

# Corporate & Property

## Winter 2009 Newsletter



## Corporate

### Directors & Their Duties

“A quick guide to who is a director and their duties”

The Companies Act 2006 which came into full force and effect on 1 October 2009, (“the **CA 2006**”) defines a director as “any person occupying the position of a director by whatever name called”. This, therefore, includes any person who behaves as a director, whether or not formally appointed as a director and whether or not the job title refers to that person as being a director.

If, therefore, a person who has not been formerly and properly appointed as a director nevertheless behaves as a director and participates or controls the board of directors from “behind the scenes” then such a person would be deemed a “shadow director”.

Directors can be appointed as either “executive” or “non-executive” directors. Executive directors are those who tend to devote substantially all of their working time to the company, whereas non-executive directors tend to be part time professionals appointed to give expertise. There is no legal difference between an executive or non-executive director or the duties they have.

For a person to be appointed a director he or she must be at least 16 years old but there is no statutory requirement for a director in the UK to be of a particular nationality or resident in a particular country.

The position of a “director” in the UK is a composite of several different, but overlapping, legal roles including, “officer” of the company, “agent”, and as he acts for and on behalf of the company in circumstances which give rise to a

relationship of trust and confidence he also is a “fiduciary”. In addition, he can be seen as an “employee” if he works for the company.

A director's conduct is therefore, regulated in a number of ways by virtue of the above roles. These include duties being imposed by legislation, the company's constitutional documents, and his service agreement, if any.

If a director breaches his duties, he could incur personal liability and (where there is no available statutory defence) criminal sanctions. One of the consequences could also be his removal and/or disqualification as a director, the latter for up to 15 years. However, so long as a director does not breach his duties, he is not usually liable for the company's debts and defaults, which remain the responsibility of the Company.

### What are the main duties of a director?

A director principally owes duties to the company. However, if a company is approaching insolvency the directors also owe duties to the company's creditors under corporate and insolvency laws. Also, in certain circumstances a director may owe fiduciary and other duties to third parties such as shareholders and employees.

The main duties of a director under the CA 2006 are:

#### 1. To act within powers (s171, CA 2006):

Essentially this requires the director to pursue the **objectives listed** in the company's constitutional documents, using the **powers granted** in the company's constitutional documents.

#### 2. To promote the company's success (s.172, CA 2006):

● This requires the director to act in a way which he believes in good faith will most likely promote the company's success (i.e. usually, but not always, long term increase in value), for

the benefit of the shareholders as a whole. However if the company is insolvent the interests of the creditors replace the interests of the shareholders.

- Some relevant factors to consider in promoting the success of the company (this list is not exhaustive) are: long and short term consequences; employees' interests; the need to foster business relationships; the impact on the community and the environment; the need to maintain a business reputation and the need to act fairly as between the shareholders.

Also, as part of this duty, a director is expected to report his or her own wrongdoing to the company.

**3. To exercise independent judgement (s.173, CA 2006):** A director must not allow others to influence his decision and/or to make a decision for him, except to the extent where the company's constitutional documents or agreements allow for (or require) a particular action to take place.

**4. To exercise reasonable care, skill and diligence (s.174, CA 2006):**

- This requires a director not to act negligently. This duty would be breached if a director is shown to have exercised less care, skill and diligence than a reasonable, diligent person with the knowledge, skill and experience which may reasonably be expected of a director in the same position and the general knowledge, skill and experience which that director actually possesses.

- This, therefore, requires the director, if he feels he lacks the relevant experience or knowledge to reach a particular decision, to seek the advice of an appropriate professional before making that decision.

- A director can be held to be in breach of this duty if he fails to adequately supervise and prevent the wrongdoing of a fellow director, but only to the extent that the failure to act would have reduced the company's losses. This could be of particular concern to non-executive directors who are resident abroad or to those who become executive directors but then have little or no involvement with the running of a company.

**5. To avoid conflicts of interest (s.175, CA 2006):** Essentially a wide duty that covers all actual or potential conflicts between the

company's interests and the director's own interests - except to the extent that: the nature and extent of those conflicts relating to existing or proposed transactions have been properly disclosed to the board of directors; the shareholders have authorised the directors to proceed despite the conflict; or the non-conflicted directors have authorised the conflicted director to proceed despite the conflict. Essentially therefore it is advisable for a director to disclose all potentially conflicting interests as soon as he is aware of them.

