanimously that directors who exercise powers in the company's articles to issue restrictions notices must do so for a proper purpose. It is not enough that the directors have acted in what they believed to be in the best interests of the company. The court identified three proper purposes for issuing restrictions notices. These are: inducing shareholders to provide information; protecting the company and shareholders against having to decide about their interests in ignorance of relevant information; and as a sanction for failure to provide the information.

Comment

Although the case concerns the exercise of a specific power, the decision also has wider implications. Notably, the members of the Supreme Court expressed views on how to decide whether a power has been exercised for a proper purpose where there is more than one purpose motivating the directors. Lord Sumption proposed a "but for" test. In other words, if without the improper purpose(s) the decision would not have been made, then it should not stand even if the directors also had other, proper considerations in mind. As there was no argument by the parties before the Supreme Court on the scope of the proper purpose rule, a majority of the court preferred to defer a final view on this "but for" approach. The test is therefore not binding on the lower courts, but may nonetheless be persuasive.

Eclairs Group Ltd and another v. JKX Oil & Gas plc [2015] UKSC 71

The new rule against contractual penalties

The Supreme Court has in two cases, reported together, reviewed and reformulated the basis on which courts will uphold as non-penal a contractual term providing for a sum to be paid, or other sanction to apply, on breach of contract. One of those cases, *Cavendish Square Holdings BV v. Makdessi,* involved the sale of a group of companies.

Background

The leading authority on penalties for a century has been the House of Lords decision in *Dunlop Pneumatic Tyre Company Ltd v. New Garage & Motor Company Limited* [1915] AC 79. This has generally been regarded as authority for the proposition that a term which is triggered on breach of contract is penal if it is not a genuine pre-estimate of the loss likely to flow from that breach.

Facts

Mr Makdessi was the founder of a group of companies that became the largest advertising and communications group in the Middle East. As majority shareholders, Mr Makdessi and his co-owner together entered an agreement to sell a 60% shareholding in the relevant holding company to Cavendish. The consideration, which was payable in instalments, reflected considerable elements for goodwill. Each seller also had a put option to elect to sell later their residual shareholding.

Mr Makdessi remained a director of the target after the transaction. The agreement subjected him and his co-seller to various restrictive covenants. These included not

carrying on any competing business and non-solicitation of business or staff. The agreement provided that, on a breach of any restrictive covenant, a seller would no longer have the right to certain deferred consideration payments which were otherwise payable under the agreement (the forfeiture provisions). Breach would also trigger Cavendish's right to exercise a call option to buy that seller's remaining shareholding at a price calculated by reference to net asset value (the call option). This was likely to be significantly less than the price the sellers would have expected to receive if they exercised their put options.

Cavendish later alleged Mr Makdessi had breached his duty to the target company by his involvement with a competing business and soliciting clients away from it. Mr Makdessi admitted breach of fiduciary duty and settled the claim by paying US$ 500,000. However, these activities also amounted to breach of the restrictive covenants. Cavendish exercised its right to withhold the deferred payments and exercised its call option. Mr Makdessi argued that Cavendish could not enforce these terms because they were penal.

Decision

The Supreme Court, overruling the Court of Appeal and restoring the High Court decision, unanimously decided that neither the forfeiture provisions nor the call option fell foul of the rule against penalties, as reformulated by the Supreme Court.

The Supreme Court held the true test for a penalty is whether the clause is a secondary obligation which imposes an obligation on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. A clause is not penal merely because it is not a genuine pre-estimate of loss, even if it operates as a deterrent (though a straightforward "liquidated damages" clause probably still needs to satisfy the "genuine pre-estimate of loss" test).

A majority of the Supreme Court judges thought that the forfeiture provisions and the call option were primary obligations because they operated as price adjustment provisions and (in the case of the call option) as a provision enabling the parties to de-couple their relationship following the buyer's breach. So, on this view, the rule on penalties did not apply at all. But the Supreme Court was not unanimous in its view that the rule on penalties did not apply to the call option. However, even in that scenario the court thought the clauses did not breach the rule because the remedy stipulated for the breach was not, in the circumstances, extravagant or unconscionable.

Comment

The Supreme Court's decision is generally positive for those trying to uphold alleged penalty clauses in corporate transactions or other commercial contracts.

The reformulated rule stresses the innocent party's legitimate interest in performance of the contract. A draftsman should, therefore, consider including details of that legitimate interest and why the remedy is proportionate, unless these matters are obvious and beyond argument. For example, in a contract like that in *Cavendish*, there could be reference to the importance of the on-going loyalty and commitment of a seller who is continuing as a director and to the significance of goodwill to the eventual price.