**6. Not to accept a benefit (including bribes) from a third party (s.176, CA 2006):** A director must not accept bribes or benefits from third parties because of his office, or to entice him to do or not do something as a director. There is a limited exception for "authorised benefits".

**7. To disclose an interest in a proposed and/or existing transaction/arrangement (s.177 and s.182, CA 2006):** Directors must declare the nature and extent of any interest, in an existing or proposed new transaction or arrangement, to the board of directors. This is different to conflicts of interest as it is irrelevant whether or not there is a conflict and any interests in existing or proposed transactions or arrangements must be declared. If declared the declaring director can then form part of the quorum of the meeting of the directors and be able to vote on the relevant issue at that board meeting.

### **A trap for the unwary!!!**

Often directors, particularly those in owner managed businesses, feel it does not matter how they behave as no one is going to complain of their errors or wrongdoing: for example, if the directors are the only directors and are also the sole shareholders, or the shareholders are unlikely to bring any claim or action against them. However, should the company liquidate, the liquidator has to report to the authorities on the conduct of the company's directors. Any wrong doing could lead to a disqualification from being able to act as a company director for between 2 and 15 years, as well as other claims and actions. Equally, shareholders can now bring direct derivative actions for breaches of directors duties without having to do it on behalf of the company, so any shareholder disputes could lead to such actions, particularly where there is cause. All directors should, therefore, act as if

they were and could be held to account to independent third parties. Records should also be kept (even if personal ones) of decisions and the reasons behind them.

If you have any queries, please do not hesitate to contact **Michelle Mathers** on **0113 243 6601** or **michelle.mathers@forwarn.com**.

## "Pre-packs"

a possible solution for those companies wishing to survive the downturn, but don't have the cash-flow or finances to do so!!!

### What is a "pre-pack"?

The primary objective of administration (as opposed to a liquidation) is the rescue of the company as a going concern. It is, therefore, as part of this insolvency process, what is commonly known as a "pre-pack", is usually considered.

A "pre-pack" is a business saving arrangement under which you sell the company's business and assets **before** the company goes into a formal insolvency process such as administration or liquidation.

The idea is that the "good bits" (i.e. assets and useful rights) of your struggling business are sold to a new company (also known as "Newco") controlled by the existing directors/shareholders of the struggling company (also known as "Oldco"). The "bad bits" (i.e. the debts) can then be left behind in Oldco, which will be subsequently liquidated. All of this is in line with the Government's aim to nurse ailing companies back to health.

### So how may we help?

We can assist you in the pre-pack process by helping you save the "good bits" of your business and removing the "bad bits".

In addition to assisting you throughout the legal process, we have strong contacts with insolvency practitioners and turnaround practitioners to advise on the financial process, in particular parties who could assist in sourcing finance for the purchase by Newco of Oldco's "good bits".

Our firm has the expertise to advise on the sale documents and processes, shareholder rights, directors' personal liability and any other issues

that need to be resolved to successfully complete the pre-pack process. Specialists in our corporate, insolvency, commercial property, employment and regulatory teams regularly work together on such transactions, and co-ordinated advice is available to you which will be given in a cost and time efficient manner.

### Why bother?

**Saves costs and time:** If properly managed, pre-packs can result in a relatively smooth and swift transfer of the "good bits" of a business, when compared with other insolvency processes. The costs of the pre-pack process can therefore be reduced, which in turn could result in a better return for your creditors.

**Keeps you trading:** A pre-pack may be the only way to keep a company in financial difficulties trading, particularly in service or retail industries (where the businesses' principal assets are the employees, forward contracts or intellectual property).

**Helps preserve confidence:** Employees and creditors may have negative views and concerns on hearing about an insolvency. Therefore, a quick pre-pack sale could prove useful in retaining employees' and creditors' confidence in your business.

**Helps preserve more jobs:** In the vast majority of pre-pack cases, all of the employees are usually transferred. Therefore, pre-packs preserve more jobs than business sales which are negotiated and arranged after the commencement of the formal insolvency procedure. This again helps build confidence in the staff (who are vital stakeholders and contributors in the survival of your business).

**Better return for secured creditors:** The average return for secured creditors in a pre-pack tends to be more than in a business sale and therefore creditors could be more likely to be supportive of a pre-pack. However, early consultation with secured creditors such as banks would be prudent, since some banks may be reluctant to allow a pre-pack sale to a Newco controlled by the existing directors/shareholders of Oldco.

### The process requires:

**1. Insolvency/financial advice:** You initially holding a board meeting to approve the appointment of insolvency practitioners or business turnaround practitioners to advise on the company's

financial position, and legal advisers to advise on minimising loss to creditors (so as to to minimise personal liability for wrongful trading under the Insolvency Act 1986).

**2. Legal issues:** You checking, amongst other things that: existing important commercial contracts and banking arrangements will allow for a pre-pack sale; your creditors are in support; your important employees will wish to be employed by Newco; your important suppliers will wish to continue supplying the Newco on acceptable commercial terms; and the landlords of your business premises will be willing to have the lease of Oldco assigned.

**3. Purchase finance:** You putting in place finance to fund the acquisition of the assets and business by Newco. This may be done via factoring, asset based lending, loans and bank facilities. Some venture capital companies or “business angels” may even help fund the pre-pack as part of a strategic investment for them to “buy, build and profitably exit”.

**4. Business plan:** You preparing a business plan showing, amongst other things, working capital requirements. This should assist the administrator to determine if the survival of the business is viable.

**5. The pre-pack deal:** You agreeing the terms of the deal (including the valuation of the business) with an Insolvency Practitioner before he formally takes office as administrator/liquidator.

**6. Sale completion:** The pre-pack sale from Oldco to Newco completing on or immediately after the Insolvency Practitioners' formal appointment as administrator/liquidator. He will need to take into account each applicable insolvency practitioner guideline (known as a statements of insolvency practice (or “SIP”)), and his powers and duties under Schedule 1, Schedule B1 and other applicable parts of the Insolvency Act 1986.

**7. Distributions and liquidation of Oldco:** The administrator/liquidator procuring that the sale proceeds from the pre-pack sale are used to pay off creditors and Oldco's debts and liabilities, with Oldco then being liquidated and eventually dissolved.

## Conclusion

The advantages of the pre-pack process can therefore be significant in the right context and if properly managed.

**For you:** the business and its assets (with its staff and structures) may essentially be retained and continued in a Newco that rises from the ashes of Oldco as a “Phoenix”. Your business therefore has a chance of surviving without the “bad bits”!!

**For creditors:** a pre-pack should mean a better return - since the administrator/liquidator should generally get a better price for the business and assets (especially goodwill).

We can assist in providing the legal input and can put you in touch with suitable professionals to advise on the finance, accountancy, tax and funding aspects.

**For further details please contact Michelle Mathers on 0113 243 6601 or [michelle.mathers@forwarn.com](mailto:michelle.mathers@forwarn.com).**

## Benefits of Green Leases

Heavy power users will have been preparing for the Government's CRC Energy Efficiency Scheme (“CRC”) stating in April 2010. The retail and other industries affected have expressed concern at its effects on cash flow in today's challenging economic environment. So actual charging for allowances has been deferred for a year and will start in April 2011 but otherwise the Scheme's April 2010 commencement remains unaffected.

If you are a landlord we can:

- check your leases and advise to what extent you can recoup the costs of enhancing your buildings' energy performances under them.

- Draft lease clauses and memoranda of understanding that encourage your tenants to use energy more efficiently .

If you are a tenant, CRC aims to reward good environmental behaviour.

Will your leases share these rewards with you; or

will they expose you to the new extra costs that may arise without the benefits? We can advise you in relation to existing or proposed leases.

## Verbal Authority Sufficed

Section 2 of the Law of Property (Miscellaneous Provisions) Act 1989 allows land sale contracts to be signed "on behalf of" buyers and sellers. Parties frequently telephone their solicitors to authorise them to sign the contract. But does that authority need to be in writing? In **McLaughlin -v- Duffill (2009)** a 3 bedroomed semi-detached house had failed to reach its £145,000.00 reserve price at auction.

The property was re-marketed at the same price on the open market. The respondent purchased it for £115,000.00 later. The agent had signed the contract on the seller's behalf. The Court found that the seller had verbally authorised this. Though the land contract the agent signed and the eventual land transfer had to be in writing, ordinary "agency" rules applied to the authority that the seller was found to have given to the agent. Nothing in those agency rules required that authority to be given in writing. Accordingly, the seller was bound by the sale contract that the agent had signed.