Alternatively, it may be possible to avoid engaging the reformulated penalties test by drafting clauses which operate on breach in a way that highlights their importance to the overall substantive package between parties. Such clauses, as opposed to ones which simply set out a remedy for breach, are more likely to be treated as primary obligations and therefore not engage the new rules on penalties. However, as already mentioned, not all members of the Supreme Court could agree on applying these distinctions, and certainty on this point may therefore be difficult in practice.

Another way to avoid the engaging rule on penalties, which is not new, is to draft a clause so it is not a breach that triggers the remedy specified. For example, rather than providing that breach of a restrictive covenant results in loss of deferred consideration, the contract could instead provide that the right to deferred consideration is conditional on compliance with the restrictive covenant.

For a more detailed analysis of the *Cavendish decision (and ParkingEye Ltd v. Beavis* decided by the Supreme Court at the same time), see Supreme Court unshackles the rule on penalties.

Cavendish Square Holding BV (Appellant) v. Talal El Makdessi (Respondent); ParkingEye Limited (Respondent) v. Beavis (Appellant) [2015] UKSC 67

Regulatory update

AIM Rules: changes for investing companies and on a fundamental change of business

The London Stock Exchange (LSE) has made changes to the AIM Rules for Companies which apply to investing companies and to AIM companies that undertake a fundamental change of business on or after 1 January 2016.

Investing companies

Formerly, an applicant seeking admission as an investing company (i.e. a company which has the investing of its funds in securities, businesses or assets of any description as its primary business or objective) had to raise £3 million in cash via an equity fundraising on, or immediately before, admission. This has now been increased to £6 million.

Fundamental business changes

An AIM company that becomes a cash shell following a fundamental disposal is no longer automatically classified as an investing company. Instead it will be regarded as an AIM Rule 15 cash shell. Within six months of becoming a Rule 15 cash shell, the company must undertake an acquisition or acquisitions which constitute a reverse takeover. (For the purpose of this rule only, becoming an investing company in accordance with Rule 8 will count as a reverse takeover.) If it does not its securities will be suspended. Where an AIM company does not wish to undertake a reverse takeover, the LSE will expect it to get shareholder approval to cancel its admission to AIM accordingly and consider how best to return any remaining funds to shareholders.

AIM Notice 43

FCA Handbook: 2016 changes to the market abuse regime

The EU Market Abuse Regulation (MAR) updates the civil market abuse framework established by the EU Market Abuse Directive (MAD) and will apply from 3 July 2016. Unlike MAD, MAR will have direct application in the UK.

The Financial Conduct Authority (FCA), in November 2015, published a consultation on its proposals for the necessary changes to the FCA Handbook to implement MAR in the UK. MAR will also involve amendments to UK primary and secondary legislation, including the Financial Services and Markets Act 2000 (FSMA). The Treasury will make these changes via statutory instrument.

The FCA is proposing to keep the existing structure and content of the FCA Handbook to the extent that this does not conflict with MAR. However, given the scope and nature of MAR, the consultation includes significant

proposed amendments to the Handbook. It highlights three areas of the Handbook that will be particularly affected:

- **Code of Market Conduct:** Substantial amendments to both the content and legal status of the Code of Market Conduct (MAR1 in the FCA Handbook) will result from the repeal of the sections of FSMA which required the FCA to provide guidance on what behaviours constituted market abuse and the factors to take into account when deciding this.

- **Model Code:** The Model Code, which is part of the Listing Rules, is partially incompatible with MAR which brings in new rules to govern dealing during closed periods. The FCA is proposing to replace it with guidance for firms to use when developing their processes to allow persons discharging managerial responsibilities to apply for clearance to deal.

- **Disclosure Rules:** Because MAR will apply directly in the UK, the FCA will no longer have powers to make the Disclosure Rules. As a result, the Disclosure Rules in Chapters 1 to 3 of the Disclosure Rules and Transparency Rules will be replaced with signposts to the relevant MAR provision, and renamed as "Disclosure Guidance".

Although MAR is directly applicable, there are two areas where it offers member states alternative options for implementation. These concern the requirement for issuers to provide an explanation of delays in disclosing inside information and the threshold for disclosure of managers' transactions.

Policy proposals and Handbook changes related to the implementation of the Market Abuse Regulation

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