## Build or Be Damned

Many tenants faced with the expiry of their lease will have received landlords' termination notices citing redevelopment proposals as grounds for refusing a new tenancy under Section 30 (1)(f) of the Landlord and Tenant Act 1954. That occurred in **Inclusive Technology -v- Williamson (2009)**. Here, the tenant's response was to offer a higher rent of £45,000.00 per annum to remain in the premises.

The landlord declined that offer in mid-August. However, by October the landlord was no longer proposing to undertake the redevelopment work at, or within a reasonable time of, the end of the tenancy as required by subsection (f). The landlord directed its agent to re-market the property without telling the tenant of the change of plan. By November, the tenant had signed up to alternative accommodation. The tenant tried to sue the landlord under Section 37A of the Landlord & Tenant Act 1954.

It argued that it had been induced to vacate the premises on the basis of a misrepresentation or concealment by the landlord. The Court of

Appeal ruled in the tenant's favour. The termination notice and its covering letter were a continuing representation of the landlord's redevelopment intention. As such they became a "misrepresentation" when the landlord's intentions changed and that representation became false. The Court said that the facts might also be interpreted as "concealment". The letter and its circumstances were such that the tenant might legitimately expect the landlord to have informed it if it changed its mind. So any failure to inform the tenant might be regarded as concealment. The Court awarded the tenant £48,000.00 compensation.

This was based on the difference between the £45,000.00 per annum, that the tenant had offered to pay the landlord before the landlord suspended its redevelopment proposal and the higher rent the tenant had to pay for alternative accommodation.

## Relief For Time Barred Planning Consents

The Town and Country Planning (General Development Procedure) (Amendment Number 3) England Order 2009 came into force on 1 October. This may afford relief for developers struggling to implement planning permissions for schemes within the statutory 3 year limitation period in the current economic climate. Where development has yet to begin Email: [mark.crabtree@forwarn.com](mailto:mark.crabtree@forwarn.com) under an existing planning permission granted on or before 1 October 2009 an applicant can apply for the substitution of a new planning permission with a revised time limit.

Second time around, the planning authority need only consult the routine persons or bodies it "considers appropriate" Also a design and access statement will not be required. A lesser fee is envisaged. However, reduced fees have yet to be brought in since the rules need to be approved by Parliament. The new application is also subject to screening or more detailed environmental impact assessments.

This may lead to an earlier environmental statement having to be brought up to date. Whether the renewal application is granted will be determined upon the same statutory basis i.e. to accord with the local planning authority's

Development Plan save where “material considerations” militate to the contrary. So the prospects of success may be swayed one way or the other by any changes that have occurred in the Development Plan since the original planning consent was granted.

## **Planning permission saved by infrastructure agreement**

The case of *R (on the application of Brown) -v- Carlisle City Council (2009)* arose from works being carried out to Carlisle Airport. The Airport's long leaseholders had applied for planning consent to runway works and a new passenger terminal, offices and hangars (“Infrastructure Works”) and warehousing accommodation. After that application was called in by the Secretary of State, they withdrew it. They re-submitted a less ambitious application omitting the Infrastructure Works.

On considering the revised application, Carlisle City Council considered the application complied with their Development Plan so long as the applicant would commit to carry out the Infrastructure Works in an agreement under Section 106 of the Town and Country Planning Act 1990. The Court ruled at first instance that this approach had been correct. Taken in isolation, the application deviated from the Development Plan. However on these facts, the City Council had successfully avoided any departure from the Development Plan through its insistence on the Section 106 Agreement which had the overall effect of ensuring that the development complied with that Development Plan.

Accordingly, the planning permission stood and there had been no need for the Council to refer any deviation from the Development Plan to the Secretary of State.

The material contained in this newsletter is for information purposes only. It does not constitute comprehensive legal advice and should not be relied upon as such. Professional advice should always be taken for specific legal problems.

**For more information, please contact  
Philip Taylor, Partner, Commercial Property or  
Mark Crabtree, Partner, Commercial Property  
Tel: 0113 243 6601  
Fax: 0113 234 0905  
Email: [philip.taylor@forwarn.com](mailto:philip.taylor@forwarn.com)**

Westgate Point, Westgate, Leeds, LS1 2AX  
Tel: 0113 2436601  
Fax: 0113 2420905  
MDX 706968 Leeds  
Email: [clientmail@forwarn.com](mailto:clientmail@forwarn.com)  
Web: [forwarn.com](http://forwarn.com)

**excellence and endeavour**